



Fitch Downgrades Kazkommertsbank to 'CCC'; Takes Actions on Other Kazakh Banks

Fitch Ratings-Moscow-19 January 2016: Fitch Ratings has downgraded Kazkommertsbank's (KKB) the Long-term Issuer Default Ratings (IDRs) to 'CCC' from 'B-'. The agency has also affirmed the Long-term IDRs of Subsidiary Bank Sberbank of Russia, JSC (SBK) at 'BB+' Halyk Bank of Kazakhstan (HB) at 'BB', Tsesnabank (TSB) at 'B+', Bank Centercredit (BCC) at 'B' and ATF Bank JSC at 'B-'.

The Outlook on Tsesnabank has been revised to Negative from Stable. The Outlooks on Halyk, BCC and ATF are Stable and on SBK Negative. SBK's Viability Rating (VR) has been downgraded to 'b+' from 'bb-'. The full list of the rating actions is provided at the end of this commentary.

The negative rating actions on KKB, SBK and Tsesnabank reflect increased pressure on the banks' asset quality and capitalisation, primarily as a result of the depreciation of the Kazakh tenge and the slowdown of the domestic economy. The affirmation of HB reflects the bank's sizable capital buffer and strong pre-impairment profitability, which should enable it to absorb any moderate further pressure on asset quality. The affirmations of BCC and ATF reflect their low ratings, which already largely capture risks relating to the weaker operating environment, and - in BCC's case - a fairly low proportion of foreign currency loans.

Each of the banks has faced considerable increase in deposit dollarisation over the last two years, with the proportion of foreign currency liabilities ranging between 58% and 68% (with the exception of BCC - 46%) at end-3Q15. Banks have been able to maintain close-to-flat FX positions as a result of cheap currency swaps from the National Bank of Kazakhstan (NBK), and Fitch expects these to remain available. However, increased balance sheet dollarisation has resulted in a heightened proportion of foreign currency loans, which will be difficult to reduce materially over the medium term.

KEY RATING DRIVERS - IDRS, VRS AND NATIONAL RATINGS

KKB

KKB's downgrade reflects a significant increase in the volume of problem (mostly foreign currency-denominated) exposures relative to Fitch Core Capital (FCC), primarily as a result of the tenge's devaluation. The ratings also consider the bank's weak recurring profitability. Taking into account the increased volume and weaker recovery prospects of the problem exposures, Fitch believes KKB will, ultimately, likely require external capital support and/or a restructuring of its liabilities to restore its solvency. However, the extended track record of regulatory forbearance and debt service to date suggests that the bank's resolution may not be a near-term event.

KKB's main problem asset is its exposure to former subsidiary BTA Bank, which increased to 5.3x FCC at end-3Q15 from 4.1x FCC at end-1H15 (3.5x FCC estimated by Fitch when it downgraded KKB in August 2015) and comprised 51% of KKB's gross loans. These loans, which are ultimately backed by land exposures on BTA's balance sheet with remote/unclear recovery prospects, are likely to have increased to approximately 6.5x FCC at end-2015, following further tenge depreciation in 4Q15.

Non-performing loans (NPLs) made up a further 14% of gross loans (i.e. 27% of the portfolio net of the BTA exposure) at end-3Q15, and a moderate 0.4x FCC net of specific impairment reserves. Further asset quality risks stem from currently performing foreign-currency loans, which accounted for 8% of the loan portfolio (0.8x FCC) and property investments comprising an additional 0.2x FCC at end-3Q15.

Pre-impairment profit (excluding fair-value gains on funding from the Problem Loan Fund, uncollected accrued interest on loans and foreign-currency gains) was slightly negative in 9M15 and we expect this to deepen to an amount equal to approximately 1.4% of gross loans in 2016, net of interest accrued on the BTA exposure. After provisions (and notwithstanding the fair-value and trading gains) the 9M15 net loss consumed 5% of end-2014 equity, and there is a high likelihood of net losses in 2016 further eating into capital.

The FCC/ risk-weighted assets (RWAs) ratio fell to 9% at end-3Q15 from 12% at end-2014 due to the tenge's devaluation and net losses, and is likely to have fallen by a further 1ppt in 4Q15 as a result of further tenge weakening. The regulatory Tier I ratio declined to 9.8% at end-November 2015 from 11.4% at end-November 2014, and the Total ratio fell to 13.8% from 14.4% as foreign-currency gains on subordinated debt helped partially offset the pressure. Outstanding hybrid and subordinated instruments were equal to a material 4.1% of RWAs at end-3Q15, but bail-in of these would by itself be insufficient to restore the bank's solvency, in Fitch's view, given the scale of the BTA exposure.

