14 Aug 2020 | Affirmation

Fitch Affirms Standard Chartered PLC at A; Outlook Negative

Fitch Ratings-London-14 August 2020:

Fitch Ratings has affirmed Standard Chartered PLC's (Standard Chartered) and Standard Chartered Bank's (SCB) Long-Term Issuer Default Ratings (IDR) at 'A' and at 'A+', respectively with Negative Outlook. Their Viability Ratings (VRs) are affirmed at 'a'. A full list of rating actions can be found below.

Key Rating Drivers

The ratings of Standard Chartered reflect its consolidated risk profile, which mainly consists of principal operating subsidiaries, UK-based SCB and Hong Kong-based Standard Chartered Bank (Hong Kong) Limited. We reflect the group's consolidated profile in SCB's ratings as well, as we believe that its risk profile is highly correlated with the group's, reflecting deep integration.

Fitch believes that the economic fallout from the pandemic has heightened risks to the group's ratings, which is underlined in the Negative Outlook on the Long-Term IDRs. We believe that the group's asset quality and earnings will deteriorate, and the path to pre-pandemic targets will be delayed by a challenging economic outlook. Rating headroom is limited because the group's earnings and asset quality were lagging those of similarly rated peers pre-crisis. On the other hand the group maintains solid capitalisation, stable funding and ample liquidity.

Fitch expects a sharp contraction in global economic activity of 4.6% in 2020, and a long route back to pre-crisis levels of economic activity. The severity varies across Standard Chartered 's footprint, with the group's main markets (Hong Kong, Singapore, UK), and two of the four larger turnaround markets (UAE, India) facing deeper economic shocks than the global average. At the same time other markets (China, Korea, Taiwan) are showing signs of recovery and less pronounced effects from the pandemic.

The group's operating profit/risk-weighted assets (RWAs) fell to 1.4% in 1H20, driven by larger expected credit losses (ECLs), while the bank maintained positive jaws even amid declining income in 2Q20. We expect 2H20 pre-provision earnings to moderate given seasonally weaker financial markets, lower interest rates feeding through and lagged recovery in markets still under lockdown.

A recovery should become evident in 2021, but given downside risks to economic activity, interest rates and trade flows, we believe that Standard Chartered's previous earnings target of a 10% return on tangible equity will be unattainable in 2021 and more difficult to achieve even with a one to two years of delay, and targeted cost reductions.

The Hong Kong business has remained resilient to social unrest, COVID-19 disruptions and heightened geopolitical tensions so far. A loss of attractiveness of HK as a business location, with longer-lasting economic impact for the territory would affect the group negatively.

The prospects for progress in the group's turnaround markets are mixed. Improvements were seen in India, Indonesia and Korea, but the economic outlook (in particular in India) is tough. UAE was loss-making in 1H20 and remains under pressure because of a combination of COVID-19 and oil price slump.

We expect ECLs to remain large going into 2021, considering the potential for further adverse credit migrations, and defaults, especially as loan moratoriums end over the coming quarters. A proportion of lower-rated and early-alert loans will require additional impairments should they become non-performing. Stage 3 loans increased to 3.2% in 1H20 from 2.7% in 2019.

We see SCB's corporate, commercial and institutional banking (CCIB) business as most vulnerable to deterioration during this crisis. This business has sizeable exposures to sectors under immediate pressure such as oil and gas and commodity trading, although they have decreased from historical peaks. The retail exposure mostly consists of mortgages that should have limited losses because of generally conservative collateralisation, although this will also partly depend on unemployment and the performance of real-estate markets.

Standard Chartered's CET1 ratio increased 50bp in 1H20 to 14.3% as net profitability, dividend cancellation and the disposal of Permata Bank offset RWA growth related to COVID-19. The bank targets a 13%-14% CET1 ratio, which we expect to be maintained, absent deterioration of the economic outlook beyond our base case. However, our assessment of capitalisation could be revised lower if the economic outlook changes adversely, or if the group's financial performance deteriorates, making the target no longer commensurate with its risk profile at an 'a' level.

The funding and liquidity assessment is underpinned by Standard Chartered's deposit-led funding profile, stable liquidity, and manageable refinancing needs. The liquidity coverage ratio (LCR) was broadly stable at 149% at end-June 2020, and well in excess of requirements on a consolidated level and at the main subsidiaries. The provision of liquidity by central banks around the world meant that wholesale funding market disruptions in 1Q20 were brief. The strong liquidity profile underpins the group's Short-Term IDR and debt ratings of 'F1'.

The IDR of SCB is one notch above its and the group's VRs as we believe that its senior creditors are protected by the group's junior and bail-in-able senior debt in a resolution, given its role as a material legal entity in the group's resolution planning.

