FITCH UPGRADES NIBC TO 'BBB'; OUTLOOK STABLE

Fitch Ratings-London-20 December 2017: Fitch Ratings has upgraded NIBC Bank NV's (NIBC) Long-Term Issuer Default Rating (IDR) to 'BBB' from 'BBB-' and Viability Rating (VR) to 'bbb' from 'bbb-'. The Outlook on the Long-Term IDR is Stable. A full list of rating actions is at the end of this rating action commentary.

The upgrade reflects structural improvement in NIBC's earnings, which Fitch expects will be sustained. It also reflects a significant reduction of legacy non-performing commercial real estate (CRE) loans and our expectation that potential asset quality deterioration from NIBC's exposure to stressed shipping and offshore services industries would be manageable for the bank.

KEY RATING DRIVERS
IDRS, VR and SENIOR DEBT
The ratings of NIBC reflect its niche franchise and business model, improved earnings and overall adequate asset quality, despite continued lending to some cyclical industries. The ratings are underpinned by the sound capital and leverage ratios.

NIBC's business model is focused on providing tailored asset-based lending and capital market solutions to its target segment of medium-sized companies. In addition, it offers residential mortgage loans in the Netherlands and online savings. Revenue is mainly driven by net interest income and depends on NIBC's pricing power. While its pricing power is likely lower than major Dutch banks overall, we believe that NIBC has a sound franchise in certain segments and niches, as reflected by its ability in recent years to achieve better margins mainly through loan repricing. We also believe the bank's risks are now priced more appropriately, ensuring higher revenue is the first line of defence against credit losses rather than capital.

NIBC's lending is a combination of a sound-quality Dutch residential mortgage loan book (around half of total loans at end-June 2017) and an increasingly granular corporate book. Non-performing mortgage loans are low and in line with larger Dutch banks, supporting NIBC's overall asset quality. In corporate lending, NIBC's business model exposes the bank to some cyclical industries (particularly shipping, offshore services and CRE, in total around 40% of corporate and 20% of total loans) and lower-rated corporate borrowers, for which the bank typically mitigates the risks with high collateralisation.

Corporate non-performing exposures decreased to 5% at end-June 2017 (6.6% at end-2016), as pressures in the shipping and oil services sectors were more than offset by a sharp decrease in legacy impaired CRE exposure. Non-performing exposures in shipping and offshore services are elevated (5.4% and 13.6% at end-June 2017 respectively), as are performing forborne loans, although we expect a significant part of the latter to cure in 2018. We expect the pressure on loan quality from these two sectors to persist, but overall it will be manageable for the bank, and the non-performing loan ratio for the total loan book will likely remain moderate.

NIBC's capital and leverage ratios are strong, compare well with domestic and international peers, and capitalisation is broadly commensurate with the bank's risk profile. At end-June 2017, the Fitch core capital/risk-weighted assets ratio was 21.9% and the fully-loaded Basel III leverage ratio was solid at over 7%. Capital ratios at the level of NIBC's immediate parent NIBC Holding NV, where the regulatory capital requirements are set, are also solid and support our assessment.

The bank estimated that the adoption of IFRS 9 from 1 January 2018 will have a negative impact on risk-weighted capital ratios of about 4 percentage points. This is driven by the anticipated reclassification of old mortgage loans carried at fair value into amortised cost, resulting in a reversal of the accumulated revaluation gain. Capital ratios will remain sound, however, and capitalisation will remain a rating strength. Furthermore, the reclassification will result in higher revenue due to the reversal of the accumulated revaluation loss on related hedging derivatives over the remaining life of the loans.

NIBC reduced over years its reliance on wholesale funding by attracting retail savings, which at end-June 2017 made up around a half of non-equity funding excluding derivatives, and by tapping institutional deposits through its subsidiary in Germany. NIBC also maintains access to wholesale funding markets, as demonstrated by the issues of benchmark senior unsecured and covered bonds. The bank remains structurally dependent on the market to fund part of its loan book and is hence sensitive to investor sentiment. Liquidity is comfortable, with a liquidity coverage ratio of 261% at end-June 2017, although not exceptional for the rating level, and the Short-Term IDR of 'F3' maps to the lower of the two options for a Long-Term IDR of 'BBB'.

SUPPORT RATING AND SUPPORT RATING FLOOR
The Support Rating '5' and Support Rating Floor of 'No Floor' reflect Fitch's view that senior creditors can no longer rely on receiving full extraordinary support from the sovereign if NIBC becomes non-viable. This reflects the bank's lack of systemic importance in the Netherlands, as well as the implementation of the EU's Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM). These provide a framework for resolving banks that is likely to require senior creditors participating in losses, if necessary, instead of or ahead of a bank receiving sovereign support.

Similarly, while there is a possibility that its owner, a consortium led by the private equity firm JC Flowers & Co, may support NIBC in case of need, Fitch is unable to adequately assess the owner's capacity to support. As a result potential support from its ultimate shareholders is not factored into NIBC's Support Rating.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES
NIBC's hybrid Tier 1 securities are rated four notches below the VR, reflecting the higher-than-average loss severity risk of these securities (two notches from the VR) as well as a high risk of non-performance (an additional two notches).

RATING SENSITIVITIES
IDRS, VR and SENIOR DEBT
A further upgrade of the ratings is unlikely within the constraints of NIBC's company profile, but a record of strong performance through-the-cycle demonstrating the resilience of the bank's niche business model under stress could be credit-positive. A sudden weakening of profitability as a result of weaker revenue or consistently higher loan impairment charges, a significant shock to asset quality resulting in a material erosion of NIBC's capitalisation or sharp deterioration of the bank's liquidity position, although not expected, could result in a downgrade.

SUPPORT RATING AND SUPPORT RATING FLOOR
Any upgrade of the Support Rating and upward revision of the Support Rating Floor would be contingent on a positive change in the Netherland's propensity to support its banks, as well as NIBC significantly growing its systemic importance. While not impossible, this is highly unlikely in Fitch's view.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES
The ratings of hybrid Tier 1 securities are sensitive to changes in NIBC's VR as well as Fitch's assessment of the probability of their non-performance relative to the risk captured in NIBC's VR.

The rating actions are as follows:

Long-Term IDR: upgraded to 'BBB' from 'BBB-'; Outlook Stable
Short-Term IDR: affirmed at 'F3'
Viability Rating: upgraded to 'bbb' from 'bbb-'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
Senior unsecured debt Long-Term rating: upgraded to 'BBB' from 'BBB-'
Senior unsecured debt Short-Term rating: affirmed at 'F3'
Hybrid Tier 1 securities: upgraded to 'BB-' from 'B+'

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Applicable Criteria
Global Bank Rating Criteria (pub. 25 Nov 2016)
https://www.fitchratings.com/site/re/891051