Fitch Ratings-London/Paris/Moscow-27 November 2014: Fitch Ratings has affirmed the Long-term Issuer Default Ratings (IDR) of Credit Europe Bank N.V. (CEB) and of its Russian subsidiary, Credit Europe Bank Ltd (CEBR), at 'BB-'. The Outlooks on the Long-term IDRs are Stable. A full list of rating actions is available at the end of this rating action commentary.

KEY RATING DRIVERS - CEB's IDRs AND VR
CEB's Long-term IDR is driven by the bank's standalone strength as reflected in its VR. CEB's VR continues to primarily reflect its modest capitalisation, considering the bank's substantial exposure to volatile operating environments (albeit with some geographical diversification) and cyclical sectors, and high borrower concentrations. The VR also factors 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. The Stable Outlook on CEB's Long-term IDR reflects Fitch's expectation that the group would avoid significant losses as a result of the slowdown in the Russian economy.

CEB's consolidated Fitch Core Capital (FCC) ratio remains modest, amounting to 8.3% at end-June 2014. Fitch's view of the bank's capital takes into account reported ratios, but also its exposures to less advanced economies and cyclical industries. At end-June 2014, 45% of the consolidated customer loan book was to Russian clients, and 14% to Romania, and exposures to the real estate sector and shipping sector accounted for 76% and 55% of FCC respectively. At the same time, the absolute size of CEB's equity is fairly small, leaving it vulnerable to the bank's top exposures in the loan book; the top 20 exposures represented a high 231% of FCC at end-June 2014. CEB has informed Fitch that it is looking at ways to improve the quality of its capital ratios, with a focus on core capital.

Asset quality metrics improved in 1H14, but largely due to the sale of problem loans in Romania and significant write-offs. In Fitch's view, CEB's asset quality remains vulnerable, due to significant borrower concentrations, exposures to volatile operating environments and a large stock of watch list (WL) loans.

At end-June 2014, non-performing loans (NPLs, overdue by 90 days or more) represented a moderate 4.9% of gross loans, and were 73.4% reserved by impairments. However, NPLs and WL loans combined amounted to 11.4% of gross loans and unreserved NPLs and WL loans represented a high 85% of FCC. Fitch believes these risks are mitigated by the bank's generally sound track record of managing credit risk and a risk appetite that is commensurate with the volatile environments it operates in. Asset quality will be hit by the current difficult operating environment in Russia, but it is Fitch's current base case that the strains should remain manageable for the bank, as reflected in the Stable Outlook on CEBR.

CEB reported solid pre-impairment profitability equal to 3.2%-3.3% of average assets in 2013-9M14, supported by a healthy net interest margin (4.5% in 1H14) and high cost efficiency (cost/income ratio of 44%). However, sizable loan impairment charges (LIC) have kept return on assets consistently below 1%, and increased LIC on Russian exposures in 2014 will further constrain bottom-line results. That said, Fitch believes that CEB will report a consolidated net profit for FY14 (9M14: 9% ROE), which will contribute to capital build-up, as it has been the shareholder practice to support capitalisation and business growth over dividend pay-out.
The group's consolidated funding profile is supported by CEB's granular and stable retail deposit base in western Europe (loans/deposits ratio of 108% at end-June 2014), but its strong expansion in Russia has mostly relied on wholesale funding, which is sensitive to general confidence. Nevertheless, the short-dated nature of CEB's consolidated balance sheet (including CEBR) mitigates refinancing risks at group level.

Capital markets and interbank funding is largely raised at subsidiary bank level, and intra-group lending exposures have reduced and are at acceptable levels. Liquidity management at the group level is prudent, with the Basel III liquidity coverage ratio and net stable funding ratio at 318% and 116%, respectively, at end-June 2014.

RATING SENSITIVITIES - CEB's IDR{s AND VR
Negative rating action may result if stress in the Russian operating environment turns out to be greater than envisaged by Fitch. Significant asset quality deterioration, resulting in a further tightening of capitalisation, could put downward pressure on the ratings.

The VR may be upgraded on materially stronger capitalisation. Reduced reliance on the Russian operations could also cause upward rating pressure, provided this is achieved through the bank's raising its share of lower-risk activities (such as trade finance) in stable operating environments.

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.

KEY RATING DRIVERS - CEBR's IDR{s, VR and SUPPORT RATING
CEBR's Long-term IDR{s and VR are constrained by the bank's tight liquidity and high refinancing risk, and by the deteriorating operating environment for retail lenders in Russia. However, the ratings positively consider (i) the bank's lower volatility of credit losses and profitability to date compared with other Russian retail-focused banks; (ii) fairly conservative management, translating into a somewhat lower-risk profile of CEBR's retail loan book compared with peers; and (iii) healthy capitalisation.

