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Israel Discount Bank Ltd.

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Israel Discount Bank Ltd.

SACP: bbb → **Support: +1** → **Additional factors: 0**

SACP: bbb		
Anchor	bbb	
Business position	Adequate	0
Capital and earnings	Adequate	0
Risk position	Moderate	-1
Funding	Adequate	0
Liquidity	Adequate	
CRA adjustment		+1

Support: +1	
ALAC support	0
GRE support	0
Group support	0
Sovereign support	+1

Issuer credit rating
BBB+/Negative/A-2

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Overview

Key strengths	Key risks
Good home-market franchise.	Uncertain economic outlook and exposure to security and geopolitical risk.
Well-diversified revenue base by product and segment.	High exposure to the real estate and construction sectors.
A large and granular customer deposit base.	Still-lower efficiency than peers despite improvement.

Credit Highlights

Geopolitical tensions implies potential risks for Israeli banks, including Israel Discount Bank Ltd. (IDB). Military operations in the region have introduced considerable risks to Israel's economic outlook, because banks might face protracted effects from changed economic prospects and credit conditions. The long-term impact on the economy and its attractiveness also remains uncertain.

IDB's diversified business model will continue to support earnings resilience. The business portfolio combines retail and commercial banking, cards and payments, and small operations in the U.S. We expect this diversification will continue to support overall performance. After strong results in 2023, we anticipate moderately declining earnings while the group continues pursuing efforts to improve efficiency.

IDB's capitalization will stabilize over the next two years, in our view. We expect the risk-adjusted capital (RAC) ratio before concentration adjustments will land at about 8.0% in 2026, from 8.1% at end-2023 (pro forma the current Banking Industry Country Risk Assessment's [BICRA's] parameters). Profitability will sustain capital despite strong lending growth and higher dividend distributions, but the war's uncertain direction clouds our forecast.

Asset quality appears resilient but remains a key risk. We expect cost-of-risk to decline in 2024-2026, while remaining above domestic peers' average, at about 40 basis points (bps) per year, given banks' already-large stock of collective provisions and some signals of economic recovery. However, IDB's high exposure to small and midsize enterprises

(SMEs) and real estate and construction sector in particular, leave the bank's performance highly sensitive to domestic developments.

Our long-term issuer credit rating carries a one-notch uplift amid our expectation that the issuer can benefit of extraordinary government support.

Outlook

The negative outlook on IDB indicates that further escalation of the war could have negative implications for the bank's creditworthiness over the next 12-24 months.

Downside scenario

We could lower the ratings on IDB if we downgraded Israel because we would consider the government less likely to provide the bank with extraordinary support in case of need. We could also lower the rating if we thought that a structural increase in economic risks for Israel was likely to have negative consequences for the banking sector and IDB's asset quality, capitalization, or earnings.

We could also downgrade IDB if we expected its creditworthiness to weaken relative to that of peers. This could happen, for example, if the bank failed to deliver resilient performance and its asset quality, capitalization, or earnings weakened.

Upside scenario

We could revise the outlook to stable if we revised that on Israel to stable and thought that security risks and the resulting pressure on domestic economic prospects had lessened.

Key Metrics

Israel Discount Bank Ltd.--Key ratios and forecasts

	--Fiscal year ended Dec. 31 --				
(%)	**2022a**	**2023a**	**2024f**	**2025f**	**2026f**
Growth in operating revenue	20.0	24.8	(2.3)-(2.8)	(4.2)-(5.1)	(7.7)-(9.5)
Growth in customer loans	12.8	7.7	7.2-8.8	7.2-8.8	5.9-7.2
Net interest income/average earning assets (NIM)	3.1	3.5	2.9-3.3	2.6-2.8	2.1-2.4
Cost to income ratio	57.6	50.9	52.0-54.6	55.0-57.9	48.2-50.6
Return on average common equity	15.1	15.7	12.4-13.7	8.7-9.6	10.6-11.8
New loan loss provisions/average customer loans	0.2	0.6	0.3-0.3	0.5-0.5	0.2-0.3
Gross nonperforming assets/customer loans	1.1	1.3	1.2-1.3	1.3-1.4	1.1-1.2
Risk-adjusted capital ratio	8.9	8.1	7.7-8.1	7.6-8.0	7.7-8.1

All figures are S&P Global Ratings-adjusted. NIM--Net interest margin. a--Actual. e--Estimate. f--Forecast.

Anchor: 'bbb' For Banks Operating Only In Israel

We use our BICRA's economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for banks operating only in Israel is 'bbb'.

