FitchRatings

15 Jan 2020 | Affirmation

Fitch Affirms Abu Dhabi Commercial Bank at 'A+'; Outlook Stable

Fitch Ratings-Moscow-15 January 2020:

Fitch Ratings has affirmed UAE-based Abu Dhabi Commercial Bank's (ADCB) Long-Term Issuer Default Rating (IDR) at 'A+' with a Stable Outlook and Viability Rating (VR) at 'bb+'. A full list of rating actions is at the end of this rating action commentary.

Key Rating Drivers

IDRS, SUPPORT RATING (SR) AND SUPPORT RATING FLOOR (SRF)

ADCB's IDRs, SR and SRF reflect an extremely high probability of support available to the bank from the UAE authorities.

Fitch's view of support factors in the sovereign's strong capacity to support the banking system, sustained by sovereign wealth funds and recurring revenue mostly from hydrocarbon production. Fitch also expects high willingness from the authorities to support the banking sector. This has been demonstrated by the UAE authorities' long track record of supporting domestic banks, as well as close ties with and part government ownership links to a number of banks.

ADCB's 'A+' SRF is at the Abu Dhabi domestic systemically important banks (D-SIB) SRF level, reflecting its high systemic importance. The Abu Dhabi D-SIB SRF is one notch above that of other UAE banks due to Abu Dhabi's superior financial flexibility compared with the UAE as a whole.

In its current form ADCB was established on 1 May 2019, when the former Union National Bank (UNB) merged with ADCB. The combined bank in turn purchased 100% of shares in Al Hilal Bank (AHB). The Abu Dhabi Investment Council (ADIC) - which was formerly controlling shareholder at all three banks - holds a 60.2% stake in the merged bank. ADCB, which now ranks as the third-largest bank by assets in the UAE, has retained the legal registrations and board of the former ADCB. AHB continues to operate as a wholly-owned Islamic subsidiary of ADCB.

We assign Short-Term IDRs according to the mapping correspondence described in our rating criteria. An 'A+' Long-Term IDR can correspond to a Short-Term IDR of either 'F1' or 'F1+'. In the case of ADCB we opted for 'F1', the lower of the two Short-Term IDR options. This is because a significant proportion of the UAE banking sector funding is related to the government and a stress scenario for the banks is likely to come at a time when the sovereign itself is experiencing some form of stress. Fitch judges this "wrong-way" risk to be high in the UAE, but is only likely to happen in the short term.

DEBT RATINGS

ADCB's commercial paper programme is rated in line with the bank's Short-Term IDR, reflecting Fitch's view that the likelihood of default of these obligations is the same as the likelihood of default of the bank. Similarly, the ratings of the bank's unsecured debt (programmes and notes), including that issued by ADCB's special purpose vehicle (SPV) ADCB Finance (Cayman) Limited, are in line with the bank's Long- and Short-Term IDRs.

ADCB assumed UNB's senior unsecured programmes and notes at the time of the merger. As they rank pari passu with ADCB's senior unsecured debt, they are rated in line with ADCB's IDRs.

Subordinated debt issued through ADCB Finance (Cayman) Limited is notched off ADCB's support-driven IDR, as is common in the GCC, reflecting Fitch's view that the probability of sovereign support remains sufficiently strong to extend to the bank's subordinated notes. The notes are rated one notch below the IDR anchor rating to reflect loss severity relative to senior unsecured debt but zero notches for non-performance risk.

VR

ADCB's VR reflects the bank's fairly high risk appetite and only adequate asset quality, and in light of this, only adequate capitalisation. It also considers the bank's solid domestic franchise, which has further strengthened as a result of the merger (at end-9M19 it accounted for about 12% of the UAE banking sector), reasonable performance and good funding and liquidity.

High lending concentration to the real estate and development sector (end-9M19: 30% of the loan book) and significant borrower concentration are symptomatic of the bank's higher risk appetite and only adequate asset quality, although both have decreased post-merger. In addition, Fitch views the business model of ADCB's subsidiary, AHB, to be more vulnerable to asset quality volatility, given its higher appetite for retail and SME financing and the weaker quality of its corporate lending exposures. There has also been only limited amortisation of several of ADCB's large exposures. Therefore in Fitch's view the bank's reported asset quality metrics may not fully capture loan seasoning risks and the actual level of problematic loans is likely to be higher than current reported ratios.

Reported Stage 3 loans were equal to 2.5% of gross loans (excluding loans to banks) at end-9M19.