CEBR is highly reliant on wholesale funding (the loans-to-deposits ratio was a high 290% at end-1H14), while its buffer of liquid assets is quite thin (just 6% of total assets at end-10M14). Wholesale funding repayments in 4Q14-2015 (mainly RUB20bn of local bonds and RUB13bn due to third-party banks, equivalent to 25% of end-10M14 liabilities in total) represent a significant refinancing risk. CEBR has pencilled in several deals (including a RUB5bn-10bn car portfolio securitisation and a RUB45bn standby local bond issue programme), but given unfavourable market conditions for Russian borrowers we expect that the bank will rely heavily on its deleveraging capacity to meet these obligations. CEBR's ability to deleverage is supported by the bank's fairly rapidly amortising retail loan book, which generates around RUB6bn monthly in cash from repayments. In addition, Fitch believes that group resources would be available to support CEBR's liquidity, in case of need.
CEBR's asset quality is under pressure from the weaker performance of its retail portfolio in a currently more challenging operating environment. The NPL origination rate (net increase in NPLs plus write-offs, a proxy for credit losses) reached 5.6% of average performing loans in 1H14 (up from 4.1% in 2013) and is likely to stay elevated in 2015. However, compared with most Russian consumer finance banks, CEBR is in a more comfortable position to withstand negative asset quality trends. This is because (i) 45% of its retail portfolio comprises secured car loans, which show markedly higher recoveries on originated NPLs; (ii) the profile of unsecured borrowers is slightly better at CEBR due to lower-risk customer acquisition channels; (iii) the portfolio seasoning effect is less pronounced at CEBR following slower recent expansion than peers and (iv) the bank's pre-impairment profit depends less on loan issuance volumes and remained sound in 1H14 at 7% of average performing loans, covering actual credit losses despite loan book contraction.

CEBR's corporate book is concentrated (the 20 largest borrowers accounted for 53% of corporate loans at end-1H14 or 83% of FCC, net of reserves), fairly long-term, exposed to the construction sector and is potentially vulnerable to rouble devaluation as most loans are foreign-currency denominated. The financial standing of the largest borrowers is also fairly weak. Given the slowdown of the Russian economy, the performance of construction loans and the repayment of the bulk of foreign-currency-denominated loans from companies' cashflows are uncertain, in Fitch's view. However, Fitch acknowledges the reasonable collateral coverage of the exposures and, in most cases, conservative collateral valuations. Higher-risk exposures (assessed as such mainly due to weaker collateral) constituted a manageable 21% of FCC at end-1H14.

CEBR's sound 15.7% FCC ratio is supported by a contracting loan book and a still positive bottom-line. Regulatory capitalisation is also adequate, with a total regulatory capital ratio of 13.2% at end-10M14 (slightly down from 13.4% at end-2013 due to a dividend pay-out). High risk-weights on unsecured high-margin loans have had little effect on CEBR's capital ratios due to the low share of such loans in the bank's portfolio. The bank's capital buffer is sufficient to allow the bank to reserve an additional 4% of gross loans before breaching regulatory capital requirements, which is reasonable in light of adequate coverage of existing problem loans by reserves (1x at end-1H14).

CEBR's Support Rating '4' reflects the limited probability of support from CEB, in case of need. This view is based on CEB's constrained ability to provide capital support, given its moderate capitalisation and CEBR's large size. CEBR accounted for 40% of group loans and 31% of group assets at end-1H14.

RATING SENSITIVITIES - CEBR's IDR, VR and SUPPORT RATING
Downward pressure on CEBR's ratings could result from a marked deterioration of asset quality, or a significant tightening of liquidity / increase in refinancing risks. Conversely, a more balanced funding profile and extended track record of reasonable asset quality and performance, coupled with the recovery of the operating environment, would be credit-positive. Changes to CEB's capitalisation would have a corresponding effect on CEBR's Support Rating through the parent's ability to provide support to its subsidiary.

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.

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 Stable
Short-term IDR: affirmed at 'B'
National Long-term rating: affirmed at 'A+(rus)'
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+'

Contact:

Primary Analysts
Philippe Lamaud (CEB)
Director
+33 144 29 91 26
Fitch Rating S.A.S.
60, rue de Monceau
75008 Paris

Dmitri Vasiliev (CEBR)
Director
+7 495 956 5576
Fitch Ratings CIS Limited
26 Valovaya Street
Moscow 115054

Secondary Analysts
Eris Huang (CEB)
Analyst
+44 203 530 1493

Konstantin Yakimovich (CEBR)
Associate Director
+7 495 956 9978

Committee Chairperson
James Watson
Managing Director
+7 495 956 6657

Media Relations: Elaine Bailey, London, Tel: +44 203 530 1153, Email: elaine.bailey@fitchratings.com; Ksenia Ivanova, Moscow, Tel: +7 495 956 99 01, Email: ksenia.ivanova@fitchratings.com.

Additional information is available on www.fitchratings.com


Applicable Criteria and Related Research:
ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY’S PUBLIC WEBSITE ‘WWW.FITCHRATINGS.COM’. PUBLISHED RATINGS, CRITERIA AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH’S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE ‘CODE OF CONDUCT’ SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.