Standard Chartered's VR also considers moderate common equity double leverage (108% at end-2019) at the holding company level.

SUBORDINATED & HYBRID DEBT

The subordinated Tier 2 debt is rated two notches below the respective issuers' VRs, which is Fitch's baseline notching for loss severity for this type of debt given our expectations of poor recoveries. Upper Tier 2 debt is rated three notches below SCB's VR, including one notch for non-performance given cumulative coupon deferral features.

High-trigger contingent capital Tier 1 instruments and preference shares with no constraints on coupon omission are rated four notches below the VR, as we expect that the group will maintain at least a 100bp buffer over capital requirements.

SUPPORT RATING AND SUPPORT RATING FLOOR

Standard Chartered's and SCB's Support Rating of '5' and Support Rating Floor of 'No Floor' reflect Fitch's opinion that senior creditors cannot rely on extraordinary support from the UK government if the group becomes non-viable.

RATING SENSITIVITIES

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

Standard Chartered's and SCB's Long- and Short-Term IDRs are mainly sensitive to the factors driving the VRs, which in turn are mainly sensitive to the economic and financial market fall-out from the pandemic, and to a meaningful increase in the group's risk appetite as a response to medium-term pressures on profitability.

The economic fallout of the pandemic represents a risk to our assessment of the group's operating environment, earnings, asset quality, capitalisation, and ability to achieve the group's strategic objectives. As the duration of the pandemic is still unknown, we see downside risks to current economic forecasts, which would increase the likelihood of the group's ratings being downgraded.

Potential negative implications from unfolding geopolitical tension between China and the US on the group's company profile, strategy and financial position could also drive a negative rating action.

The ratings could come under pressure if the quality of Standard Chartered's assets deteriorates sharply, causing further weakness in earnings (beyond Fitch's expectation) or pressure on capitalisation; if an improvement in earnings in 2021 and beyond, and towards the targeted 10% return on tangible equity, becomes unlikely; if the group's CET1 ratio falls below the targeted 13%-14% without a plan to restore it swiftly; or if reported capital ratios are no longer commensurate with the group's risk profile, for example due to a meaningful rise in uncovered impaired loans or other problem assets.

SCB's IDR would be downgraded to the level of the bank's VR if we no longer believe that creditors will be protected in a resolution by the group's buffer of subordinated and senior holding company debt.

Senior debt ratings are primarily sensitive to the issuers' IDRs.

AT1 and Tier 2 subordinated notes are primarily sensitive to changes in the issuers' VRs. The AT1 notes' ratings are also sensitive to Fitch's assessment of their non-performance risk relative to the risk captured in the VR. They could be downgraded to five or more levels below the VRs of Standard Chartered and SCB if non-performance risk is assessed to have increased, for instance due to a shift in capital requirements, lower capital targets, or heightened likelihood that the buffer over maximum distributable amount (MDA) thresholds will decrease below 100bp.

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

The Outlook could be revised to Stable if the economic downturn is not prolonged and pressure on asset quality and earnings proves to be temporary. An upgrade of the IDR and VR is unlikely in the medium term unless we see a sustained improvement in the group's operating environment, capitalisation and capital targets, earnings and evidence that asset quality will not be materially affected by the downturn. An upgrade would also require evidence that risk appetite has not increased meaningfully.

Tier 2 debt could be upgraded if the group's tier 2 and AT1 debt increase sustainably to over 10% of RWAs as this would lead to better recovery prospects.

The Support Rating is sensitive to changes in assumptions around the propensity or ability of the UK sovereign to provide timely support. An upgrade of the banks' Support Ratings and upward revision of their Support Rating Floors would be contingent on a positive change in the sovereign's propensity to support the banks, which we see as highly improbable.

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
The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Standard Chartered Bank; Long Term Issuer Default Rating; Affirmed; A+; RO:Neg
; Short Term Issuer Default Rating; Affirmed; F1
; Viability Rating; Affirmed; a
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
----senior unsecured; Long Term Rating; Affirmed; A+
----subordinated; Long Term Rating; Affirmed; BBB+
----subordinated; Long Term Rating; Affirmed; BBB
----senior unsecured; Short Term Rating; Affirmed; F1
Standard Chartered PLC; Long Term Issuer Default Rating; Affirmed; A; RO:Neg
; Short Term Issuer Default Rating; Affirmed; F1
; Viability Rating; Affirmed; a
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF

----subordinated; Long Term Rating; Affirmed; BBB-
----preferred; Long Term Rating; Affirmed; BBB-
----senior unsecured; Long Term Rating; Affirmed; A
----subordinated; Long Term Rating; Affirmed; BBB+
----senior unsecured; Short Term Rating; Affirmed; F1

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Additional information is available on www.fitchratings.com

Applicable Criteria
Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Status
Endorsement Policy