FitchRatings

15 Sep 2020 | Downgrade

Fitch Downgrades ABN AMRO's Long-Term IDR to 'A'; Outlook Negative

Fitch Ratings-Warsaw-15 September 2020:

Fitch Ratings has downgraded ABN AMRO Bank N.V.'s Long-Term Issuer Default Rating (IDR) to 'A' from 'A'+' and affirmed its Viability Rating (VR) at 'a'. The Outlook on the Long-Term IDR is Negative. A full list of rating actions is below.

The downgrade of the Long-Term IDR by one notch and its equalisation with the bank's VR is driven by our expectation that the decline in ABN AMRO's qualifying junior debt (QJD) buffer (consisting of additional Tier 1 (AT1) and Tier 2 debt) below 10% of its risk-weighted assets (RWAs) will be sustained. Under Fitch's criteria, the buffer must exceed 10% of RWAs on a sustained basis for Fitch to notch a bank's Long-Term IDR above its VR.

At end-June 2020, the QJD buffer shrank to 9.5% of RWAs, factoring in the call of AT1 instrument planned in September 2020. We do not expect future material issuance of Tier 2 or AT1 debt as ABN AMRO plans to meet its resolution buffers using senior non-preferred debt. Moreover, the bank plans to accelerate the frontloading of Basel III end-game rules, which will inflate its RWAs.

The Negative Outlook reflects Fitch's view that the risks to the bank's operating environment, asset quality, profitability and capitalisation are skewed to the downside due to the economic fallout from the coronavirus outbreak. The bank has headroom to emerge from the crisis with its VR intact, given the relative strength of its financial profile at its current VR, particularly because of its sound capital buffers, ample liquidity and healthy funding profile.

Key Rating Drivers

IDRS, VR

ABN AMRO's IDRs and VR reflect its strong domestic universal banking franchise complemented by a solid European private banking foothold. ABN AMRO's international corporate and institutional banking (CIB) franchises provides a degree of revenue diversification, but also increases the risk of lumpy credit losses due to large single-name exposures to cyclical industries. The bank's solid risk-weighted capitalisation and sound funding and liquidity profile are rating strengths. The VR also factors in ABN AMRO's well-executed strategy, good asset quality and sound earnings.

Fitch revised its baseline eurozone GDP growth expectation for 2020 to a contraction of 9% in its latest forecast (followed by a tentative recovery of 5.5% in 2021). Fitch also expects a recession in the Netherlands, but to a smaller extent due to a less severe drop in economic activity. As a result, our assessment of the Dutch operating environment is negative. The ultimate impact of the coronavirus outbreak will largely depend on its depth and duration, and the effectiveness of fiscal support for the private sector. The Dutch government has recently prolonged some of the key support measures, although they will be offered more selectively.

Asset quality is a rating weakness. At end-June 2020, the bank's impaired loan ratio (Stage 3 loans) had increased to 3.1% from 2.5% at end-2019. We expect further asset-quality pressure in cyclical sectors such as oil and gas, offshore and other sectors directly affected by the coronavirus outbreak (transportation, leisure and non-food retail). We expect mortgage lending to continue to perform well during the coronavirus stress, given prudent underwriting and assuming an only moderate increase in unemployment. At end-June 2020, the impaired mortgage loan ratio was low at 0.8%.

In 1H20, loan impairment charges (LICs) spiked at EUR1.8 billion (129% of pre-impairment operating profit) and were inflated by credit losses on three large single names (EUR616 million). ABN has guided for 2020 full-year LICs of EUR3 billion (around 110bp of average loans), including about EUR400 million of additional impairments for non-core CIB, and about EUR500 million for commercial banking (SMEs) in 2H20. in 2021, we expect LICs to subside, but remain considerably higher than through-the-cycle average of 25bp-30bp.

In August 2020, the bank decided to exit its international non-European corporate and institutional business due to unsatisfactory profitability and risk profile. ABN AMRO will only focus on Netherlands and mid-sized clients in Northwest Europe, targeting at least 10% return on equity. The non-core assets equal about 6% of the loan book and mainly comprise exposures to cyclical sectors, such as trade and commodity finance, global transportation and logistics and natural resources segment (including US oil and gas). The winddown execution risk is moderate because non-core assets are dominated by loans, of which about 80% mature by end-2023.

