

Research Update:

LGT Bank Outlook Revised To Stable From Positive Amid COVID-19 Related Economic Downturn; 'A+/A-1' Ratings Affirmed

May 12, 2020

Overview

- Despite governments' measures to contain the COVID-19 pandemic, the global economy will be in a recession in 2020, leading to weaker business prospects for private banking entities.
- The related decline in LGT Bank's assets under management (AUM) and the investments on its balance sheet will weigh on the bank's earnings and capitalization over 2020.
- Moreover, we don't expect to add an ALAC uplift in our rating over the next two years, due to a likely delay in the introduction of the regulatory minimum requirement for own funds and eligible liabilities (MREL) and in LGT's issuance of bailable debt.
- We are therefore revising our outlook on LGT to stable from positive and affirming our 'A+/A-1' ratings.
- The stable outlook reflects our view that LGT is well positioned to withstand the deteriorated economic environment and that the group's planned reorganization won't materially weaken its private banking franchise.

PRIMARY CREDIT ANALYST

Heiko Verhaag, CFA, FRM
Frankfurt
(49) 69-33-999-215
heiko.verhaag
@spglobal.com

SECONDARY CONTACT

Benjamin Heinrich, CFA, FRM
Frankfurt
+ 49 693 399 9167
benjamin.heinrich
@spglobal.com

Rating Action

On May 12, 2020, S&P Global Ratings revised its outlook on Liechtenstein-based LGT Bank AG to stable from positive. At the same time, we affirmed our 'A+/A-1' long- and short-term issuer credit ratings and 'AA-/A-1+' resolution counterparty ratings on the bank, as well as all our issue ratings on LGT Bank's debt instruments.

Rationale

The outlook revision reflects our view that economic and capital market stress, triggered by the COVID-19 pandemic, is likely to pressure LGT's earnings in 2020-2021 and delay the buildup of additional capital buffers we previously expected. We also believe that the contemplated changes

in the group's structure, effective as of January 2021, and a carve-out of the asset management operations won't materially affect the key strengths of LGT's global private banking franchise.

We initially expected LGT's strong earnings capacity to gradually strengthen its capitalization, with the risk-adjusted capital (RAC) ratio forecast at around 11% by 2021. However, we now project a lower AUM over 2020 combined with a decline in fees from trading due to market uncertainty, leading to weaker income and therefore lower-than-expected earnings retention. In addition, negative asset valuations in LGT's co-investment product "Princely Portfolio," weighs on our RAC ratio forecast. The performance of LGT's Princely Portfolio has been generally favorable, but the high share of alternative assets and equity investments in the portfolio could lead to valuation adjustments and further volatility of the bank's RAC ratio.

The uncertain market environment and potential delays in the introduction of Liechtenstein's MREL framework, will slow down LGT's buildup of material buffers of additional loss-absorbing capacity (ALAC) that would protect senior unsecured creditors and depositors. We acknowledge that LGT issued two senior nonpreferred bonds totaling CHF310 million in 2019, and we expect these will count toward its MREL in the future. However, the Liechtenstein Financial Market Authority has not yet communicated on the eligible liabilities or any bank-specific requirements, and we don't expect it will do so this year. Given the limited amount of LGT's outstanding MREL instruments so far and uncertainty regarding its future MREL maturity profile, there could be a higher level of future maturity concentrations than for larger peers. We therefore apply a higher ALAC threshold (up 50 basis points), namely 5.5% of our risk-weighted assets metric, for an uplift.

LGT announced on May 5 its reorganization and the carve-out of its asset management and impact investment businesses, which together represent reported AUM of around CHF55 billion, from the private banking group in 2021. After the reorganization, each of these three business lines will fall under separate entities owned directly by the Prince of Liechtenstein Foundation. Although the AUM and related fee income at the rated banking entity will decrease following the carve-out, we do not believe this will materially impair the strong private banking franchise and solid profitability.

Outlook

The stable outlook reflects our view that the economic downturn linked to COVID-19 and related drop in asset values will slow down LGT's capital improvements and buildup of bail-inable capital over the next 24 months but not impair its banking franchise. During that period, we expect to gain more clarity on the local MREL requirements and the implications of LGT's issuance plans.

Upside scenario

We could consider a positive rating action if LGT gradually accumulated bail-inable capital and improved capitalization beyond our expectations for its stand-alone credit profile, resulting in an ALAC buffer above the adjusted threshold of 5.5% of S&P Global Ratings risk-weighted assets. This buffer would protect the bank's senior unsecured creditors should the bank become nonviable.

However, we would consider an upgrade only if our comprehensive view of LGT were comparable with that of peers at the 'AA-' level, which is a very high rating in an international comparison.

Downside scenario

We could take a negative rating action on LGT if further deterioration of the macroeconomic environment triggered a strong reduction in the value of the Princely portfolio and AUM, weakening LGT's earnings capacity and risk adjusted capitalization.

We could also consider a downgrade if lower earnings retention or larger acquisitions hindered the bank from maintaining strong capitalization or if the contemplated reorganization weakened the group's franchise.

Ratings Score Snapshot

Issuer Credit Rating A+/Stable/A-1

SACP a+

- Anchor a-
- Business position Strong (+1)
- Capital and earnings Strong (+1)
- Risk Position Adequate (0)
- Funding and Average and (0)
- Liquidity Adequate

Support (0)

- ALAC Support (0)

Additional factors (0)

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- 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
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Banking Industry Country Risk Assessment: Liechtenstein, Feb. 5, 2020
- LGT Bank AG, Oct. 7, 2019
- Liechtenstein-Based LGT Bank's First Issuance Of Senior Non-Preferred Notes Rated 'A', June 28, 2019

Ratings List

Ratings Affirmed

Resolution Counterparty Rating	AA--/A-1+
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LGT Bank AG

Senior Unsecured	A+
Senior Subordinated	A

Ratings Affirmed; Outlook Action

	To	From
LGT Bank AG		
Issuer Credit Rating	A+/Stable/A-1	A+/Positive/A-1

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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