This was below Fitch's estimated end-2018 consolidated Stage 3 ratio of 3.9%, as ADCB accounted for some UNB and AHB impaired exposures at fair value. The bank does not disclose Stage 2 ratio on interim dates, while Fitch believes this was in the range of 6% to 8%. Stage 3 loans were fully covered by total impairment reserves but reserves coverage of total problematic loans (including Stage 2 and Stage 3) was much weaker, estimated by Fitch in the 30%-35% range.

Capitalisation is only adequate for the bank's risk profile. Its Fitch Core Capital (FCC) ratio at end-3Q19 was 13.3%, down from 13.6% (pre-merger) due to the recognition of AED4.3 billion of goodwill (excluded from FCC) relating to the merger. The Tier 1 ratio was higher, at 15%, reflecting AED6 billion of additional Tier 1 capital securities. ADCB is already in compliance with Basel III fully-loaded capital requirements applicable from 1 January 2021, including a core Tier 1 ratio of 11%, a Tier 1 ratio of 12.5% and a total capital adequacy ratio of 14.5%.

ADCB is funded by customer deposits (end-9M19: 79% of total funding) and benefits from its solid franchise (further strengthened by the merger), links to the Abu Dhabi government and ruling family and D-SIB status, in this respect. Consolidated customer deposits (based on pro-forma accounts) decreased by 8% in 9M19 due to a reduction in wholesale deposits as ADCB strategically targeted a decrease in its cost of funding. Liquid assets (cash and balance with the Central Bank of the United Arab Emirates (CBUAE) excluding mandatory reserves, short-term deposits with other banks and short-term repo placements and liquid bonds) accounted for 20% of total assets at end-9M19, or 32% of customer deposits. The liquidity coverage ratio was 121% at end-9M19, comfortably above CBUAE's requirement of 100%.

RATING SENSITIVITIES

IDRS, SRFs, SRs

ADCB's IDRs, SR and SRF are sensitive to a change in Fitch's view of the creditworthiness of the UAE authorities, or of their propensity to support the banking system or the bank.

SPV AND DEBT RATINGS

A change in the bank's IDRs would lead to a change in the ratings of the unsecured bond programme, the senior notes rated under these programmes, as well as other senior and subordinated debt including issued by ADCB Finance (Cayman) and debt inherited from UNB.

ADCB's subordinated debt rating could be downgraded by one notch if the Bank Rating Criteria is published in its current Exposure Draft form. The Exposure Draft is available at www.fitchratings.com.

VR

ADCB's VR could be downgraded if the bank's risk appetite and strategy lead to a weakening in the bank's asset quality or capital ratios. A record of successful operations post-merger, greater business model diversification and amortisation/seasoning of large exposures could lead to an upgrade.

Criteria Variation

Under Fitch's Bank Rating Criteria, SRFs are based on the ability and propensity of the government to provide support. Within the UAE, Fitch assesses the potential for support at a federal level as Fitch believes that support would be forthcoming from the UAE authorities acting together. However, in respect of Abu Dhabi, Fitch has varied the criteria to reflect the superior financial flexibility of the Abu Dhabi authorities. As such, the SRFs for banks in Abu Dhabi are based on Fitch's assessment of the ability and propensity of the Abu Dhabi authorities to provide support in their own right. This results in a one-notch higher SRF for Abu Dhabi banks (compared with other UAE banks), and results in a one-notch higher Long-Term IDR for Abu Dhabi banks.

Public Ratings with Credit Linkage to other ratings

ADCB's IDRs, SR and SRF reflect an extremely high probability of support available to the bank from the UAE authorities.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3 - 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 our ESG Relevance Scores, visit www.fitchratings.com/esg.

Abu Dhabi Commercial Bank PJSC; Long Term Issuer Default Rating; Affirmed; A+; RO:Sta
; Short Term Issuer Default Rating; Affirmed; F1
; Viability Rating; Affirmed; bb+
; Support Rating; Affirmed; 1

; Support Rating Floor; Affirmed; A+
----senior unsecured; Long Term Rating; Affirmed; A+
----senior unsecured; Short Term Rating; Affirmed; F1
ADCB Finance (Cayman) Limited
----senior unsecured; Long Term Rating; Affirmed; A+
----subordinated; Long Term Rating; Affirmed; A

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Additional information is available on www.fitchratings.com

Applicable Criteria

Bank Rating Criteria (pub. 12 Oct 2018)
Short-Term Ratings Criteria (pub. 02 May 2019)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
Solicitation Status

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