Fitch Affirms Credit Europe Bank N.V. at 'BB-'; Revises Outlook on Russian Subsidiary to Negative

Fitch Ratings-Paris/London-05 February 2015: Fitch Ratings has affirmed the Long-term Issuer Default Ratings (IDR) of Credit Europe Bank N.V. (CEB) and its Russian subsidiary, Credit Europe Bank Ltd (CEBR) at 'BB-'. The Outlook on CEB's Long-term IDR is Stable. The Outlook on CEBR's Long-term IDR has been revised to Negative from Stable. A full list of rating actions is available at the end of this rating action commentary.

Key Rating Drivers - CEBR's IDRs, VR and Support Rating
The revision of the Outlook on CEBR's Long-term IDR to Negative reflects the sharp deterioration of the Russian operating environment, which will weigh on Russian banks' credit profiles (see "Fitch Revises Outlook on 20 Mid-sized Russian Banks to Negative" dated 29 December 2014 at www.fitchratings.com).

At the same time, the affirmation of CEBR's Long-term IDR and VR reflects Fitch's view that the bank's significant near-term refinancing risks and increasing pressure on asset quality are moderately offset by its currently reasonable financial metrics and historically lower volatility of credit losses and profitability compared with peers. The agency also positively considers the recent track record of indirect liquidity support the bank has received from its immediate parent bank and the broader group.

CEBR is exposed to high refinancing risk in light of significant upcoming repayments (RUB30bn in 2015 or 22% of end-2014 liabilities), while its liquidity buffer is fairly tight (8% of total assets at end-2014) and customer deposits in the sector are becoming increasingly flighty due to exchange rate volatility (CEBR experienced a customer funding outflow of around 8% in December, adjusted for exchange rate effects). In order to preserve liquidity, the bank has cut new lending, increased deposit rates and sold a RUB10bn portfolio of corporate loans to other group banks. Fitch expects that CEBR will primarily rely on its deleveraging capacity (supported by a fast amortising retail book, monthly generating around RUB6bn of cash) to meet repayments in 2015. Fitch also believes that group resources would be available to further support the bank's liquidity, if needed.

Fitch expects that CEBR's asset quality will be increasingly pressured in 2015. Most of the bank's concentrated corporate loan book (25% of gross loans at end-2014 as per draft IFRS statements) is denominated in foreign currency, while borrowers' revenues are not fully hedged. Fitch acknowledges historically conservative collateral valuations and reasonable collateral coverage of most corporate exposures, but views these as only moderate mitigating factors given recent exchange rate volatility.

Retail borrowers' ability to repay debt will be undermined by reducing real household incomes resulting from high inflation and rouble devaluation, which will likely lead to an increase in to date moderate credit losses (calculated as the net increase in NPLs plus write-offs; equal to 5.6% (annualised) of average performing loans in 1H14). At the same time, the secured nature of car lending (45% of retail loans) will likely offset part of the negative asset quality shock due to both lower NPL origination than on unsecured lending and higher recoveries.

CEBR's capitalisation (Fitch Core Capital ratio was a sound 15.7% at end-1H14) is supported by a shrinking balance sheet and a still positive bottom line. However, some weakening of the capital ratios is likely in 2015 as a result of the revaluation of FX-denominated assets and weaker profitability (due to increased funding costs and impairment charges).
CEBR's Support Rating of '4' reflects the limited probability of support from CEB, in case of need. This view is based on (i) CEB's somewhat constrained ability to provide capital support, given CEB's reducing but still significant size (around 25% of group's assets at end-2014); and (ii) increasing uncertainty over the longer-term business prospects for the Russian market.

RATING SENSITIVITIES - CEBR's IDRs, VR AND SUPPORT RATING
CEBR's Long-term IDR and VR could be downgraded if (i) the weaker operating environment translates into deterioration of the bank's financial metrics; or (ii) prospects for Russia's economy and macroeconomic stability continue to deteriorate significantly. Upside potential is currently limited, but stabilisation of the operating environment would be credit positive. CEBR's Support Rating is sensitive to CEB's ratings and any marked changes in the group's strategic commitment to the Russian market.

KEY RATING DRIVERS AND SENSITIVITIES - CEBR's DEBT RATINGS
CEBR's senior unsecured debt is rated in line with its Long-term IDR, and its subordinated debt rating is notched down once from the VR. Any changes to the bank's Long-term IDR and VR would likely impact the ratings of these instruments.

