Fitch Affirms Abanca at 'BBB-'; off RWN; Outlook Negative

Fitch Ratings- Barcelona-23 September 2020:

Fitch Ratings has affirmed Abanca Corporación Bancaria, S.A.'s (Abanca) ratings, including the Long-Term Issuer Default Rating (IDR) at 'BBB-', and removed them from Rating Watch Negative. The Rating Outlook is Negative. A full list of rating actions is below.

The affirmation of the ratings primarily reflects our view that Abanca's ratings are not immediately at risk from the impact of the economic fallout from the pandemic. The Negative Outlook reflects our view that risks, however, remain tilted to the downside in the medium term, especially if the recession proves deeper or the recovery weaker than our forecasts. In this case, Abanca's ratings might come under pressure from higher-than-anticipated inflows of new impaired loans and weaker earnings, which could ultimately result in capital erosion.

Key Rating Drivers

IDRs AND VR

Abanca's ratings are primarily driven by better-than-average asset-quality metrics domestically, stable funding mainly based on a resilient customer-deposit base, and satisfactory capital buffers above regulatory minimum requirements. The ratings also reflect Abanca's appetite for external growth, which has put pressure on capitalisation. Profitability is a rating weakness and we expect this to deteriorate during the economic downturn.

Fitch expects Spain's GDP to contract by a sizeable 13.2% in 2020 followed by a recovery in 2021. Furthermore, we see downside risks to these economic forecasts, including the risk of further containment measures or lockdowns, causing further shocks to the economy. While the Spanish authorities have taken several fiscal support measures for the private sector, which should be positive for Abanca as for the other Spanish banks, these measures are temporary. The financial implications on the financial sector will therefore likely only become more apparent in 2021.

In 2019, Abanca completed the acquisition of the private and commercial clients business of Deutsche Bank AG in Portugal (DBP) and Banco Caixa Geral (BCG) in Spain (together accounting for about 15% of Abanca's loan book). In July 2020 Abanca announced a preliminary agreement with Credit Agricole to acquire its subsidiary Bankoa S.A., a small retail bank (around 4% of Abanca's
total assets) in the wealthy region of Basque Country. All these acquisitions are aimed at strengthening Abanca's franchise and business model, particularly in diversifying by region and into more fee-based business (mainly asset management) where DPB and Bankoa in particular add significant volumes for their size.

Despite recent acquisitions and their associated capital absorption, Abanca maintains capitalisation with satisfactory buffers over regulatory requirements. The regulatory CET1 ratio stood at around 13% at end-June 2020, which Abanca's management have indicated will maintain, including upon the completion of Bankoa acquisition expected in 2021. However, we see limited headroom in case of sustained economic pressure leading to greater-than-expected asset-quality deterioration and a material increase in the level of capital encumbered by unreserved problem assets (17% of CET 1 at end-June 2020).

Abanca enters the economic downturn with better asset-quality metrics than domestic peers. At end-June 2020 its problem asset ratio (including impaired loans and net foreclosed assets) stood at 3.4%, at the low end compared with Spanish banks', and was supported by strong impaired loans coverage of 66%. The acquisition of Bankoa will not weigh on Abanca's overall credit risk profile given the former's size and the two banks' fairly similar asset-quality metrics (Bankoa had an impaired loan ratio of 3% at end-June 2020). However, we expect inflows of new impaired loans to increase towards end-2020 and more significantly in 2021 as borrower-support measures are lifted and asset quality pressures are likely to arise.

Abanca's core banking earnings have improved in recent years on growing business volumes, particularly fee-generating business, to support revenue growth and offset the impact of low interest rates. However, core profitability still falls short in comparison with investment-grade peers' due to a less diversified revenue mix and weaker cost efficiency. While Abanca continues to improve its core earnings generation helped by recent acquisitions, we expect the tougher operating environment to challenge profitability as loan impairment charges are likely to increase due to rising impaired loans. In addition, implementing cost-efficiency measures will be key to structurally improving the bank's operating profitability.

Abanca's main funding source is a stable and granular customer-deposit base (around 73% of total funding at end-June 2020), which fully funds the bank's loan book. Wholesale-funding reliance is moderate and mostly secured. The bank's liquidity position is adequate for upcoming maturities.

SUPPORT RATING AND SUPPORT RATING FLOOR

Abanca's Support Rating (SR) of '5' and Support Rating Floor (SRF) of 'No Floor' reflect Fitch's belief that senior creditors of the bank can no longer rely on receiving full extraordinary support from the sovereign in the event that the bank 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 to participate in losses, instead of, or ahead of a bank receiving sovereign support.

SUBORDINATED DEBT

Subordinated Tier 2 debt is rated two notches below Abanca's Viability Rating (VR) for loss severity, reflecting poor recoveries arising from its subordinated status.

The bank's AT1 notes are rated four notches below Abanca’s VR, two notches for loss severity in light of the notes' deep subordination, and two notches for additional non-performance risk relative to the VR given fully discretionary coupons.

RATING SENSITIVITIES

IDRs AND VR

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

The most immediate downside sensitivity for Abanca’s ratings relates to the economic fallout arising from the coronavirus outbreak. The bank's ratings could be downgraded if the regulatory CET1 ratio falls below 13% without a credible plan to restore it in a timely manner. This could stem from a more substantial and prolonged deterioration in profitability than we currently envisage or a larger-than-expected increase in impaired loans.

A continued appetite for inorganic growth without preserving current capital levels or resulting in a weaker credit risk profile could also be rating-negative.

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

The Outlook may be revised to Stable if the operating environment stabilises and the bank successfully manages the challenges arising from the economic downturn, limiting downside risks to its asset quality, profitability and, ultimately, capitalisation.

Rating upside is currently limited. In the long-term, a rating upgrade would require improved prospects for the operating environment and a meaningful and sustained improvement of core profitability, combined with improvements in the bank's credit quality and capitalisation.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

The ratings on the subordinated and AT1 notes are primarily sensitive to changes in Abanca's VR.
The ratings are also sensitive to a change in the notes' notching, which could arise if Fitch changes its assessment of their incremental non-performance relative to the risk captured in the VR.

SUPPORT RATING AND SUPPORT RATING FLOOR

An upgrade of the SR and upward revision of the SRF would be contingent on a positive change in the sovereign's propensity to support Abanca. While not impossible, this is highly unlikely, in Fitch's view.

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

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

ABANCA Corporacion Bancaria, S.A.; Long Term Issuer Default Rating; Affirmed; BBB-; Short Term Issuer Default Rating; Affirmed; F3
Viability Rating; Affirmed; bbb-
Support Rating; Affirmed; 5
Support Rating Floor; Affirmed; NF
----subordinated; Long Term Rating; Affirmed; BB
----junior subordinated; Long Term Rating; Affirmed; B+

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Additional information is available on www.fitchratings.com

Applicable Criteria
Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
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