FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms IKB at 'BBB-'; Outlook Stable

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Fitch Ratings - Frankfurt am Main - 30 Nov 2023: Fitch Ratings has affirmed IKB Deutsche Industriebank AG's (IKB) Long-Term Issuer Default Rating (IDR) at 'BBB-' with a Stable Outlook and Viability Rating (VR) at 'bbb-'. A full list of rating actions is below.

KEY RATING DRIVERS

Profitability Constrains Ratings: IKB's ratings reflect its specialised business model, weak profitability, satisfactory asset quality, underpinned by good quality mid-cap corporate borrowers, as well as adequate capitalisation, funding and liquidity. IKB's VR is one notch below the 'bbb' implied VR, because weak average earnings have a high influence on its credit profile.

Specialised Business Model: IKB's franchise and competitive position benefit from its strong relationships with the majority of larger German mid-cap companies, for which it structures and provides public development loans (PDL), predominantly sourced from KfW, Germany's largest development bank. This mitigates its overall small size and modest market shares. However, its focus on lending to domestic mid-cap corporates offers limited product scope and modest ability to generate fee income independently from its lending business.

Improved Risk Controls: IKB has implemented various measures to address regulatory findings after a review of its risk-management framework in 2021, including the calibration of its risk-bearing capacity and market risk models. It also reduced market risks in its securities portfolio since end-2021. Interest rate risk from IKB's loans and deposits is adequately hedged, and the bank does not have a trading book. Loan underwriting standards are sound and have been tightened in 2023.

Satisfactory Asset Quality: IKB's impaired loans ratio remained resilient at 1.7% at end-1H23 with an adequate level of provisioning. We expect loan quality metrics to moderately deteriorate in the next two years because the bank's mid-cap clients are exposed to subdued economic growth in Germany, lower foreign demand, energy price inflation and higher interest rates.

In particular, we expect defaults to increase in the commercial real estate development portfolio, which accounted for 7% of gross loans, but overall the impaired loans ratio should remain below 3%. Our assessment of IKB's asset quality also factors in the high single borrower concentration inherent to its business model.

Improving, But Weak Profitability: We expect operating profit/risk-weighted assets (RWA) to improve to above 0.5% in 2023, sustained by faster repricing of assets than funding, which more than offsets the negative effect from the termination of central bank tenders (TLTRO). Write-downs and disposal losses in the bank's securities portfolio led to an operating loss in 2022 (Fitch excludes the release of capital reserves from the operating income).

We expect operating profit/RWA to improve in the next two years to around 1%, sustained by sound new business origination after regulatory capital constrains limited the bank's growth ambitions in 2022 and 2023. Higher than expected loan impairment charges are a downside to our forecast.

Stabilised Capitalisation, Adequate Levels: IKB's transitional common equity Tier 1 (CET1) ratio of 15.8% at end-1H23 is comfortably above the bank's CET1 requirement of 11.1%, sustained by the bank's suspension of pay-outs and generation of higher-rated new business. The bank expects the ratio to increase to above 19% in 2024 as it plans to make use of certain transitional rules under the Capital Requirements Regulation III. However, its strategic objectives include a target CET1 ratio of 12%. We believe that the bank's business model requires higher capitalisation metrics than universal banks.

Adequate Funding and Liquidity: Maturity-matched funding from 'AAA' rated German state-owned development banks covers the entire PDL portfolio, for which IKB consequently does not carry funding or asset-liability management risk. The remaining funding consists mainly of price-sensitive online retail deposits, corporate deposits, central bank and inter-bank repos. The bank's under-developed capital-market franchise constrains our assessment of the funding profile. Strong regulatory liquidity metrics mitigate high liquid assets encumbrance from secured inter-bank funding.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

IKB's ratings would come under pressure if there were extended structural operating losses and a decline of the CET1 ratio below 13% without clear recovery prospects. A material and structural deterioration in the impaired loan ratio to above 3% without a credible plan to reduce it would also put pressure on the ratings.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade would require sustainable earnings recovery, with an operating profit/RWA ratio converging toward 1% and an extended record of operations with the current reduced risk appetite. An upgrade would also require the maintenance of good asset quality metrics through the economic downturn and capitalisation around current levels.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

The bank's 'F3' Short-Term IDR is the only option mapping to its 'BBB-' Long-Term IDR.

IKB's deposit ratings are aligned with its IDRs. The bank's preferred resolution strategy is liquidation. Therefore, we do not expect the bank to be subject to a minimum requirement for own funds and eligible liabilities and to build or maintain buffers of junior and senior non-preferred debt in excess of 10% of RWAs.

Government Support Rating (GSR): IKB's GSR of 'no support' reflects Fitch's view that senior creditors can no longer rely on full extraordinary state support. This is driven by the EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism, which provide a resolution framework that is likely to require senior creditors participating in losses, if necessary, instead or ahead of a bank receiving government support.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

IKB's deposit ratings are sensitive to changes in its IDRs.

IKB's GSR is at the bottom of Fitch's rating scale and therefore cannot be downgraded.

An upgrade of the GSR would require a higher propensity of sovereign support. While not impossible, the Bank Recovery and Resolution Directive makes this highly unlikely.

VR ADJUSTMENTS

The asset quality score of 'bbb+' has been assigned below the 'a' implied category score, due to the following adjustment reason: concentrations (negative).

The earnings and profitability score of 'bb+' has been assigned above the 'b and below' implied category score, due to the following adjustment reason: historical and future metrics (positive).

The capitalisation and leverage score of 'bbb' has been assigned below the 'a' implied category score, due to the following adjustment reason: risk profile and business model (negative).

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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
IKB Deutsche Industriebank AG	LT IDR	BBB- Rating Outlook Stable	Affirmed	BBB- Rating Outlook Stable
	ST IDR	F3	Affirmed	F3
	Viability	bbb-	Affirmed	bbb-
	Government Support	ns	Affirmed	ns
long-term deposits	LT	BBB-	Affirmed	BBB-

short-term deposits	ST	F3	Affirmed	F3

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 01 Sep 2023) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

IKB Deutsche Industriebank AG	EU Issued, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

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