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Fitch Revises Outlook on Three Saudi Arabian Banks to Negative

Fitch Ratings-Dubai/London-03 November 2015: Fitch Ratings has revised the Outlooks on the Long-term Issuer Default Ratings (IDRs) of Saudi British Bank (SABB), Banque Saudi Fransi (BSF) and Arab National Bank (ANB) to Negative from Stable and upgraded the Viability Rating (VR) of Alinma Bank (Alinma). Fitch has affirmed all other ratings as part of its 2015 peer review of the Saudi Arabian banking sector. A complete list of rating actions is at the end of this rating action commentary.

The revision of the banks' Outlooks to Negative reflects Fitch's view of a tougher operating environment facing the Saudi Arabian banking sector, mainly due to the effect of lower oil prices on government spending and the filter down effect this has on the rest of the economy. The Long-term IDRs of the three banks are driven by their 'a' VRs, which are capped at this level by the operating environment. A deteriorating operating environment could be characterised by slowing loan growth, a reduction in earning and profitability growth, a deterioration in asset quality metrics, and subsequent impact on capital, as well as tighter liquidity, and could result in a downgrade of the banks' Long-term IDRs.

While the deteriorating environment could have similar consequences on the VRs of the other eight Saudi banks rated by Fitch, their Outlooks are not directly affected as their Long-term IDRs are all driven by their Support Ratings (SR) and Support Rating Floors (SRF), based on our view of extremely high likelihood of support from the Saudi authorities. Nevertheless, the Outlooks on Al Rajhi Bank's (ARB), National Commercial Bank's (NCB), Riyad Bank's (RB) and SAMBA Financial Group's (SAMBA) Long-term IDRs have remained Negative (see rationale below).

The upgrade of Alinma's VR mainly reflects the greater size, maturity and track record of its franchise. Alinma has built a more significant Islamic corporate franchise in Saudi and is building a solid Islamic retail franchise. It is now a strongly recognised Islamic brand in the kingdom and a more mature bank, having finished the start-up and growth phase. It also reflects management's strong track record of performance. The bank has performed well since start up and we expect this to continue.

KEY RATING DRIVERS: SRs AND SRFs FOR ALL 11 BANKS; IDRs FOR ARB, NCB, RB, SAMBA, SHB, SAIB, ALINMA, BAJ AND AJC
The Saudi banks' SRs and SRFs reflect the extremely high probability of support from the Saudi authorities, if required. Fitch's opinion of support is based on the strong ability and willingness of the authorities to support the banking sector.

Support has been demonstrated by the Saudi authorities' long track record of supporting domestic banks, as well as close ties and ownership links with the government at a number of banks. Fitch's view of support is also underpinned by the sovereign's strong capacity to support the banking system supported by its sovereign wealth funds and on-going revenues mostly from its hydrocarbon production, and the moderate size of the Saudi Arabian banking sector in relation to the country's GDP.

Fitch identifies domestic systemically important banks (D-SIBs) based on its view of each bank's systemic importance relative to other banks in the banking system, and considering, among other things, market share, franchise and government ownership. The 'A+' SRF of the four Saudi banks -ARB, NCB, RB and SAMBA - are at the Saudi banks' D-SIB SRF of 'A+', reflecting their very high systemic importance.

The Negative Outlook on the Long-term IDRs of these four banks reflects the Negative Outlook on the Saudi Arabian sovereign due to the fact that their Long-term IDRs are at the SRF for Saudi D-SIBs.

The 'A-' SRFs of the four JV banks SABB, BSF, ANB and Saudi Hollandi Bank (SHB), are below the Saudi D-SIB SRF. This reflects Fitch's view that the large stakes held in these banks by foreign financial institutions could result in slightly lower willingness (albeit still high) by the sovereign to support these banks and their slightly lower systemic importance based on their slightly smaller sizes, franchises and market shares.

The 'A-' SRFs of the remaining three banks, Saudi Investment Bank (SAIB), Alinma and Bank Aljazira (BAJ) are below the Saudi D-SIB SRF. This reflects Fitch's view of their lower relative systemic importance in comparison to the larger banks, due to even smaller sizes, market shares and franchises.

The IDRs of ARB, NCB, RB, SAMBA, SHB, SAIB, Alinma and BAJ are driven by support from the authorities.

Aljazira Capital's (AJC) IDRs and Support Rating reflect the extremely high probability of institutional support, if needed, from its 100% owner, BAJ (A-/Stable). AJC's IDRs are equalised with those of its parent. This reflects Fitch's opinion that AJC is a key and integral subsidiary of BAJ.

