MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades the ratings of five South African banks following downgrade on the South African sovereign. The outlook is negative

31 Mar 2020

London, 31 March 2020 -- Moody's Investors Service ("Moody's") has today downgraded to Ba1 from Baa3 the long-term local currency and foreign currency deposit ratings of The Standard Bank of South Africa Limited, FirstRand Bank Limited, ABSA Bank Limited, Nedbank Limited and Investec Bank Ltd., the five largest banks in South Africa. The rating agency has also downgraded to Ba2 from Ba1 the long-term issuer ratings of the holding companies Absa Group Limited and Standard Bank Group Limited.

The outlook on all the South African banks' long-term deposit ratings remains negative.

At the same time, Moody's downgraded to Ba2 from Ba1 the long-term local currency deposit rating of First National Bank of Namibia Limited, the Namibian subsidiary of South Africa's FirstRand Limited, and changed the outlook on this rating to stable from negative.

Please click on this link https://www.moodys.com/viewresearchdoc.aspx?docid=PBC_ARFTL421844 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and identifies each affected issuer.

The primary driver for today's rating actions is the increasingly difficult operating environment for banks in South Africa as reflected by Moody's decision to lower South Africa's Macro Profile score from 'Moderate' to 'Moderate-'.

A secondary driver of today's rating actions is the weakening credit profile of the South African government given banks' high sovereign exposure, mainly in the form of government debt securities held as part of their prudential liquidity requirements, which links their credit profiles to that of the government.

These actions follow the downgrade of the South African government's issuer rating to Ba1 from Baa3 on 27 March 2020. The driver behind the sovereign rating downgrade is the continuing deterioration in South Africa's fiscal strength and structurally very weak growth, which Moody's does not expect current policy settings to address effectively (refer to the sovereign press release Moody's downgrades South Africa's ratings to Ba1, maintains negative outlook; https://www.moodys.com/research/--PR_420630).

RATINGS RATIONALE

WEAKENING MACRO PROFILE

The key driver of today's rating actions is the lowering of South Africa's Macro Profile score to 'Moderate-' from 'Moderate' to reflect the increasingly challenging operating environment for banks. The lower Macro Profile score results in the downgrade of the Baseline Credit Assessments (BCAs) to ba1 from baa3 of the five largest South African banks.

The rating agency expects a GDP contraction of 2.5% in 2020 and growth of 1.1% in 2021, significantly below the level required to reduce both high poverty and unemployment levels (29.1%, 2019) materially. As the weak economy strains borrower cash flows and makes it more difficult for borrowers to meet their loan obligations, Moody's expects a deterioration of the banking system's problem loan ratio over the next 12 to 18 months, from their average of 3.9% as of year-end 2019, and declining profitability metrics. However, Moody's expects banks' capitalization to be broadly stable over the next 12 months as pre-provision income should be sufficient to absorb banks' rising loan losses.

South Africa's Macro Profile continues to reflect the funding risks that the South African banking system faces given its high reliance on short-term domestic institutional deposits. Large institutional deposits (including interbank deposits), along with debt securities (primarily held by financial institutions), account for around 34% of the banking system's funding base, and corporate deposits 18%, as of December-end 2019.

Additionally, the unprecedented deterioration in the global economic outlook caused by the rapid spread of the coronavirus outbreak will exacerbate South Africa's economic and fiscal challenges, complicate the emergence of effective policy responses and negatively impact banks' credit profiles through asset quality, profitability and liquidity pressures.

Though operating conditions are challenging, it is important to note that Moody's does not have any particular governance concern for the rated South African banks and does not apply any corporate behaviour adjustments to them.

BANKS' EXPOSURE TO THE SOUTH AFRICAN GOVERNMENT

A secondary driver of today's rating actions is South African banks' high sovereign exposure, mainly in the form of government debt securities held as part of their prudential liquidity requirements, which links their credit profiles to that of the government. The banks' overall sovereign exposure, including loans to state-related entities, averages 176% of their capital bases, as of December-end 2019.

In view of the weakening operating environment and the correlation between sovereign and bank credit risk, the banks' standalone credit profile and ratings are constrained by the credit profile of the government.

