FitchRatings

RATING ACTION COMMENTARY

Fitch Revises Credit Europe Bank's Outlook to Stable; Affirms IDR at 'B+'

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Fitch Ratings - Milan - 20 Oct 2022: Fitch Ratings has revised Credit Europe Bank N.V.'s (CEB) Outlook to Stable from Negative, while affirming its Long-Term Issuer Default Rating (IDR) at 'B+' and Viability Rating (VR) at 'b+'. A full list of rating actions is below.

The revision of the Outlook reflects reduced asset-quality pressures following tightened underwriting and post-pandemic recovery, as well as our expectation that CEB's capitalisation will remain adequate through the cycle. We believe the bank's financial profile will remain comfortably within the rating tolerance levels, despite an expected global economic slowdown amid higher interest rates and inflationary pressures.

Fitch has withdrawn CEB's Support Rating of '5' and Support Rating Floor of 'No Floor' as they are no longer relevant to the agency's coverage following the publication of its updated Bank Rating Criteria. In line with the updated criteria, we have assigned CEB a Government Support Rating (GSR) of 'no support' (ns).

KEY RATING DRIVERS

Emerging Markets Exposure; Weak Profitability: CEB's ratings capture its improved post-pandemic performance and reduced impaired loans, although profitability remains weak due to its significant exposure to emerging markets and cyclical industries. Also, capital encumbrance is higher than that of peers. The bank's niche and established franchise and stable and experienced management are rating strengths. CEB also benefits from a stable and granular funding profile.

Weakening Operating Environment: We expect the bank's operating environment to deteriorate due to slower-than-expected global GDP growth in 2023 under Fitch's forecast. However, we expect the impact to trade finance banks to be mitigated to some extent by their focus on less cyclical trades of essential goods and short-term transactions.

Niche Trade-Finance Bank: CEB has a niche commodity-trade finance and corporate franchise with diversification into the retail segment in Romania. CEB's trade-finance business volumes should continue to benefit from high commodity prices, though the bank's exposure to developing economies makes it vulnerable to stress.

High Concentration; Low Coverage: Impaired loans declined to 7.5% of total loans at end-1H22 (still above that of peers), helped by tightened underwriting policies and increased lending in developed markets. However, sizeable concentrations and exposure to emerging markets make the bank's asset quality potentially more volatile than traditional banks'. Also, coverage of impaired loans by total loan loss allowances was low, reflecting its reliance on collateral.

Performance Remains Weak: CEB's revenue largely depends on global trade flows and commodity volumes, but profitability remains modest. Its operating profit/risk-weighted assets (RWAs) has been low over the past three years, and pre-impairment profits only provide a weak buffer against credit losses.

High Capital Encumbrance: CEB's consolidated common equity Tier 1 (CET1) ratio (14.3% at end-1H22) will likely be maintained around current levels due to its modest performance and low loan growth expectations.

Capitalisation metrics are moderately above the regulatory minimum requirements, but the buffer is small in nominal terms in light of business concentrations and capital encumbrance. Unreserved impaired loans amounted to about a quarter of CEB's CET1 capital. We believe CEB has capacity to scale down RWAs fairly swiftly due to the short-term nature of its trade-finance portfolio, which should help strengthen its capital ratios in case of need.

Granular Deposit Franchise: CEB is mainly funded by granular retail deposits, which are collected online mostly in Germany, and, to a lesser extent, in the Netherlands and Romania. Almost all household deposits benefit from deposit-guarantee schemes in all three countries, contributing to funding stability. Corporate and interbank deposits are originated from CEB's trade-finance and corporate-banking operations. Wholesale borrowings are limited to one subordinated bond placement.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

We would likely downgrade CEB's ratings if the challenging macroeconomic environment leads to asset- quality deterioration (with impaired loans over 10% of total loans), resulting in persistently weak profitability, in particular if coverage by loan loss allowances remains low.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

We could upgrade the ratings on an improvement in the operating environment, a continued reduction in impaired loans, lower capital encumbrance and wider buffers against CEB's minimum capital requirements. Stronger profitability, with an operating profit/risk-weighted assets above 1%, would also be credit-positive.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

CEB's Tier 2 subordinated debt is rated two notches below the banks' VR, reflecting poor recovery prospects for this type of debt.

CEB's GSR of 'ns' reflects Fitch's view that senior creditors cannot rely on receiving full extraordinary support from the sovereign if CEB 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 requires senior creditors participating in losses, if necessary, instead of, or ahead of, a bank receiving sovereign support.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

The subordinated debt's rating is primarily sensitive to a downgrade of the VR, from which it is notched. The rating is also sensitive to an adverse change in the notes' notching, which could arise if Fitch changes its assessment of their non-performance relative to the risk captured in the VR.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The subordinated debt's rating is primarily sensitive to an upgrade of the VR.

An upgrade of the GSR would be contingent on a positive change in the sovereign's propensity to support the bank. In Fitch's view, this is highly unlikely, although not impossible.

VR ADJUSTMENTS

The operating environment score of 'bb+' is below the category implied score of 'aa' due to following adjustment reason: international operations (negative).

The business profile score of 'bb-' is above the category implied score of 'b' due to following adjustment reason: management and governance (positive).

The capitalisation and leverage score of 'b+' is below the category implied score of 'bb' due to following adjustment reason: reserve coverage and assets valuation (negative).

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, 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 the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit fitchratings.com

RATING ACTIONS

ENTITY / DEBT ⬍	RATING ⬍		RECOVERY ⬍	PRIOR ⬍

Credit Europe Bank N.V.	LT IDR	B+ Rating Outlook Stable	Affirmed		B+ Rating Outlook Negative
	ST IDR	B	Affirmed		B
	Viability	b+	Affirmed		b+
	Support	WD	Withdrawn		5
	Support Floor	WD	Withdrawn		NF
	Government Support	ns	New Rating		
subordinated	LT	B-	Affirmed	RR6	B-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 08 Sep 2022) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Credit Europe Bank N.V.	EU Issued, UK Endorsed

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