Israeli banks benefit from a wealthy and diversified domestic economy, although they display concentration in their lending books and are vulnerable to high geopolitical and security risks, which impede the country's economic performance. We expect real GDP to expand a low 2.2% in 2025, after stagnating in 2024. Israel's real estate sector, which represents about a fifth of banks' loan books, is among the most vulnerable to current developments, in addition to tourism, small businesses, and services. We think the economic slowdown, coupled with prolonged high cost of debt service, will dent borrowers' creditworthiness. We therefore expect banks' asset quality to deteriorate in the next year. In our base-case scenario, we assume credit losses will increase to 30-35 bps over 2024-2026.

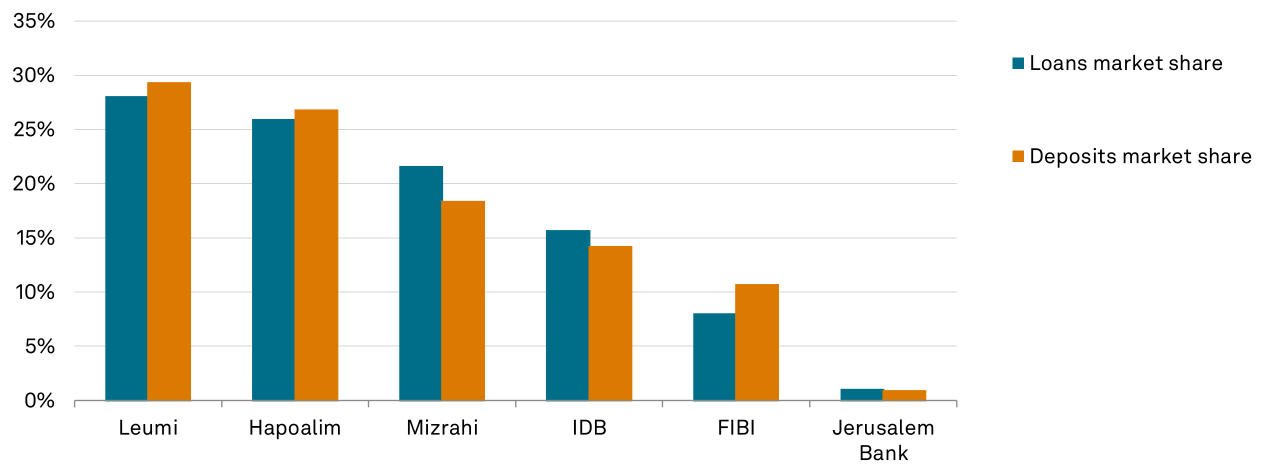
Low funding risk and the proactive regulator support Israel's banking industry. The sector benefits from a large domestic funding base and a net external creditor position, providing a cushion in the challenging environment. Prudent regulatory oversight from the Bank of Israel (BoI) partly mitigates risks of concentration and geopolitical instability. Israeli banks' profitability benefits from still-high interest rates, durable inflation--amid the significant indexation of the balance sheet--strong cost containment efforts introduced after the pandemic, and high recourse to digital solutions. Competition among banks and nonbank financial institutions remains a potential constraint on margins and fees.

Business Position: A Solid Domestic Second-Tier Bank In Israel

In our view, IDB's solid market position in Israel supports revenue stability. The bank is the fourth-largest in the country.