KEY RATING DRIVERS: VRs FOR ALL 11 BANKS; IDRs FOR ANB, BSF AND SABB

Saudi Arabia is the largest economy in the Gulf Cooperation Council (GCC), with solid growth prospects supported by significant government spending on infrastructure projects, strong oil revenues, albeit at a lower price and an expanding non-oil private sector. All banks benefit from a favourable operating environment, high barriers to entry, a strict and hands-on regulator, sound liquidity and capital ratios, and pre-impairment operating profit levels that enables them to absorb high impairment charges, if necessary.

However, Fitch expects the operating environment to weaken over the next two years as lower oil prices impact government spending, slowing loan growth and impacting growth in earnings and profitability, and over time impacting asset quality, all of which could result in lower capital ratios. In addition, the impact of lower oil prices will likely reduce some of the liquidity in the system, although this is not expected to be significant, either through an outflow of government-linked deposits or an increase in the cost of government or other deposits. A weakening operating environment could create a cap at 'a-' for Saudi banks' VRs.

The IDRs of ANB, BSF and SABB reflect their intrinsic creditworthiness and financial strength, as underlined by their respective VRs. Where an issuer's VR is equal to or above its SRF, the IDRs reflect the VR.

The BSF Sukuk Ltd trust certificate issuance programme and the senior unsecured notes issued under it are rated in line with BSF' IDRs.

ARB
ARB's VR reflects the bank's leading domestic retail franchise, strong profitability and capital ratios, lower balance sheet concentrations than peers, sound asset quality, and large and stable retail deposit base. The VR also considers higher loan impairment charges and less sophisticated risk management compared with peers, given its retail focus.

NCB
NCB's VR reflects the bank's leading domestic franchise and strong, albeit under pressure profitability and stable funding. The VR also considers falling core capital ratios and an increasing risk appetite for international investments.

RB
RB's VR reflects the bank's solid capital ratios, strong commercial franchise with leading market shares in some business lines, solid core earnings generation and diversification, and sound asset quality. It also reflects high concentration risks in assets and liabilities.

SAMBA
SAMBA's VR reflects the bank's sound capital ratios, resilient franchise and stable business model. It also reflects strong financial metrics, including its sound liquidity and strong and stable earnings. The rating is constrained by high concentration risks in both assets and liabilities (by sector and by name).

ANB
ANB's VR reflects strong liquidity, consistently sound profitability, and the benefits of being an associate bank of Arab Bank Plc (BBB-/Negative). The VR also considers some concentrations on both sides of the balance sheet as is similar to other Saudi banks and lower than sector average capital ratios.

BSF
BSF's VR reflects its low risk appetite compared with peers. This is driven by the bank's focus on lower risk, large corporates. The risk appetite also benefits from an investment portfolio almost entirely comprising domestic government securities and also considers

the benefits of being an associate bank of Credit Agricole Corporate and Investment Bank (CACIB; A/Positive), with whom BSF has a technical services agreement. The VR reflects BSF's strong asset quality and improved earnings. It also considers the bank's lower capital ratios compared with larger peers in Saudi Arabia, and lower diversification of earnings outside of corporate banking, achieved by many peers.

SABB
SABB's VR reflects its consistently strong profitability and core earnings generation, and comfortable liquidity. The ratings also consider SABB's strong franchise and the benefits of being an associate bank of HSBC Holdings plc (AA-/Stable) with a technical services agreement with the HSBC group. The VR also reflects SABB's slightly lower capital ratios compared with the Saudi Arabian sector average and SABB's high large customer exposures relative to equity compared with larger Saudi peers.

SHB
SHB's VR reflects its weaker Tier 1 capital ratio than peers, smaller, but growing, franchise, recent fast loan growth and high concentrations on both sides of the balance sheet. The VR also considers the bank's sound asset quality, healthy profitability and strong funding and liquidity. The uncertainty relating to its future ownership, if it remains unresolved, could constrain its ability to raise new share capital and therefore could affect SHB's ability to execute its strategy in the long term, constraining its competitive position. ABN AMRO Bank N.V. currently holds a 40% stake in SHB. This stake is considered non-strategic and is likely to be sold in due course.

SAIB
SAIB's VR reflects the bank's rapid loan growth in 2014 and 2013, which is likely to put pressure on asset quality metrics in the medium term. Profitability metrics now compare well with similarly sized peers. These factors are counterbalanced by SAIB's limited capital buffers compared with peers. Other factors constraining its VR include the bank's smaller franchise and its high concentration in deposits.

ALINMA
Alinma's VR reflects the bank's more established Islamic bank franchise and market share, albeit still low in the context of the banking system. It also reflects the bank's fairly high loan growth since inception, that the bank is still a young bank, as well as concentrations on both sides of the balance sheet. The expected continued expansion of the bank's operations, albeit at a slower pace, will inevitably bring the bank's current strong capital ratios more in line with peers. The VR also considers the bank's sound liquidity and asset quality metrics and lower than peers, but improving profitability.

