Rating_Action: Moody's assigns first-time Ba1 deposit and issuer ratings to Advanzia Bank; outlook positive

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Paris, March 16, 2023 -- Moody's Investors Service ("Moody's") today assigned first-time local-currency and foreign-currency long-term and short-term deposit and issuer ratings of Ba1/Not Prime to Advanzia Bank S.A. ("Advanzia"). The outlook on the long-term deposit and issuer ratings is positive.

Moody's also assigned a Baseline Credit Assessment (BCA) of ba2, an Adjusted BCA of ba2, as well as long-term and short-term Counterparty Risk (CR) Assessments of Baa2(cr)/Prime-2(cr) and Counterparty Risk Ratings of Baa2/Prime-2.

RATINGS RATIONALE

Advanzia's deposit and issuer ratings of Ba1 result from (1) the bank's BCA of ba2, (2) the application of Moody's Advanced Loss Given Failure (LGF) analysis, resulting in a low loss given failure and a one-notch uplift for deposit and issuer ratings and (3) a low probability of government support, resulting in no uplift.

Advanzia's BCA of ba2 reflects (1) the bank's very high asset risk incurred through its unsecured consumer lending activities pursued in Western Europe, primarily in Germany, since its foundation in 2005, (2) its very high profitability resulting from high-margin revolving credits, providing good coverage of loan-loss charges, (3) its limited risk-weighted capitalisation buffer above regulatory minima, reflecting high loan growth and dividend payouts, (4) its funding profile dependent on price-sensitive online saving deposits which will gradually diversify into more stable, albeit confidence-sensitive, market funding instruments, (5) its adequate liquidity and (6) elevated European Union (EU) regulatory risks on consumer lending activities, especially as the bank is exclusively focused on these activities.

Advanzia's asset risk is very high, reflecting the risk characteristics of unsecured credit card lending, which Moody's views as prone to high levels of impairment in economic downturns. The bank's problem loan ratio was 7.3% at year-end 2022, a ratio which is not fully reflective of asset risks because problem loans are regularly sold or written off, which deflates the ratio. Advanzia's cost of risk was 5.1% of outstanding credit card borrowings in 2022. Although asset risk is very high, it is also very granular with an average loan size of only around €1,700 and the performance of behavioural risk underwriting and monitoring models developed by Advanzia have been improving in recent years. Moody's expects inflationary pressures to weigh on the bank's cost of risk going forward. In addition, the expansion into new countries, namely Spain and Italy, will typically result in higher loan-loss charges, as risk models are not as seasoned as in the bank's core German market.

Advanzia's capitalisation offers only modest buffers above regulatory minima to offset high asset risks. The bank's common equity tier 1 (CET1) capital ratio was 11.3%, excluding interim profits, at year-end 2022. This was modestly above the EU's Supervisory Review and Evaluation Process (SREP) CET1 minimum of 9.8%. The cushion above the regulatory minima is constrained by the bank's significant loan growth (16% per year on average during the period 2017-2022) and the track record of high earnings distributions (83% on average in the period 2019-2021) on an excess-cash-versus-capital basis.

Advanzia reports strong profitability and efficiency metrics thanks to the very high interest rates charged to its credit card borrowers. Net income was 3.8% of tangible assets in 2022, unchanged versus 2021. These high profits are largely driven by very high net interest margins, which were reported to be 15.1% on the customer loan book in 2022. The bank's net interest margins amply cover operating expenses, resulting in strong operating efficiency as shown by its low cost-to-income ratio of 32.4% in 2022. Operating profits allow good coverage of credit losses. Loan-loss charges represented 45% of operating profits in 2022. Going forward, profitability should remain high, but profit margins will be slightly under pressure. Interest rate rises will increase the cost of Advanzia's price-sensitive online-deposits and market funding sources, whereas the bank has little leeway to increase the interest rates charged to customers, resulting in lower net interest margins. In addition, sluggish macroeconomic conditions will add pressure on loan-loss charges. As a result, Moody's expects profitability, measured as return on assets, to marginally decrease in 2023 from the high levels observed in 2021 and 2022.