Chart 1

IDB is the fourth largest bank in Israel

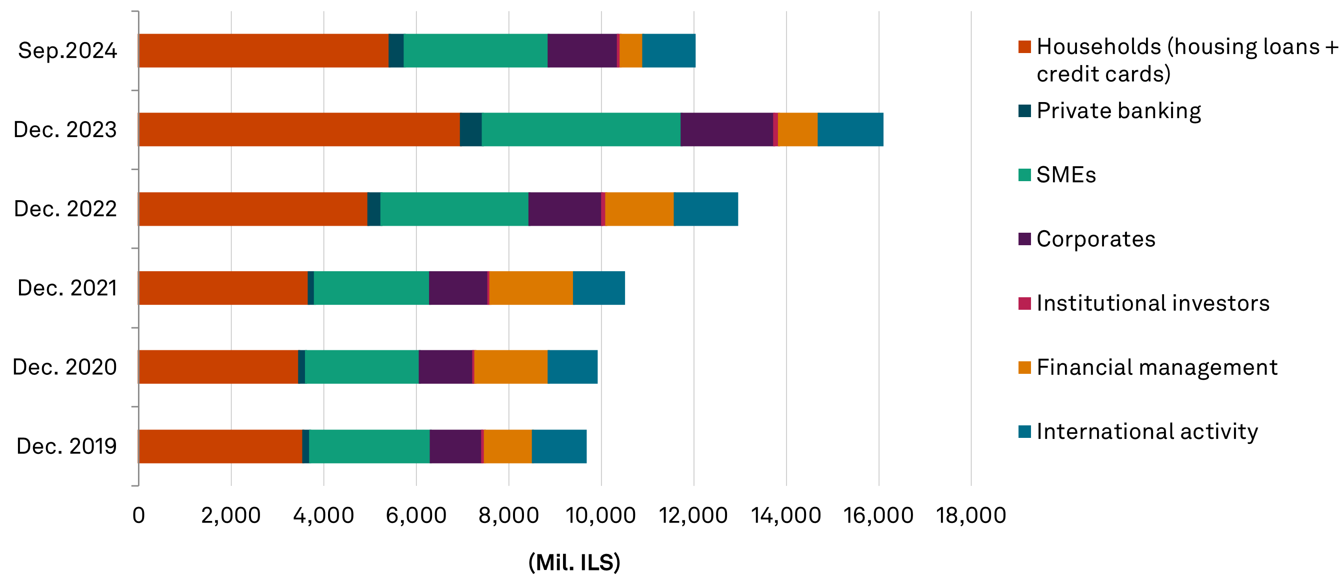


Source: S&P Global Ratings.

Its business model provides sound diversification to its income, which are well spread among products and segments, and balances the risks from geographic concentration. IDB is the only banking group that maintains its own credit card subsidiary, but as with other players in previous years, Israel's finance minister requested the bank divest its majority stake in its credit card subsidiary, CAL, by January 2026. In our view, the disposal of CAL would have limited ratings implications because the bank is signing agreements with other cards providers, implying limited profitability reduction (IDB declared a contribution of about 4% as of end-September 2024).

Chart 2

Total revenues are diversified by segments



ILS--New Israeli shekel. Source: S&P Global Ratings.

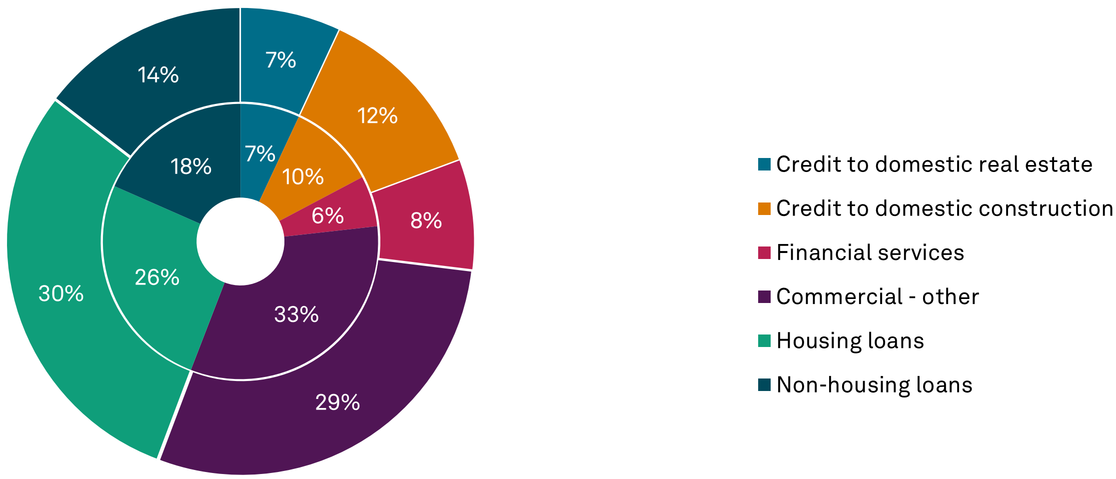
IDB is on track to achieve its business plan's 2020-2025 goals. Most relevant updated metrics include:

- A return on equity goal exceeding 12.5% in 2025; and
- An efficiency ratio goal of less than 55% in 2025.

IDB's strategy is based on growing faster than peers, especially in housing, small businesses, and commercial banking, by leveraging digital solutions. We see positively that the bank is targeting better efficiency, as it has historically demonstrated lower efficiency than peers. This is partly because of the more complex group structure and the treatment of commissions related to its credit card business, which inflate costs. We expect IDB to continue focusing on cost reductions in the next two years, along with continuously enforcing the bank's digitalization, but we think higher provisions due to the war could impair profitability.

Chart 3

IDB is significantly growing the share of the housing segment in its loans portfolio



Data as of Sept 2024 in the outer ring, vs 2020 in the center. Source: S&P Global Ratings.

