

FITCH AFFIRMS BANK LEUMI AT 'A'; OUTLOOK STABLE

Fitch Ratings-London-09 January 2019: Fitch Ratings has affirmed Bank Leumi Le Israel B.M.'s (Leumi) Long-Term Issuer Default Rating (IDR) at 'A' and Viability Rating (VR) at 'a-'. The Outlook on the Long-Term IDR is Stable. A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

IDRs, SUPPORT RATING AND SUPPORT RATING FLOOR

Leumi's IDRs, Support Rating (SR) and Support Rating Floor (SRF) reflect Fitch's expectation of an extremely high probability that support will be provided to the bank by the state of Israel (A+/Stable) if needed. Fitch's expectation of support from the authorities is underpinned by Israel's strong ability to provide support to domestic banks, as reflected in the sovereign's ratings, combined with Fitch's belief that the state has a strong willingness to do so.

This view is reinforced by Leumi's large domestic franchise, accounting for about 30% of sector assets, its importance to the Israeli economy, and the government's objective to preserve confidence in the banking sector especially considering the absence of a deposit guarantee scheme and of effective recovery and resolution legislation.

VR

Leumi's VR reflects the bank's strong domestic franchise as the largest banking group in Israel by total assets, modest risk appetite, healthy asset quality and relatively strong capitalisation.

Leumi's asset quality is healthy, resulting from its fairly modest risk appetite, which benefits from a growing economy, low unemployment and low interest rates. Impaired loans and past-due loans not impaired are low and reserved at over 100% at end-September 2018.

Underlying profitability has been gradually increasing, benefiting from improving efficiency. Revenue is underpinned by wide interest margins, which are set to improve further following a rise in domestic interest rates as the bank benefits from large volumes of non-interest bearing deposits and yields will rise on securities and other investments.

The cost to income ratio is relatively high, but efficiency continues to improve as result of cost-cutting measures, and further savings should emerge in the medium term. Overall profitability has been supported by very low loan impairment charges in recent years, reflecting a benign economic cycle. These changes are rising from the lows reached in 2016 but we are not expecting a significant rise in impairments.

Divestment of the credit card business, a regulatory requirement, is expected in 1H19. This will likely reduce revenue although the impact is as yet difficult to quantify. We do not expect that the impact will be material as Leumi will continue to provide card services and credit through alternative channels.

Capitalisation is strong. The bank has built up sound buffers over regulatory requirements and we expect Leumi's capitalisation to continue to improve on the back of retained earnings. Risk weightings are conservative, in particular for housing loans, which account for around one-third of the bank's loan portfolio.

Leumi benefits from a solid and stable customer deposit base, which fully covers its lending needs. It is able to access local wholesale markets to issue domestic bonds and extend the maturity of its

funding. There is little need to access the international capital markets. Its liquidity buffer of cash and high-quality sovereign bonds is comfortable.

RATING SENSITIVITIES

IDRs, SR AND SRF

The IDRs, SR and SRF are sensitive to a change in Fitch's assumptions around the Israeli authorities' propensity or ability to provide timely support to the banking sector. While the introduction of a resolution law is in discussion, Fitch does not expect this law to come into effect within the next 24 months. The country does not operate a deposit guarantee scheme and the practical implementation of resolution tools, such as bail-in of senior creditors, remains unlikely, in Fitch's view.

An upgrade of Israel's Long-Term IDR is unlikely to result in an upgrade in Leumi's Long-Term IDR. In line with our criteria, 'A'/'A-' are typical SRFs for domestic systemically important banks in countries whose sovereigns are rated 'AA' or 'AA-' and where support propensity is high.

VR

Leumi's VR would likely be downgraded if the bank's capital falls below its current targets, which could be the case if profitability weakens significantly or if the bank increases its risk appetite. This is not our base case.

Given the already high rating in the context of the operating environment, an upgrade of the VR is currently unlikely. However, improving profitability whilst maintaining strong capital ratios and healthy asset quality could allow for the bank's VR to be upgraded.

The rating actions are:

Long-Term IDR affirmed at 'A'; Outlook Stable

Short-Term IDR affirmed at 'F1'

Viability Rating: affirmed at 'a-'

Support Rating: affirmed at '1'

Support Rating Floor: affirmed at 'A'

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Applicable Criteria

Bank Rating Criteria (pub. 12 Oct 2018)

<https://www.fitchratings.com/site/re/10044408>

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