The liquidity and funding profile remains a moderately supportive credit driver, but highly liquid assets (mostly cash held with the NBK) tightened to 13% of total liabilities at end-3Q15 from 25% at end-1H15, as KKB financed some customer funding outflows in 3Q15. The bank made repayments on senior debt (including a USD0.3bn eurobond payment in November 2015) and upcoming repayments of senior eurobonds for 2016 and 2017 are not onerous from a liquidity stand-point, amounting to, respectively, USD0.3bn and USD0.4bn (2% and 3% of total liabilities). Total foreign liabilities of USD1.9bn at end-3Q15 comprised 13% of the bank's liabilities.

HALYK BANK OF KAZAKHSTAN (HB)

The affirmation of HB's 'BB' Long-term IDRs, driven by the 'bb' VR, reflects Fitch's view that the bank's resilience to economic headwinds remains fairly strong due to its prominent domestic market positions, sound capitalisation, solid pre-impairment profitability and robust liquidity. At the same time, HB's ratings also factor in risks relating to elevated levels of moderately provisioned problem loans, material loan concentrations and foreign-currency lending to potentially unhedged borrowers.

Significant asset quality risks result from NPLs and restructured loans comprising 13% and 8% of gross loans, respectively, at end-3Q15 and only moderate 62% reserve coverage of these by total loan impairment reserves. Further risks stem from potential deterioration of currently performing (neither NPLs nor restructured) foreign-currency loans, amounting to 22% of gross loans at end-3Q15.

Nevertheless, loss absorption capacity is solid, as reflected by a 17% FCC ratio at end-3Q15 and pre-impairment profit equal to 7% of average gross loans (annualised) in 9M15. The high 28% return on average equity in 9M15 was also moderately supported by foreign-currency gains and recent limited loan impairment charges.

Robust liquidity is underpinned by a large stock of highly-liquid assets, mostly placements with the NBK and unencumbered sovereign securities, equal to a high 55% of customer funding at end-3Q15. Refinancing risks are moderate, with no upcoming repayments of eurobond issues in 2016 and repayments amounting to USD0.6bn or 5% of total liabilities in 2017, only slightly higher than 2015 levels and manageable relative to the liquidity buffer.

HB'S SUBSIDIARIES ALTYN BANK JSC (AB) AND JSC HALYK FINANCE (HF)

The 'BB' Long-term IDRs of AB and HF are equalised with the parent HB's ratings. Fitch considers AB and HF to be core subsidiaries of HB based on their prominent roles in providing key services (in commercial and investment banking) to domestic clients (large corporate and private banking clients by AB and investment banking and brokerage clients and related parties by HF). The moderate size of the subsidiaries (in aggregate, equal to 8.4% of group total assets at end-3Q15) and healthy balance sheets should make it relatively easy for HB to support them, if needed. Fitch has not assigned AB a Viability Rating given the still evolving business model of the bank following its acquisition by HB in 4Q14.

TSESNABANK (TSB)

The revision of TSB's Outlook to Negative reflects increased single-name and sector concentration in the bank's loan book, tighter capitalisation and significant volumes of foreign-currency lending to potentially unhedged borrowers, which may result in asset quality deterioration in the medium term.

TSB's ratings also continue to factor in the bank's lower than peers' problem loans, a track record of accessing state-controlled companies' funding, limited wholesale debt, solid liquidity and reasonable profitability.

The levels of NPLs and restructured loans remained moderate, at 4% and 5% of gross loans, respectively, at end-3Q15, although in part this reflects an unseasoned loan book and long loan tenors. Concentration risks have increased as a result of additional moderately secured lending to companies Fitch considers affiliated with one large agricultural group, which in aggregate comprised 13% of gross loans or 1.4x FCC at end-3Q15, up from 5% of loans and 0.6x FCC at end-1Q15.

TSB's foreign-currency lending is higher than peers at 55% of gross loans at end-3Q15. A material 25% share of foreign-currency loans related to the agricultural (mostly, grain-producing) sector, whose operating margins could benefit from devaluation as grain is an export commodity. However, real-estate loans, which made up a significant 18% of foreign-currency loans and were equal to 1.1x FCC at end-3Q15, could be negatively affected.