Internationally, the bank's main focus is existing operations in the U.S. The U.S. subsidiary makes up a relatively small piece of the overall banking group--accounting for about 10% of total assets--and it is operating in a competitive environment that makes it tough to absorb high cost of funding. Its 6.3% return on equity remains well below the group level.

Capital And Earnings: Strong Core Earnings Should Support Capitalization Despite The Difficult Economic Environment

We expect IDB's capitalization to stabilize over the next two years. We expect the RAC ratio before concentration adjustments will land at about 8% in 2026, compared with 8.1% at end-2023 pro forma our revised BICRA parameters (see "Various Rating Actions On Israeli Banks On Increased Geopolitical Risks; All Outlooks Negative," published May 2, 2024, on RatingsDirect).

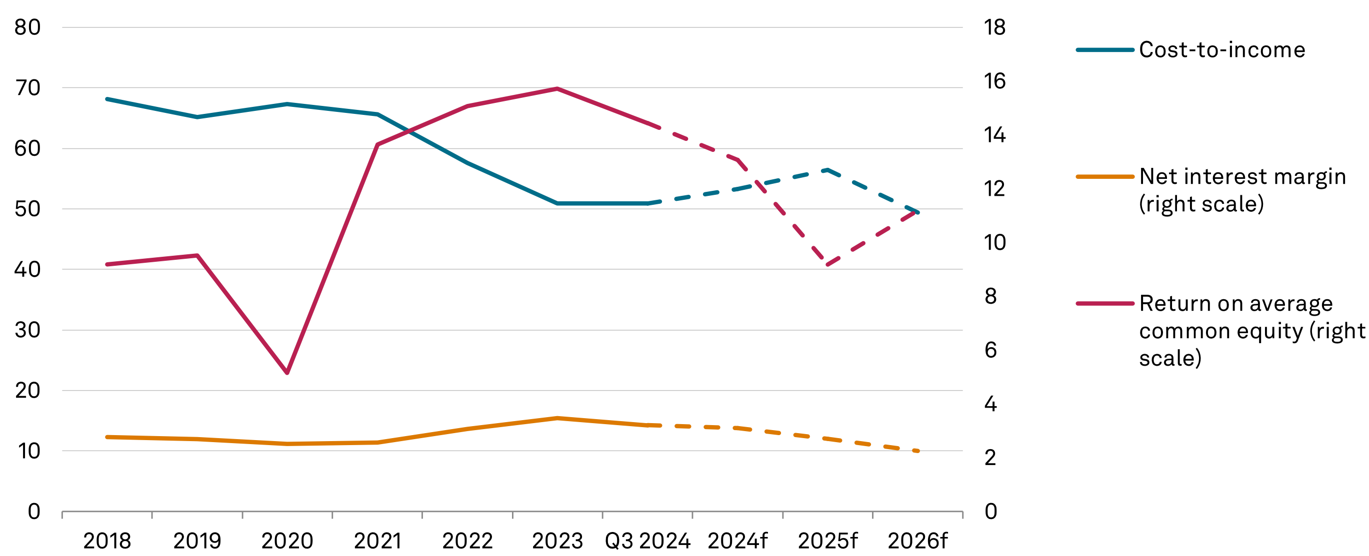
Our forecasts assume moderately declining earnings, strong lending growth, and higher dividend distribution. The war's direction clouds our forecast, though. More specifically, we expect:

- Stable lending expansion, at about 8% in 2025 and accelerating to about 10% in 2026, as geopolitical tensions ease.
- A gradual compression in margins in 2025-2026 after it peaked in 2023 at about 3.5%, driven by decreasing interest rates and resilient deposits pricing.
- Contained operating cost to increase 1%-2%, reflecting still-high technology investments and some wage pressure, partly offset by cost-cutting efforts from the bank.

- Credit losses to stabilize at about 40 bps per year on average in 2025 and 2026.
- Windfall tax of about Israeli shekel (NIS) 200 million per year in 2024 and 2025.
- Our expectation that management will calibrate dividend distributions and growth of risk-weighted assets to safeguard capital. We also anticipate a 40% dividend payout over 2025 and 2026 as the situation normalizes.
- Deconsolidation of the credit card company from 2026. Depending on the price and use of proceeds, the sale might boost IDB's RAC ratio, but we are not factoring in one.

Chart 4

We expect IDB's profitability to have peaked in 2023



f--Forecast. Source: S&P Global Ratings.

