

# **FITCH AFFIRMS CREDIT EUROPE BANK AT 'BB-';OUTLOOK STABLE**

Fitch Ratings-London-12 October 2018: Fitch Ratings has affirmed Credit Europe Bank N.V.'s (CEB) Long-Term Issuer Default Rating (IDR) at 'BB-' with a Stable Outlook and Viability Rating (VR) at 'bb-' and removed them from Rating Watch Positive (RWP). A full list of rating actions is at the end of this rating action commentary.

The rating actions follow the completion of the spin-off of CEB's Russian subsidiary, Credit Europe Bank (CEBR). CEBR's ownership has been transferred to CEB's ultimate parent, Fiba Group but CEB will retain a minority 10% stake in CEBR. The affirmation of CEB's Long-Term IDR and the VR and the removal from RWP reflects Fitch's view that the expected positive impact of the spin-off on the bank's credit profile, primarily through reduced exposure to volatile markets and expected lower volatility of earnings and asset quality, is offset by the recent sharp deterioration of the Turkish operating environment, to which CEB remains materially exposed.

## **KEY RATING DRIVERS**

### **CEB's IDRS AND VR**

CEB's ratings reflect its reduced but still significant direct and indirect exposure to volatile operating environments, in particular Turkey, inherent to its business model. They also reflect a niche but established trade finance franchise, comfortable funding and liquidity and strengthened capitalisation. The latter provides a buffer against CEB's deteriorated asset quality, which is a rating weakness.

As a result of CEBR's spin-off, the share of developed markets in CEB's total on- and off-balance sheet risk exposure and in gross loans increased to 52% and 37%, respectively, at end-June 2018. We expect the share of business conducted in western Europe to increase further. However, CEB will remain significantly exposed to emerging markets through its presence in Romania (almost a third of gross loans) and reducing but still material direct exposure to Turkey (about a quarter of gross loans). In our view, CEB's approach of targeting local operations of large Turkish corporates in Europe may also further indirectly expose it to the deterioration of the Turkish operating environment, as weakening of the parents' credit profiles could have a negative spill over effect on their international operations, which CEB lends to.

CEB's Stage 3 loans are elevated, at 7.7% of gross loans at end-June 2018 (the denominator includes EUR152 million of loans that are mandatorily carried at fair value under IFRS 9 but are not staged; excluding these the ratio would have been 8.1%). Legacy foreign currency mortgage loans in Romania comprised about half of total Stage 3 loans. We believe that the risk of further losses on this portfolio is limited given extra provisions booked in 2016-2017 and in light of the steady growth of local real estate prices. However, the recovery of these non-performing loans is likely to be slow, and they will continue to weigh on our assessment of CEB's asset quality. At end-June 2018, CEB also reported a high volume of Stage 2 loans (18% of gross loans). About 40% of these came from Turkey, suggesting the potential for further pressure on asset quality as the impact of Turkish lira exchange rate volatility, recent interest rate hikes and weaker growth outlook feeds through into CEB's Turkish client base.

CEB's capitalisation has been strengthened by the shareholder in anticipation of the spin-off by a USD25 million equity injection and a USD50 million additional Tier 1 placement. The bank's Fitch Core Capital (FCC) ratio and its fully-loaded common equity Tier 1 (CET1) capital ratio pro-forma for CEBR deconsolidation both stood at an adequate 14.1% at end-June 2018, up by about 200bp in the last two years. High risk-weight density results in low leverage in the European context.

We estimate that the pro-forma tangible equity/tangible assets ratio was 10.7%. Our assessment of CEB's capitalisation also takes into account high single name concentration in the loan book. The on- and off-balance sheet exposure to 20 largest borrowers accounted for more than 2x FCC at end-June 2018. High concentrations are partly mitigated by the close involvement of the bank's executives in managing corporate customers.

