FITCH AFFIRMS CREDIT EUROPE BANK; REVISES OUTLOOK ON RUSSIAN SUBSIDIARY TO STABLE

Fitch Ratings-Moscow/London-05 December 2016: Fitch Ratings has affirmed Credit Europe Bank NV's (CEB) and Russia-based subsidiary, Credit Europe Bank (CEBR)'s, Long-Term Issuer Default Ratings (IDRs) at 'BB-'. The Outlook on CEBR's Long-Term IDR has been revised to Stable from Negative while that on CEB is 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 and Viability Rating (VR) reflect the bank's high exposure to volatile operating environments and cyclical industries inherent to the bank's business model. They also reflect a niche but established trade finance franchise, the bank's acceptable asset quality, strengthened capitalisation and adequate liquidity and funding.

CEB's business is concentrated in emerging economies, and at end-June 2016, exposures to Russia, Turkey and Romania represented 26%, 25% and 16% of gross loans, respectively. The bank has been gradually growing its corporate loan book in western Europe by targeting local operations of large Turkish corporates. This, together with maintaining its niche franchise in trade and commodity finance, could reduce the volatility of CEB's performance over the longer term. Fitch expects lending in developed markets and to Turkish borrowers to be the main profit generator for the bank in 2H16 and 2017.

CEB is exposed to cyclical industries, particularly construction and real estate, which made up about a quarter of corporate loans (1.3x of Fitch core capital (FCC)) at end-June 2016. Single-name concentration remains high, with the 20-largest borrowers accounting for almost half of corporate loans (2.3x FCC). This is partly mitigated by the bank's hands-on approach to managing corporate customers.

Non-performing loans (NPLs) were moderate at 6.4% of gross loans at end-June 2016 (5.9% at end-2015). CEB's sizeable portfolio of sub-standard loans (5.4% of gross loans at end-June 2016) also represents a risk for the bank, although the absolute amount of NPLs and substandard loans has been declining over the last 18 months. In Russia, credit losses have moderated and we believe asset quality has stabilised, but remains weak, as does the quality of the Romanian exposure. The better-performing Turkish loan book and exposures to developed markets somewhat offset these pressures.

In Romania, CEB's main risk is in the legacy mortgage loan book (0.4x FCC, roughly equally split between loans denominated in euro and Swiss franc). CEB stopped issuing mortgage loans in 2008 but loan book amortisation has been slow. In May 2016 the Romanian parliament passed a law allowing retail mortgage borrowers to return real estate collateral to banks in exchange for loan write-off. This could have a material negative impact on CEB because of the high loan-to-value ratios of most of its mortgage loans, which provide borrowers incentives to use the debt/asset swap (although so far the take-up has been moderate according to the bank).

Additional risk stems from the proposed law on the conversion of Swiss franc-denominated loans into local currency at historical exchange rates. We believe that these developments, while negative, are sufficiently offset by CEB's strengthened capitalisation.

CEB's capitalisation has improved in the last two years due to loan book contraction, an EUR100m equity injection from CEB's ultimate owner in 1Q15 and a USD126m subordinated perpetual debt conversion into common equity in 4Q14. The bank's consolidated FCC/FCC-adjusted risk-weighted assets ratio stood at a reasonable 12.5% at end-June 2016, although it remains exposed to high loan book concentrations.

Granular deposits are CEB's main funding source, and most are collected in the Netherlands and Germany (48% of non-equity liabilities at end-June 2016). The majority of deposits are covered by the Dutch deposit guarantee, which contributes to funding stability. Liquidity is adequate, with high-quality liquid assets (cash, central bank deposits and securities that can be pledged with central banks) amounting to 8% of total assets at end-June 2016.

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 recent 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.

CEBR'S ISSUER RATINGS AND SENIOR DEBT
The affirmation of CEBR's IDRs and VR reflects reasonable asset quality metrics to date, strong capitalisation and reduced pressures on the bank's bottom line, driven by lower impairment charges. The ratings also factor in CEBR's tight liquidity position in light of bulky wholesale repayments within the next 12 months. However, Fitch believes that refinancing risks should be manageable.

The revision of the Outlook to Stable from Negative reflects moderate improvement in the bank's asset quality metrics, Fitch's expectation that the bank's future credit losses should be fully absorbed by pre-impairment profits, without eroding capital, and Fitch's view that the bank's performance in 2017 should further improve following a decline in funding costs and loan impairment charges.

Asset quality pressures moderated in 1H16 as reflected in the 5% NPL origination rate (defined as the increase in loans overdue above 90 days, plus write-offs, divided by average performing loans), down from 8% in 2015. The corporate loan book remains highly concentrated, with the largest 20 groups of borrowers accounting for 72% of total corporate loans, or 1.3x of FCC at end-1H16, most of which operate in the high-risk construction and real estate segments.

