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Fitch Upgrades Ibercaja to 'BBB-'; Outlook Stable

Fitch Ratings - Barcelona - 13 Jul 2022: Fitch Ratings has upgraded Ibercaja Banco, S.A.'s (Ibercaja) Long-Term Issuer Default Rating (IDR) to 'BBB-' from 'BB+'; Short-Term IDR to 'F3' from 'B'; and its Viability Rating (VR) to 'bbb-' from 'bb+'. The Outlook on the Long-Term IDR is Stable. A full list of rating actions is detailed below.

The upgrade reflects a material improvement of the bank's financial profile in the last four years, reflected in better asset-quality metrics and strengthened capitalisation. The upgrade also considers our expectation that Ibercaja's improved capacity to organically generate profits will be sustainable, underpinned by the bank's diversified business model, a leaner operating structure and low loan impairment charges (LIC) after completing an asset-quality clean-up.

Fitch has withdrawn Ibercaja's Support Rating and Support Rating Floor as they are no longer relevant to the agency's coverage following the publication of its updated Bank Rating Criteria on 12 November 2021. In line with the updated criteria, we have assigned Ibercaja a Government Support Rating (GSR) of 'no support' (ns).

Key Rating Drivers

Strengthening Financial Profile: Ibercaja's ratings reflect its improved capitalisation, which is now in line with that of its domestic peers, and accelerated balance-sheet de-risking, which results in asset-quality metrics that are better than domestic averages. Funding and liquidity are sound and stable. Profitability remains a rating weakness, although this is improving on fewer legacy issues and a reasonably diversified revenue profile.

Concentrated Franchise, Diversified Revenue: Ibercaja has a leading but concentrated regional franchise, with small market shares at the national level. The bank's business model is, however, supported by well-developed insurance and asset-management businesses, which provide it with more revenue diversification through fee-income generating activities than similarly rated peers.

Moderate Risk Profile: Ibercaja's risk profile is commensurate with its business model, which is dominated by retail mortgages (62% of performing loans at end-March 2022), and benefits from large collateralisation. The bank has moderate market risk, mainly in the form of interest-rate sensitivity of its loan book. The bank's debt securities portfolio mainly comprises Spanish sovereign debt at amortised cost, while the insurance portfolio has more exposure to private counterparties and a large part of assets classified at fair value, which results in some capital volatility.

Improving Asset Quality: Ibercaja's problem-asset ratio (which includes impaired loans and net foreclosed assets) fell significantly to 2.9% at end-March 2022 from 8% at end-2018, on limited new impaired loans, portfolio sales and stable recoveries.

Fitch's assessment of the bank's asset quality considers expected asset-quality pressures as grace periods of state-guaranteed loans come to an end in 2Q22 and as higher interest rates and inflation hit household disposable income. However, we expect asset-quality deterioration to be moderate, given the bank's focus on retail mortgage loans and strengthened impaired loans coverage (79% at end-March 2022).

Strengthened Profitability: Ibercaja's operating profit/risk weighted assets (RWA) improved to 1.5% in 2021, after having been affected by low interest rates, restructuring costs and high LICs. We expect operating profits/RWA to continue to rise in 2022 and 2023, supported by higher interest rates, cost-reduction initiatives, fairly low LIC, and despite pressures on loan growth. Our projections are based on our expectation that the economic recovery in Spain will remain resilient and inflation pressures will subside.

Adequate Capitalisation: Ibercaja's capitalisation is maintained with satisfactory buffers over regulatory minimum requirements, with a regulatory common equity Tier 1 (CET1) ratio of 13% reported at end-March 2022 (12.5% on a fully-loaded basis). Ibercaja's capital encumbrance from unreserved problem assets has decreased in recent years (15% of CET1 capital at end-March 2022). We expect the bank to maintain its fully-loaded CET1 at about 12.5% underpinned by improved earnings generation and despite high capital distribution (dividend pay-out above 60%) and potential negative market impact on its debt securities portfolio.

No Required Listing: Ibercaja is no longer required to be listed before end-2022 on the basis the bank's majority owner, Ibercaja Banking Foundation, builds a reserve fund of 1.75% of the bank's RWA by end-2025. Ibercaja will have more flexibility to undertake its IPO when market conditions are more favourable.

We also believe the banking foundation will be able to build the reserve fund based on the bank's expected recurring dividends and without weighing on Ibercaja's capitalisation. The reserve fund is, in any case, legally earmarked for a potential recapitalisation of the bank in compliance with the Spanish savings bank law.

