23 JUN 2023

Fitch Affirms ProCredit Holding's and ProCredit Bank AG's IDRs at 'BBB'

Fitch Ratings - Milan - 23 Jun 2023: 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'. Fitch has also affirmed subsidiary ProCredit Bank AG's (PCBDE) support-driven IDRs.

A full list of rating actions is detailed below.

Key Rating Drivers

Shareholder Support Drives IDRs: PCH's IDRs and Shareholder Support Rating (SSR) are driven by Fitch's view of a high probability of external support being forthcoming to PCH from its largest international financial institution (IFI) shareholder KfW (AAA/Stable).

We use KfW as anchor to our support assessment, although we expect KfW to act in cooperation with other shareholders. Other IFI shareholders, European Bank for Reconstruction and Development (EBRD, AAA/Stable) and DOEN Foundation, could provide further support, given the same strategic nature of their investment in PCH, their role in governance structure and a record of liquidity and capital support already provided to PCH and its subsidiaries. However, potential support from these shareholders does not drive the ratings.

Strong Governance, Less Stable Economies: Fitch assesses PCH on a consolidated basis. Its VR reflects the group's business model focused on cautious SME lending in less stable and less advanced economies, its prudent risk management and strong corporate governance. In addition, its subsidiary banks have typically nominal domestic franchises but sound through-the-cycle asset quality.

High Propensity to Support: The wide notching between ratings of KfW and PCH is driven by its propensity to support being constrained by KfW's only 13.2% minority stake, its limited synergies with PCH other than an aligned mission and strategic impact-orientation, and contained reputational risk in a PCH default. We believe support would be made available to cover temporary shortages of capital or liquidity provided there are no material risks over the viability of PCH's business model.

Consolidated Profile Basis for Assessment: 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 group being regulated at the consolidated level and the fungibility of capital and liquidity across the group, subject to its operating companies fulfilling their regulatory requirements.

It also reflects centralised liquidity management, with contingency plans; our expectations that double leverage at the holding company will stabilise below 120% (end-1Q23: 119% under IFRS) on a sustained basis; and a simple organisational structure with full ownership of banking subsidiaries.

Operations Concentrated in South&Eastern Europe: Our 'bb-' operating environment score for the ProCredit Group reflects the group's operations in less stable and less advanced economies, with moderate to weak income levels and significant structural weaknesses. However, we have also factored in the benefits from the holding company being based in Germany, which includes the high-quality supervision of the consolidated group by the European and German regulator (BaFin) and access to the German deposit and capital markets.

Exposure on Ukraine: PCH's asset-quality metrics have been consistently better than the average in the banking sectors where its subsidiaries operate. This reflects its conservative approach to risk management and, mostly, collateralised lending.

We expect loan portfolio in Ukraine to remain a main risk for asset quality in the near term. It amounted to EUR553 million equivalent net of provisions or 61% of the group's equity. Deterioration of the quality of this portfolio has lifted the group's historically low Stage 3 ratio to 3.2% at end-1Q23.

Challenges to Profitability: PCH's profitability is moderate by international standards and is prone to performance swings due to its business model. Widening net interest margin and reasonable cost efficiency supported its sound performance in 1Q23. However, we expect weaker PCH's results for 2023 and 2024 due to higher loan impairment charges, slower lending growth, and higher funding costs.

Capitalisation Vulnerable to Country Risks: The group's risk-weighted capital ratios (common equity Tier 1 (CET1) ratio of 14.1% and total capital ratio of 15.4% at end-1Q23) are reasonable, but remain only adequate in the context of its operations in weaker and less stable economies, which are more susceptible to shocks. We expect PCH to gradually steer its CET1 ratio towards 13% via moderate growth and capital distributions.

Diversified Funding, Reasonable Liquidity: Our assessment of the group's funding and liquidity considers the generally nominal standalone deposit franchise of its subsidiary banks, established relationships with IFIs investors and reasonable liquidity, which is managed centrally.

