

22 DEC 2022

# Fitch Affirms Mizrahi Tefahot Bank at 'A'; Outlook Stable

Fitch Ratings - London - 22 Dec 2022: Fitch Ratings has affirmed Mizrahi Tefahot Bank Ltd's (UMTB) Long-Term Issuer Default Rating at 'A' with a Stable Outlook and Short-Term IDR at 'F1+'. The bank's Viability Rating (VR) has been affirmed at 'a-'.

## Key Rating Drivers

**Support Drives Ratings:** UMTB's IDRs reflect Fitch's view of a very high probability that Israel (A+/Stable/F1+) would provide support to the bank, if needed. Fitch believes that Israel's ability and propensity to support UMTB is very high, particularly given the bank's systemic importance in the country, with almost 20% of banking system assets.

**Strong Retail Banking Franchise:** UMTB has a strong franchise in Israel as the third-largest bank by total assets. The ratings reflect conservative underwriting, resilient asset quality and adequate capitalisation. UMTB's business model is less diversified than its two larger peers, but has a particular strength in residential mortgages, with almost 40% of the market, making it the largest mortgage lender. We expect the integration of Union Bank and UMTB's diversification strategy to further solidify UMTB's franchise and support the stable business model.

**Close Regulatory Oversight:** Underwriting standards are conservative, helped by tight regulatory limits and oversight, particularly for mortgage loans and construction and real estate lending. Like other Israeli banks, UMTB has material exposure to the residential real estate market, through mortgages as well as construction loans, but this is mitigated by the low indebtedness of Israeli households as well as high population growth that drives high demand for new construction.

**Asset Quality Remains Sound:** UMTB's impaired loans ratio increased to 1.0% at end-September 2022 due to the implementation of current expected credit losses and adjustments to the impaired loan definition on 1 January 2022. We expect asset quality to be affected by higher interest rates and high inflation (albeit lower than many other countries). However, due to sound underwriting and Israel's resilient operating environment we expect the impaired loans ratio to remain below 1.5% over the next two years.

**Strong Profitability:** UMTB's improved profitability in 9M22 benefited from higher net interest income due to strong loan growth (12.1%) and rising interest rates. Cost efficiency continues to improve due to ongoing efficiency programmes. We expect positive profitability trends to continue, with the bank's operating profit/risk-weighted assets (RWA) ratio expected to remain above 2% in 2023 despite slowing loan demand due to weakened credit demand on higher mortgage rates and a decrease in housing

transactions in Israel, already observable in 4Q22.

**Adequate Capital Buffers:** The headroom available in our capitalisation assessment is limited, even though capitalisation has remained relatively stable in recent years, with a reported common equity Tier 1 (CET1) ratio of 9.92% at end-September 2022, the lowest among domestic peers. Like all banks in Israel, UMTB calculates RWAs using the standardised approach, which resulted in RWA-density of 57% at end-September 2022, which is conservative considering the bank's high proportion of lower-risk mortgage loans.

In our capitalisation assessment, we also consider the bank's improved internal capital generation and better profitability prospects. We expect the bank to maintain a moderate buffer above the regulatory minimum requirement, which has reverted to 9.61% following a temporary reduction during the pandemic.

**Sound Funding and Liquidity:** UMTB's loan-to-deposit ratio is higher than that of domestic peers, reflecting greater use of wholesale funding. However, UMTB's funding benefits from the bank's stable and granular retail and SME deposit base, and liquidity is sound.

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

## Rating Sensitivities

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

**Sovereign Support:** UMTB's IDR are primarily sensitive to a change in Israel's ability or propensity to support the bank. A downgrade of Israel's Long-Term IDR would likely result in a downgrade of UMTB's Government Support Rating (GSR) and its 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 to start and subsequently effective bank resolution legislation, would also result in a downgrade of the bank's IDRs and GSR.

**Asset Quality and Capitalisation:** A sharp deterioration of asset quality that results in an impaired loan ratio of above 2% for an extended period combined with the CET1 ratio declining below current levels and weakening internal capital generation could result in a VR downgrade. Given the bank's exposure to the 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:

**Limited Upside:** 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 domestic systemically important banks in countries whose sovereigns are rated 'AA' or 'AA-' and where support propensity is high.

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

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

**Subordinated Debt:** Subordinated debt is notched down from the bank's VR, in accordance with Fitch's assessment of each instrument's respective non-performance and relative loss severity risk profiles.

UMTB's Tier 2 instruments are rated two notches below UMTB's VR, reflecting poor recovery prospects in the event of a failure of the bank, in line with Fitch's base-case notching for Tier 2 debt.

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

**Subordinated Debt:** The ratings of UMTB's Tier 2 notes are sensitive to changes in the bank's VR.

## **VR ADJUSTMENTS**

The operating environment score has been assigned below the implied score due to the following adjustment reasons: sovereign rating (negative), size and structure of economy (negative)

The business profile score has been assigned above the implied score due to the following adjustment reason: market position (positive).

The capitalisation & leverage score has been assigned above the implied score due to the following adjustment reason: leverage and risk weight calculation (positive).

The funding & liquidity score has been assigned above the implied score due to the following adjustment reason: deposit structure (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>

## **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 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)

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## Rating Actions

ENTITY/DEBT	RATING		RECOVERY	PRIOR
Mizrahi Tefahot Bank Ltd	LT IDR	A 	Affirmed	A 

ENTITY/DEBT	RATING		RECOVERY	PRIOR
	ST IDR	F1+	Affirmed	F1+
	Viability	a-	Affirmed	a-
	Government Support	a	Affirmed	a
• subordinated		BBB	Affirmed	BBB

## RATINGS KEY OUTLOOK WATCH

POSITIVE	⊕	◆
NEGATIVE	⊖	◆
EVOLVING	◊	◆
STABLE	○	

## Applicable Criteria

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

## Additional Disclosures

[Solicitation Status](#)

## Endorsement Status

Mizrahi Tefahot Bank Ltd    UK Issued, EU Endorsed

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