Capitalisation remains a constraint on the ratings in light of the bank's low capital adequacy ratios, high concentrations, weakly secured exposures and uncertainty around the financing sources of the 2014 equity injection. The FCC ratio dropped moderately to 8% at end-3Q15 from 9% at end-2014 due to devaluation and related growth of foreign-currency RWAs, and could have fallen further, to around 7%, by end-2015. However, pre-impairment profit was equal to about 4% of average gross loans (annualised) in 9M15, and interest income generation is supported by state interest-rate subsidies on agricultural loans.

The liquidity position has slightly improved recently as liquid assets (mostly cash placed with the NBK) increased to 18% of customer deposits at end-November 2015 from a relatively tight 13% at end-3Q15, despite some senior debt repayments.

BANK CENTERCREDIT (BCC)

BCC's 'B' Long-term IDRs and 'b' VR are constrained by high problem loans, low core capital ratios, and modest core profitability. However, the ratings benefit from moderate foreign currency lending, stable domestic funding and comfortable liquidity.

Weak loan quality was reflected by a high 16% NPL ratio and 17% restructured loans at end-3Q15 and only moderate 46% coverage of total problem loans by loan impairment reserves. At the same time, downside risks are moderately reduced by lower-than-peers' exposure to foreign-currency lending (20% of gross loans at end-3Q15), mostly relating to loans already recognised as problematic/impaired.

BCC's 8% FCC ratio and 7% core Tier I regulatory capital ratio (2ppt above the NBK-required minimum level) at end-3Q15 were weak in light of unreserved problem exposures equal to a significant 2.5x FCC at end-3Q15 and a moderate pre-impairment profit (net of interest accrued but not received in cash and foreign-currency gains) equal to 2% of average gross loans (annualised) in 9M15. However, hybrid and subordinated instruments (equal to a combined 8% of RWAs at end-3Q15) potentially provide significant additional loss absorption capacity, moderately reducing risks for the bank's senior creditors.

Liquidity remains comfortable with liquid assets, including cash, short-term bank placements and unencumbered repo-able securities, covering a high 27% of customer deposits. Repayments on wholesale debt in 2016 are immaterial.

ATF BANK

ATF's 'B-' Long-term IDR reflects weak asset quality, capitalisation and core profitability and a significant foreign currency loan exposure. The ratings also factor in small volumes of outstanding wholesale debt, moderately improved liquidity, some on-going performance improvement and moderately improved recovery prospects for some of its deeply impaired problem loans driven by the shareholder's strong domestic political and business connections.

Asset quality remains burdened by high NPLs, albeit reduced by write-offs, and by restructured loans comprising 25% and 22% of gross loans, respectively, at end-3Q15. At the same time, total loan impairment reserves covered NPLs by only a moderate 65% and coverage of NPLs and restructured loans in aggregate was a modest 34%.

The tenge's devaluation could exacerbate problems as performing (neither NPLs nor restructured) foreign-currency loans comprised a significant 19% of gross loans at end-3Q15 or 2x FCC, mostly relating to vulnerable sectors, such as trade, transportation and real estate. Devaluation could also put further pressure on problem loan recoveries, as net problem foreign-currency loans equalled 2.2x FCC, including unreserved foreign currency NPLs at 1.1x FCC. Foreclosed property and other assets held for sale made up an additional 0.5x FCC at end-3Q15.

The bank's 9.3% FCC ratio at end-3Q15 is modest, relative to unreserved problem loans. Pre-impairment profit, net of interest accrued but not received in cash and foreign-currency gains, equalled to a weak 0.2% of average gross loans (annualised) in 9M15, down slightly from 0.5% in 2014.

The liquidity cushion at end-November 2015 was sufficient to meet repayment of a USD200m eurobond and other wholesale debt due in the next 12 months. Highly liquid assets, net of near-term debt repayments, were equal to 20% of customer deposits, and mostly comprised placements with the NBK. However, this is only moderate in light of the considerable historical volatility of ATF's state-controlled company deposits (24% of customer funding).

