

22 DEC 2022

Fitch Affirms Bank Leumi at 'A'; Outlook Stable

Fitch Ratings - London - 22 Dec 2022: Fitch Ratings has affirmed Bank Leumi Le-Israel B.M.'s Long-Term Issuer Default Rating (IDR) 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: Leumi'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 assesses Israel's ability and propensity to support Leumi as very high, particularly given the bank's systemic importance in the country, with about 30% of banking system assets.

Strong Domestic Franchise: The VR reflects Leumi's strong universal banking franchise in Israel, modest risk appetite, sound funding and liquidity and adequate capitalisation. It also reflects Fitch's view that asset quality will remain resilient and profitability will continue to improve, supported by loan growth and the higher interest rate environment.

Diversified Business Model: Leumi is the largest bank by total assets in Israel with a stable and diversified business model. It is a universal bank that provides a wide range of retail, commercial, capital market and private banking services, with good domestic market shares across these segments. Leumi's strong franchise, including its position as market leader in key retail products, provides the group with considerable pricing power. The sale of its US subsidiary, Leumi USA, to Valley National Bancorp is consistent with its peers reducing international operations in recent years.

Market Risk Appetite Above Domestic Peers: Leumi's market risk exposure in the banking book is in line with domestic peers and appropriately controlled by internal risk limits. However, the bank is also exposed to market risk from equity investments in non-financial companies made through Leumi Partners, which at end-2021 amounted to about 9.5% of the consolidated common equity Tier 1 (CET1) capital, although we expect this to remain broadly stable.

Sound Asset Quality: Leumi's impaired loans decreased to 0.6% of gross loans at end-September 2022, partly benefiting from high loan growth this year, particularly in mortgages. We expect higher loan impairment charges next year as the loans season. Asset quality will also be affected by higher interest rates and high inflation (albeit lower than many other countries), but 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: Leumi's operating profit has benefited from an increase in net interest income due to the strong loan growth (+11.7%) and improving margins due to increasing interest rates in

9M22. The bank's US subsidiary also completed its merger with Valley National Bancorp, in April 2022, which resulted in non-recurring income of ILS645 million. We expect positive profitability trends to continue with the bank's operating profit/risk-weighted assets (RWAs) 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 Capitalisation Buffers: Headroom in our assessment is limited, but capitalisation has remained adequate with a common equity Tier 1 (CET1) ratio of 11.41% at end-September 2022. We view buffers as adequate because Leumi calculates RWAs using the standardised approach, which results in fairly high RWAs density (RWAs/total assets) of 59% at end-September 2022. Our capital assessment also considers Leumi's improved internal capital generation.

Large, Stable Deposit Base: The bank's funding benefits from a stable, granular and low-cost deposit base that exceeds the size of the loan book. The bank also has proven access to domestic and international debt markets, which it demonstrated through the issuance of senior unsecured notes in July 2022. The 127% liquidity coverage ratio at end-September 2022 was adequately above the 100% minimum regulatory requirement.

Leumi'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: Leumi's IDRs are primarily sensitive to a weakening of Israel's ability or propensity to support the bank. A downgrade of Israel's Long-Term IDR would likely result in a downgrade of Leumi'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: A sharp deterioration of asset quality that results in an impaired loan ratio of above 2% for an extended period combined with the CET1 declining below current levels and weakening internal capital generation could result in a VR downgrade. Given the bank's significant 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 and GSR 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.

A VR upgrade 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

Senior Debt: Leumi's senior unsecured notes are rated in line with the Long-Term IDR as they constitute the bank's unsecured and unsubordinated obligations.

Subordinated Debt: Leumi's Tier 2 subordinated notes are rated two notches below the bank's VR to reflect poor recovery prospects in the event of a failure or non-performance of the bank.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Senior Debt: The ratings are sensitive to changes in the bank's Long-Term IDR.

Subordinated Debt: The ratings 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)

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

Leumi'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.

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Rating Actions

| ENTITY/DEBT | RATING | | RECOVERY | PRIOR |
|------------------------------|-----------|---|----------|---|
| Bank Leumi Le-Israel B.M. | LT IDR | A  | Affirmed | A  |
| | ST IDR | F1+ | Affirmed | F1+ |
| | Viability | a- | Affirmed | a- |

| ENTITY/DEBT | RATING | | RECOVERY | PRIOR |
|--------------------|--------------------|-----|----------|-------|
| | Government Support | a | Affirmed | a |
| • subordinated | | BBB | Affirmed | BBB |
| • senior unsecured | LT | A | Affirmed | A |

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

Bank Leumi Le-Israel B.M. UK Issued, EU Endorsed

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