NEGATIVE OUTLOOK REFLECTS SOVEREIGN OUTLOOK

The negative outlook of the South African banks' ratings reflects our expectation that the weak economic environment will increase the downside risks for banks' credit profiles. The challenging operating environment will translate to higher impairments for the banks; exerting negative pressure on revenues and testing the resilient performance they have demonstrated in recent years. However, Moody's does not anticipate that the asset quality deterioration will materially compromise banks' capitalisation. The negative outlook on the banks is aligned with the outlook on the sovereign rating, which reflects downside risks around economic growth and fiscal metrics, that could lead to an even more rapid and sizeable increase in the debt burden, further lowering debt affordability and potentially weakening South Africa's access to funding.

NATIONAL SCALE RATINGS (NSR)

There has also been a recalibration of South Africa's NSR mappings, triggered by the downgrade of South Africa's government bond rating. Moody's NSRs are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks.

INDIVIDUAL BANKS' MAIN RATING DRIVERS

- The Standard Bank of South Africa Limited (SBSA) and Standard Bank Group Limited (SBG)

Moody's downgraded the BCA of SBSA to ba1 from baa3 primarily as a result of the increasingly difficult operating conditions, and our expectation that the bank's profitability and asset quality metrics will deteriorate over the next 12 months. However, SBSA's ba1 BCA continues to reflect our expectation of resilient capital buffers despite an increasing cost of risk on account of the challenging operating environment. We also expect that the bank's robust risk-management framework will continue to be supportive of its solvency profile. The bank's credit loss ratio increased marginally over 2019 and the bank's nonperforming loans (NPLs) ratio stood at 3.6% as of December-end 2019. SBSA's reported Common Equity Tier 1 (CET1) ratio was 13.2% as of December-end 2019, which compares favourably to its South African peers.

SBG's issuer rating of Ba2 is positioned one notch lower than the deposit ratings of its fully owned main banking subsidiary SBSA, reflecting the structural subordination of SBG's creditors to those of SBSA.

- FirstRand Bank Limited (FRB)

Moody's downgraded the BCA of FRB to ba1 from baa3 primarily as a result of the increasingly difficult operating conditions, and our expectation that the bank's profitability and asset quality metrics will deteriorate over the next 12 months. However, FRB's ba1 BCA continues to reflect its solid franchise in the South African banking sector. The bank's BCA also takes into account our expectation that the bank's (1) capital buffers will remain resilient; and (2) profitability will continue to compare favourably with that of its similarly rated local peers, despite some negative pressure. The bank's credit loss ratio increased to 107bps in the six months ended 2019 up from 93bps in the same period in 2018 and the bank's reported nonperforming loans (NPLs) ratio stood at 4.2% as of December-end 2019. FRB's reported Common Equity Tier 1 (CET1) ratio was 13.7% as of December-end 2019, which is the highest amongst its South African peers.

- ABSA Bank Limited and Absa Group Limited

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Moody's downgraded the BCA of ABSA Bank Limited to ba1 from baa3 primarily as a result of the increasingly difficult operating conditions, and our expectation that the bank's profitability and asset quality metrics will deteriorate over the next 12 months. However, ABSA Bank Limited's ba1 BCA continues to capture its sound risk management practices and ability to maintain a solid earnings generating capacity. The bank's reported nonperforming loans (NPLs) ratio stood at 4.5% as of December-end 2019. The ratings also capture its adequate capital buffers (with a core Tier 1 ratio of 11.4% as of December 2019, on a normalized basis), but which remain below international peers.

Absa Group Limited's issuer rating of Ba2 is positioned one notch lower than the deposit ratings of its fully owned main banking subsidiary, ABSA Bank Limited, reflecting the structural subordination of Absa Group Limited's creditors to those of ABSA Bank Limited.

- Nedbank Limited (Nedbank)

Moody's downgraded the BCA of Nedbank Limited to ba1 from baa3 primarily as a result of the increasingly difficult operating conditions, and our expectation that the bank's profitability and asset quality metrics will deteriorate over the next 12 months. However, Nedbank's BCA of ba1 continues to reflect the bank's solid local franchise and material investments in digitisation and information technology and its resilient capitalisation (a reported Common Equity Tier 1 capital ratio of 11.5%, as of December 2019). Nedbank's asset quality metrics deteriorated only marginally over 2019 with NPLs rising to 3.6% as of December-end 2019 from 3.5% as of December-end 2018.

