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## Fitch Affirms Emirates Islamic Bank at 'A+'/Stable; Upgrades VR to 'bb+'

Fitch Ratings - London - 03 Apr 2023: Fitch Ratings has affirmed Emirates Islamic Bank (EI) Long-Term Issuer Default Rating (IDR) at 'A+' with Stable Outlook and upgraded its Viability Rating (VR) to 'bb+' from 'bb'.

The upgrade of the VR reflects a stronger business profile, improved asset quality over the last two years and a profitability recovery to sound levels, while capital buffers have remained solid.

### Key Rating Drivers

EI's IDRs are driven by potential support from its 99.9% shareholder, Emirates NBD Bank PJSC (ENBD; A+/Stable/F1).

EI's VR factors in the bank's improved but moderate franchise, adequate asset quality that is now in line with peers', adequate capital and strong profitability, as well as a stable retail funding profile underpinned by healthy liquidity. The VR also considers EI's high concentration risk.

**Shareholder Support Rating of 'a+':** EI's IDRs are in line with ENBD's. ENBD's IDRs are based on potential support from the UAE authorities, which we believe would flow through to EI. Fitch believes support would be forthcoming because of EI's role and record in the group, the very high reputational risk to ENBD of an EI default, and the Central Bank of the UAE's (CBUAE) propensity to support as EI and ENBD operate in the same market.

**Favourable Environment:** Fitch expects operating conditions to remain solid for UAE banks in 2023. The sector's credit growth will remain modest at 4%-5% in 2023 due to weak credit demand, tighter underwriting standards and higher interest rates, but the latter may result in stronger profitability, particularly for banks with high shares of current and savings accounts.

**Group Benefits for Business Profile:** Our assessment of EI's business profile reflects the benefits of being a retail-oriented bank and the third-largest Islamic bank in the country, as well as those stemming from being part of the ENBD group. However, the bank still has a niche franchise in the UAE, with an approximate 2% share of system assets and deposits.

**Moderate Risk Profile:** UAE nationals account for more than 75% of EI's retail portfolio, with mostly affluent, salaried expatriates making up the remainder. Exposure to SMEs is below 5% of total financing and has been on a run-off basis. EI's financing book is less concentrated than local and regional peers' given the bank's retail focus.

**Adequate Asset Quality:** EI's asset quality has recovered well from the pandemic. Its Stage 3 (S3) financing ratio was reduced to 7% at end-2022 from 8.2% at end-2021, mainly due to higher financing growth and a decline in net stage 3 financing. Stage 2 (S2) financing accounted for only 2.4% of total financing at end-2022 and we do not expect considerable migration to S3. Reserve coverage of S3 loans strengthened to 128% at end-2022 from 115% at end-2021.

**Strong Profitability Above Direct Peers':** EI's profitability has recovered strongly from the pandemic low, with a return on average equity (ROAE) of 14% in 2022, which compared well with medium-sized peers'. Its net financing margin increased 70bp to a strong 4.1%, due to repricing of its financing book and a high proportion of zero-cost funding.

Operating return on risk-weighted assets (RWAs) improved to 2.35% in 2022 (2021: 1.8%). We expect profitability to improve in 2023 from continued high financing growth and low financing impairment charges (FICs), given already high provisioning.

**Adequate Core Capital:** EI has strong capital buffers and its capital ratios compare well with the peer average, but we view it as only adequate for the bank's risk profile. Its common equity Tier 1 (CET1) ratio was 17.9% at end-2022, down from 18.6% at end-2021, due to strong financing growth, but still comfortably above the minimum regulatory requirement of 9.5% and the peer average of 13.5% at end-2022. We do not expect significant pressure on capitalisation, given the bank's adequate reserve coverage.

**Stable Funding; Healthy Liquidity:** EI's funding is well-managed and underpinned by its Islamic franchise. Strong deposit collection in retail (77% of total deposits) led to a decreased in the financing-to-deposit ratio to 94% at end-2022 from 100% at end-2021. Low-cost current and savings accounts accounted for 73% of deposits at end-2022 and have proven inelastic. EI's liquidity coverage and net stable funding ratios are comfortably above their minimum regulatory requirements.

## Rating Sensitivities

### **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 to the UAE authorities' ability or propensity to provide support. EI's IDRs could also be downgraded and rated below ENBD's if EI becomes less core to the group and if Fitch believes ENBD's propensity to provide support has weakened, although this is unlikely.

Asset-quality deterioration leading to materially weaker capitalisation and loss-absorption capacity or an increase in the bank's risk appetite with rapid growth in high-risk segments would lead to a downgrade of the VR.

### **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 IDRs, which is unlikely as ENBD's support

driven Long-Term IDR of 'A+' is already one notch above the UAE domestic systemically important banks' Government Support Rating, reflecting the bank's flagship status in the UAE, and Dubai in particular.

An upgrade to the VR is unlikely unless the bank sees significant expansion in its domestic franchise and improvement in its risk profile and asset quality, while maintaining other financial metrics at their current levels.

## **OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS**

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.

## **OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES**

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 ADJUSTMENTS**

The operating environment score of 'bbb' is below the 'aa' category implied score due to the following adjustment reasons: size and structure of economy (negative), financial market development (negative) and regulatory and legal framework (negative).

The capital and leverage score of 'bb+' is below the 'bbb' category implied score due to the following adjustment reason: risk profile and business model (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**

EI's IDRs are linked to ENDB's IDRs.

## ESG Considerations

EI has an ESG Relevance Score of '4' for governance structure in line 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, either due to their nature or to 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).

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## Rating Actions

ENTITY/DEBT	RATING	RECOVERY	PRIOR
El 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+	Upgrade	bb
	Shareholder Support a+	Affirmed	a+

### RATINGS KEY OUTLOOK WATCH

POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

### Applicable Criteria

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

[Sukuk Rating Criteria \(pub.13 Jun 2022\)](#)

### Additional Disclosures

[Solicitation Status](#)

## Endorsement Status

El Sukuk Company Limited      UK Issued, EU Endorsed

Emirates Islamic Bank PJSC      UK Issued, EU Endorsed

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