FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Rabobank's IDR to 'A+', Outlook Negative; Affirms VR

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Fitch Ratings - Paris - 15 Sep 2020: Fitch Ratings has downgraded Cooperatieve Rabobank U. A.'s (Rabobank) Long-Term Issuer Default Ratings (IDRs) to 'A+' from 'AA-' and Short-Term IDR to 'F1' from 'F1+'. The Outlook on the Long-Term IDR is Negative. At the same time Fitch has affirmed Rabobank's Viability Rating (VR) at 'a+' and removed it from Rating Watch Negative (RWN). A full list of rating actions is below.

The reference liability for Rabobank's Long-Term IDR is senior non-preferred (SNP) debt. The downgrade of the Long-Term IDR to the level of the bank's VR reflects Fitch's view that Rabobank's buffer of qualifying junior debt (QJD, consisting of additional Tier 1 and Tier 2 debt) will no longer sustainably exceed 10% of its risk-weighted assets (RWA), which is required under Fitch's criteria to notch up a bank's Long-Term IDR. At end-June 2020, Rabobank's QJD was 9.9% of RWA, pro-forma for an additional Tier 1 issuance in early July. We expect the QJD buffer to remain substantial but to reduce over time as a percentage of RWA given that the latter are likely to increase due to regulatory changes and as a result of rating migrations caused by the economic fallout from the pandemic.

Rabobank's SNP debt is rated in line with its Long-term IDR and has also been downgraded, but its senior preferred (SP) debt rating has been affirmed, as SP debt continues to benefit from the protection offered by the QJD and SNP debt buffers.

We have affirmed Rabobank's VR and removed it from RWN because we expect the bank's capitalisation, which we score 'a+' and is a rating strength, to remain sufficiently robust to offset the likely material deterioration of the bank's asset quality and earnings (both scored 'a-') over the next two years as a result of the economic shock caused by the pandemic. The Negative Outlook on the Long-Term IDR reflects downside risks to this expectation from a potentially greater-than-expected or more permanent deterioration in asset quality, or delays to the recovery of profitability towards Rabobank's longer-term average levels. A slowdown of the currently observed economic recovery due to a resurgence of the virus would exacerbate these downside risks.

KEY RATING DRIVERS

IDRS, VR AND SNP DEBT

Rabobank's IDRs and VR are underpinned by its solid capitalisation and its modest risk appetite, which we believe will remain central to the bank's strategy. The ratings are also supported by Rabobank's leading market position in Dutch retail banking, complemented by a solid franchise in the global food and agriculture (F&A) sectors, and its sound funding and liquidity profile. Asset quality and profitability are rating weaknesses and we expect increased pressure on both in the near term as a result of the economic fallout from the coronavirus pandemic.

Rabobank's impaired loans/gross loans ratio (as calculated by Fitch, where impaired loans are defined as Stage 3 loans under IFRS, and loans include exposures to the public sector but exclude reverse repos), improved to 3.3% at end-June 2020 from 3.5% at end-2019. We believe the bank's definition of non-performance is conservative, as highlighted by the low share of past due loans in total non-performing loans (NPLs; 22% at end-2019). Rabobank's stock of NPLs has been consistently declining, and the pace of reduction has accelerated since 2018 as the bank has taken a more active approach to NPL management in anticipation of provisioning backstop regulation and supervisory expectations on NPL coverage.

We expect this improving trend to reverse in the near term, and for the bank's impaired loans ratio to go up materially as a result of the economic disruption caused by the pandemic as government support measures are gradually wound down. At the same time, we do not expect a deterioration that would push Rabobank's four-year average impaired loans ratio materially above 4% in the next two years.

Asset quality should be supported by the high share of low-risk domestic mortgage loans in the loan book and by the moderate exposure to sectors most affected by lockdowns and social distancing rules (at end-June 2020, Rabobank's exposure to transport, non-food retail, restaurants and leisure/entertainment was EUR17.5 billion or about 4% of total loans). Rabobank's focus on the F&A industry (about a quarter of total loans) may also lead to a lower than average impact on its asset quality as we generally do not expect companies in the food supply chains to suffer significant revenue declines in 2020-2021 (see "The Road Back: Post-Lockdown Assumptions for Global Corporates" published in June 2020).

Specific coverage of Stage 3 loans (23% at end-June 2020) is low relative to peers and reflects the highly secured nature of the loan book and availability of collateral, but exposes Rabobank to fluctuations in collateral values.

Operating profit fell sharply in 1H20 to 0.4% of RWA as loan impairment charges (LICs) surged to EUR1.4 billion or 69bp of average loans and as non-interest revenues suffered from lower client activity and negative asset revaluations. Rabobank expects LICs of EUR 2billion to EUR2.5 billion for the full year 2020. We expect Rabobank's operating profit to recover in 2021 but to remain below 1% of RWA in both 2020 and 2021 as LICs are likely to remain elevated in the near term. At the same time, we expect revenue pressure from low interest rates to be partly offset by structural cost savings from the ongoing efficiency programmes. The ratings factor in our view that with normalised LICs (20bp-25bp of average loans), Rabobank will be able to generate operating profit/RWA of about 1.5% even in a continued low rate environment.

