FitchRatings

29 Apr 2020 | Rating Watch

Fitch Places CIT Group on Rating Watch Negative on Coronavirus Impact

Fitch Ratings-New York-29 April 2020:

Fitch Ratings has placed CIT Group Inc.'s 'BBB-' Long-Term Issuer Default Rating (IDR), 'F3' Short-Term IDR and 'bbb-' Viability Rating (VR) on Rating Watch Negative reflecting significant operating environment headwinds due to the disruption to economic activity and financial markets from the coronavirus pandemic. This review was part of Fitch's ongoing horizontal review of all U.S. financial institutions.

Fitch revised the Rating and Sector Outlook to Negative from Stable for all U.S. banks on March 18, 2020, reflecting the expectation that credit fundamentals for the sector will deteriorate in the near-to-medium term. Fitch believes the drop in short-term and long-term rates will adversely affect spread revenue for a number of quarters while fee income will also be hampered from lower levels of client activity. Bank profits will be further pressured from higher levels of provisioning for credit losses under the Current Expected Credit Loss (CECL) accounting framework. Fitch expects credit quality for issuers with relatively more exposure to industries and asset classes affected by the spread of coronavirus to be significantly more adversely affected over the course of the next two to three quarters than contemplated in Fitch's U.S. Bank Outlook published during fourth quarter 2019. Please refer to Fitch's press release "Fitch Ratings: Sector and Rating Outlook for U.S. Banks Revised to Negative" that was published on March 18, 2020, available on fitchratings.com.

Along with a revised Global Economic Outlook, Fitch also has published a common set of baseline and downside-scenario parameters against which all ratings groups globally are evaluating the impact of the coronavirus pandemic. As part of this portfolio review, rating actions have been taken in line with expected trajectories under the baseline scenario. For more information please refer to "Fitch Ratings: Coronavirus Baseline and Downside Scenarios" published on April 2, 2020.

Key Rating Drivers

IDRs, VRs, Senior Unsecured Debt and Revolving Credit Facility

CIT's ratings have been placed on Rating Watch Negative reflecting Fitch's expectation that CIT's financial performance will be significantly and negatively affected as a result of the coronavirus pandemic. Fitch considers CIT's risk appetite to be higher than similarly sized commercial bank peers, which could result in significant asset quality and earnings deterioration and could make it difficult for CIT to maintain capital ratios in line with what is incorporated to its current rating.

Fitch's upgrade of CIT in November 2019 incorporated the expectation that CIT's CET1 capital ratio would fall to the lower end of its 10%-11% target range, but that CIT would build its CET1 capital ratio to 10.5% within one year of closing the Mutual of Omaha Bank acquisition. CIT's regulatory CET1 capital ratio, which excludes the full impact from the new loss accounting methodology, was 9.7% at 1Q20. The company has indicated that while it still intends to build its CET1 capital ratio back to 10.5%, Fitch believes this may be challenging in the current environment, especially if management maintains the current level of dividend payments.

Fitch also expects the build of capital to be slowed by earnings challenges due to CIT's asset mix, which contains more exposure to vulnerable sectors than similarly sized commercial banks. Fitch estimates that these portfolios collectively represent over 25% of CIT's total assets.

CIT's 1Q20 provision expense was over 20 times its provision expense in 4Q19. If economic conditions worsen relative to what CIT's 1Q20 provision incorporated, Fitch expects that CIT's provision expense will remain significantly elevated over the Outlook Horizon. While these provision expenses do not represent actual losses incurred, CIT's 1Q20 allowance coverage is approximately 60% of CIT's nine-quarter cumulative forecasted losses under its internally run stress tests that are based on the Federal Reserve's 2019 severely adverse scenario .

Further challenging earnings and ultimately capital accretion is Fitch's expectation that CIT will continue to experience more margin pressure than peers due to challenges from both an asset yield and funding cost standpoint. Deposit costs in CIT's online deposit platform have remained stubbornly high for CIT along with online bank peers despite the Fed's rate cuts to near zero. CIT has historically paid among the highest money market deposit rates in the industry. Online deposit rates are expected to remain well above brokered deposit costs going forward despite the rate reductions seen in recent weeks across the industry. Further, the net financing margin in CIT's rail leasing portfolio has come down significantly in 1Q20, and Fitch expects that this business will continue to experience pressure over the coming quarters.

The duration of depressed economic activity and heightened unemployment related to the coronavirus spread and resultant COVID-19 remains uncertain and depends on the success of containment efforts that are difficult to predict. Therefore, to the extent that there is a slower than anticipated recovery (i.e. Fitch's Downside Scenario), Fitch may review CIT's ratings further.

SUPPORT RATING AND SUPPORT RATING FLOOR

The Support Ratings of '5' reflect Fitch's view that external support cannot be relied upon. The Support Rating Floors of 'No Floor' reflect Fitch's view that there is no reasonable assumption that CIT will receive sovereign support.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

CIT's and CIT Bank's subordinated debt is notched one level below the respective entities' VRs for loss severity. In accordance with the Bank Rating Criteria, this reflects alternate notching to the base case of two notches due to Fitch's view of U.S. regulators' resolution alternatives for an entity like CIT and CIT Bank as well as early intervention options available to banking regulators under U.S. law.

Per Fitch's updated Bank Rating Criteria published Feb. 28, 2020, CIT's preferred stock has been upgraded to 'B+' to reflect a reduction in incremental non-performance risk and is no longer on UCO. Preferred stock is now four notches from the VR, which encompasses two notches for non-performance and two notches for loss severity.