Advanzia finances its credit card lending activities essentially through retail saving deposits raised online, which proved to be a relatively stable and flexible source of funding historically. Saving deposits represented 72% of total funding (including shareholders' equity) at year-end 2022, the remainder being provided by securitization (14%), Tier 2 (2%), Additional Tier 1 (AT1) (2%), common equity (9%) and other liabilities (2%). The bank also has a €25 million senior secured multicurrency overdraft facility, which is usually only partially drawn for hedging purposes. Moody's views positively the objectives of the bank to diversify its funding sources away from competitive and price-sensitive online deposits.

The bank maintains ample liquidity on its balance sheet. Liquid assets of €857 million, consisting of cash at central banks, nostro bank accounts and loans to financial institutions, represented 27% of tangible assets and 37% of deposits at year-end 2022, offering good security against deposit outflows and unexpected client drawdowns on unused credit card limits. Credit card loan balances reached €2.6 billion at year-end 2022, but undrawn revolving credit limits, which are off-balance sheet commitments, reached an additional €5.8 billion at the same date.

Lastly, Moody's believes that concentration of the bank's activity in the credit card business, primarily in Germany, exposes its strategy to unexpected regulatory evolutions for consumer credit in the EU.

In addition, Moody's Advanced LGF analysis indicates a low loss given failure for both deposit and issuer ratings, thanks to subordination in the form of AT1 securities and Tier 2 subordinated debt, resulting in a one-notch uplift for these ratings.

The assigned ratings also incorporate Advanzia's environmental, social and governance (ESG) considerations, as per Moody's Investors Service's General Principles for Assessing Environmental, Social and Governance Risks Methodology. Moody's assessment of Advanzia's exposure to governance risks is moderately negative, reflected in a Governance Issuer Profile Score (IPS) of G-3. This assessment is supported by an appropriate board oversight and effectiveness, management track record, reporting and compliance. It also reflects relatively low capital retention and buffer above minimum requirements, in light of high asset risks, and a highly concentrated ownership structure. Moody's assessment of Advanzia's exposure to social risks is highly negative, reflected in a Social IPS of S-4, similar to most banks involved in retail banking activities. Moody's expects that industry-wide social risks from customer relations could represent a material challenge for the bank should unexpected regulatory evolutions affect consumer credit activities in Europe. Advanzia's governance and social risks drive an ESG Credit Impact Score of CIS-3 which indicates a moderately negative impact of ESG factors on the assigned ratings.

POSITIVE OUTLOOK

The outlook on Advanzia's long-term deposit and issuer ratings is positive, reflecting Moody's expectation that these ratings will benefit from higher volume and subordination of loss-absorbing instruments, as the bank plans to diversify its funding sources with the issuance of €300 million of senior unsecured debt in 2023.

Moody's also expects that the bank will maintain adequate capital buffers and improve its funding profile in the face of likely deterioration of asset quality and profitability due to muted macroeconomic conditions.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Advanzia's deposit and issuer ratings would be upgraded as a result of a decrease in loss given failure, should depositors and senior creditors benefit from higher subordination and instrument volume than is currently the case. Moody's expects upward rating pressure to materialise when the bank sells at least €100 million of senior unsecured debt, out of the €300 million planned in 2023. The senior unsecured debt rating would, in this case, be positioned at the same level as the issuer rating.

Moody's could also upgrade the BCA and ratings if the bank decided to substantially increase its capitalisation buffers, while preserving its profitability and risk profile.

Moody's could downgrade the BCA and ratings as a result of a significant deterioration in asset quality impacting profitability and capitalisation. In addition, a downgrade could also occur if net interest margins and profitability substantially fall due to interest rate movements or due to unfavourable regulatory developments. Although unlikely at present, Advanzia's long-term deposit and issuer ratings could also be downgraded as a result of an increase in loss given failure, should these instruments benefit from lower subordination and instrument volume than is currently the case.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at https://ratings.moodys.com/api/rmc-documents/71997. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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At least one ESG consideration was material to the credit rating action(s) announced and described above.

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