SUPPORT RATING FLOORS AND SUPPORT RATINGS

HB's 'B' Support Rating Floor (SRF) reflects moderate potential support from the Kazakh authorities due to the bank's high systemic importance, as reflected in its 21% market share in retail deposits. That said, Fitch does not factor in significant support expectations into HB's SRF, resulting in a multi-notch difference between HB's SRF and the sovereign 'BBB+' Long-term IDR, due to a track record of the sovereign's withholding support to some systemically important banks in the past.

KKB's 'No Floor' SRF reflects Fitch's opinion that solvency support from the Kazakh authorities, in an amount sufficient to address the bank's asset quality problems without senior creditors facing losses, cannot be relied upon. Moderate capital assistance and continued regulatory forbearance remain possible, and liquidity support, at least in local currency, is likely, in our view.

The 'No Floor' SRFs of TSB, BCC and ATF reflect those banks' moderate systemic importance and the mixed recent track record of sovereign support for banks.

IDRS, VR, NATIONAL RATING AND SUPPORT RATING

SB SBERBANK OF RUSSIA JSC (SBK)

SBK's 'BB+' Long-term IDRs are based on its '3' Support Rating which, in turn, reflects potential support from SBK's parent Sberbank of Russia (BBB-/Negative). Fitch's view of potential support is based primarily on the strategic importance of the CIS region for Sberbank and the small size of SBK relative to its parent.

The downgrade of SBK's VR to 'b+' from 'bb-' reflects the recent deterioration of the bank asset's quality and high additional risks stemming from considerable foreign-currency lending. The VR continues, however, to factor in SBK's sound liquidity.

NPLs remained at a moderate 8% at end-3Q15 (end-2014: 4%), but restructured loans increased to

27% (end-2014: 19%), partially due to portfolio seasoning after rapid expansion in 2012-14, and reserves comprised a moderate 7% of total loans. The share of foreign-currency lending was a high 40% of gross loans. Although this partially relates to loans already recognised as impaired. Fitch estimates performing (neither NPLs nor restructured) foreign-currency loans at around 10% of gross loans at end-3Q15.

The FCC ratio was a moderate 10% at end-3Q15 (11% at end-2014), while unreserved problem loans (mostly, restructured) were equal to a significant 2.2x FCC. Fitch has been informed that equity injections from Sberbank are not expected in 2016. Due to high impairment charges, internal capital generation dropped to 2% in 9M15 from 19% in 2014; pre-impairment profit (net of uncollected interest and foreign currency gains) fell to a moderate 4% of average gross loans (annualised), from 5% in 2014.

Liquid assets (mostly cash placed with the NBK) and an uncommitted credit line from the parent covered customer deposits by a solid 47% at end-November 2015, and wholesale repayments to third parties due in the next 12 months were insignificant.

DEBT RATINGS

Senior unsecured debt ratings are aligned with Long-term IDRs based on average recovery expectations. Systemically important Kazakh banks have not faced bankruptcy proceedings upon default in recent years. Recoveries for senior creditors (typically in the 30%-50% range) have depended on the extent to which the authorities have supported banks' restructurings with capital injections, and so have essentially been the outcome of political decisions.

Subordinated debt ratings are notched down by one level from banks' Long-term IDRs, and the perpetual debt ratings of KKB, BCC and ATF are rated two notches lower than the banks' VRs, reflecting lower recovery expectations.

RATING SENSITIVITIES

KKB's ratings could be further downgraded if the likelihood increases that senior creditors will suffer losses as a result of measures to restore the bank's capital, or if the bank's capital ratios are further eroded as a result of tenge depreciation and losses. The ratings could be upgraded if the bank is recapitalised without senior creditors facing losses.

The VRs of HB, TSB, BCC, ATF and SBK, and consequently the Long-term IDRs of the first four banks and of HB's subsidiaries, could be downgraded if their asset quality, core profitability, and capitalisation deteriorate and/or liquidity levels fall substantially. SBK's Long-term IDRs would likely be downgraded if the parent's Long-term IDRs are downgraded, a risk reflected in the Negative Outlooks on both banks.

An upgrade of the ratings of HB and its subsidiaries would be on contingent on the operating environment improving and the bank maintaining its currently strong financial metrics. An upgrade of the VRs of BCC, ATF and SBK, and consequently the Long-term IDRs of BCC and ATF, would be contingent on significant problem loan recoveries and/or additional capital provided by their respective shareholders (more likely in the case of SBK).

TSB's ratings could stabilise at their current levels in case of an extended track record of reasonable asset quality and performance metrics in the tougher operating environment.

