FitchRatings

17 Apr 2020 | Rating Changed Outlook to Negative

Fitch Revises Outlook on Standard Chartered to Negative on Coronavirus Outbreak; Affirms Ratings

Fitch Ratings-London-17 April 2020:

Fitch Ratings has revised the Outlooks on Standard Chartered (SC) and Standard Chartered Bank's (SCB) Long-Term Issuer Default Ratings (IDR) to Negative from Stable and affirmed the IDRs at 'A' and at 'A+', respectively. The issuers' Viability Ratings (VRs) have been affirmed at 'a'.

The rating actions reflect our expectation that the economic disruption caused by the coronavirus spread will pose significant challenges to SC's earnings, asset quality, capitalisation and ability to execute on its strategy. However in the near term this is somewhat mitigated by strong funding and liquidity, measures to protect capitalisation, and a more cautious risk management approach adopted over the past few years.

Fitch expects a sharp contraction in global economic activity of -1.9% in 2020, and even worse in some of SC's key operating markets. As the duration of the health crisis and related lock-downs are still unknown, we see material downside risk to these economic forecasts, which would increase the prospect of the group's ratings being downgraded.

The rating actions include upgrades and downgrades of a number of issue ratings and Standard Chartered Bank AG's (SCB AG) issuer ratings that were placed Under Criteria Observation (UCO) following the publication of Fitch's new Bank Rating Criteria on 28 February 2020. The affected ratings have been removed from UCO. A full list of rating actions is at the end of this commentary.

Key Rating Drivers

SC and SCB

Fitch believes that the economic fallout from the pandemic has heightened risks to the group given its exposure to emerging markets affected by lockdowns and falling global demand, direct exposure to oil and gas and related sectors, and a business model sensitive to global trade flows. The group entered the crisis with moderate ratings headroom, as earnings faced rising challenges and were not yet at a level commensurate with its risk profile.

We expect pressure on SC's asset quality metrics, in particular in the corporate and institutional bank and commercial banking businesses. SC's exposure to oil and gas, commodities, and to jurisdictions dependent on related revenues are significant concentrations, although they have been de-risked over the past few years. We continue to see relative strength in SC's retail exposure in North Asia, in particular Hong Kong.

We no longer expect the earnings improvements envisaged in the group's strategy to materialise in 2020, and the prospects for reaching the targeted 10% return on tangible equity in two to three years will depend on the shape of the economic recovery. Risks to earnings come from lower lending and transaction volumes across most businesses, and lower interest rates, although parts of the corporate and institutional bank could benefit from wider spreads and demand for liquidity. Loan and other credit impairments will likely increase, but this is mitigated in the near term by the UK regulator's guidance that payment holidays, forbearance and breaches of covenants in the context of government support measures should not automatically trigger higher expected credit losses.

The group entered the crisis with solid capitalisation and its 13.8% consolidated core equity Tier 1 ratio (CET1) was within the 13%-14% targeted range. Capitalisation will be underpinned by the cancellation of dividends and further share-buy backs in 2020 at the UK regulator's request, and the planned sale of Permata Bank (AAA(idn)/RWN). We see risks to capitalisation from credit risk losses, valuation mark-downs, risk-weighted assets (RWA) growth from credit-risk migrations and draw-downs on committed credit facilities.

Funding and liquidity are relative strengths, underpinned by a modest loans-to-deposits ratio (67% at end-2019), and liquidity metrics well in excess of requirements. We believe that tighter liquidity conditions have eased, benefiting from central banks' provision of US dollar liquidity, and support to commercial paper markets. The strong and stable liquidity profile underpins Standard Chartered's Short-Term IDR and debt ratings of 'F1'.

Fitch has downgraded SC and SCB's subordinated Tier 2 debt to 'BBB+', from 'A-', two notches below the issuers' VRs, and removed them from UCO. This was driven by the change in Fitch's baseline notching for loss severity to two notches (from one) for this type of debt and our expectations of poor recoveries.

Legacy upper Tier 2 debt was affirmed at 'BBB' and removed from UCO. We continue to rate these bonds three notches below the VR. We have narrowed incremental non-performance risk to one notch (from two) as non-payment is less easily activated than on Tier 1 instruments, while widening loss-severity to two notches (from one), reflecting poor recovery prospects.

High-trigger contingent capital Tier 1 instruments and preference shares with no constraints on coupon omission have been upgraded to 'BBB-' from 'BB+', and removed from UCO, due to a change in baseline notching to four (from five) below the VR, and an expectation that the group will maintain at least a 100bp buffer over capital requirements that would trigger coupon omission on the bonds.

Standard Chartered Bank AG

Fitch has upgraded SCBAG's Long-Term IDR to 'A+' from 'A' and assigned a Negative Outlook. SCB AG's ratings are now anchored to SCB's Long-Term IDR rather than its VR. We believe that its senior creditors would benefit from the group's large buffer of junior debt and bail-in-able senior debt in a group resolution scenario, because of high balance sheet and business integration with the parent, and similar resolution regimes in the UK and EU.

Unless noted above, the key rating drivers for SC, SCB and SCB AG are those outlined in our Rating Action Commentaries published in September 2019, available on www.fitchratings.com.

These rating actions were subject to an external appeal, which resulted in a different rating outcome from the original committee.

RATING SENSITIVITIES

SC, SCB, SCB AG

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

SC and SCB's ratings are mainly sensitive to the economic and financial market fallout arising from the pandemic, as this represents a risk to our assessment of earnings, asset quality, capitalisation, and ability to achieve strategic objectives.

The ratings could be downgraded if it becomes less likely that the health crisis is resolved globally in 2H20, which would make a recovery in global growth - and SC's key markets - in 2021 more remote. They would also come under pressure if the quality of SC's exposure to commodities deteriorates sharply, causing pre-tax losses or pressure on capitalisation; if the CET1 ratio falls below the targeted 13% -14% range on a consolidated level; if liquidity metrics come under stress, or if an improvement in earnings in 2021 and beyond, relative to 2019, and towards the targeted 10% return on tangible equity target, becomes unlikely.

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 levels below the VRs of SC 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 requirements will decrease below 100bp.

Downgrades of SCB AG's ratings could arise from any negative rating action on SCB's IDRs. They could also be triggered if Fitch believes that the group's propensity to support SCB AG has diminished because of strategic considerations, or if we no longer believed that senior creditors would benefit from protection in resolution.

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 prove to be temporary. An upgrade is unlikely in the medium term and would only follow if there is a sustained improvement in earnings and evidence that asset quality will not be materially affected by the downturn.

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

Any positive rating action/upgrade on SCB's IDRs would trigger similar rating action on the SCB AG's IDRs.

Unless noted above, the sensitivities for SC, SCB and SCB AG are those outlined in our Rating Action Commentaries published in September 2019, available on www.fitchratings.com.

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions 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

Standard Chartered Bank AG's ratings are linked to its direct parent Standard Chartered Bank's.

ESG Considerations

ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or 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; Downgrade; BBB+
----subordinated; Long Term Rating; Affirmed; BBB
----senior unsecured; Short Term Rating; Affirmed; F1
Standard Chartered Bank AG; Long Term Issuer Default Rating; Upgrade; A+; RO:Neg
; Short Term Issuer Default Rating; Affirmed; F1
; Support Rating; Affirmed; 1
; Derivative Counterparty Rating; Upgrade; A+(dcr)
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; Downgrade; BBB+
----subordinated; Long Term Rating; Upgrade; BBB-
----preferred; Long Term Rating; Upgrade; BBB-
----senior unsecured; Long Term Rating; Affirmed; A
----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

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