BAJ
BAJ's VR is constrained by its lower capital ratios from rapid financing growth and weaker company profile than peers, and high concentration in deposits. The VR also considers BAJ's improved asset quality and weaker earnings metrics compared with peers.

AJC
Despite AJC being a separate legal entity, Fitch believes it is not meaningful to analyse AJC in its own right, viewing it more as a BAJ business line. Moreover, Fitch does not usually assign VRs to non-banking financial institutions.

RATING SENSITIVITIES - SRs AND SRFs FOR ALL 11 BANKS; IDRs FOR ARB, NCB, RB, SAMBA, SHB, SAIB, ALINMA, BAJ AND AJC
The banks' SRs and SRFs are sensitive to a reduction in the perceived ability or willingness of the authorities to provide support to the banking sector. The willingness of the Saudi sovereign to support the banks is unchanged and is demonstrated by the authorities' strong track record of support for local banks. However, the Negative Outlook on the sovereign reflects its weakening ability to support the banks due to the significant deterioration in its fiscal position.

The IDRs of ARB, NCB, RB and SAMBA will be downgraded by one notch if the Negative Outlook on the sovereign results in a one-notch downgrade of Saudi Arabia. The IDRs of the other four banks with Long-term IDRs driven by potential state support (SHB, SAIB, ALINMA and BAJ) would not be downgraded if the sovereign was downgraded by one notch as their SRFs are below the current D-SIB SRF of 'A+'. All eight banks' IDRs would be downgraded if the sovereign was downgraded by more than one notch.

Upward potential for the ratings is limited in light of a weakening sovereign and operating environment.

Where the banks' IDRs are driven by sovereign support, these would be sensitive to a change in their SRs or SRFs.

AJC's IDRs and SR are sensitive to a change in BAJ's ratings or in Fitch's view of BAJ's willingness to support AJC. However, Fitch notes the high level of strategic and financial importance of AJC to BAJ and the latter's 100% ownership.

Saudi Arabia is an FSB/G20 member country and has implemented Basel III. As such, resolution legislation is being implemented. We will review the SRFs once the legislation is closer to being fully enacted, although we currently do not expect any changes.

RATING SENSITIVITIES: VRs FOR ALL 11 BANKS; IDRs FOR ANB, BSF AND SABB
A weakening of the operating environment is the most likely driver of negative rating action at all banks, especially if this results in lower loan growth, impacts earning and profitability and asset quality, leading to a reduction in capital ratios. Most notably, 'a' VRs would likely be downgraded if the operating environment weakened. Reduced concentration in loans and deposits could be beneficial for the VRs.

ARB
Upside to ARB's VR is limited given its current high level. The VR could be downgraded

if there is a notable deterioration in asset quality indicators, capital ratios, or profitability to a level that would significantly affect internal capital generation.

NCB
An upgrade of NCB's VR is unlikely given its already high level and its high loan book concentration. Pressure on NCB's VR could come from further deterioration in capital ratios, and/or asset quality as a result of rapid loan growth, especially at NCB's Turkish subsidiary.

RB
Upside to RB's VR is limited, considering its current high level. Downside could result from deterioration in asset quality, if this leads to a significant decline in profitability and an erosion of the capital ratios. However, revenues from its core banking businesses should be ample to cover any future loan impairment charges.

SAMBA
Negative pressure on SAMBA's VR could occur if there is deterioration in the bank's asset quality, both in loans and investments, or if there is a sharp reduction in capital ratios. An upgrade is unlikely considering the already high level of the VR.

ANB
ANB's IDR is sensitive to any change in its VR. However, any downward movement would be limited to one notch due to its SRF of 'A-'. Support is not factored into ANB's IDR.

Negative pressure on ANB's VR would be driven by a significant weakening of the bank's capital ratios compared with larger peers. This would be most likely through a deterioration in the bank's loan quality or strong loan growth. Upside is limited given the current high level of the rating.

BSF
BSF's IDR is sensitive to any change in its VR. However, any downward movement would be limited to one notch due to its SRF of 'A-'. Support is not factored into BSF's IDR.

Negative pressure on BSF's VR could be driven by a significant weakening of the bank's capital ratios compared with larger peers. If the technical services agreement between BSF and CACIB was terminated, this could also put pressure on the VR, but this is not the agency's base case. Upside is limited given the fairly low capital ratios and high concentrations.

The BSF Sukuk Ltd trust certificate issuance programme and the senior unsecured notes issued by these entities are subject to the same sensitivities.

SABB
SABB's IDR is sensitive to any change in its VR. However, any downward movement

would be limited to one notch due to its SRF of 'A-'. Support is not factored into SABB's IDR.

Negative pressure on SABB's VR could be driven by a significant weakening of the bank's capital ratios compared with larger peers, together with a significant increase in large customer exposures relative to equity. If the technical services agreement between SABB and HSBC was terminated, weakening its franchise, this could also put pressure on the VR but this is not our base case. Upside is limited given the fairly low capital ratios compared with larger peers and high concentrations.