The bank's regulatory Tier 1 capital ratio stood at about 10.57% on Sept. 30, 2024, compared with the requirement of 9.2%. As other Israeli banks, IDB works with narrower buffers than international peers. Israeli banks use the standardized approach to calculating risk-weighted assets and apply the BoI's more conservative requirements to some real-estate-related exposures. We don't regard this as a risk because we understand that the regulator is comfortable with these narrow margins and the bank is not willing to approach the minimum threshold.

Risk Position: Asset Quality Is Resilient So Far, But Risks Remain High

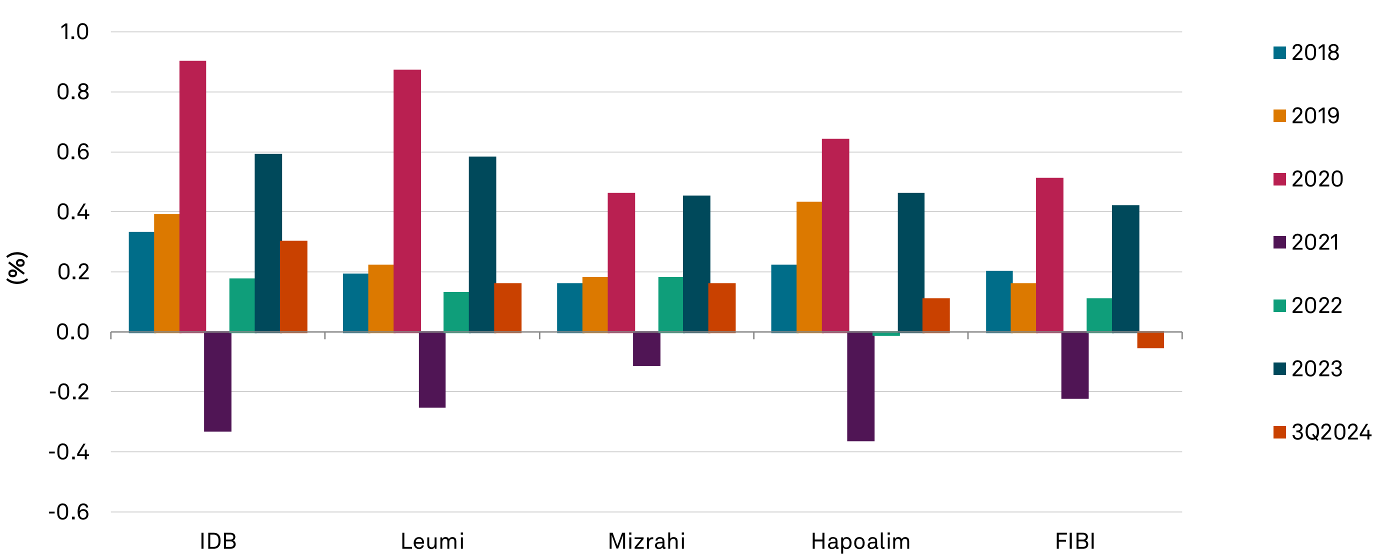
IDB's business model results in higher sensitivity to downturns than international peers are exposed to. Although the bank's combined exposure to construction and real estate (22%) is lower than that of largest peers, it is relevant and has increased materially over the past 12 months. Therefore, we think IDB has high sensitivity to tail risks and displays significant single-name concentration. In addition, the bank holds credit card operations, which has intrinsically higher risk.

Positively, IDB has been expanding its low-risk mortgage portfolio, which represented 30% of the loan book as of Sept. 30, 2024, versus 26% in December 2020. This points to both the dynamism of the Israeli mortgage market, despite a slowdown in 2023 and early 2024 due to higher rates and the war, and, the bank's strategy to catch up with domestic peers in this segment. The current share is in line with the system average. We anticipate the risk associated with mortgage exposures will remain contained. This is because we expect underlying demand for housing will likely support the sector through economic turbulence, and because IDB follows prudent risk management, as required by BoI. As of Sept. 30, 2024, 60.1% of IDB's mortgages had a loan-to-value (LTV) ratio below 60%, with about half of it having a LTV below 45%, and 99.7% of mortgages had payment-to-income ratios below 40%.

We expect cost of risk to decline in 2024-2026 from 2023 levels, although remaining above domestic peers' average. Over the next two years, we forecast the cost of risk will reach 40 bps on average, below the 2023 level of 59 bps. We see loans to SMEs--about 23% of total loans--and to construction and real estate as carrying higher risk. Also thanks to promotions by developers, the construction sector has shown resilience despite labor shortages from the war. We expect this segment will continue benefiting from structural demand for housing in Israel amid demographic dynamics, once security conditions normalize, but we see it as among the more vulnerable.

