Fitch Revises Standard Chartered PLC's Outlook to Stable; Affirms at 'A'

Fitch Ratings - London - 06 Jul 2022: Fitch Ratings has revised Standard Chartered PLC's (SC) and Standard Chartered Bank's (SCB) Outlooks to Stable from Negative, while affirming their Long-Term Issuer Default Ratings (LT IDR) at 'A' and 'A+', respectively. Their Viability Ratings (VRs) have been affirmed at 'a'.

The revision of SC's Outlook to Stable from Negative primarily reflects our expectations for the group's profitability to materially improve as interest-rate rises offset the pressures on business model from a previously low interest-rate environment. We believe stronger revenue from higher interest rates will significantly help the group meet its profitability targets by 2024 and also mitigate pressures arising from higher operating costs and heightened macroeconomic risks.

Fitch has withdrawn SC's and SCB's Support Rating Floors of 'NF' and Support Ratings of '5' and because they are no longer relevant to the agency's coverage following the publication of our updated Bank Rating Criteria on 12 November 2021. In line with the updated criteria, we have assigned the two entities Government Support Ratings (GSR) of 'ns'.

Key Rating Drivers

SC's LT IDR is driven by its VR and balances the group's strong capital and liquidity buffers and fairly conservative risk controls, against its exposure to inherently riskier emerging markets and weaker-than-peers' profitability and asset quality. The VR also reflects the group's strong franchise across key markets, and a business model that will materially benefit from higher interest rates and stronger profitability.

SC's 'a' VR is one notch above its 'a-' implied VR as we believe the group's business profile will, over the long term, have a positive impact on its financial metrics beyond that currently captured in the financial key rating drivers. This reflects our view of material improvements to profitability, primarily driven by higher interest rates.

Franchise Supported by International Network: Our assessment of SC's business profile considers benefits from a wide international network via its corporate, commercial and institutional banking (CCIB) business, and from some reasonably strong local retail franchises in key markets, primarily in Asia.

We have revised the outlook on the 'a' business profile score to stable from negative, as improved profitability prospects in the rising interest-rate environment balance strategy-execution risks.
business profile also captures SC's wide international footprint, spanning across Asia, Africa, Europe and the US in contributing to the group's network income, and its diversified and fairly stable business despite earnings weakness relative to peers.

Resilient Asset Quality; Macro Risks: SC's asset quality has remained fairly resilient during the pandemic and Stage 3 loans fell to 2.4% of gross loans at end-1Q22 (end-2021: 2.7%; end-2020: 3.2%), reflecting write-offs and recoveries. Nevertheless, macroeconomic risks have increased and we expect moderately higher non-performance across the portfolio as a result, particularly in more vulnerable sectors (including commercial real estate (CRE)) and countries (mainly in southeast Asia).

We do not expect the Stage 3 loans ratio to rise materially above 3% by end-2023 and therefore loan impairment charges (LICs) should remain fairly manageable, given available management overlay provisions and recent years of de-risking. Our asset-quality assessment also considers SC's non-loan exposure, which is generally of sound quality and provides headroom to absorb moderate loan-quality deterioration.

Rate Rises to Boost Earnings: We expect SC's net interest income to materially benefit from accelerated interest-rate rises, given a fairly short-term asset base and limited pass-through on deposit costs. Nevertheless, wealth-management revenue is likely to remain subdued and financial-market income could face volatility, after a strong performance in 1Q22, given macroeconomic uncertainty.

On balance, however, SC's operating profit/risk-weighted assets (RWAs; 2017-2021 four-year average: 1.2%) is likely to improve materially in 2022-2023 and has led to us to revise the outlook on the earnings and profitability score to stable from negative. The 'bbb+' score continues to reflect earnings weakness compared with that of peers rated in the 'a' category, primarily driven by weaker cost efficiency.

Adequate Capital Buffers: SC's common equity Tier 1 (CET1) ratio fell 20bp to 13.9% in 1Q22, mainly due to regulatory changes and share buybacks, but remains at the top end of the group's 13%-14% target range. We expect the CET1 ratio to be managed within this target, underpinning the 'a' capitalisation and leverage score, helped by RWA optimisation and improving internal capital generation and despite likely higher shareholder returns.

SC's stronger profitability should offset any RWA inflation from potential asset-quality deterioration and regulatory changes in 2H22-2023. The 'a'/stable score for capitalisation and leverage is above the implied score at the top end of the 'bbb' range and reflects our view of SC's flexibility in maintaining its CET1 ratio within the target range, including through RWA optimisation or lower capital returns to shareholders.

