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Research Update:

Netherlands-Based NIBC Bank Upgraded To 'BBB/A-2' On Improved Funding And Earnings Profile; Outlook Stable

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Overview

- We think that NIBC Bank N.V.'s proactive balancing of its funding profile has increased its overall resiliency.
- Alongside asset repricing and improving operational efficiency, the replacement of more confidence-sensitive wholesale funding has also led to improving profitability, which we think will be more predictable over time.
- As a result, we are raising our long- and short-term counterparty credit ratings to 'BBB/A-2' from 'BBB-/A-3' and our issue rating on the bank's additional Tier 1 instrument to 'BB-' from 'B+'.
- The stable outlook reflects our expectation that NIBC will maintain its niche franchise, strong capitalization, similar risk appetite, and sound asset quality.

Rating Action

On Oct. 12, 2017, S&P Global Ratings raised its long- and short-term counterparty credit ratings on Netherlands-based NIBC Bank N.V. to 'BBB/A-2' from 'BBB-/A-3'. The outlook is stable.

We also raised our issue rating on the bank's additional Tier 1 instrument to 'BB-' from 'B+'.

Rationale

The upgrade of NIBC is underpinned by the gradual balancing of its funding profile over recent years. Primarily, we have observed a deepening of its retail deposit base that has reduced its proportionate reliance on wholesale funding sources, combined with a broadening range of long-term wholesale issuance. Although the overall franchise remains limited given its niche focus, we think these developments have reduced the bank's confidence sensitivity relative to the larger, higher rated Dutch banking peers. The bank reported retail deposits to total funding of 43% at June 30, 2017. During the last six years, this has steadily increased and has been supported by NIBC offering more attractive rates through its online channels compared with larger domestic peers. Over the same time frame, we calculate NIBC's loans-to-customer deposits ratio to have fallen to 146% from 269%, reflecting the bank's conscious move to reduce its reliance on wholesale funding sources following years of post-financial crisis retrenchment and restructuring. These metrics are now in line with the industry averages and we expect them to remain broadly stable over our outlook horizon of 18-24 months as NIBC has reached a steady state of funding that we consider more suitable for its asset profile. We also expect the stable funding ratio to remain comfortably above 100% and NIBC's wholesale funding to be well diversified and strongly biased toward long-term maturities.

The split of NIBC's €19 billion loan book is relatively even between its retail and commercial lending. It continues to have a niche focus on parts of the residential mortgage market, and providing collateralized lending to midsize corporates across a range of asset classes. While we do not expect material growth in the loan book, we forecast further modest improvements in the bank's profitability. At the holding company level, NIBC's reported net interest margin was up to 1.58% at June 30, 2017, from 1.39% 12 months earlier, moving closer in line with domestic peers. We expect the bank's net interest income to continue to benefit from the reduction in its average cost of funding, as well as improving asset spreads. For example, NIBC has continued to expand into higher margin buy-to-let lending, and is successfully replacing low-yielding corporate assets. Further supporting profitability is the growth in noninterest income sources. In the six months to June 30, 2017, noninterest income increased to €20 million, up 82% from the same time last year. The increase was supported by the full integration of NIBC Markets, combined with the introduction of its residential mortgage "originate to manage" offering. In our view, this adds some diversity to the bank's revenue streams and to the overall quality of its earnings profile. Reported return on equity has therefore increased to 11.7% at June 30, 2017 from 5.1% 12 months earlier. Overall, we think that NIBC's earnings are now more predictable than previously, and represent an adequate first line of defense against potential unexpected losses.

Notwithstanding the enduring improvement in the bank's funding profile and earnings prospects, our assessments of other factors underpinning the ratings on NIBC remain unchanged. Specifically, although we think that earnings capacity and predictability have improved, our business position assessment remains constrained by its revenue concentration, modest market shares, and exposure to potential volatility in its chosen corporate sectors. We expect its combined capital and earnings and risk position assessments to remain positive for the ratings. This reflects NIBC's strong capitalization, with a risk-adjusted capital (RAC) ratio of 11.1% at year-end 2016 (we expect our RAC ratio to be about 10.25%-10.75% over the next 24 months); well-collateralized loan book; and good risk management capabilities--despite noteworthy concentrations in the corporate loan book. NIBC's liquidity position is supported by a stock of high-quality liquid assets and the absence of material short-term wholesale funding.

We recognize receding economic imbalances in the Dutch banking system as a positive (see "Various Dutch Bank Outlooks To Positive On Receding Economic Imbalances In The Netherlands," published on Sept. 15, 2017, on RatingsDirect). However, NIBC's exposure to volatile corporate segments, focus on niche parts of the residential mortgage market, and noteworthy concentrations in its corporate loan book, lead us to consider future upside as limited within the next two years.

The long-term rating on NIBC remains at the level of its group credit profile (GCP; which captures NIBC and its nonoperating holding company NIBC Holding N.V.), as we consider the group to be of low systemic importance in The Netherlands. This implies to us that the bank might be put into bankruptcy if regulators determined it to be nonviable. We continue to monitor developments in this area. For example, we anticipate that regulators will set a minimum requirement for eligible liabilities on NIBC within the next year. Among other elements, this could inform us of the authorities' preferred resolution strategy and so the possible eligibility for additional loss-absorbing capacity (ALAC) uplift.

Outlook

The stable outlook reflects our expectation that NIBC will maintain its niche strategic focus and robust capitalization, combined with a stable risk appetite and sound asset quality. We think the maintenance of strong capital ratios is important to the overall stability of the financial profile because NIBC's business model remains more sensitive to market confidence than the large universal banks dominating the Dutch market. Indeed, NIBC's future profitability and internal capital generation hinge on its capacity to continue to attract funds at moderate costs, be it on the wholesale markets or via retail deposits.

Downside scenario

We could lower the ratings on NIBC in the next two years if we observe a more aggressive capital policy, leading to its RAC ratio falling below 10%. We could also lower the ratings if we observe deterioration in the bank's asset quality or a material increase in its risk appetite or concentrations.

Upside scenario

Although we see a positive economic risk trend for the Dutch banking industry, a further positive rating action on NIBC is unlikely over our two-year rating horizon, in part because we expect NIBC will remain focused on cyclical corporate segments and specialist mortgage lending. Over time, an upgrade could occur if NIBC materially increases its market share in its primary markets, further supporting the stability of its customer base and franchise, or builds a substantially higher level of capital than our base-case assumes.

Ratings Score Snapshot

NIBC Bank N.V.

	To	From

Issuer Credit Rating	BBB/Stable/A-2	BBB-/Positive/A-3
SACP	bbb	bbb-
Anchor	bbb+	bbb+
Business position	Weak (-2)	Weak (-2)
Capital and earnings	Strong (+1)	Strong (+1)
Risk position	Adequate (0)	Adequate (0)
Funding and Liquidity	Average/Adequate (0)	Below Average/Adequate (-1)
Support	(0)	(0)
ALAC	(0)	(0)
GRE	(0)	(0)
Group	(0)	(0)
Sovereign	(0)	(0)
Additional factors	(0)	(0)

Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Upgraded; Outlook Action

	To	From
NIBC Bank N.V.		
Counterparty Credit Rating	BBB/Stable/A-2	BBB-/Positive/A-3

Upgraded

	To	From
NIBC Bank N.V.		
Certificate Of Deposit		
Foreign Currency	BBB	BBB-

Senior Unsecured	BBB	BBB-
Subordinated	BB+	BB
Junior Subordinated	BB-	B+
Commercial Paper	A-2	A-3

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