The dollarisation of corporate loans is high at about 80%, while the share of naturally hedged borrowers is low. NPLs (loans overdue above 90 days) in the corporate loan book stood at a moderate 11%, being only 37% covered by impairment reserves. However, adequate collateral coverage and its reasonable valuation, in Fitch's view, mitigate credit risks to an extent.

The gradual recovery of the Russian consumer finance market shrank credit losses on the bank's retail portfolio to 7% in 1H16 from 10% in 2015. The large share of secured products (car loans and mortgages, 38% of gross retail loans at end-1H16) should further ease the magnitude of losses. Retail NPLs of 9% at end-1H16 were almost fully covered by reserves. However, in Fitch's view, CEBR's retail loan book continues to be under pressure from high borrower indebtedness and weak economic conditions, and its future performance will largely depend on the broader economy.

The bank's profitability metrics started to recover in 2016 after a marked weakening in 2015 caused by broader deterioration of the economy, a spike in the key CBR key rate and increased tensions between Turkey and Russia. In 1H16, the bank's cost of risk declined to 4.7%, from 6.1% in 2015, as a result of stabilising asset quality. However, pre-impairment profits are still under pressure from elevated funding costs (9.4% in 1H16). Fitch expects the bank's net interest margin and overall profitability to improve in 2017 against the backdrop of declining funding costs, as the bank should gradually reprice the bulk of its expensive wholesale funds and continue to reduce its customer deposits rates.

CEBR's capitalisation is robust with a high 17.1% FCC ratio at end-1H16, supported by sizeable loan book deleveraging (28% in 2015-1H16). The Tier 1 Regulatory CAR was a weaker 9.5% at end-10M16 due to higher statutory risk weights applied to high margin retail loans and a sizeable operational risk component. CEBR also holds a junior tranche of its asset-backed securities on the balance sheet, which is 12.5x risk-weighted, according to regulatory standards. The securitisation matures in June 2017, as a result of which the bank's Tier 1 Regulatory CAR should increase by about 3 ppts, according to Fitch's estimate.

The bank's refinancing risks are high in light of potential wholesale debt repayments within the next 12 months (RUB18bn, including RUB10bn of put options, or 23% of end-10M16 total liabilities). Only 30% of these redemptions are covered by liquid assets. However, a sizeable pre-committed credit line from the parent bank is available in case of need, according to bank's management. Fitch also believes that CEBR should be able to refinance at least some of its wholesale debt. In addition, the bank could sell some of its corporate loans to other banks of the group, which should help CEBR preserve its liquidity in a stress scenario.

CEBR's senior unsecured debt is rated in line with the bank's Long-Term IDR.

CEBR's Support Rating of '4' reflects the limited probability of support from CEB, in case of need. This view is based on CEB's somewhat constrained ability (as reflected in the 'BB-' rating) to provide capital support, given CEBR's large size (around 20% of group's assets at end-1H16).

CEB's AND CEBR'S SUBORDINATED DEBT
CEB's Tier 2 subordinated debt and CEBR's old-style subordinated debt is rated one notch below the banks' VR (CEB) and Long-Term IDR (CEBR), reflecting below-average recovery prospects for this type of debt.

RATING SENSITIVITIES
CEB
Upside for CEB's Long-Term IDR and VR is currently limited, although a further rebalancing towards lending in less volatile operating environments would be credit-positive. Ratings could be downgraded in case of marked asset quality deterioration, leading to a material erosion of CEB's capitalisation.

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. While not impossible, this is highly unlikely in Fitch's view.

The subordinated debt rating is likely to move in tandem with CEB's VR.

CEBR
CEBR's Long-Term IDR and VR could be downgraded if there is a marked deterioration of the bank's asset quality metrics, translating into significant erosion of capital, or in case of a material tightening of liquidity and increase in refinancing risks. Upside is currently limited, though a

material strengthening of bank's franchise and improvement of CEBR's asset quality, profitability metrics and funding profile would be credit positive.

CEBR's Support Rating is sensitive to CEB's ratings (and hence, its ability to provide support) and any marked changes in the group's strategic commitment to the Russian market.

CEBR's senior and subordinated debt ratings are sensitive to changes in the bank's Long-Term IDR.

The rating actions are as follows:

Credit Europe Bank NV
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: affirmed at 'B+'

Credit Europe Bank
Long-Term IDR: affirmed at 'BB-', Outlook revised to Stable from Negative
Short-Term IDR: affirmed at 'B'
National Long-Term rating: affirmed at 'A+(rus)', Outlook revised to Stable from Negative
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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Applicable Criteria
Global Bank Rating Criteria (pub. 25 Nov 2016)
https://www.fitchratings.com/site/re/891051