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Fitch Affirms Emirates Islamic Bank at 'A+'; Outlook Stable

Fitch Ratings - Dubai - 10 May 2021: Fitch Ratings has affirmed UAE-based Emirates Islamic Bank PJSC's (EI) Long-Term Issuer Default Rating (IDR) at 'A+' with a Stable Outlook and Viability Rating (VR) at 'bb-'. A full list of rating actions is below.

Key Rating Drivers

IDRS AND SUPPORT RATING

The IDRs and Support Rating (SR) of EI are in line with its parent Emirates NBD Bank PJSC's (ENBD; A+/Stable/F1), reflecting Fitch's view that EI is a key and integral subsidiary of its 99.9% shareholder.

Fitch assigns Short-Term IDRs according to the mapping correspondence described in its rating criteria. An 'A+' Long-Term IDR can correspond to a Short-Term IDR of either 'F1' or 'F1+'. In the case of EI, Fitch opted for 'F1', the lower of the two Short-Term IDRs, in line with its parent's.

ENBD's IDRs reflect potential support available from the UAE authorities (AA-/Stable), if needed. Fitch believes this support would flow through to EI, given EI's role and record in the group as the group's Islamic finance arm, the very high reputational risk to ENBD should EI default, as well as the Central Bank of United Arab Emirates' (CBUAE) inclination to favour support, as EI operates in the same home market as ENBD.

SPV AND SENIOR DEBT

The rating of senior unsecured debt (Sukuk) issued by EI's special purpose vehicle (SPV), EI Sukuk Company, is in line with the bank's Long-Term IDR, because Fitch views the likelihood of default on senior unsecured obligations issued by the SPV the same as that of the bank.

VR

EI's VR reflects the bank's high impaired financing origination, higher-than-peers' average impaired financing ratio, and renewed asset-quality pressures. The VR also factors in EI's moderate franchise, adequate capital and a generally stable retail funding profile underpinned by healthy liquidity.

EI's company profile benefits from the bank's association with ENBD. However, the bank still has a moderate franchise in the UAE banking sector, with an approximate 2% share of system assets and deposits, despite its large branch network and being the third-largest Islamic bank in the country.

EI's asset quality was on an improving trend supported by tightened underwriting standards and write-offs, before it came under renewed pressures in 2020. Stage 3 financing (S3) ratio increased to 9% at end-2020 (7.6% at end-2019) due to the impairment of one of its largest exposures and deterioration in its mid-corporates portfolio, which tend to be vulnerable in economic downturns. EI wrote off AED855 million of impaired financing in 2020, indicating a high impaired financing origination of 4%.

At end-1Q21, a high 28% of the bank's financing exposures was deferred under the CBUAE's Targeted Economic Support Scheme (TESS). Its Stage 2 (S2) financing ratio was 2.4% at end-2020 but we expect higher restructuring and migration to S2 financing following the expiry of the TESS scheme at end-2021. At end-2020 S3 financing was adequately provided for by specific reserves (81%) and S2 financing 27%.

EI's pre-impairment operating profit is healthy covering 3%-4% of average financing, providing some cushion against higher financing impairment charges (FICs) before affecting the bank's capital. EI's net financing margin (3% in 2020) compares well with peers', supported by a focus on high-yielding retail financing and a high portion of low-cost current- and saving-accounts deposits. Profitability came under pressure in 2020 from high FICs (150% of pre-impairment operating profit), resulting in net losses of AED482 million.

EI has adequate buffers. Its CET1 ratio dropped to 18% at end-2020 (19.5% at end-2019) due to the bank's net loss for the year but still compares well against peers'. Unreserved S2 and S3 financing formed 10% of CET1 capital at end-2020. Further deterioration in asset quality could put pressure on retained earnings and capitalisation. However, EI has not been distributing dividends, and Fitch expects the bank to be able to raise capital from its parent if needed (as in 2016).

EI's liquidity is well-managed. The bank's financing-to-deposits ratio increased to 96% at end-2020 (91% at end-2019) due to 9% financing growth. Liquid assets including cash balance less mandatory reserves, interbank placements and investment-grade securities covered 45% of total deposits at end-2020 (29% without interbank borrowing). The bank's Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) ratios were comfortably above the 100% minimum regulatory requirement at end-2020.

In assessing EI's ratings, Fitch considers important differences between Islamic and conventional banks. These factors include closer analysis of regulatory oversight, disclosure, accounting standards and corporate governance. Islamic banks' ratings do not express an opinion on the bank's compliance with sharia. Fitch will assess non-compliance with sharia if it has credit implications.

RATING SENSITIVITIES

IDRS

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

EI's IDRs are equalised with ENBD's. Accordingly, EI's IDRs would be downgraded if ENBD's IDRs are downgraded. ENBD's IDRs could be downgraded on an adverse change in the UAE authorities' ability or propensity to provide support. EI's IDRs could also be downgraded and rated below ENBD if EI becomes less core to the group and Fitch believes ENBD's propensity to provide support has weakened, although this is unlikely.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

An upgrade of EI's IDRs would require an upgrade of ENBD's IDR, which is unlikely as ENBD's IDRs are already driven by an extremely high probability of support available to the bank from the UAE authorities, and its Support Rating Floor (SRF) of 'A+' is one notch above the UAE domestic systemically important bank SRF of 'A', reflecting the bank's flagship status in the UAE, and Dubai in particular.

SPV AND SENIOR DEBT

The sukuk issued via EI Sukuk Company Limited is rated in line with EI's IDRs and is therefore subject to the same sensitivities as the IDR.

VR

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

Further asset-quality deterioration leading to materially weaker capitalisation and loss absorption capacity or an increase in the bank's risk appetite resulting in high financing growth that materially exceeds the bank's internal capital generation and puts pressure on its capital ratio would be negative for the VR.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

EI's VR could be upgraded if the bank demonstrates further improvements in its asset-quality metrics and maintains adequate capital levels and consistent profitability.

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

EI's IDRs are linked to ENBD's.

ESG Considerations

EI has an ESG Relevance Score of '4' for Governance Structure inline with other Islamic banks (in contrast to a typical ESG relevance score of '3' for comparable conventional banks } given that all Islamic banks need to ensure compliance of their entire operations and activities with sharia principles and rules. This entails additional costs, processes, disclosures, regulations, reporting and a sharia audit, which has a negative impact on their credit profiles, and is relevant to the rating in conjunction with other factors.

In addition, Islamic banks have an Exposure to Social Impacts ESG Relevance Score of '3' (in contrast to a typical ESG Relevance Score of '2' for comparable conventional banks), which reflects that Islamic banks have certain sharia limitations embedded in their operations and obligations, although this only has a minimal credit impact on the entities.

Except for the matters discussed above, 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.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
EI Sukuk Company Limited					
• senior unsecured	LT	A+	Affirmed		A+
Emirates Islamic Bank PJSC	LT IDR	A+	Affirmed		A+
	ST IDR	F1	Affirmed		F1
	Viability	bb-	Affirmed		bb-
	Support	1	Affirmed		1

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

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

Sukuk Rating Criteria (pub.15 Feb 2021)

Additional Disclosures

Solicitation Status

Endorsement Status

EI Sukuk Company Limited	UK Issued, EU Endorsed
Emirates Islamic Bank PJSC	UK Issued, EU Endorsed

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