S&P Global
Ratings

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Research Update:

Banque Internationale a Luxembourg 'A-/A-2' Ratings Affirmed; Outlook Revised To Negative On Risk Management Concerns

October 30, 2024

Overview

- Banque Internationale a Luxembourg (BIL)'s asset quality deteriorated with the nonperforming asset (NPA) ratio increasing to 5.1% in the first half of 2024 from 3.5% in 2022 on the back of pressure on its real estate exposures while nonperforming coverage fell to 28% in first half of 2024 compared to 51% in 2022.
- BIL's strong capitalization could help to absorb potentially higher credit losses, but rapid asset quality deterioration raises questions on the quality of risk management and adequacy of the risk-return profile of the bank.
- Therefore, we revised our outlook on BIL to negative from stable and affirmed all ratings.
- The negative outlook reflects the downside risks over the next 12-24 months linked to BIL's rapid asset quality deterioration, which could translate into higher credit losses and put pressure on its risk-adjusted profitability and overall performance compared with peers in the long run.

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Rating Action

On Oct. 30, 2024, S&P Global Ratings affirmed its 'A-' long-term issuer credit rating and 'A-2' short-term issuer credit rating on Banque Internationale à Luxembourg. We also affirmed all our ratings on the bank's debts. We revised our outlook to negative from stable.

Rationale

Rapid degradation of BIL's asset quality could weigh on its risk-adjusted profitability. We think BIL's NPAs have or will peak in 2024 with reported nonperforming loans (NPLs) of 5.1% as of mid-2024. We expect NPL cession, and some additional provisioning will support asset quality metrics over the next two years. However, asset quality volatility that is higher than peers and a lower provisioning level could be indicative of lower risk management standards if not properly addressed. While the cost of NPL disposals and provisions will likely be manageable for BIL, due to still solid capitalization, this will reduce earning buffers to cope with potential shocks which could, if they arose, challenge the path toward improved asset quality metrics. Even in absence of unexpected additional shocks to BIL's asset quality, the bank's risk-adjusted profitability, standing at 0.5% according to our metrics as of the first half of 2024, might still depart from regional peers closer to 0.9%.

Strong capital levels are still supportive of BIL's creditworthiness. By our metrics BIL's return on average assets stood at 0.5% in the first half of 2024. While we anticipate that profitability will lower over 2024-2026 to about 0.4%-0.5%, this compares favorably to 2018-2021 levels. However, we consider that BIL's profitability is partly supported by a lower provisioning level compared with peers, which is not credit positive.

We forecast S&P Global Ratings' risk-adjusted capital (RAC) ratio will hover around 11.0% (from 10.7% as of end-2023) over the next two years largely supported by a limited increase in S&P Global Ratings' risk-weighted assets, mainly due to moderate lending growth projection, and despite our expectation of a regular 50% profit distribution.

We expect Luxembourg's difficult lending environment to start easing in 2025. The lending environment in Luxembourg has suffered from lower credit demand since 2022 due to the raised interest rates and is only expected to recover in 2025. Over 2022-2024 BIL's gross loans book remained broadly stable, and we forecast credit growth of 3%-4% in 2025 and 2026. In the long term, a structural lack of residential real estate supply compared to the underlying demand and lower interest rates will support lending growth even if only by low single digits.

Outlook

Our negative outlook reflects BIL's rapid asset quality deterioration and NPA metrics that are more volatile than peers, which could translate into higher credit losses and put pressure on its risk-adjusted profitability over the next 12-24 months.

However, we expect capitalization to remain strong and our additional loss-absorbing capacity (ALAC) ratio to be well above the S&P Global Ratings-adjusted threshold of 3.5% for one notch of ALAC extraordinary support and below our 7.0% adjusted threshold for a second notch of support.

In our view, BIL's creditworthiness will not be negatively affected by its 90% parent Legend Holdings' weaker credit standing. This is because of the bank's regulated status and the influence of independent board members, both of which create a high level of insulation.

Downside scenario

We could lower our ratings on BIL over the next 12-24 months if the bank's asset quality metrics fail to improve to a level closer to its peers or we observe higher credit losses compared with peers, which could indicate a weakening of the bank's risk management. We could also lower our ratings if we observed a weakening of the bank's franchise strength compared to similarly rated peers.

Although a very remote scenario, we could also lower our ratings on BIL if we see a change in the bank's capital management leading to the RAC ratio falling below 10%.

Upside scenario

We could revise our outlook to stable in the next two years if the bank successfully improves its asset quality metrics while maintaining a strong level of capital, and if in our view the bank displays risk management and franchise strength in line with similarly rated peers.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	A-/Negative/A-2	A-/Stable/A-2
SACP	bbb+	bbb+
Anchor	a-	a-
Business position	Moderate (-1)	Moderate (-1)
Capital and earnings	Strong (+1)	Strong (+1)
Risk position	Moderate (-1)	Moderate (-1)
Funding and liquidity	Adequate and adequate (0)	Adequate and adequate (0)
Comparable ratings analysis	0	0
Support	+1	+1
ALAC support	+1	+1
GRE support	0	0
Group support	0	0
Sovereign support	0	0
Additional factors	0	0

SACP--Stand-alone credit profile. ALAC--Additional loss-absorbing capacity. GRE--Government-related entity.

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Banking Industry Country Risk Assessment: Luxembourg, Aug. 9, 2024
- Banque Internationale a Luxembourg, Oct. 30, 2023

Ratings List

Ratings Affirmed		
Banque Internationale a Luxembourg		
Resolution Counterparty Rating	A/--/A-1	
Banque Internationale a Luxembourg		
Senior Unsecured	A-	
Senior Subordinated	BBB	
Subordinated	BBB-	
Ratings Affirmed; Outlook Action		
	To	**From**
Banque Internationale a Luxembourg		
Issuer Credit Rating	A-/Negative/A-2	A-/Stable/A-2