Fitch Downgrades Standard Chartered to 'A+', Maintains Negative Outlook

Fitch Ratings-Hong Kong-05 November 2015: Fitch Ratings has today downgraded Standard Chartered PLC's (SC) and its subsidiary Standard Chartered Bank's (SCB) Long-Term Issuer Default Ratings (IDRs) to 'A+' from 'AA-'. Their Outlooks were maintained on Negative. At the same time, Fitch downgraded their Viability Ratings (VRs) to 'a+' from 'aa-' and Short-term IDRs to 'F1' from 'F1+'. A full list of rating actions is at the end of this commentary. Fitch will review the support-driven IDRs of SC's subsidiaries in due course.

The rating actions follow the bank's 3Q15 results announcement and its new strategic plan which is accompanied by a USD5.1bn rights issue. The bank's restructuring is comprehensive as it targets about USD100bn out of USD315bn of risk weighted assets (RWAs) at end-3Q15.

KEY RATING DRIVERS
IDRS, VRS AND SENIOR DEBT
The downgrades reflect SC's unfavourable profitability and asset quality trends as well as its underperformance relative to peers. Fitch believes that the bank's proposed restructuring measures address several aspects that Fitch had previously highlighted as potential negative rating factors and that it will help realign SC's capital with evolving risks. However, Fitch has taken the view that SC remains vulnerable to volatility from a difficult operating and regulatory environment. Increasing correlations between its key emerging markets will, in Fitch's view, continue to diminish some of the geographical diversification benefits of SC's strong franchise.

Fitch maintains the Negative Outlook as we believe that implementing the plan could be challenged by headwinds from further downturn in the credit cycle as well as high management and staff turnover. We consider it likely that a portion of its short-term exposure, which is often rolled-over in line with common practice in emerging markets, may be more difficult to terminate as borrowers struggle to pay or fail to negotiate refinancing and thus continuing to weigh on profitability and capital generation. While we would not expect such developments to materially weigh on the bank's liquidity it could cause further loan impairments.

Fitch believes that narrowing the relative size of exposure to, for example sectors, individual issuers and countries is commensurate with our previous risk appetite assessment and sensible in the current environment. The importance of this rating factor and that of asset quality to Fitch's rating assessment have, however, increased. The bank's tighter risk limits lead to a sizeable portfolio of non-compliant exposures of USD20bn in RWA at end-2016, which could lead to losses of USD1.5bn as per management's estimate.

Furthermore, impaired loan ratios remain above peers' and appear to have become more volatile as a result of concentrated sector and country exposure. The considerable uptick in loan impairment charges (LICs) in 2015 from already identified areas such as commodities (exposure of USD43bn or just above 100% of Common Equity Tier 1 (CET1) at end-September 2015 including the proposed capital increase) and India (USD33bn or 81% of adjusted CET1) stems from cyclical deterioration as well as structural changes in the operating environment. Fitch also believes that management's desire to address future problems plays a role in this uptick.

SC's concentration on China exceeds peers' with a net exposure of USD60bn or 145% of adjusted CET1. The rating reflects Fitch's expectation that this portfolio will continue to perform well.

Non-performing loans (NPLs) at end-September 2015 stood at USD9.5bn which is an increase of

20% compared to end-2014 or 9% compared to end-June 2015. The increase in the NPL ratio to 3.5% (2014: 2.7%) is significant and, in Fitch's view, could increase further from pressure on unsecured retail exposure and the ongoing evaluation of identified wind-down assets. Capital encumbrance from unprovisioned NPLs remains low. Reserve coverage improved to 58% at end-September from 54% at end-June 2015 and 50% at end-2014.

Fitch views the bank's improved capitalisation in line with the rating. SC's Fitch Core Capital (FCC) ratio and the CET1 ratio are expected to initially increase by 160bps to 13.8% and 13.1%, respectively, levels which compare well with peers'. Fitch expects that the bank will, however, have to deliver quickly on its RWA efficiency goals as internal capital generation has halted and will remain weak in 2016. While there is currently a cyclical downturn, over the longer-term, SC's target market should experience above average growth trends and so raising profitability levels to generate sufficient internal capital generation to support growth will be important. The targeted return on equity of 8% by 2018 and 10% by 2020 is weaker compared to peers while the new CET1 target of 12-13% is in line.

