S&P Global
Ratings

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Research Update:

Raiffeisen Bank International Affirmed At 'A-' Despite Material Russian Risks; Outlook Negative; AT1s Downgraded To 'BB'

May 30, 2023

Overview

- Raiffeisen Banking Group (RBG) and its core subsidiary Raiffeisen Bank International (RBI) have improved their cushion significantly against difficult markets characterized by inflationary pressures and the high risk related to RBI's Russian subsidiary.
- We therefore affirmed our 'A-' long-term and 'A-2' short-term issuer credit ratings on RBI.
- The unchanged negative outlook reflects our view that RBG faces several downside risks in the coming 12-24 months, due to geopolitical and macroeconomic challenges across its countries of operation and RBI's Russian subsidiary.
- We maintained our approach to notching down RBI's additional tier 1 (AT1) instruments from our group-supported issuer credit rating, but introduced a further negative notch to reflect additional nonpayment risks.
- We therefore lowered our ratings on RBI's regulatory AT1 instruments to 'BB' from 'BB+'.

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Rating Action

On May 30, 2023, S&P Global Ratings affirmed its 'A-' long-term and 'A-2' short-term issuer credit ratings on Raiffeisen Bank International (RBI). The outlook remains negative. We also affirmed our 'A-' issue rating on the senior unsecured debt and 'BBB' issue rating on the subordinated debt. At the same time, we lowered our issue ratings on RBI's regulatory AT1 instruments to 'BB' from 'BB+'.

Rationale

RBG's solid profits and improved capital headroom provide a comfortable cushion against the initial commercial, economic, and franchise impacts from high RBI risk in Russia. Our rating on RBI reflects not only the creditworthiness of RBI itself but also the benefits to RBI of being part of a stronger, broader banking group. RBG and RBI have markedly improved their cushion against difficult markets under inflationary pressure as well as risks from the Russian-Ukraine war, including a potential need to exit RBI's Russian subsidiary. RBG posted a much improved 16.8% return on average common equity (ROE) for 2022, after 12% for 2021. It benefited from interest margin increases across all regions but also from unsustainably high windfall profits from RBI's Russian operations (which are locked in the Russian subsidiary). RBG comfortably improved its risk adjusted capital (RAC) ratio by 30 basis points (bps) to 9.7% by year-end 2022. Modelling RBI's potential full divestment of its Russian subsidiary, we estimate that RBG's RAC ratio would fall to a still satisfactory 8.9%, after deducting a €4.1 billion full write down of the capital investment and deconsolidating €13.4 billion of associated regulatory risk-weighted assets (RWA).

RBI's own financial resilience improved against risks and secondary effects from the Russia-Ukraine war. RBI continues to post strong profitability with a 15.8% annualized consolidated ROE for the first quarter of 2023, or more importantly, a solid 10.4% ROE excluding its operations in Russia and Belarus. We expect this level of profitability to wane as the Russia-Ukraine conflict continues and the global economy further slows through 2023. However, thanks to this temporary boost, RBI materially improved its consolidated regulatory common equity tier 1 (CET1) ratio to 16.0% by March 31, 2023, from 12.3% a year earlier. More importantly, RBI reported that it would be able to maintain a 13.7% CET1 ratio after March 31, 2023, under a deconsolidation scenario of its Russian subsidiary. RBI stated that any decision on dividend payments will be based on whatever remains above its 13.5% target for 2023.

We estimate RBI's stand-alone RAC ratio at 9.0% as of year-end 2022, which we believe would fall to a pro forma 7.5% after deconsolidation of its Russian subsidiary. We consider this an adequate capitalization level also in the context of RBI's sound risk management against the backdrop of difficult economic conditions in its main markets. RBI reported a 1.5% nonperforming exposure (NPE)-to-total loans ratio on March 31, 2023, as it saw meaningful improvements in all regions except Eastern Europe where its NPE ratio deteriorated to 2.3%, after 1.4% a year earlier.

Our downgrade of RBI's AT1 instruments reflects our view of increasing coupon nonpayment risk. We now apply an additional notch deduction beyond our four-notch standard minimum notching for AT1s from our unchanged issuer credit rating approach. This reflects two developments:

- We have reflected further on RBG's decentralized group structure and the potential operation of its institutional protective support mechanism in a stress scenario. We continue to notch RBI's AT1s from its 'A-' long-term issuer credit rating to reflect that we fundamentally expect group support to be timely and to the benefit of all its creditors, including its discretionary AT1 coupons. This reflects, among others, that AT1 coupon nonpayment could risk some reputational damage that RBG would likely want to avoid, given the importance of RBI's external funding franchise to the group. Nevertheless, we consider it possible that RBG's support might come only after RBI has meaningfully depleted its own financial resources.
- Although we expect that RBI would maintain regulatory maximum distributable amount (MDA) headroom of at least 200 bps even after it divests its Russian subsidiary, from 4.3% on March 31, 2023, we see some risk from a potential regulatory nonsynchronous treatment of capital and RWA that could temporarily lead to tighter-than-expected MDA headroom.

We see RBI's senior nonpreferred and tier 2 hybrids as unaffected by these factors, since they have mandatory coupon payments.

Outlook

The negative outlook reflects our view that RBG continues to face significant downside risks in the coming 12-24 months, mainly due to geopolitical and macroeconomic challenges faced by RBI's Russian subsidiary, as well as possible spill-over effects into its main markets. We also see potential heightened reputational, political, and financial tail risk arising from its outsized Russian operations persisting until it executes an orderly exit.

Downside scenario

We could lower our rating on RBI in the next 12-24 months if the operating environment proves worse than expected, resulting in setbacks to RBG's profitability, asset quality, or capitalization that are beyond our base-case expectations. This could happen, for example, if asset quality problems increased significantly in its main operating markets. Higher-than-expected loss of equity investments in these countries, particularly in Russia, could also lead us to lower the rating. A material weakening of RBI's capitalization due to pronounced credit losses and weaker earnings in higher-risk regions could also lead to a downgrade.

Upside scenario

We could revise the outlook to stable if RBG successfully navigates its exit from Russia, which would also need to be supported by expectations of RBG's robust asset quality, earnings, and capitalization. An outlook revision would also become more likely if, in addition, RBG improved its operational efficiency and profitability in Austria.

Ratings Score Snapshot

Issuer Credit Rating	A-/Negative/A-2
SACP	a-
Anchor	bbb+
Business position	Adequate (0)
Capital and earnings	Adequate (0)
Risk position	Adequate (0)
Funding and liquidity	Strong and Strong (+1)
Comparable ratings analysis	0
Support	0
ALAC support	0
GRE support	0
Group support	0
Sovereign support	0

Issuer Credit Rating	A-/Negative/A-2
Additional factors	0

SACP--Stand-alone credit profile.

ESG credit indicators: E-2, S-2, G-2

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Raiffeisen Bank International AG; Dec. 19, 2022
- Raiffeisen Bank International's Very Strong, Albeit Unsustainable Half-Year 2022 Results Cushion Risks, Aug. 2, 2022

Ratings List

Downgraded

	To	From
Raiffeisen Bank International AG		
Junior Subordinated	BB	BB+
Ratings Affirmed		
Raiffeisen Bank International AG		
Issuer Credit Rating	A-/Negative/A-2	
Raiffeisen Bank International AG		
Senior Unsecured	A-	

Subordinated	BBB