Stable Funding Profile: The bank's main funding source is a stable and granular retail deposit base, which fully funds its loan book. Wholesale funding is mostly in the form of covered bonds and ECB funding, which strengthens the bank's ample liquidity. Ibercaja has access to institutional markets for funding, although it is a less frequent issuer than larger domestic entities.

Ibercaja's 'F3' Short-Term IDR maps to a 'BBB-' Long-Term IDR on Fitch's rating scale.

Rating Sensitivities

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

The ratings could be downgraded if the fully-loaded CET1 ratio falls sustainably below Ibercaja's guidance of 12.5% without a credible plan to restore it in the short term, or if capital encumbrance to unreserved problem assets increases substantially. Rating pressure could also result from an inability to structurally improve profitability and the problem-asset ratio increasing towards high single digits due to higher-than-expected asset-quality pressures.

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

A further upgrade of the ratings would require a meaningful and sustained improvement of operating profitability (above 2% of RWA), a problem-asset ratio consistently below 3% and a fully-loaded CET1 above 12.5%. An upgrade would also require that the bank maintain the current conservative approach to risk-taking.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

SENIOR PREFERRED DEBT (SP)

Ibercaja's SP debt is rated in line with the bank's Long-Term IDR and therefore has also been upgraded to 'BBB-' from 'BB+', and reflects our expectation that Ibercaja will use SP debt to meet its resolution buffer requirements, and that the combined buffer of additional Tier 1, Tier 2 and senior non-preferred (SNP) debt is unlikely to exceed 10% of the bank's RWA.

SUBORDINATED DEBT

Subordinated Tier 2 debt is rated two notches below the VR for loss severity, reflecting poor recoveries arising from its subordinated status. Fitch has upgraded this kind of debt to 'BB' from 'BB-' following the upgrade of the bank's VR.

AT1 debt is rated four notches below Ibercaja's VR, which is the baseline notching for this type of debt under Fitch's criteria. This notching reflects poor recoveries, due to the notes' deep subordination (two notches) as well as incremental non-performance risk relative to the VR (two notches), given fully discretionary coupon payments and a write-down trigger. Fitch has upgraded this kind of debt to 'B+' from 'B' following the upgrade of the bank's VR.

GSR

Ibercaja's GSR of 'ns' reflects Fitch's belief that senior creditors can no longer rely on receiving full extraordinary support from the sovereign if Ibercaja becomes non-viable. The EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism for eurozone banks provide a framework for resolving banks that is likely to require senior creditors to participate in losses instead of or ahead of a bank receiving sovereign support.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

SP DEBT

The SP debt rating is primarily sensitive to a change in the bank's Long-Term IDR, which itself is sensitive to the bank's VR. The rating is also sensitive to a change in the bank's strategy to meet its resolution buffer requirements. Although currently not expected, the rating could be upgraded by one notch if the size of the combined buffer of junior and SNP debt is expected to sustainably exceed 10% of RWA or if resolution requirements are expected to be met only with SNP debt and more junior instruments.

SUBORDINATED DEBT

Subordinated debt ratings are primarily sensitive to a change in Ibercaja's VR. The ratings are also sensitive to a change in notching should Fitch change its assessment of loss severity or relative non-performance risk.

The AT1 notes' rating is primarily sensitive to changes in Ibercaja's VR. The rating is also sensitive to adverse changes in its notching from Ibercaja's VR, which could arise if Fitch changes its assessment of the probability of the notes' non-performance relative to the risk captured in the VR. This may reflect a change in capital management in the group or an unexpected shift in regulatory capital requirements, for example.

GSR

An upgrade of the GSR would be contingent on a positive change in the sovereign's propensity to support its banks. Although not impossible, this is highly unlikely, in Fitch's view.

VR ADJUSTMENTS

The operating-environment score of 'bbb+' is below the 'a' category implied score due to the following adjustment reason: economic performance (negative).

The asset-quality score of 'bbb-' is above the 'bb' category implied score due to the following adjustment reason: historical and future metrics (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.

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

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Ibercaja Banco, S.A.	LT IDR	BBB-	Upgrade		BB+

ENTITY/DEBT	RATING			RECOVERY	PRIOR
	ST IDR	F3	Upgrade		B
	Viability	bbb-	Upgrade		bb+
	Support	WD	Withdrawn		5
	Support Floor	WD	Withdrawn		NF
	Government Support	ns	New Rating		
• junior subordinated	LT	B+	Upgrade		B
• subordinated	LT	BB	Upgrade		BB-
• Senior preferred	LT	BBB-	Upgrade		BB+

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Bank Rating Criteria (pub.12 Nov 2021) (including rating assumption sensitivity)

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Endorsement Status

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