Strong Funding and Liquidity: We view SC's funding and liquidity profile as a rating strength given its strong retail funding franchise in key markets, low loans/deposits ratio (end-1Q22: 66%), strong liquidity, and manageable refinancing needs.

The group is mainly funded by customer deposits (end-1Q22: 69% of non-equity funding), with a high share of low-cost CASA deposits (end-2021: 67%), although we expect the latter to reduce as depositors
move funds into higher-yielding term deposits. SC's strong liquidity coverage ratio (end-1Q22: 144%) is supported by sizeable high-quality liquid assets (end-1Q22: USD176 billion; 21% of assets). We have maintained the funding and liquidity score at 'a+/stable.

**Ratings Reflect Consolidated Group:** Fitch assesses SC on a consolidated basis as it is managed as a group and is highly integrated with its main banks. SC's VR is therefore equalised with that of its main operating company SCB, reflecting SC's role in the group and moderate common equity double leverage (end-2021: 110%).

SCB's LT IDR is one notch above its and the group's VRs as we believe that its senior creditors are protected by internal minimum requirement for own funds and eligible liabilities (MREL) buffers, given its role as a material legal entity in the group's resolution planning.

**Rating Sensitivities**

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

SC's IDRs are mainly sensitive to the factors driving its VR, which is equalised with SCB's VR. We would likely downgrade the VR if risks to the group's business profile increase. The latter could result from operating profit/RWAs failing to improve materially as expected (to above 1.5%) or and the prospects of achieving over 10% return on tangible equity by 2024 are disrupted again. This could happen in conjunction with weaker-revenue growth than management's guidance or higher provisioning needs, for instance due to setbacks in the economic recovery, and if the group's asset quality deteriorates materially beyond an assumed four-year average impaired loans ratio of about 3%.

A decline in the CET1 ratio below the 13%-14% target range, without a credible plan to restore it swiftly, is also negative for the ratings.

SCB's IDR would be downgraded to the level of the bank's VR, and the same level as SC's IDR, if we no longer believe that creditors will be protected in a resolution by internal MREL.

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

An upgrade of the IDRs and VRs is unlikely in the medium term as it would require sustained improvements in a combination of key rating factors. This would likely include improved performance in the markets that SC operates in, strengthening of the group's business and risk profiles, as well as a higher assessment of the operating-environment score.

An upgrade would also likely be accompanied by a record of sound asset quality (with impaired loans falling towards 2% of loans and the non-loan exposure quality remaining sound) and strong earnings and profitability (with operating profit/RWAs sustainably above 2.5%).

**OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS**

Senior debt ratings are aligned with their respective issuers' IDRs.
Subordinated Tier 2 debt is rated two notches below their respective issuers' VRs, which is Fitch's baseline notching for loss severity for this type of debt given our expectations of poor recoveries.

SC's additional Tier 1 (AT1) instruments and preference shares are rated four notches below its VR, as we expect that the group will maintain a buffer over capital requirements of at least 100bp of RWAs.

**No Support:** The GSR of 'no support' of SC and SCB reflect Fitch's view that senior creditors cannot rely on extraordinary support from the UK authorities if the banks become non-viable, given legislation and regulations that require senior creditors to participate in losses in a failure.

**OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES**

Senior debt ratings are primarily sensitive to their respective issuers' IDRs.

AT1 and Tier 2 subordinated notes are primarily sensitive to changes in their respective 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 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 maximum distributable amount (MDA) thresholds will decrease below 100bp.

Tier 2 debt could be upgraded if the group's total tier 2 and AT1 debt (or qualifying junior debt buffer) increase sustainably to over 10% of RWAs leading to better recovery prospects.

An upgrade of the banks' GSRs from 'no support' would be contingent on a positive change in the sovereign's propensity to support the banks, which we see as highly improbable.

**VR ADJUSTMENTS**

The operating-environment score of 'a' is below the implied score range of 'aa' due to the following adjustment: international operations (Negative)

The capitalisation and leverage score of 'a' is above the implied score range of 'bbb' due to the following adjustment: capital flexibility and ordinary support (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.

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

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Applicable Criteria

*Bank Rating Criteria (pub.12 Nov 2021) (including rating assumption sensitivity)*

Additional Disclosures

*Solicitation Status*
Endorsement Status

Standard Chartered Bank  UK Issued, EU Endorsed
Standard Chartered PLC  UK Issued, EU Endorsed

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