Profitability recovered in 1H18 after a muted performance in 2016-2017, with annualised operating profit/RWAs of 2.3% (pro-forma for the spin-off). Operating profit benefited from releases from loan loss allowances in Romania, which we do not expect to be repeated at the same scale. At the same time, CEB's ratings reflect our expectation that the weak performance of recent years will not be repeated, and that profitability will be less volatile. We also expect that CEB's ability to generate capital internally will improve due to the almost full elimination of hedging costs related to the bank's Russian rouble-denominated investment in CEBR (recorded in other comprehensive income and in recent years consuming the bulk of CEB's consolidated profit).

Granular deposits are CEB's main funding source, and most are collected in the Netherlands and Germany (60% of total funding excluding derivatives and other liabilities). The majority of deposits are covered by the Dutch deposit guarantee, which contributes to funding stability. Liquidity is comfortable, with high-quality liquid assets (cash, central bank deposits and securities that can be pledged with central banks) amounting to 19% of pro-forma total assets at end-June 2018.

#### CEB's SUPPORT RATING AND SUPPORT RATING FLOOR

CEB's Support Rating of '5' and Support Rating Floor of 'No Floor' reflect Fitch's view that senior creditors cannot rely on receiving full extraordinary support from the sovereign if CEB becomes non-viable. This reflects the bank's lack of systemic importance in the Netherlands, as well as the implementation of the EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism. These provide a framework for resolving banks which is likely to require senior creditors participating in losses, if necessary, instead or ahead of a bank receiving sovereign support.

Similarly, support from the bank's private shareholder, although possible, cannot be reliably assessed.

#### CEB's SUBORDINATED DEBT

CEB's Tier 2 subordinated debt is rated one notch below the banks' VR, reflecting below-average recovery prospects for this type of debt.

#### CEBR's SUPPORT RATING AND SUPPORT RATING FLOOR

As a result of the spin-off, Fitch has downgraded CEBR's Support Rating to '5' from '4' since we cannot reliably assess the ability and propensity of Fiba Group, the bank's new majority shareholder, to provide extraordinary support in case of need. Fitch has also assigned CEBR a Support Rating Floor of 'No Floor', reflecting its view that support from the Russian authorities cannot be relied upon due to the bank's low systemic importance.

#### RATING SENSITIVITIES

##### CEB's IDRS AND VR

The ratings could be downgraded in case of a larger than expected deterioration of CEB's asset quality that would put pressure on the bank's capitalisation. An upgrade would require a track record of loan book resilience and a reduction of risks stemming from the bank's exposure to the Turkish operating environment.

#### CEB's SUPPORT RATING AND SUPPORT RATING FLOOR

An upgrade of the Support Rating and upward revision of the Support Rating Floor would be contingent on a positive change in the Netherlands' propensity to support its banks and a significant increase in CEB's systemic importance. While not impossible, this is highly unlikely in Fitch's view.

#### CEB's SUBORDINATED DEBT

CEB's subordinated debt rating is sensitive to changes in CEB's VR.

#### CEBR's SUPPORT RATING AND SUPPORT RATING FLOOR

A higher Support Rating and Support Rating Floor for CEBR would require a significant increase of the bank's systemic importance in Russia, which we view as unlikely.

The rating actions are as follows:

#### Credit Europe Bank N.V.

Long-Term IDR affirmed at 'BB-'; , off RWP, Outlook Stable

Short-Term IDR affirmed at 'B'

Viability Rating affirmed at 'bb-'; off RWP

Support Rating affirmed at '5'

Support Rating Floor affirmed at 'No Floor'

Subordinated debt long-term rating affirmed at 'B+'; off RWP

#### Credit Europe Bank

Long-Term IDR unaffected at 'BB-'; Stable Outlook

Short-Term IDR unaffected at 'B'

Viability Rating unaffected at 'bb-'

Support Rating downgraded to '5' from '4'; off Rating Watch Negative

Support Rating Floor assigned at 'No Floor'

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## Applicable Criteria

Bank Rating Criteria (pub. 22 Jun 2018)

<https://www.fitchratings.com/site/re/10034713>

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