We maintain the same IDRs and VRs for SC and its main operating entity, SCB as their risk profiles remain aligned and liquidity at the top holding company is adequately managed. The rights issue creates flexibility for SC from a double leverage perspective to downstream capital into SCB when needed.

SCB's IDR is equalised with its VR as we believe that qualifying junior debt is not sufficient to provide protection for senior creditors.

SUPPORT RATING AND SUPPORT RATING FLOOR
SC's and SCB's Support Rating (SR) of '5' and Support Rating Floor (SRF) of 'No floor' reflect Fitch's opinion that UK sovereign support cannot be relied upon.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES
Subordinated debt and other hybrid regulatory capital securities issued by SC and SCB are notched down from their VRs. The ratings on SC's capital securities are notched down five times, reflecting two notches for loss severity and three notches for non-performance risk. The ratings on SCB's capital securities are notched down four times, reflecting two notches for loss severity and only two notches for non-performance risk, taking into account their cumulative coupons. SCB's UT2 securities are notched down three times with one notch for loss severity and two notches for non-performance. Subordinated debt is notched down once from the respective banks' VRs.

RATING SENSITIVITIES
IDRS, VRS AND SENIOR DEBT
Fitch would revise the Outlook to stable if SC demonstrates that it can implement the new strategy successfully resulting in a leaner organisation that draws franchise strength from its global network and from profitable domestic operations.

SC's ratings may be downgraded if the bank fails to strengthen earnings and reduce risks or if loan quality deterioration accelerated undermining its capital strength. Outsized fines or material business restrictions from litigation could also lead to a downgrade.

In addition, the VR and IDRs of SC are sensitive to an adverse change in relevant factors affecting holding company notching, including high double leverage (above 120%), less prudent liquidity management, more complex group structure or regulatory/legal risk specific to the holding company.

SCB's Long-term IDR could benefit from a one notch uplift from its VR depending on the size of its junior debt buffers on a long-term sustainable basis.

SUPPORT RATING AND SUPPORT RATING FLOOR
The SR is sensitive to any change in assumptions around the propensity or ability of the UK sovereign to provide timely support. Any upgrade to SC's and SCB's SR and upward revision to their SRFs

would be contingent on a positive change in the sovereign's propensity to support its banks or a holding company. Both are highly unlikely in Fitch's view.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES
The securities' ratings are primarily sensitive to a change in the VR. SC's AT1 securities are also sensitive to a change in Fitch's assessment of the probability of their non-performance relative to the risk captured in SC's VR. This could arise due to a change in Fitch's assessment of SC's conservative approach to capital management, reducing SC's flexibility to service the securities, or an unexpected shift in regulatory buffer requirements.

The rating actions are as follows:

Standard Chartered PLC
Long-term IDR downgraded to 'A+' from 'AA-'; Outlook maintained at Negative
Short-Term IDR: downgraded to 'F1' from 'F1+'
Viability Rating: downgraded to 'a+' from 'aa-'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
Senior unsecured debt: downgraded to 'A+'/'F1' from 'AA-'/'F1+'
Dated subordinated debt: downgraded to 'A' from 'A+'
Capital securities (US853254AC43, US853254AB69, US853254AA86, USG84228AT58,): downgraded to 'BBB-' from 'BBB'
Contingent convertible securities (USG84228CE61, US853254AT77): downgraded to 'BBB-' from 'BBB'

Standard Chartered Bank
Long-Term IDR: downgraded to 'A+' from 'AA-; Outlook maintained at Negative
Short-Term IDR: affirmed at 'F1' from 'F1+'
Viability Rating: downgraded to 'a+' from 'aa-'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
Senior unsecured debt: downgraded to 'A+'/'F1' from 'AA-/F1+'
Dated subordinated debt: downgraded to 'A' from 'A+'
Upper Tier 2 notes (XS0222434200, XS0119816402) downgraded to 'BBB+' from 'A-'
Capital securities (XS0129229141): downgraded to 'BBB' from 'BBB+'

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Applicable Criteria
Global Bank Rating Criteria (pub. 20 Mar 2015)
(https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=863501)

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