In 2020, ABN AMRO will likely incur annual loss due to high LICs and additional restructuring costs related to the winddown of non-core assets. In the following periods, we expect ABN AMRO's revenue to remain resilient (underpinned by its well-performing mortgage portfolio), despite deposit margin compression and weak growth prospects. Expenses should be modestly lower thanks to ABN AMRO's cost-saving programmes. We expect the bank's quarterly earnings to gradually normalise in 2021, assuming no further economic stress.

ABN AMRO's risk-weighted capital ratios are strong. At end-June 2020, the bank's common equity Tier 1 (CET1) ratio declined slightly to 17.3%, modestly below its internal target of 17.5%-18.5%. However, it remained comfortably above the regulatory minimum of 9.7% (revised from 12.1% at end-2019), which cushions growing capital encumbrance by unreserved impaired loans.

ABN AMRO reported a Basel III leverage ratio of 4.3% at end-June 2020, which is only moderate compared with peers, due to balance sheet inflation from the bank's clearing business. A planned change in the regulatory approach to cleared derivatives should in 2021 increase the bank's leverage ratio by 50bp.

ABN AMRO's funding is diversified, and the bank maintains good access to the wholesale market. ABN AMRO uses wholesale funding to fund part of the loan book, but its gross loans/deposits ratio has been slowly improving and reached 110% at end-June 2020. The large mortgage loan market in the Netherlands combined with significant pension savings (resulting in limited inflow of deposits into the banking system) means that this is unlikely to change in the medium term.

ABN AMRO's funding is diverse, and the bank maintains good access to the wholesale markets as highlighted by its first two senior non-preferred debt issuances in 1H20. ABN AMRO's liquidity buffer (cash and highly rated bonds) increased to EUR108 billion at end-June 2020 (21% of assets) and comfortably covered wholesale funding maturing in the next 12 months (EUR24 billion).

The bank is subject to an investigation by the Dutch public prosecutor office in relation to requirements under the Act on the Prevention of Money Laundering and Financing of Terrorism. Any potential outcome is difficult to assess at this stage, and the investigation is likely to take time. ABN AMRO's VR factors in Fitch's view that the bank's earnings and capital provide a material buffer against most outcomes.

SHORT-TERM IDR AND SENIOR NON-PREFERRED DEBT

ABN AMRO's Short-Term IDR of 'F1' is the lower of the two options mapping to a Long-Term IDR of 'A'. This reflects our assessment of the bank's funding and liquidity factor at 'a+', compared with the minimum level of 'aa-' for a Short-Term IDR of 'F1+'.

Senior long-term non-preferred debt is rated in line with ABN AMRO's Long-Term IDR because it is a direct, unsecured and senior obligation of the bank. Fitch views the probability of default on the senior non-preferred debt as the same as the probability of default of the bank.

SENIOR PREFERRED DEBT, DERIVATIVE COUNTERPARTY RATING (DCR) AND DEPOSIT RATINGS

Fitch has affirmed ABN AMRO's senior preferred debt and DCR at 'A+', one notch above the bank's Long-Term IDR of 'A', to reflect the protection that could accrue to senior preferred debt from the bank's junior resolution debt and equity buffers. ABN AMRO targets its minimum requirements for own funds and eligible liabilities (MREL) at 27% of RWAs and plans to meet its MREL through issuance of senior non-preferred and more junior debt. ABN AMRO's short-term senior preferred debt is mapped from the long-term senior preferred debt rating and reflect our assessment of the bank's funding and liquidity.

We also assigned ABN AMRO long and short-term deposit ratings of 'A+'/'F1', one notch above the bank's Long-Term IDR, because deposits benefit from the same protection as derivative counterparties and preferred senior creditors coming from the planned build-up of bank resolution debt and equity buffers.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Fitch has downgraded ABN AMRO's subordinated Tier 2 debt by one notch to 'BBB+ ' from ' A-', due to reduction in the bank's Tier 2 and AT1 debt buffers below 10% of its RWAs. Consequently, we apply baseline notching for loss-severity of two notches from the VR.

