

## RATING ACTION COMMENTARY

# Fitch Rates Israel Discount Bank 'A'/Stable; Senior Debt 'A(EXP)'

Tue 17 Jan, 2023 - 3:55 AM ET

Fitch Ratings - London - 17 Jan 2023: Fitch Ratings has assigned Israel Discount Bank Limited (IDB) a Long-Term Issuer Default Rating (IDR) of 'A' with a Stable Outlook, a Short-Term IDR of 'F1+' and a Viability Rating (VR) of 'a-'. Fitch has also assigned IDB's proposed issue of senior unsecured notes an expected rating of 'A(EXP)'.

The assignment of a final rating is contingent on the receipt of final documents that are consistent with the information already received.

## KEY RATING DRIVERS

**Support Drives Ratings:** The IDRs of IDB reflect Fitch's view of a very high probability that Israel (A+/Stable/F1+) would provide support to IDB, if needed. Fitch assesses Israel's ability and propensity to support IDB as very high, particularly given the bank's systemic importance in the country, with about 15% of banking-system assets.

**Universal Banking Franchise:** IDB's VR reflects a good domestic universal banking franchise, improved asset quality and profitability, and adequate capitalisation and funding. Unlike its two largest domestic peers, IDB was not required to sell its credit card subsidiary, Cal, in 2019 to improve competition. While this decision will be reviewed in 2023, the sale of Cal would not significantly alter our view of IDB's business profile.

**High Growth in Lower-Risk Segments:** The bank has grown its mortgage book by 18% in 9M22 and taken market share from competitors, but we view this segment as lower risk due to conservative underwriting standards as a result of prudent regulatory limits (eg maximum 75% loan-to-value (LTV)) and close oversight. IDB has also grown construction and real estate lending, a higher-risk segment, by 12% over the same period, though demand is driven by high population growth in Israel, ultimately translating into housing credit demand, which mitigates risks.

**Sound Asset Quality:** Impaired loans were 0.6% of gross loans at end-September 2022, which were low compared with both domestic and international peers', but in our view the decrease from 0.8% at end-2021 was mainly due to exceptionally high growth in mortgage loans, which have not seasoned. We expect the impaired loans ratio to be slightly higher than domestic peers' though the cycle as long as IDB owns a credit card subsidiary but to remain below 1.5% over the next two years.

**Interest Rate, CPI Benefit Earnings:** Strong 27% net interest income year-on-year growth in 9M22 was largely supported by several interest-rate rises and higher loan volumes. Operating profitability, which has historically been lower than peers', is benefiting from improved cost efficiency, with a Fitch-calculated cost/income ratio of 59% compared with an average of 73% over the last decade. We expect operating profit to be above 2% of risk-weighted assets (RWA) in 2022 and 2023 based on continued, albeit slowing, net interest income upside and improving cost controls.

**Adequate Capital Buffers:** Headroom in our assessment is limited, but capitalisation has remained adequate with a 10.17% common equity Tier 1 (CET1) ratio at end-September 2022 versus its 9.19% minimum regulatory requirement. The total capital ratio of 12.79% had a smaller 29bp buffer over the 12.5% requirement. We expect the bank to manage its capitalisation proactively, particularly during periods of high growth, and to maintain current buffers over regulatory requirements.

Our capitalisation assessment also considers the bank's improved internal capital generation and its fairly high ratio of RWAs to total assets (64% at end-September 2022) given the bank uses the standardised approach to calculate credit-risk RWAs.

**Sound Funding and Liquidity:** IDB's 83% loan-to-deposit ratio is broadly in line with domestic and international peers'. Funding benefits from the bank's stable and granular deposit base, split equally between retail and corporate deposits. Liquidity is sound, with a

liquidity coverage ratio of 125% at end-9M22. Unlike its largest domestic peers, access to international wholesale markets is untested.

**Strong State Support:** IDB's Long-Term IDR is at the same level as the Government Support Rating (GSR), which itself is in line with the domestic systemically important bank (D-SIB) GSR for Israel, and reflects Fitch's view of a very high probability that Israel would provide support to IDB, particularly given the bank's systemic importance in the country with a market share of about 15% of banking-sector assets. Fitch believes that Israel has a strong ability to support its banking sector, as underlined by its 'A+' IDR.

## **RATING SENSITIVITIES**

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

IDB's IDRs are primarily sensitive to a weakening of Israel's ability or propensity to support the bank. A downgrade of Israel's Long-Term IDR would likely result in a downgrade of IDB's GSR and IDRs. A reduced propensity of the Israeli authorities to support the country's largest banks, which could be signalled by the introduction of a deposit guarantee scheme followed by effective bank-resolution legislation, would also result in a downgrade of the bank's IDRs and GSR.

Sharp deterioration of asset quality that results in an impaired loan ratio of above 2% for an extended period of time combined with the CET1 ratio declining below current levels and weakening internal capital generation could result in a VR downgrade. Given the bank's significant exposure to the construction and real estate sector, a sharp decline in real estate prices would put pressure on asset quality and therefore on the VR.

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

An upgrade of Israel's Long-Term IDR is unlikely to result in an upgrade of the bank's GSR and Long-Term IDR as we typically do not assign GSRs above 'a' for D-SIBs in countries whose sovereigns are rated 'AA' or 'AA-' and where support propensity is high.

An upgrade of IDB's VR is unlikely given the bank's geographical concentration unless it sees material and structural improvement in profitability that allows the bank to generate stronger and more stable operating profit/RWA while also maintaining materially higher capital ratios, which we do not expect.

## **OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS**

IDB's 'F1+' Short-Term IDR is the higher of two possible options that map to an 'A' Long-Term IDR. This is because we view the sovereign's propensity to support as more certain in the near term.

The 'A(EXP)' expected rating of IDB's proposed senior unsecured notes is in line with IDB's 'A' IDR and in line with the baseline approach for senior debt ratings under our criteria. This reflects our view that a default on senior unsecured debt equates to a default of the bank. It also reflects Fitch's expectation of average recovery prospects.

## **OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES**

The expected rating on the proposed senior unsecured notes is sensitive to a change in IDB's IDR.

## **VR ADJUSTMENTS**

The 'a' operating environment score is below the 'aa' category implied score due to the following adjustment reasons: sovereign rating (negative), size and structure of economy (negative)

The 'a-' business profile score is above the 'bbb' category implied score due to the following adjustment reason: market position (positive)

The 'a-' capitalisation & leverage score is above the 'bbb' category implied score due to the following adjustment reason: leverage and risk-weight calculation (positive).

## **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>

## **DATE OF RELEVANT COMMITTEE**

20 December 2022

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

IDB's IDRs and GSR reflect Fitch's expectation of a very high probability of state support from Israel.

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 [www.fitchratings.com/esg](http://www.fitchratings.com/esg).

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕		
Israel Discount Bank Limited	LT IDR	A Rating Outlook Stable	New Rating
	ST IDR	F1+	New Rating
	Viability	a-	New Rating
	Government Support	a	New Rating
senior unsecured	LT	A(EXP)	Expected Rating

[VIEW ADDITIONAL RATING DETAILS](#)

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**APPLICABLE CRITERIA**

[Bank Rating Criteria \(pub. 07 Sep 2022\) \(including rating assumption sensitivity\)](#)

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Israel Discount Bank Limited

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