SHB
An upgrade of SHB's VR would stem from greater diversification of the franchise and a stronger capital cushion that is more in line with its domestic peers. An end to the uncertainty surrounding SHB's ownership and future strategy could also positively affect the VR. The VR could be downgraded as a result of high loan growth having a negative impact on asset quality and capital ratios.

SAIB
Upside for SAIB's VR could result from more sustainable growth rates, increasing internal capital generation and reducing asset quality cyclicality. Downward pressure on the VR could arise from a sharp deterioration in asset quality, following the seasoning of recent high loan growth, contributing to erosion of already limited capital buffers.

ALINMA
Diversification on both sides of the balance sheet, increasing and extending its funding profile, as well as improving internal capital generation, could result in an upgrade. Rapid growth leading to asset quality deterioration could put pressure on Alinma's VR, as would a sharp deterioration in profitability.

BAJ
There is upward potential for BAJ's VR should the bank complete a successful Tier 1 capital increase, following plans announced in 1H15 by the bank. Downward pressure on BAJ's VR could come from deterioration in its Fitch core capital and Tier 1 capital ratios, most likely attributable to fast financing growth or deteriorating asset quality.

A Special Report with more details on the banks will shortly be available at www.fitchratings.com.

The rating actions are as follows:

Al Rajhi Bank
Long-term IDR affirmed at 'A+', Outlook Negative
Short-term IDR affirmed at 'F1'
Viability Rating affirmed at 'a'
Support Rating affirmed at '1'
Support Rating Floor affirmed at 'A+'

National Commercial Bank
Long-term IDR affirmed at 'A+', Outlook Negative
Short-term IDR affirmed at 'F1'
Viability Rating affirmed at 'a'
Support Rating affirmed at '1'
Support Rating Floor affirmed at 'A+'

Riyad Bank
Long-term IDR affirmed at 'A+', Outlook Negative
Short-term IDR affirmed at 'F1'
Viability Rating affirmed at 'a'
Support Rating affirmed at '1'
Support Rating Floor affirmed at 'A+'

SAMBA Financial Group
Long-term IDR affirmed at 'A+', Outlook Negative
Short-term IDR affirmed at 'F1'
Viability Rating affirmed at 'a'
Support Rating affirmed at '1'
Support Rating Floor affirmed at 'A+'

Arab National Bank
Long-term IDR affirmed at 'A', Outlook revised to Negative from Stable
Short-term IDR affirmed at 'F1'
Viability Rating affirmed at 'a'
Support Rating affirmed at '1'
Support Rating Floor affirmed at 'A-'

Banque Saudi Fransi
Long-term IDR affirmed at 'A', Outlook revised to Negative from Stable
Short-term IDR affirmed at 'F1'
Viability Rating affirmed at 'a'
Support Rating affirmed at '1'
Support Rating Floor affirmed at 'A-'

BSF Sukuk Limited
Trust Certificate Issuance Programme affirmed at 'A'
Senior unsecured trust certificates affirmed at 'A'

Saudi British Bank
Long-term foreign currency IDR affirmed at 'A', Outlook revised to Negative from Stable
Short-term foreign currency IDR affirmed at 'F1'
Long-term local currency IDR affirmed at 'A', Outlook revised to Negative from Stable
Viability Rating affirmed at 'a'
Support Rating affirmed at '1'

Support Rating Floor affirmed at 'A-'
EMTN programme affirmed at 'A'/'F1'
Senior unsecured notes affirmed at 'A'

Saudi Hollandi Bank
Long-term IDR affirmed at 'A-', Outlook Stable
Short-term IDR affirmed at 'F2'
Viability Rating affirmed at 'bbb'
Support Rating affirmed at '1'
Support Rating Floor affirmed at 'A-'

Saudi Investment Bank
Long-term IDR affirmed at 'A-', Outlook Stable
Short-term IDR affirmed at 'F2'
Viability Rating affirmed at 'bbb-'
Support Rating affirmed at '1'
Support Rating Floor affirmed at 'A-'

Alinma Bank
Long-term IDR affirmed at 'A-', Outlook Stable
Short-term IDR affirmed at 'F2'
Viability Rating upgraded to 'bbb' from 'bbb-'
Support Rating affirmed at '1'
Support Rating Floor affirmed at 'A-'

Bank Aljazira
Long-term IDR affirmed at 'A-', Outlook Stable
Short-term IDR affirmed at 'F2'
Viability Rating affirmed at 'bb+'
Support Rating affirmed at '1'
Support Rating Floor affirmed at 'A-'

Aljazira Capital
Long-term IDR affirmed at 'A-', Outlook Stable
Short-term IDR affirmed at 'F2'
Support Rating affirmed at '1'