Chart 5

Cost of risk remains above peers but in line with expectations



Source: S&P Global Ratings.

Operational risks are material because of the geopolitical tensions in the region, related potential damage, and other adverse events like cyber. We partly reflect these risks in our anchor for Israeli banks and consider that IDB actively protects itself from cyber risks.

Funding And Liquidity: A Well-Diversified Funding Base Supports Metrics

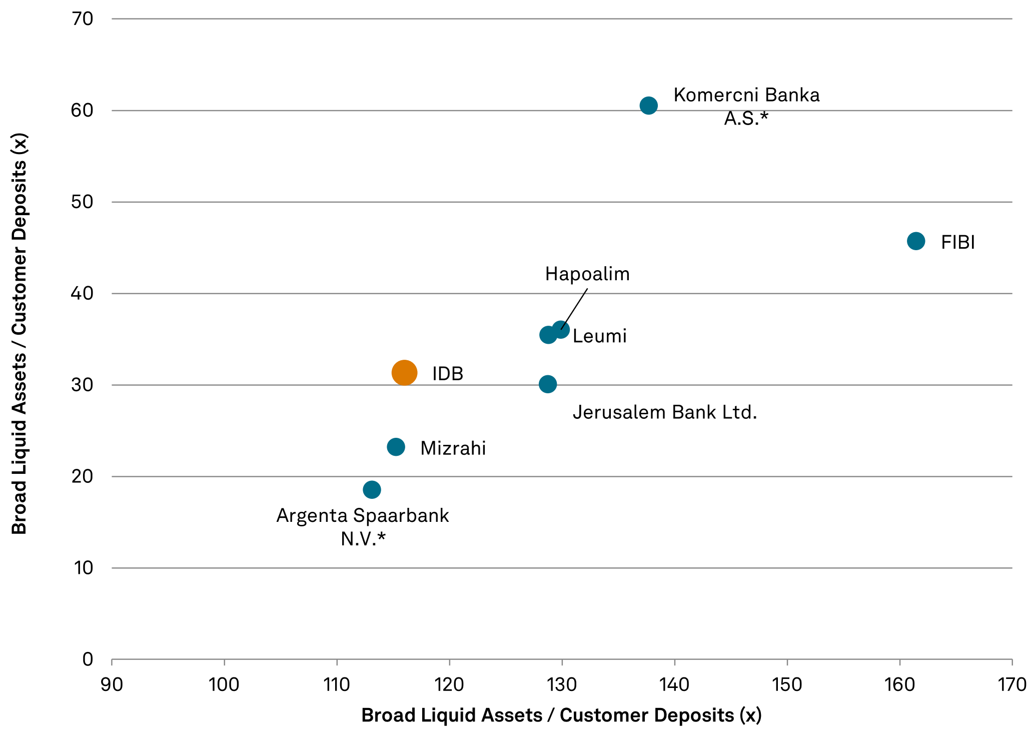
We think IDB will continue enjoying a robust liquidity and funding profile. This translates into solid funding and liquidity metrics that have proven resilient to difficult operating conditions. Since the war began, we have not witnessed any volatility in IDB's deposit base. Noninterest-bearing deposits fell to approximately 22% as of Sept. 30, 2024, from about 29% as of end 2021, so margins have been somewhat eroded.

The bank primarily relies on deposits for funding. As with domestic peers, most of IDB's funding base stems from stable and granular customer deposits, which account for about 88% of the total funding base. The remaining is composed of senior or subordinated debt, placed largely domestically. We do not expect IDB to have major difficulty in accessing domestic capital markets despite the conflict, because domestic investors maintained their appetite for banks' issuances.

In our view, IDB benefits from sound liquidity. Cash at the central bank, other bank placements, and investment securities constituted about 29.5% of the bank's assets and 42% of the short-term customer deposits as of Sept. 30, 2024. IDB's ratio of broad liquid assets to short-term wholesale funding was 4.61x on that date. We do not expect a significant deviation in the bank's overall liquidity profile over the next two years. Finally, IDB's key funding and liquidity ratios compare adequately with those of peers. The bank's liquidity coverage ratio stood at 130% and the net stable funding ratio at 121% for third-quarter 2024.

Chart 6

IDB's displays funding and liquidity metrics in line with peers



*Data as of 1H '24. S&P Calculations Based On Bank's Regulatory Disclosures. Source: S&P Global Ratings.