Capitalisation is a rating strength. Rabobank's common equity Tier 1 ratio stood at 16.6% at end-June 2020, slightly up from 16.3% at end-2019. The ratios do not benefit from transitional arrangements. In our base case, Rabobank's CET1 ratio remains above 15% in 2020 and 2021 despite the likely RWA inflation from the ECB's Targeted Review of Internal Models (TRIM) and the increase in credit risk RWAs due to negative internal rating migrations. The Basel III leverage ratio (5.9% at end-June 2020) is also solid and compares well with peers.

Rabobank's funding mix is diversified and benefits from the bank's strong deposit franchise in the Netherlands and sound access to the wholesale market. The liquidity buffer is ample and has increased to EUR134 billion or 22% of total assets at end-June 2020 (including EUR30 billion of eligible retained RMBS and covered bonds). The liquidity coverage ratio of 160% and the net stable funding ratio of 124% are sound.

We have downgraded Rabobank's Short-Term IDR to 'F1' from 'F1+' following the downgrade of the Long-Term IDR. The 'F1' Short-Term IDR is the baseline option mapping to a Long-Term IDR of 'A+' under Fitch's criteria. This is because Rabobank's funding and liquidity score of 'a+' is not sufficient to achieve a higher Short-Term IDR.

SNP debt is rated at the same level as the Long-Term IDR as a default on SNP debt would in our view constitute a default of the bank.

DERIVATIVE COUNTERPARTY RATING (DCR), SP DEBT AND DEPOSITS

Rabobank's DCR and long-term SP debt ratings have been affirmed and are now one notch above the bank's Long-Term IDR. This reflects the protection offered to preferred creditors by the resolution buffers of equity and more junior debt. Rabobank has publicly stated that it intends to meet its minimum requirement for own funds and eligible liabilities (MREL) using subordinated and SNP instruments only. We have also assigned Rabobank a long-term deposit rating of 'AA-' because deposits benefit from the same protection as other preferred creditors. Short-term SP debt and the assigned short-term deposit rating of 'F1+' are the only short-term rating options mapping to the long-term ratings of 'AA-'.

SUBORDINATED DEBT

Fitch has widened the notching of Rabobank's subordinated Tier 2 debt to the baseline two notches below its VR. As a result, Tier 2 debt has been downgraded to 'A-' from 'A'. The downgrade reflects our expectation that the bank's QJD buffer will not exceed 10% of RWAs on a sustained basis, which is required under our criteria to rate Tier 2 debt one notch below the VR.

Additional Tier 1 instruments with fully discretionary coupons and legacy hybrid debt with partly discretionary coupons are rated four notches below the VR, in line with the baseline notching for this type of debt. This reflects the significant distance between the bank's CET1 ratio and mandatory coupon omission triggers.

SUPPORT RATING (SR) AND SUPPORT RATING FLOOR (SRF)

The SR of '5' and SRF of 'No Floor' reflect Fitch's view that senior creditors can no longer rely on receiving full extraordinary support from the sovereign if Rabobank becomes non-viable. The EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism for eurozone banks 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.

RATING SENSITIVITIES

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

The ratings are primarily sensitive to the extent and the duration of the weakening of the bank's financial profile as a result of the pandemic shock to the economy. We would likely downgrade Rabobank's Long-Term IDR and VR in case its CET1 ratio falls materially below 15% without a credible plan to restore it to this level while asset quality and profitability challenges persist. A sharper-than-expected weakening of asset quality meaning that Rabobank's impaired loans ratio would remain above 4%, or setbacks to our expectation that Rabobank's operating profit/RWA will be restored to around 1.5% by 2022, would also likely lead to a downgrade.

The DCR, SP debt and deposit ratings could be downgraded to the level of the IDRs if we expect Rabobank to fulfil part of its MREL requirement with SP debt and the buffer of QJD and SNP debt to fall below 10% of RWA.

Subordinated debt ratings would be downgraded if Rabobank's VR is downgraded. The ratings of the additional Tier 1 instruments could also be downgraded if we see a heightened risk that capital cushions above the mandatory coupon omission triggers will fall below 100bp.

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

The Outlook on the Long-Term IDR could be revised to Stable in case of a lower-than-expected impact on Rabobank's asset quality and earnings and if downside risks to our forecasts subside. The Outlook could also be revised to Stable if following the initial shock, profitability recovers to its longer-term average level and impaired loans ratio returns to a firm downward trend. In the event Rabobank withstands ratings pressure arising from the coronavirus outbreak, an upgrade of the VR and the Long-Term IDR would be unlikely as it would require a significant and structural improvement in profitability and asset quality.

Rabobank's Short-Term IDR would be upgraded if its Long-Term IDR is upgraded or if its funding and liquidity score is upgraded to 'aa-' or above.

The subordinated debt ratings would be upgraded if Rabobank's VR was upgraded.

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.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Cooperatieve Rabobank U.A.	LT IDR	A+ Rating Outlook Negative	Downgrade	AA- Rating Watch Negative
	ST IDR	F1	Downgrade	F1+ Rating Watch Negative
	Viability	a+	Affirmed	a+ Rating Watch Negative
	Support	5	Affirmed	5
	Support Floor	NF	Affirmed	NF

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APPLICABLE CRITERIA

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

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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