Deposit funding has increased, supporting a decrease in the gross loans/customer deposits ratio to below 100%. Liquidity is well-managed across the group and adequate reserves are held at the group level to cover the subsidiary banks' and PCH's liquidity needs. Its Basel III liquidity ratios were comfortably above 100% at end-1Q23.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/ Downgrade

A weakening of support available to PCH from KfW due to a material decrease in its stake accompanied by a change in its support stance, could lead to downgrade PCH's IDRs and SSR unless offset by support from another strong shareholder.

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 to below 12% or an increase of its Stage 3 ratio above 5% would likely result in a downgrade.

The VR could also be downgraded if the holding company's IFRS 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 KfW increases or if other IFI shareholder with strong credit profile and a very high propensity to support PCH increases its stakes above KfW's.

Fitch does not expect a VR upgrade in the medium term unless the group's operating environment score improves. This could lead to an upgrade if combined with maintaining good asset quality, improvement in profitability and significant strengthening of capitalisation.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

PCH's 'BB(xgs)' Long-Term IDR (xgs) is in line with the bank's VR. Its 'B(xgs)' Short-Term IDR (xgs) is mapped to its Long-Term IDR (xgs).

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

PCH's Long-Term IDR (xgs) shares the same sensitivities as the bank's VR.

SUBSIDIARIES & AFFILIATES: KEY RATING DRIVERS

The equalisation of PCBDE's IDRs, IDRs (xgs) and SSR with those of PCH reflect Fitch's view of a high likelihood of support being provided to PCBDE and that, in case external support is required, it will flow through PCH. 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 includes a provision requiring a capital injection by the parent if PCBDE's regulatory total capital ratio falls below 13%. The Stable Outlook on PCBDE's rating reflects that on the parent.

Fitch does not assign a VR to PCBDE because the bank's business model is highly dependent on that of the parent and its operations rely on strong integration within the broader group, resulting in a limited standalone franchise. PCBDE's role as a 'service' bank to other group members means that it concentrates on providing treasury, clearing, trade finance and liquidity management services to sister banks. The bank also offers some co-financing with sister banks and financing to German SMEs, but the latter is narrow in scope. PCBDE is the regulatory anchor for the group's consolidated supervision by BaFin and Bundesbank.

PCBDE's deposit ratings are aligned with its respective IDRs and IDRs(xgs). We have not given any deposit rating uplift because in our view the bank's qualifying debt buffers would not afford 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

A change in PCH's IDRs would lead to a corresponding change in PCBDE's ratings. The bank's xgs ratings will move in tandem with PCH's xgs ratings.

VR ADJUSTMENTS

The operating environment score at 'bb' is below the 'aa' category implied score due to the following adjustment reason: international operations (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 largest shareholder- KfW. PCBDE's ratings are driven by support from PCH.

ESG Considerations

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.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
ProCredit Bank AG	LT IDR	BBB	Affirmed		BBB
	ST IDR	F2	Affirmed		F2
	LT IDR (xgs)	BB(xgs)	Affirmed		BB(xgs)
	Shareholder Support	bbb	Affirmed		bbb
	ST IDR (xgs)	B(xgs)	Affirmed		B(xgs)

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• long-term deposits	LT	BBB	Affirmed		BBB
• short-term deposits	ST	F2	Affirmed		F2
• long-term deposits	LT (xgs)	BB(xgs)	Affirmed		BB(xgs)
• short-term deposits	ST (xgs)	B(xgs)	Affirmed		B(xgs)
ProCredit Holding AG & Co. KGaA	LT IDR	BBB	Affirmed		BBB
	ST IDR	F2	Affirmed		F2
	Viability	bb	Affirmed		bb
	LT IDR (xgs)	BB(xgs)	Affirmed		BB(xgs)
	ST IDR (xgs)	B(xgs)	Affirmed		B(xgs)
	Shareholder Support	bbb	Affirmed		bbb

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		

RATINGS KEY	OUTLOOK	WATCH
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Bank Ex-Government Support Ratings Criteria (pub.11 Apr 2023) (including rating assumption sensitivity)

Bank Rating Criteria (pub.07 Sep 2022) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

ProCredit Bank AG	EU Issued, UK Endorsed
ProCredit Holding AG & Co. KGaA	EU Issued, UK Endorsed

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