The additional Tier 1 securities are four notches below ABN AMRO's VR to reflect the higher-than average loss severity risk of these securities (two notches) as well as the high risk of non-performance (two notches). Our assessment is based on the bank operating with a CET1 ratio that is comfortably above maximum distributable amount thresholds and our expectation that this will continue.

SUBSIDIARY AND AFFILIATED COMPANY

ABN AMRO Funding LLC is a US-based funding vehicle fully owned by ABN AMRO. The rating of the US commercial paper debt securities issued by the vehicle is aligned with ABN AMRO's Short-Term IDR, based on Fitch's view of an extremely high probability of support from ABN AMRO if required. This view is underpinned by ABN AMRO's guarantees on the securities issued by ABN AMRO Funding LLC.

RATING SENSITIVITIES

IDRS, VIABILITY RATING

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

The most immediate downside rating sensitivity for the bank's ratings relates to the economic and financial market fallout arising from the coronavirus outbreak. This represents a clear risk to our assessment of asset quality, profitability and capitalisation in case of a prolonged recession, high unemployment and material property price correction. We would downgrade ABN AMRO's ratings if we expect that the bank's restructuring efforts in the non-retail portfolio are insufficient to reduce its impaired loan ratio below 3% in the medium term. This would likely require a further material inflow of impaired loans in the bank's vulnerable corporates (such as oil and gas or transportation and logistics) and SME portfolio (under reduced government support measures).

Additionally, a potential CET1 ratio erosion below 14% would lead to a reassessment of the bank's capitalisation, which combined with a deterioration in other factors, could trigger a downgrade.

ABN AMRO's VR could also be downgraded if the investigation by the authorities results in a capital-depleting fine or reveals significant risk management shortcomings.

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

Upside rating potential is limited in the near term in light of the investigation and its uncertain outcome. Should the outcome have limited implications for ABN AMRO's financial profile, an extended record of strong performance against stated targets demonstrated in improved asset quality and profitability could be rating positive over time.

DERIVATIVE COUNTERPARTY RATING, SENIOR PREFERRED DEBT, DEPOSIT RATINGS

ABN AMRO's DCR, long-term senior preferred debt and long-term deposit ratings are notched up from and are sensitive to the bank's Long-Term IDR. The ratings are also sensitive to changes in the bank's resolution buffer requirements, which would lead to a reduction of the level of protection.

SENIOR NON-PREFERRED DEBT

ABN AMRO's senior non-preferred debt rating is sensitive to the bank's Long-Term IDR.

SUPPORT RATING AND SUPPORT RATING FLOOR

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

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Subordinated debt and other hybrid securities are sensitive to a change in ABN AMRO's VR and the assessment of the probability of their non-performance risk relative to the risk captured in the bank's VR. The additional Tier 1 ratings could be downgraded if non-performance risk increases relative to the risk captured in ABN AMRO's VR, for example if capital buffers over regulatory requirements are materially eroded.

SUBSIDIARY AND AFFILIATED COMPANY

ABN AMRO Funding LLC's debt rating is aligned with ABN AMRO's short-term debt rating and is therefore sensitive to changes to ABN AMRO's Short-Term IDR.

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.

Public Ratings with Credit Linkage to other ratings

ABN AMRO Funding LLC's debt rating is aligned with ABN AMRO's short-term debt rating.

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.

ABN AMRO Funding USA LLC
----senior unsecured; Short Term Rating; Affirmed; F1
ABN AMRO Bank N.V.; Long Term Issuer Default Rating; Downgrade; A; RO:Neg
; Short Term Issuer Default Rating; Affirmed; F1
; Viability Rating; Affirmed; a
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
; Derivative Counterparty Rating; Affirmed; A+(dcr)
----subordinated; Long Term Rating; Downgrade; BBB+
----Senior preferred; Long Term Rating; Affirmed; A+
----Senior non-preferred; Long Term Rating; Downgrade; A
----subordinated; Long Term Rating; Affirmed; BBB-
----long-term deposits; Long Term Rating; New Rating; A+
----Senior preferred; Short Term Rating; Affirmed; F1
----short-term deposits; Short Term Rating; New Rating; F1

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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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Endorsement Status

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