Comparable Ratings Analysis

While we anticipate a deterioration in IDB's profitability and asset quality metrics due to the war's indirect impact, we view it as manageable, also thanks to the bank's recent efficiency improvements. Consequently, although IDB faces higher risks, for now we see the rating as comparable with that on peers, and therefore apply a one-notch upward adjustment under our comparable rating analysis. This reflects our holistic view of the bank's operating performance, supporting a 'bbb' stand-alone credit profile (SACP).

Support: One Notch Of Uplift For Government Support

The long-term rating on IDB is one notch higher than its SACP, as we expect a moderately high likelihood of receiving extraordinary government support from Israel, which we consider supportive to the banking sector. Contrary to its domestic peers, we consider that the bank is still likely to receive extraordinary government support, if needed, because of its relative creditworthiness and our rating on Israel.

Environmental, Social, And Governance

We think environmental, social, and governance credit factors have no material influence on our credit rating analysis of IDB.

We regard the management team as professional and experienced. Also, IDB exhibits a robust system of checks and balances in decision-making with independent directors that contribute to the bank's strategy.

Environment and social factors do not affect credit quality differently from industry peers. IDB is also committed to increasing the scope of "green lending" to ILS12 billion and reduce its carbon footprint by 40% by 2030. Regarding social risk, IDB will continue staff reduction as part of its strategy. We think early retirements will be handled carefully. We also understand that the bank intends to increase to 25% the share of new hires from underrepresented populations.

Key Statistics

Table 1

Israel Discount Bank Ltd.--Key figures

	--Year ended Dec. 31--				
(Mil. ILS)	**2024***	**2023**	**2022**	**2021**	**2020**
Adjusted assets	426,761	394,056	375,330	333,726	292,603
Customer loans (gross)	284,144	266,014	246,887	218,860	195,952
Adjusted common equity	31,037	28,495	25,205	20,438	17,530
Operating revenues	12,033	15,648	12,535	10,447	9,926
Noninterest expenses	6,124	7,966	7,217	6,858	6,681
Core earnings	3,282	4,010	3,252	2,788	988

*Data as of Sept. 30. ILS--ILS-New Israeli Sheqel.

Table 2

Israel Discount Bank Ltd.--Business position

	--Year ended Dec. 31--				
(%)	**2024***	**2023**	**2022**	**2021**	**2020**
Loan market share in country of domicile	N/A	N/A	N/A	N/A	17.0
Deposit market share in country of domicile	N/A	N/A	N/A	N/A	15.2
Total revenues from business line (currency in millions)	12,034.0	16,063.0	12,971.0	10,511.0	9,955.0
Commercial banking/total revenues from business line	38.6	39.9	37.4	36.1	36.8
Retail banking/total revenues from business line	47.8	46.3	40.4	36.2	36.4
Commercial & retail banking/total revenues from business line	86.4	86.1	77.9	72.3	73.1
Other revenues/total revenues from business line	13.6	13.9	22.1	27.7	26.9
Return on average common equity	14.4	15.7	15.1	13.6	5.2

*Data as of Sept. 30. N/A--Not applicable.

Table 3

Israel Discount Bank Ltd.--Capital and earnings

	--Year ended Dec. 31--				
(%)	**2024***	**2023**	**2022**	**2021**	**2020**
Tier 1 capital ratio	10.6	10.7	10.2	10.2	10.4
S&P Global Ratings' RAC ratio before diversification	N/A	9.2	8.9	9.4	9.2
S&P Global Ratings' RAC ratio after diversification	N/A	8.3	8.0	8.4	8.3
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	68.5	69.9	69.3	62.5	59.4
Fee income/operating revenues	22.7	22.3	27.2	29.9	28.5
Market-sensitive income/operating revenues	8.4	7.8	3.2	7.2	11.5
Cost to income ratio	50.9	50.9	57.6	65.6	67.3
Preprovision operating income/average assets	1.9	2.0	1.5	1.1	1.2
Core earnings/average managed assets	1.1	1.0	0.9	0.9	0.4

*Data as of Sept. 30. N/A--Not applicable.

