

27 SEP 2022

## Fitch Affirms ProCredit Holding and ProCredit Bank AG at 'BBB'

Fitch Ratings - Milan - 27 Sep 2022: Fitch Ratings has affirmed ProCredit Holding AG & Co. KGaA's (PCH) Long-Term Issuer Default Rating (IDR) at 'BBB' with a Stable Outlook. PCH's Viability Rating (VR) has been affirmed at 'bb' and removed from Rating Watch Negative (RWN). Fitch has also affirmed ProCredit Bank AG's (PCBDE) support-driven IDRs.

The affirmation of PCH's VR and removal from RWN reflects our view that PCH has moderate headroom under our current baseline scenario to absorb losses from its operations in Ukraine and second-round effects of the military conflict on the other markets of its activity. Ukraine is a strategic market for PCH, forming 13% of net loans, equivalent to 96% of the group's common equity Tier 1 (CET1) capital. We expect significant loan impairment charges (LICs) at ProCredit Bank (Ukraine) (CCC-/cc) to erode the group's profit this year and to a large extent next year, but without a material negative impact on capitalisation.

### Key Rating Drivers

PCH's IDRs and Shareholder Support Rating (SSR) are driven by Fitch's view of a high likelihood of external support being forthcoming to PCH from its core international financial institution (IFI) shareholders: KfW (AAA/Stable), International Finance Corporation, and DOEN Foundation (combined stake of about 36%, according to the last disclosure of voting rights).

Fitch assesses PCH on a consolidated basis. PCH's 'bb' VR reflects the group's operations in less stable and less advanced economies, the successful financial record of its largest subsidiaries, typically nominal domestic franchises of the subsidiary banks and a business model focused on cautious SME lending and building strong customer relationships. PCH's VR is supported by the group's strong corporate governance and prudent risk management.

**Support-driven IDRs:** Fitch views the propensity of PCH's core shareholders to provide support as high, because of the long-lasting and strategic nature of IFIs' investment in PCH, their role in PCH's governance structure and a record of ordinary debt and capital support provided to PCH and its subsidiary banks. There is some uncertainty about the timeliness of support if needed, given the fragmented nature of the shareholder structure. We therefore apply wide notching between the ratings of KfW - the only Fitch-rated entity among the core shareholders - and PCH.

**Good Asset Quality Outside Ukraine:** PCH's asset quality metrics have been consistently better than average in the banking sectors where its subsidiaries operate. This reflects the group's conservative approach to risk management (which we expect to continue) and mostly collateralised lending.

Nonetheless, the group's historically low Stage 3 loan ratio reported at end-2021 (2.3%) increased in 1H22 (by about 30 bp), as did the Stage 2 bucket, both reflecting the stage transfers within the portfolio in Ukraine. We expect this to continue in the coming quarters, while increased macro risks across other markets should be manageable from an asset quality perspective.

**Profitability Hit Hard by Elevated LICs:** The bank's operating profit/risk-weighted assets ratio (OpRWA) fell to 0.2% in 1H22 from 1.7% in 2021, due to extraordinarily high LICs for operations in Ukraine. Impairment charges are likely to remain elevated over the next 18 months, in our view, pressuring PCH's results in the near term, despite positive developments across many markets outside Ukraine. The potential for further material cost savings is limited as a narrow physical network, a focus on automation and remote banking are already the foundations for the group's business model.

**Adequate Capital Buffers:** Fitch expects the group's capitalisation to remain only adequate in the context of its business profile and risks stemming from the operations in Ukraine, which drag on internal capital generation. At end-1H22, the CET1 ratio of 13.7% (end-2021: 14.1%) and the total capital ratio of 14.7% were maintained with reasonable buffers over minimum regulatory requirements.

**Diversified Funding, Reasonable Liquidity:** Our assessment of the group's funding and liquidity considers the generally nominal standalone deposit franchise of its subsidiary banks, good relationships with IFIs allowing the group access to this funding source, and reasonable liquidity, which is managed centrally. Funding has been generally stable and largely deposit-based, with a satisfactory gross loans/customer deposits ratio of 110% at end-1H22. Liquidity is well-managed across the group and adequate reserves are held at the group level to cover subsidiary banks' and PCH's potential liquidity needs. The Basel III liquidity ratios were well above 100% at end-1H22.

**Holding Company:** PCH's VR is based on Fitch's assessment of the consolidated group's financial profile, because we view its failure risk as substantially the same as that of the group. This reflects the following factors: the group being subject to consolidated supervision and required to meet regulatory requirements at the consolidated level; the fungibility of capital and liquidity across the group, subject to its operating companies fulfilling their regulatory requirements; integrated liquidity management, with contingency plans; expectations that double leverage at the holding company will stabilise sustainably below 120% (end-1H22: 118.7% under IFRS); and a simple organisational structure with full ownership of banking subsidiaries.

## Rating Sensitivities

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

A weakening of support available to PCH due to, for example, an exit of one or more core IFI shareholders, or a material decrease in their stake accompanied by a change in their support stance, could lead to downgrades of PCH's IDRs and SSR.