LONG- AND SHORT-TERM DEPOSIT RATINGS

CIT Bank's long-term deposits are rated one notch higher than the bank's IDR and senior unsecured debt because U.S. uninsured deposits benefit from depositor preference. U.S. depositor preference gives deposit liabilities superior recovery prospects in the event of default.

HOLDING COMPANY

CIT's VR is equalized with that of CIT Bank, reflecting its role as the financial holding company, which is mandated in the U.S. to act as a source of strength for its bank subsidiaries. The ratings are also equalized, reflecting the very close correlation between holding company and subsidiary failure and default probabilities. Fitch's analysis of CIT's holding company liquidity incorporates availability under the holding company's credit lines with other banks.

RATING SENSITIVITIES

IDRs, VRs, Senior Unsecured Debt and Revolving Credit Facility

Fitch expects to resolve the Rating Watch Negative within the next six months. Fitch expects that CIT's quarterly financial results and ongoing updated economic data will bring greater visibility to the ultimate impact of the coronavirus pandemic on CIT's financial performance and ultimately the company's ratings.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

A more prolonged coronavirus-related economic downturn than under Fitch's current global base case or the reemergence of infections requiring a re-imposition of lockdown measures would be negative for ratings. Although Fitch recognizes that it may take longer to reach its 10.5% CET1 target, CIT's ratings could be downgraded if it regulatory CET1 capital ratio falls below 9.5% for multiple quarters without a credible plan for making progress toward ultimately reaching its target level.

CIT's ratings could also be downgraded if net charge-offs increase substantially resulting in weaker ability to generate earnings and capital in line with its current rating level. CIT's rating could also be downgraded if CIT's net finance margin continues to decline at a faster pace than rated peers, implying structurally weaker earnings performance that would not support an investment-grade rating.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Positive rating momentum for CIT is limited at present, as indicated by the Rating Watch Negative, given the broader economic backdrop and uncertainty related to the coronavirus pandemic. Fitch could remove the Rating Watch Negative and assign a Stable Outlook if Fitch expects CIT's asset quality and earnings performance proves to be more resilient than Fitch's expectations, and/or if CIT's CET1 capital ratio converges with its 10.5% target.

SUPPORT RATING AND SUPPORT RATING FLOOR

CIT's Support Rating and Support Rating Floor are sensitive to Fitch's assumptions around CIT's capacity to procure extraordinary support in case of need.

CIT Bank's uninsured deposit ratings are rated one notch higher than the company's IDR and therefore are sensitive to any changes in CIT Bank's IDR. The deposit ratings are primarily sensitive to any change in CIT Bank's Long- and Short-Term IDRs.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

CIT's and CIT Bank's subordinated debt and CIT's preferred stock ratings are sensitive to any change in the respective entities' VRs.

LONG- AND SHORT-TERM DEPOSIT RATINGS

CIT Bank's long-term deposit rating is primarily sensitive to changes in the company's IDR. An upgrade of CIT Bank's long-term deposit rating would result in an upgrade of CIT Bank's short-term

IDR; however, a downgrade of CIT Bank's long-term deposit rating would only result in a downgrade of the company's short-term deposit rating if the long-term deposit rating was downgraded by two or more notches.

HOLDING COMPANY

While not currently expected, if CIT became undercapitalized or management increases the level of double leverage significantly, Fitch could potentially notch the holding company IDR and VR from CIT Bank. Additionally, the holding company's IDR and VR could be notched off of CIT Bank should the holding company experience financial stress arising from business activities, such as railcar leasing or factoring, conducted out of the holding company that are distinct from CIT Bank.

Fitch could also notch the holding company IDR from CIT Bank if holding company liquidity, measured as cash, liquid assets and credit line availability covered less than four quarters of required cash outlays. Fitch factors in CIT's credit lines when looking at holding company liquidity. Should CIT lose access to these credit facilities that is not offset with on-balance sheet liquidity, Fitch could notch the holding company's IDR down from CIT Bank. Additionally, upward rating momentum at the holding company could be constrained should bank credit lines comprise a significant portion of its contingency funding plan, which would be considered unique for an institution of CIT's size.

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING
The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations
The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are

credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

CIT Bank, N.A.; Long Term Issuer Default Rating; Rating Watch On; BBB-; RW: Neg
; Short Term Issuer Default Rating; Rating Watch On; F3; RW: Neg
; Viability Rating; Rating Watch On; bbb-; RW: Neg
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
----senior unsecured; Long Term Rating; Rating Watch On; BBB-; RW: Neg
----subordinated; Long Term Rating; Rating Watch On; BB+; RW: Neg
----long-term deposits; Long Term Rating; Rating Watch On; BBB; RW: Neg
----short-term deposits; Short Term Rating; Rating Watch On; F3; RW: Neg
CIT Group Inc.; Long Term Issuer Default Rating; Rating Watch On; BBB-; RW: Neg
; Short Term Issuer Default Rating; Rating Watch On; F3; RW: Neg
; Viability Rating; Rating Watch On; bbb-; RW: Neg
; Support Rating; Affirmed; 5
; Support Rating Floor; Affirmed; NF
----preferred; Long Term Rating; Upgrade; B+; RW: Neg
----senior unsecured; Long Term Rating; Rating Watch On; BBB-; RW: Neg
----subordinated; Long Term Rating; Rating Watch On; BB+; RW: Neg

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Additional information is available on www.fitchratings.com

Applicable Criteria

Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Status
Endorsement Policy