18 MAR 2021

Fitch Assigns Mizrahi Tefahot Bank 'A' Long-Term IDR; Outlook Stable

Fitch Ratings - London - 18 Mar 2021: Fitch Ratings has assigned Mizrahi Tefahot Bank Ltd (UMTB) a Long-Term Issuer Default Rating (IDR) of 'A' with Stable Outlook and Viability Rating (VR) of 'a-'. A full list of rating actions is below.

Key Rating Drivers

IDRS, SUPPORT RATING AND SUPPORT RATING FLOOR

UMTB's IDRs are based on sovereign support and together with the Support Rating (SR) and Support Rating Floor (SRF) reflect Fitch's expectation of an extremely high probability of support from Israel (A+/Stable), if needed. Our expectation is underpinned by Israel's ability to support domestic banks as well as our view that it has a strong willingness to do so. This view is reinforced by UMTB's large franchise, particularly in mortgage lending, and its importance to the Israeli economy.

Our view is also supported by the government's objective to preserve confidence in the banking sector, especially considering the absence of a deposit guarantee scheme and the lack of effective recovery and resolution legislation. UMTB accounts for about 20% of banking sector assets (including the recently acquired Union Bank) and is a domestic systemically important bank.

The bank's 'F1+' Short-Term IDR is the higher of the two possible options that map to a 'A' Long-Term IDR. This is because we view the sovereign's propensity to support UMTB as more certain in the near term. We also view the risk of a simultaneous deterioration in the liquidity profile of both Israel and UMTB as low, and have not identified other potential impediments to the prompt flow of funds to the bank.

VR

UMTB's VR reflects its strong domestic franchise, low to moderate risk appetite, and limited industry concentrations within its business lending portfolio. It also reflects resilient asset quality with low levels of impaired loans, which are lower than peers, and a higher proportion of low-risk retail mortgage lending than peers. The VR also reflects UMTB's stable business model, strong market position in retail lending and better-than-average cost efficiency, which support stable profitability. Capital, funding and liquidity ratios are sound.

Impaired loans remained a low 0.68% of gross loans at end-2020, according to Fitch's calculations. The ratio is supported by a framework for pandemic-related payment deferrals and fiscal support for borrowers as well as more flexible guidance on the classification of temporarily impaired and restructured loans. We expect impaired loans to increase in 2021 and 2022 but to a level still commensurate with our current asset quality assessment, and not materially greater than 2% of gross loans. Most borrowers who requested payment deferrals have resumed normal repayments.

Loan loss allowances increased to 143% of gross impaired loans at end-2020 as the bank used management overlays to increase its provisions to cover expected losses from pandemic-related asset-quality deterioration. We expect exposure to businesses to experience the greatest deterioration, although UMTB is less exposed to business borrowers than its larger peers.

The bank has demonstrated consistent profitability through the economic cycle thanks to its strong mortgage lending franchise and better cost efficiency than peers, with a sector-leading cost/income ratio of 54% in 2020. Operating profit/risk-weighted assets was a resilient 1.3% in 2020, despite high provisions of ILS1,050 million (2019: ILS364 million) driven by the pandemic.

UMTB's sound common equity Tier 1 (CET1) ratio of 10.0% at end-2020 reasonably exceeded its temporarily reduced regulatory requirement of 8.7%. Temporary capital requirement relief, which has reduced the minimum ratio by 100bp and also removed an additional capital requirement of 1% of outstanding residential mortgage balances, is expected to be extended to the end of September 2021. When this relief comes to an end, the capital buffer will reduce but remain adequate, in our view. Our assessment of the buffer considers the bank's conservative risk-weights across all asset classes, which is reflected in a high RWA density of 56% and a robust leverage ratio of 5.2%. Both metrics are high compared with global peers with a similar focus on residential mortgage lending.

Funding benefits from UMTB's stable and granular retail and SME deposit base and a loans/deposits ratio of 87% at end-2020. The bank also has access to capital markets where it issues senior and subordinated notes. Liquidity is sound, with a 133% liquidity coverage ratio at end-2020.

RATING SENSITIVITIES

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

We could downgrade UMTB's IDRs if we believe the Israeli authorities become less willing or able to provide timely support to the banking sector. A downgrade of Israel's Long-Term IDR would likely result in a downward revision of the bank's SRF and a downgrade of its IDRs. The introduction of a bank resolution law, which could reduce the sovereign's support propensity, is under discussion, but we do not expect this to come into effect within the rating horizon.

A downgrade of UMTB's VR would most likely be driven by a deeper and more prolonged economic disruption than our baseline expectations. A delayed recovery would likely result in more permanent damage to the bank's earnings and asset quality, which would take time to reverse. We would likely downgrade the VR if the bank's impaired loan ratio exceeds 3% over a prolonged period or if a deterioration in profitability significantly weakens the bank's capitalisation, which we do not expect. The VR would likely be downgraded if the bank's CET1 ratio falls towards its minimum requirement without a clear prospect to rebuild it quickly.

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

An upgrade of UMTB's VR would require the successful integration of Union Bank and growth in business segments that results in a materially more diversified business model while achieving stronger capitalisation and maintaining healthy asset quality. We do not expect this over the next two years, given the time required to complete the integration as well as the time required to diversify the bank's business model in a market with strong bank and non-bank competition.

An upgrade of Israel's Long-Term IDR is unlikely to result in an upgrade of UMTB's Long-Term IDR because Fitch typically does not assign SRFs above 'A' to domestic systemically important banks in countries where the sovereigns are rated 'AA' or 'AA-' and where support propensity is high.

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

10 March 2021

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

UMTB's IDRs, SR and SRF reflect Fitch's expectation of an extremely high probability of sovereign 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

Fitch Ratings Analysts

Christian Scarafia
Senior Director
Primary Rating Analyst
+44 20 3530 1012
Fitch Ratings Ltd 30 North Colonnade, Canary Wharf London E14 5GN

Maria Shishkina
Associate Director
Secondary Rating Analyst
+44 20 3530 1379

Patrick Rioual
Senior Director
Committee Chairperson
+49 69 768076 123

Media Contacts

Louisa Williams
London
+44 20 3530 2452
louisa.williams@thefitchgroup.com

Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Mizrahi Tefahot Bank Ltd	LT IDR	A	New Rating		
	ST IDR	F1+	New Rating		
	Viability	a-	New Rating		
	Support	1	New Rating		
	Support Floor	A	New Rating		

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	◆
NEGATIVE	⊖	◆
EVOLVING	⊙	◆
STABLE	⊙	

Applicable Criteria

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

Additional Disclosures

Solicitation Status

Endorsement Status

Disclaimer

Copyright

Endorsement policy

Fitch’s international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch’s approach to endorsement in the EU and the UK can be found on Fitch’s Regulatory Affairs page on Fitch’s website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.