KEY RATING DRIVERS - CEB's IDRs AND VR
The affirmation of CEB's Long-term IDR with a Stable Outlook is based on Fitch's view that the weaker operating environment and potential asset quality deterioration in Russia are reasonably offset by recent improvements in the bank's capitalisation. CEB's VR continues to reflect the bank's substantial exposure to volatile operating environments (albeit with some geographical diversification), cyclical sectors and high borrower concentrations. The VR also continues to factor in the bank's sound liquidity profile and a responsive management and flexible balance sheet, which have so far enabled the bank to withstand adverse economic and financial market developments.

CEB improved the quality of its capital in 4Q14 with the conversion of a USD125m Tier 1 hybrid instrument subscribed by the bank's shareholder (the Turkish conglomerate Fiba Group) into equity. In addition, EUR100m equity will be injected into CEB by the end of 1Q15 by Fiba Group (EUR50m already completed in late January). The conversion of the hybrid instrument and the decrease of risk-weighted assets from the contraction of business volumes in Russia and the depreciation of the rouble are expected to improve the bank's consolidated CET1 ratio to above 11% at end-2014 from just below 8% at end-June 2014. When including the EUR100m capital injection and annual net profit, the pro-forma CET1 at end-2014 ratio would be around 13%. As a result, capitalisation is no longer a key drag on the bank's ratings.

Fitch believes this substantial improvement in capitalisation is currently neutralised by the weaker operating environment faced by the Russian subsidiary, and the potential consequences for CEB's asset quality, and hence earnings and ultimately capital. CEBR has substantially supported the bank's performance, and hence internal capital generation in recent years (the bulk of consolidated net income was generated out of Russia in 2011-1H14) and group profitability will likely weaken materially as a result of more depressed results from Russia.

Reported capital ratios still needs to be considered in the light of CEB's sensitive asset quality, with large exposures to less advanced economies (intrinsically more volatile, as demonstrated by the recent economic developments in Russia) and cyclical industries. The performance of CEB Romania's Swiss franc-denominated mortgage loan book will be hit by the recent currency appreciation, but the impact should remain manageable. CEB's asset quality is also vulnerable due to significant borrower concentrations and a large stock of watch list loans.

RATING SENSITIVITIES - CEB's IDRs AND VR
Negative pressure on CEB's ratings could arise in case of a sharper than currently anticipated deterioration in CEBR's credit profile; however, Fitch does not at present expect a one-notch downgrade of CEBR's VR to have an impact on CEB's ratings.

Upside rating potential is currently limited given the pressure on CEBR's credit profile. However, if CEBR continues to perform reasonably, the Russian operating environment stabilises and CEB maintains capital ratios at current levels without increasing its overall risk appetite, this could result in an upgrade. A continued reduction in the group's Russian operations, if this is achieved through a corresponding increase in lower risk activities in more stable operating environments, could also be credit positive.

KEY RATING DRIVERS AND SENSITIVITIES - CEB's SUBORDINATED DEBT
CEB's USD400m issue of subordinated Tier 2 debt securities (XS087849279) are rated one notch below the bank's VR to reflect below-average recovery prospects for this type of debt instrument. This subordinated debt rating is likely to move in line with the VR.

KEY RATING DRIVERS AND SENSITIVITIES- CEB's SUPPORT RATING AND SUPPORT RATING FLOOR
Fitch believes that while there is a possibility that CEB's sole shareholder, the Turkish conglomerate Fiba, may support the bank in case of need, its ability to do so cannot be relied upon due to the holding company's limited size relative to CEB. Given the bank's small franchise in the Dutch market, Fitch also believes that sovereign support from the Dutch authorities cannot be relied upon, as reflected in the Support Rating of '5' and Support Rating Floor of 'No Floor'. Fitch currently does not envisage any changes to CEB's Support Rating.

The rating actions are as follows:

CEB
Long-term IDR: affirmed at 'BB-'; Outlook Stable
Short-term IDR: affirmed at 'B'
Viability Rating: affirmed at 'bb-
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
Subordinated debt securities (XS0878492791): affirmed at 'B+'

CEBR
Long-term IDR: affirmed at 'BB-', Outlook revised to Negative from Stable
Short-term IDR: affirmed at 'B'
National Long-term rating: affirmed at 'A+(rus)', Outlook revised to Negative from Stable
Viability Rating: affirmed at 'bb-
Support Rating: affirmed at '4'
Senior unsecured debt: affirmed at 'BB-/A+(rus)
Subordinated debt (issued by CEB Capital SA): affirmed at 'B+

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