The rating actions are as follows:

KKB

Long-term foreign and local currency IDRs: downgraded to 'CCC' from 'B-'

Short-term foreign and local currency IDRs: downgraded to 'C' from 'B'

Support Rating: affirmed at '5'

Support Rating Floor: affirmed at 'NF'

Viability Rating: downgraded to 'ccc' from 'b-'

Long-term senior unsecured debt (incl. issues of Kazkommerts International BV) ratings: downgraded to 'CCC' from 'B-'; Recovery Rating is at 'RR4'
Short-term senior unsecured debt ratings: downgraded to 'C' from 'B'
Subordinated debt rating: downgraded to 'CC' from 'CCC'; Recovery Rating at 'RR5'
Perpetual debt (issued by KAZKOMMERTS FINANCE BV) rating: downgraded to 'C' from 'CC'; Recovery Rating is at 'RR6'

HB

Long-term foreign and local currency IDRs: affirmed at 'BB'; Outlook Stable
Short-term foreign and local currency IDRs: affirmed at 'B'
Viability Rating: affirmed at 'bb'
Support Rating: affirmed at '4'
Support Rating Floor: affirmed at 'B'
Senior unsecured debt: affirmed at 'BB'

AB

Long-term foreign and local currency IDRs: affirmed at 'BB'; Outlook Stable
Short-term foreign-currency IDR: affirmed at 'B'
National long-term rating: affirmed at 'A+(kaz)'; Outlook Stable
Support Rating: affirmed at '3'

HF

Long-term foreign and local currency IDRs: affirmed at 'BB'; Outlook Stable
Short-term foreign and local currency IDRs: affirmed at 'B'
Support Rating: affirmed at '3'

TSB

Long-term foreign and local currency IDRs: affirmed at 'B+'; Outlook revised to Negative from Stable
Short-term foreign and local currency IDRs: affirmed at 'B'
National long-term rating: affirmed at 'BBB-(kaz)'; Outlook revised to Negative from Stable
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'NF'
Viability Rating: affirmed at 'b+'
Senior unsecured debt rating: affirmed at 'B+'; Recovery Rating at 'RR4'
Subordinated debt rating: affirmed at 'B'; Recovery Rating at 'RR5'

BCC

Long-term foreign and local currency IDRs: affirmed at 'B'; Outlook Stable
Short-term foreign-currency IDR: affirmed at 'B'
National long-term rating: affirmed at 'BB+(kaz)'; Outlook Stable
Viability Rating: affirmed at 'b'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'NF'
Senior unsecured debt rating: affirmed at 'B'; Recovery Rating at 'RR4'
National senior unsecured debt rating: affirmed at 'BB+(kaz)'
Subordinated debt rating: affirmed at 'B-'; Recovery Rating at 'RR5'
National subordinated debt rating: 'BB-(kaz)';
Perpetual debt rating: affirmed at 'CCC'; Recovery Rating at 'RR6'

ATF

Long-term foreign and local currency IDRs: affirmed at 'B-'; Outlook Stable
Short-term foreign currency IDR: affirmed at 'B'
National long-term rating: affirmed at 'BB-(kaz)'; Outlook Stable
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'NF'
Viability Rating: affirmed at 'b-'
Senior unsecured debt rating: affirmed at 'B-'; Recovery Rating at 'RR4'

National senior unsecured debt rating: affirmed at 'BB-(kaz)'
Subordinated debt rating: affirmed at 'CCC'; Recovery Rating at 'RR5'
National subordinated debt rating: 'B(kaz)';
Perpetual debt rating: affirmed at 'CC'; Recovery Rating at 'RR6'

SBK

Long-term foreign and local currency IDRs: affirmed at 'BB+'; Outlook Negative
Short-term foreign currency IDR: affirmed at 'B'
Support Rating: affirmed at '3'
Viability Rating: downgraded to 'b+' from 'bb-'
National long-term Rating affirmed at 'AA-(kaz)'; Outlook Negative
Senior unsecured debt rating: affirmed at 'BB+'
National senior unsecured debt rating: affirmed at 'AA-(kaz)'
Subordinated debt rating: affirmed at 'BB'
National subordinated debt rating: affirmed at 'A+(kaz)'

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Applicable Criteria

Global Bank Rating Criteria (pub. 20 Mar 2015)
(https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=863501)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
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