Fitch Ratings

RATING ACTION COMMENTARY

Fitch Affirms IKB at 'BBB-'; Outlook Stable

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Fitch Ratings - Frankfurt am Main - 15 Nov 2024: 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 niche 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.

Niche Business Model: IKB provides public development loans (PDLs) to corporates, in addition to commercial loans for investment purposes. Its specialised knowledge and long-term relationships with the majority of large German mid-cap corporates mitigate its small size and narrow product diversification. The bank's business model also offers limited room to expand business volumes and only a modest ability to generate fee income.

Reduced Risk Appetite: IKB has reduced the market risk in its bond and derivative portfolios, addressing regulatory findings that emerged in a review of its risk-management framework in 2021. However, hedging mismatches in the portfolios persist. Matched funding for PDLs and predominantly variable-rate commercial loans mitigate interest rate risk in the loan book. Loan underwriting standards were tightened in 2023 and IKB has increased its focus on good quality mid-cap corporates.

Satisfactory Asset Quality: IKB's impaired loans ratio remained resilient at 2% at end-1H24, with an adequate level of provisioning. Fitch expects loan quality metrics to only moderately deteriorate due to the weak German economy because a large portion of the bank's mid-cap clients are internationally diversified. However, the inherent high singleborrower concentration in its business model increases the sensitivity of the impaired loans ratio to large idiosyncratic defaults.

Weak Profitability: IKB's business model structurally limits its revenue diversification and exposes earnings to the cyclical swings and the fierce competition of lending to good quality German mid-cap corporates. Its operating profit has been weaker and less consistent than peers in recent years and could remain volatile until the bank reduces its large derivatives and bonds portfolios. This is mitigated by a good cost management record.

We expect operating profits/ risk-weighted assets (RWA) to remain close to 1% in the next two years, as sluggish loan demand and above historical average loan impairment charges should be only partially offset by lower costs, mainly the absence of bank levies and pension indexation.

Adequate Capitalisation: IKB's capitalisation is adequate in light of its business model and risk profile, which we believe require higher capitalisation metrics than universal banks. The bank's common equity Tier 1 (CET1) ratio of 17.2% at end-1H24 offers some headroom for potential dividend pay-outs, also considering the bank's above-average capital requirements.

Stable Wholesale Funding: Maturity-matched funding from 'AAA' rated German state-owned development banks (predominantly KfW, Germany's largest development bank) covers the entire PDL portfolio. Commercial loans are funded with price-sensitive online retail deposits, corporate deposits, central bank and inter-bank repos, while the bank has not tapped the capital markets in recent years. Predictable liquidity outflows 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 to below 13% without clear recovery prospects. A material and structural deterioration in the impaired loans 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 an extended new business record with the current tightened loan underwriting standards, resulting in operating profit/RWAs consistently above 1%. An upgrade would also require a further reduction of market risk in the bank's bond and derivative portfolios and the maintenance of satisfactory asset quality metrics through the economic downturn.

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 'aa' implied category score, due to the following adjustment reason: risk profile and business model (negative).

The funding and liquidity score of 'bbb' has been assigned above the 'bb' implied category score, due to the following adjustment reason: non-deposit funding (positive).

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. 15 Mar 2024) (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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