

Research Update:

Israel Discount Bank Ltd. And Discount Bank of New York Outlooks Revised To Stable; Ratings Affirmed

May 6, 2020

Overview

- We expect lockdown measures to contain COVID-19 and the associated economic downturn in Israel and the U.S. to result in an increase in credit losses, reduced business prospects, and lower profitability for Israel Discount Bank Ltd. (IDB), at least in 2020.
- Owing to the current unprecedented less benign fundamentals, IDB group's prospects of achieving better capitalization and efficiency to warrant a higher rating have diminished, in our view.
- We are revising the outlook to stable from positive and affirming our 'BBB+/A-2'long- and short-term ratings on IDB and its core subsidiary Israel Discount Bank New York.
- The stable outlook reflects our view that the bank's current capitalization provides a sufficient cushion to absorb additional credit losses and lost business but it will remain below a level that warrants higher ratings over the next two years.

PRIMARY CREDIT ANALYST

Goksenin Karagoz, FRM
Paris
(33) 1-4420-6724
goksenin.karagoz
@spglobal.com

SECONDARY CONTACT

Lena Schwartz
RAMAT-GAN
(972) 3-753-9716
lena.schwartz
@spglobal.com

Rating Action

On May 6, 2020, S&P Global Ratings revised its outlook on Israel Discount Bank Ltd. (IDB) and its core subsidiary Israel Discount Bank New York (IDBNY) and affirmed the 'BBB+/A-2'long- and short-term issuer credit ratings.

Rationale

The outlook revision to stable reflects the negative implications on earnings and asset quality for the group from the COVID-19 pandemic. We expect IDB to post substantially higher credit losses in 2020 before they start normalizing over the course of 2021. Moreover, rate cuts by the Bank of Israel and U.S. Federal Reserve mean margin contraction for the bank's operations in the U.S. and Israel. Therefore, we now see limited room for IDB to improve its capitalization to a level that warrants higher ratings due to the negative effects of the pandemic.

IDB is facing the pandemic, in the middle of a strategic transformation aimed at aligning its

efficiency with peers. During this process, the bank's capitalization was on a positive course. However, following a review of our ratings to take into account these developments, we now expect IDB's risk-adjusted capital (RAC) ratio to remain below 10% in the next 18-24 months. We expect an interest margin contraction of 20-25 basis points (bps) during 2020, followed by a flat trend in 2021. In terms of fee and commission income, we believe COVID-19-related effects will be less noticeable for IDB than its domestic peers because it did not have to dispose of its credit card operations. IDB, similarly to most other Israeli peers, announced a reduction of its targeted Tier 1 regulatory capital ratio to 8.9% from 9.9% previously, which should allow it an additional cushion to absorb unexpected losses. At the same time, the bank is not going to distribute dividends for at least two quarters.

We expect IDB to incur higher credit losses from its businesses in Israel and in the U.S., at least for 2020, as the pandemic continues to take its toll on small and midsize enterprises (SMEs) and households through higher unemployment and bankruptcies. We forecast muted loan growth for IDB in 2020 before a high-single-digit increase in 2021. New loan-loss provisions could increase above 70 bps in 2020, from 39 bps in 2019, before falling to 50 bps. We do not exclude a scenario of higher credit losses than we factor into our ratings, given IDB's relatively faster loan growth than peers'. The quality of unseasoned loans generated in the past few years will be tested in the current downturn, notably those to SMEs.

We acknowledge the significant progress made by IDB to improve its efficiency, with metrics moving on par with peers over time. Yet, this factor alone does not fully offset the more negative operating environment. Indeed, the new management will have to continue the long-term strategic transformation of the bank under much more challenging operating conditions.

In terms of funding and liquidity, we do not consider the pandemic a stress factor for Israeli banks, especially given the Bank of Israel has announced the availability of additional liquidity facilities. We expect IDB's core funding and liquidity metrics to remain resilient over the next two years, with the stable funding ratio and broad liquid assets by short-term wholesale funding needs ratio standing at 109.5% and 5.9x respectively at year-end 2019. The regulatory liquidity coverage ratio was also 121.2% at year-end 2019. These metrics support our positive view of the bank's funding and liquidity profile.

The lockdown of the Israeli economy for the past five weeks and social-distancing constraints have resulted in a sharp economic activity decline. In this respect, the sufficiency and effectiveness of policymakers' measures to support households and businesses will determine the extent of the expected recovery. Although broadly positive, the effect of the government's plans is currently not fully visible, with uncertainty still high despite gradual lockdown relief.

Outlook

The stable outlook on IDB and its core banking subsidiaries, including IDBNY, reflects our view that there is now limited room for the bank to improve its capitalization to a level that warrants higher ratings over the next two years. Due to the COVID-19 pandemic and related uncertainties, together with longer-for-lower interest rates, we now see more limited prospects for its RAC ratio to rise above 10% during this period.

Upside scenario

An upgrade of IDB over the next 24 months is unlikely unless it is less affected by the COVID-19 pandemic than we anticipate. To warrant an upgrade, we would expect IDB's RAC ratio to move

sustainably above 10%. This would hinge on IDB posting credit losses below our forecasts, improving margins, and operational efficiency. Although the bank suspended dividend payouts for at least two quarters in 2020, a likely resumption of dividends in 2021 would also affect the RAC ratio.

Downside scenario

We could lower the ratings if we see a more material deterioration of IDB's asset quality than expected that is not matched with a similar increase in provisions coverage. This could happen in a scenario of higher losses from the large amount of loans generated in the past few years, the performance of which is yet to be tested. We could also consider a negative rating action if the subdued economic environment continues for longer than we currently expect, eliminating the potential for recovery in 2021 and beyond.

Ratings Score Snapshot

	To	From
Issuer Credit Ratings	BBB+/Stable/A-2	BBB+/Positive/A-2
SACP	bbb	bbb
Anchor	bbb+	bbb+
Business Position	Adequate (0)	Adequate (0)
Capital & Earnings	Adequate (0)	Adequate (0)
Risk Position	Moderate (-1)	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)	Average and Adequate (0)
Support	+1	+1
ALAC Support	0	0
GRE Support	0	0
Group Support	0	0
Sovereign Support	+1	+1
Additional factors	0	0

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 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
- General Criteria: Methodology: Timeliness Of Payments: Grace Periods, Guarantees, And Use Of 'D' And 'SD' Ratings, Oct. 24, 2013

- 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
- General Criteria: Understanding S&P Global Ratings' Rating Definitions, June 3, 2009

Related Research

- Coronavirus Impact: Key Takeaways From Our Articles, May 4, 2020
- Banking Industry Country Risk Assessment Update: April 2020, May 1, 2020
- Europe Braces For A Deeper Recession In 2020, April 20, 2020
- An Already Historic U.S. Downturn Now Looks Even Worse, April 16, 2020
- Banking Industry Country Risk Assessment: Israel, Aug. 6, 2019

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Israel Discount Bank Ltd.		
Issuer Credit Rating	BBB+/Stable/A-2	BBB+/Positive/A-2
Israel Discount Bank of New York		
Issuer Credit Rating	BBB+/Stable/--	BBB+/Positive/--

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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 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.

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