- Investec Bank Ltd. (IBL)

Moody's downgraded the BCA of IBL to ba1 from baa3 primarily as a result of the increasingly difficult operating conditions, and our expectation that the bank's profitability and asset quality metrics will deteriorate over the next 12 months. However, IBL's ba1 BCA continues to reflect the bank's resilient capitalisation, strong liquidity and good asset quality (NPLs accounted for a modest 1.3% of gross loans as of September-end 2019). These strengths are moderated the bank's credit concentrations to both commercial and residential property-related borrowers; although these sectors have historically performed well. The bank's reported CET1 ratio was 13% as of September 2019, and its reported leverage ratio of 7.8% is one of the highest among its local peers.

- First National Bank of Namibia Limited (FNB Namibia)

Moody's downgraded to Ba2 from Ba1 the long-term local -currency deposit ratings of First National Bank of Namibia Limited as a result of the increasingly challenging operating conditions in South Africa given the negative implications these have for the credit profile of South Africa's FirstRand Limited, FNB Namibia's parent, in its capacity as affiliate support provider.

FNB Namibia's Ba2 local currency deposit rating incorporates one notch of rating uplift from the bank's BCA of ba3, based on our view of a high probability of support from the Government of Namibia (Ba2, stable), in case of need. Additionally, we also continue to expect a very high willingness of support from FNB Namibia's ultimate parent, South Africa's FirstRand Limited, in a stress scenario. FNB Namibia's BCA, its standalone credit strength, of ba3 captures our expectation that the bank's strong domestic franchise will continue to support its earnings generating capacity and robust capital ratios, both of which will continue to provide a large buffer against loan losses. As of June-end 2019, the bank's reported CET1 ratio was 17.0% and return on assets was 2.42%. These strengths are moderated by our expectation that NPLs will continue to deteriorate over the next 12 months (NPLs increased to 2.71% as of June-end 2019 from 2.30% as of December-end 2018).

The stable outlook of FNB Namibia's long-term deposit ratings reflects our view that FNB Namibia's asset risks and profitability metrics will stay within the thresholds assumed by its current ratings despite the deteriorating trend witnessed in both metrics over the last 18 months. The stable outlook is aligned with the stable outlook on the Namibian sovereign's issuer rating.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in November 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1147865 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Factors that would lead to an upgrade or downgrade of the ratings:

Any future deterioration in the creditworthiness of South Africa or Namibia would exert downward pressure on the banks' ratings in that system, in view of their sizeable holdings of sovereign debt securities held as part of their prudential liquidity requirements. In addition, the banks' ratings could be downgraded if operating conditions worsen, leading to significantly higher loan loss provisions that prompt deterioration in the banks' earnings and capital metrics that exceed the rating agency's expectations.

For the South African banks, upwards momentum of the banks' ratings is currently constrained by weak operating conditions in South Africa as reflected by the negative outlook. For FNB Namibia, any upward rating momentum is also constrained by operating conditions in South Africa, where its ultimate parent and affiliate support provider, FirstRand Limited, resides. However, for FNB Namibia, an upgrade in the bank's ratings could be triggered by an upgrade of the issuer ratings of the Namibian government, as a support provider, combined with improvements in the financial profile of the bank.

Moody's National Scale Credit Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody's global scale credit ratings in that they are not globally comparable with the full universe of Moody's rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a ".nn" country modifier signifying the relevant country, as in ".za" for South Africa. For further information on Moody's approach to national scale credit ratings, please refer to Moody's Credit rating Methodology published in May 2016 entitled "Mapping National Scale Ratings from Global Scale Ratings". While NSRs have no inherent absolute meaning in terms of default risk or expected loss, a historical probability of default consistent with a given NSR can be inferred from the GSR to which it maps back at that particular point in time. For information on the historical default rates associated with different global scale rating categories over different investment horizons, please see https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1216309 .

REGULATORY DISCLOSURES

The List of Affected Credit Ratings includes additional disclosures that vary with regard to some of the ratings. Please click on this https://www.moodys.com/viewresearchdoc.aspx?docid=PBC_ARFTL421844 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and provides, for each of the credit ratings covered, Moody's disclosures on the following items:

• Releasing Office

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 at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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