Fitch Rates Euroclear's Senior Preferred Debt 'AA+(EXP)'; Issuer Ratings Unaffected

Fitch Ratings, London/Paris/Frankfurt 26 June 2018: Fitch Ratings has assigned Euroclear Bank's (EB; AA+/Stable/F1+/aa+) EUR5 billion euro medium-term note (EMTN) programme an expected long-term rating of 'AA+(EXP)' and an expected short-term rating of 'F1+(EXP)'. At the same time, Fitch has assigned an expected rating of 'AA+(EXP)' to EB's upcoming EUR1 billion issuance of senior preferred notes issued under the programme. EB's issuer ratings are unaffected by this rating action.

The ratings of the programme apply only to senior unsecured notes issued by EB. There is no assurance that notes issued under the programme will be assigned a rating, or that the rating assigned to a specific issue under the programme will have the same rating as the programme.

The assignment of the final ratings is contingent on the receipt of final documents conforming to information already reviewed.

The main rationale for the establishment of the EMTN programme is management's expectations that once the EU regulation on central securities depositories (CSDR) has been implemented, EB will be subject to more stringent liquidity requirements concerning the bank's settlement activities. In particular, EB expects to have to comply with CSDR's "Cover 2" requirement, which prescribes sufficient liquidity in all relevant currencies to ensure timely settlement under the assumption that EB's two largest settlement counterparties default.

While EB currently complies with this requirement through the availability of committed credit lines from a number of large banks, it intends to use the EMTN programme to increase the proportion of pre-funded liquidity. In parallel, EB is in the process of optimising liquidity consumption related to settlement facilities by – among other things – reducing credit limits and enforcing a minimum requirement for the proportion of ECB-eligible collateral.

KEY RATING DRIVERS
SENIOR DEBT PROGRAMME AND SENIOR UNSECURED DEBT RATINGS
The programme's ratings are driven by, and equalised with, EB's Long- and Short-Term Issuer Default Ratings (IDRs). In Fitch's view, the likelihood of default on the senior unsecured notes under the programme reflects the likelihood of default of the bank.

EB's IDRs reflect its leading franchise in the international post-trade securities services industry, in particular in settlement and custody services, as well as its very strong financial metrics. The ratings take into account EB's resilient revenue bases despite secular challenges in the settlement industry, a very low appetite for and exposure to credit risk, adequate investments in its control framework to ensure sound operational risk controls, prudent liquidity management and strong capitalisation (see 'Fitch Affirms Clearstream Banking and Euroclear Bank; Outlooks Stable' published on 27 September 2017 on www.fitchratings.com for further details).

Under the terms of the programme, EB can issue both senior preferred and senior non-preferred notes, the latter with a view to comply with any future minimum requirement for own funds and eligible liabilities (MREL). Fitch would expect to equalise both instruments with EB's Long-Term IDR. However, Fitch could notch up the rating of EB's senior preferred notes by one notch, subject to sovereign risk considerations, once a sufficiently large buffer of qualifying junior debt and senior non-preferred notes is in place to protect senior preferred debt from default in case of failure.

EB's issuer ratings are unaffected by the planned issuance because Fitch believes the corresponding impact on EB's credit risk profile to be broadly neutral.

While investing the proceeds from the planned issuance will have a short-term negative impact on EB's regulatory capital and leverage ratios, the reduction in the EB's CET1 ratio (to around 34% at end-2018 according to management projections from around 37% at end-2017) is contained due to EB's investment policy to only invest in highly-rated instruments. The impact on EB's market risk exposure is small because of EB's policy to match investments and outstanding bonds by tenor and rate. The impact on EB's profitability due to negative carry because of the prudent investment guidelines is relatively small.

Positively, the planned issuance ensures early compliance with changing regulatory requirements, improves the robustness of EB's operational set-up, reduces counterparty concentration risk and provides longer-term clarity for EB's client base. In addition, EB's already sound liquidity profile will be strengthened further as illustrated by the material anticipated improvement in its liquidity coverage ratio.

RATING SENSITIVITIES

SENIOR DEBT PROGRAMME AND SENIOR UNSECURED DEBT RATINGS

The expected ratings of the programme and the planned debt issuance are primarily sensitive to changes in EB's Long- and Short-Term IDRs.

The Stable Outlook on EB's Long-Term IDR reflects Fitch's opinion that due to its dominant franchise EB should be in a position to continue generating sound profitability, while maintaining its current low risk profile and making the required investments to ensure its technology platform and risk management system keep pace with regulatory and industry-wide changes.

Upside potential is limited, given EB's already high ratings.

Due to its high volume business model and considerable reliance on robust IT systems, operational risk is a key rating sensitivity, in particular considering EB's low absolute volume of capital. Outsized operational losses, reputational damage causing a sustained drop in revenue, inability to adapt to regulatory changes, weakening capitalisation or a higher risk appetite could all lead to negative rating action. While maintaining sound risk-weighted capital ratios is relevant for EB's ratings, a reduction in its absolute capital base would put pressure on EB's ratings.

EB's Long-Term IDR is two notches above the Long-Term IDR of the Belgian sovereign (AA-/Stable). Because there is little direct Belgian risk in the bank's balance sheet, EB is significantly less exposed to sovereign-associated reputation, business and operational risks than Belgian commercial banks. A sovereign downgrade into the 'A' category could trigger a downgrade of EB's ratings depending on the rationale for the sovereign downgrade and the bank's direct Belgium sovereign risk exposure at the time.

The rating actions are as follows:

Euroclear Bank
EMTN programme long-term rating: assigned at 'AA+(EXP)'
EMTN programme short-term rating: assigned at 'F1+(EXP)'
Senior preferred debt long-term rating: assigned at 'AA+(EXP)'

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