PCH's VR would be downgraded if impairment charges in Ukraine and other markets increase above

our current expectations and put pressure on capitalisation. In particular, a sustained reduction in the bank's CET1 ratio below 12% and/or an increase of its Stage 3 ratio above 5% would likely result in a downgrade.

PCH's VR could also be downgraded if the holding company's common equity double-leverage is above 120% for a sustained period.

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

The IDRs could be upgraded if PCH's strategic importance for its core IFI shareholders increases.

Fitch does not foresee a VR upgrade in the medium term. A prerequisite for an upgrade would be an improvement in several of the operating environment scores for the markets where the group operates. If combined with maintaining good asset quality with an impaired loans ratio of well below 5%, healthy profitability with above 1.25% OpRWA for a sustained period and significant strengthening of capitalisation, this could lead to a VR upgrade.

### **SUBSIDIARIES & AFFILIATES: KEY RATING DRIVERS**

The equalisation of PCBDE's IDRs and SSR with those of PCH reflect Fitch's view of a high likelihood of parental support. This view is based primarily on the bank's central treasury role within the group and a strong legal commitment in the form of a profit and loss transfer agreement, which obliges PCH to replenish PCBDE's equity should the latter suffer a loss. The Stable Outlook on PCBDE's rating reflects that on the parent.

Fitch does not assign PCBDE a VR because the bank does not have a meaningful standalone franchise and its operations rely strongly on integration within the broader group. PCBDE's role as a "service" bank to other group members means that the bank concentrates on providing treasury, clearing and liquidity-management services. The bank also offers some co-financing with sister banks and financing to German SMEs, but the latter is narrow. PCBDE is the regulatory anchor for the group's consolidated supervision by BaFin and Bundesbank. A profit and loss transfer agreement between PCH and PCBDE includes a provision requiring a capital injection by the parent if PCBDE's regulatory total capital ratio falls below 13%.

PCBDE's Deposit Ratings are aligned with the bank's IDRs. We have not given any Deposit Rating uplift because in our view the bank's qualifying debt buffers would not afford any obvious additional benefit over and above the support benefit already factored into the bank's IDRs, even if they reach a sufficient size.

### **SUBSIDIARIES AND AFFILIATES: RATING SENSITIVITIES**

As PCBDE's IDRs, SSR and Deposit Ratings are equalised with PCH's IDRs, a change in PCH's IDRs would lead to a corresponding change in PCBDE's ratings.

### **VR ADJUSTMENTS**

PCH:

The operating environment score at 'bb' is below the 'aa' category implied score due to the following adjustment reason: international operations (negative).

The business profile score at 'bb' is above the 'b' category implied score due to the following adjustment reasons: management and governance (positive), and strategy and execution (positive).

The earnings & profitability score at 'b+' is below the 'bb' category implied score due to the following adjustment reason: historical and future metrics (negative).

### **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.

### **Public Ratings with Credit Linkage to other ratings**

PCH's IDRs and SSR reflect potential support from its core IFI shareholders, of which KfW is the only entity rated by Fitch. PCBDE's ratings are driven by support from PCH.

### **ESG Considerations**

For PCH 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](http://www.fitchratings.com/esg).

Fitch has assigned PCBDE ESG Relevance Scores in line with its parent.

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### Rating Actions

| ENTITY/DEBT                           | RATING                 |   | RECOVERY | PRIOR   |
|---------------------------------------|------------------------|---|----------|---|
| ProCredit<br>Holding AG &<br>Co. KGaA | LT IDR                 | BBB  | Affirmed | BBB  |
|                                       | ST IDR                 | F2  | Affirmed | F2  |
|                                       | Viability              | bb  | Affirmed | bb   |
|                                       | Shareholder<br>Support | bbb   | Affirmed | bbb   |
| ProCredit<br>Bank AG                  | LT IDR                 | BBB  | Affirmed | BBB  |

| ENTITY/DEBT           | RATING              | RECOVERY | PRIOR    |     |
|-----------------------|---------------------|----------|----------|-----|
|                       | ST IDR              | F2       | Affirmed | F2  |
|                       | Shareholder Support | bbb      | Affirmed | bbb |
| • long-term deposits  | LT                  | BBB      | Affirmed | BBB |
| • short-term deposits | ST                  | F2       | Affirmed | F2  |

#### RATINGS KEY OUTLOOK WATCH

|          |   |   |
|----------|---|---|
| POSITIVE | ⊕ | ◊ |
| NEGATIVE | ⊖ | ◊ |
| EVOLVING | ◊ | ◆ |
| STABLE   | ◐ |   |

#### Applicable Criteria

[Bank Rating Criteria \(pub.07 Sep 2022\) \(including rating assumption sensitivity\)](#)

#### Additional Disclosures

[Solicitation Status](#)

#### Endorsement Status

ProCredit Bank AG

EU Issued, UK Endorsed

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