Table 4

Israel Discount Bank Ltd.--Risk-adjusted capital framework data

(Mil. ILS)	**Exposure***	**Basel III RWA**	**Average Basel III RW(%)**	**S&P Global Ratings RWA**	**Average S&P Global Ratings RW (%)**
Credit risk					
Government and central banks	102,037	2,902	3	1,777	2
Of which regional governments and local authorities	12,190	2,503	21	439	4
Institutions and CCPs	24,336	4,358	18	5,818	24
Corporate	171,504	155,235	91	183,801	107
Retail	104,685	63,478	61	45,887	44
Of which mortgage	70,376	37,636	53	20,156	29
Securitization§	1,669	334	20	334	20
Other assets†	10,494	13,597	130	17,510	167
Total credit risk	414,724	239,905	58	255,126	62
Credit valuation adjustment					
Total credit valuation adjustment	'--	2,338	'--	0	'--
Market risk					
Equity in the banking book	2,229	2,911	131	19,297	866
Trading book market risk	'--	4,209	'--	6,314	'--
Total market risk	'--	7,120	'--	25,610	'--
Operational risk					
Total operational risk	'--	20,406	'--	29,340	'--
(Mil. ILS)	**Exposure**	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification		269,769	'--	310,077	100

Table 4

Israel Discount Bank Ltd.--Risk-adjusted capital framework data (cont.)				
Total diversification/ concentration adjustments	'--	'--	1,974,626	637
RWA after diversification	269,769		2,284,702	737
(Mil. ILS)	**Tier 1 capital**	'--	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio				
Capital ratio before adjustments	28,890	10.7	28,495	9.2
Capital ratio after adjustments‡	28,890	10.7	28,495	1.2

*Exposure at default. §Securitization Exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital.ILS--New Israeli Shekel. Sources: Company data as of Dec. 31 2023, S&P Global Ratings.

Table 5

Israel Discount Bank Ltd.--Risk position

	--Year ended Dec. 31--				
(%)	**2024***	**2023**	**2022**	**2021**	**2020**
Growth in customer loans	9.1	7.7	12.8	11.7	5.1
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	11.1	12.0	11.6	10.7
Total managed assets/adjusted common equity (x)	13.8	13.9	14.9	16.4	16.8
New loan loss provisions/average customer loans	0.3	0.6	0.2	(0.3)	0.9
Net charge-offs/average customer loans	0.3	0.2	0.1	0.0	0.2
Gross nonperforming assets/customer loans + other real estate owned	1.2	1.3	1.1	1.0	1.3
Loan loss reserves/gross nonperforming assets	123.2	120.7	123.7	140.8	143.5

*Data as of Sept. 30. N/A--Not applicable.

Table 6

Israel Discount Bank Ltd.--Funding and liquidity

	--Year ended Dec. 31--				
(%)	**2024***	**2023**	**2022**	**2021**	**2020**
Core deposits/funding base	88.4	88.0	89.9	90.2	90.3
Customer loans (net)/customer deposits	86.5	87.9	83.3	82.6	84.9
Long-term funding ratio	94.5	93.4	94.5	95.9	95.0
Stable funding ratio	116.0	113.0	117.1	118.8	114.8
Short-term wholesale funding/funding base	6.0	7.1	5.9	4.4	5.3
Regulatory net stable funding ratio	121.2	122.3	124.8	126.7	N/A
Broad liquid assets/short-term wholesale funding (x)	4.6	3.6	4.6	6.6	5.1
Broad liquid assets/total assets	23.7	22.2	23.6	25.0	23.3
Broad liquid assets/customer deposits	31.3	29.5	30.4	32.1	30.3
Net broad liquid assets/short-term customer deposits	30.6	26.7	29.8	34.1	30.5
Regulatory liquidity coverage ratio (LCR) (%)	130.5	130.7	130.5	123.1	N/A
Short-term wholesale funding/total wholesale funding	51.6	59.3	58.9	44.6	55.2

*Data as of Sept. 30. N/A--Not applicable.

Israel Discount Bank Ltd.--Rating component scores	
Issuer Credit Rating	**BBB+/Negative/A-2**
SACP	bbb
Anchor	bbb
Economic risk	4
Industry risk	4
Business position	Adequate
Capital and earnings	Adequate
Risk position	Moderate
Funding	Adequate
Liquidity	Adequate
Comparable ratings analysis	+1
Support	0
ALAC support	0
GRE support	0
Group support	0
Sovereign support	+1
Additional factors	0

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity. SACP--Stand-alone credit profile.

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- General Criteria: National And Regional Scale Credit Ratings Methodology, June 8, 2023
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

Ratings Detail (As Of February 5, 2025)*	
Israel Discount Bank Ltd.	
Issuer Credit Rating	BBB+/Negative/A-2

Ratings Detail (As Of February 5, 2025)*(cont.)	
Issuer Credit Ratings History	
31-Oct-2023	BBB+/Negative/A-2
20-Jan-2022	BBB+/Positive/A-2
06-May-2020	BBB+/Stable/A-2
Sovereign Rating	
Israel	A/Negative/A-1
Related Entities	
Israel Discount Bank of New York	
Issuer Credit Rating	BBB+/Negative/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.