FitchRatings

# Fitch Affirms 5 Foreign-Owned Turkish Banks

Fitch Ratings-London/Frankfurt-23 October 2018: Fitch Ratings has affirmed the Long-Term Foreign Currency (LTFC) IDRs of five foreign-owned, small Turkish banks. They are Alternatifbank A.S., BankPozitif Kredi ve Kalkinma Bankasi A.S. (BankPozitif), ICBC Turkey Bank A.S. (ICBC Turkey), and Burgan Bank A.S. (Burgan Bank Turkey) at 'BB-' and Turkland Bank A.S (T-Bank) at 'B+'. The Outlooks on the banks are Negative, except for T-Bank, which is Stable.

At the same time, Fitch has downgraded the Viability Ratings (VRs) of Burgan Bank Turkey, and BankPozitif to 'b' from 'b+', Alternatifbank to 'b-' from 'b+', T-Bank to 'b-' from 'b' and affirmed ICBC Turkey at 'b+'. The banks' VRs have been removed from Rating Watch Negative (RWN). A full list of rating actions is available at the end of this commentary.

The downgrades of the VRs of Burgan Bank Turkey, Alternatifbank, T-Bank and BankPozitif reflect increased risks to their standalone credit profiles since we placed the VRs on RWN on 1 June 2018. In Fitch's view, the banks' performance, asset quality, capitalisation, liquidity and funding profiles are now more likely to come under pressure following the recent period of market volatility, and given the increased risk of a hard landing for the economy and deterioration in investor sentiment. Significant depreciation of the Turkish lira (by about 25% against the US dollar since 1 June 2018), the hike in interest rates, and the weaker growth outlook have materially increased risks to the banks' VRs.

In addition, the downgrade of the VRs reflect our view of the appropriate levels of the banks' VRs relative to larger Turkish bank peers, whose ratings were downgraded earlier this month (see Fitch Downgrades 20 Turkish Banks; Outlook Negative dated 1 October 2018) and to other small private Turkish banks whose ratings were also downgraded last month (see Fitch Downgrades 4 Turkish Banks; Removes from RWN dated 11 September 2018).

The affirmation of ICBC Turkey's 'b+' VR reflects the bank's improved ability to implement its strategy in financing Chinese and Turkish corporates despite a tough operating environment. The VR at its current level also captures the bank's reasonable financial metrics, which have improved in recent years and a growing franchise. ICBC Turkey has grown rapidly since its acquisition in 2015 by Industrial and Commercial Bank of China (ICBC) and should continue to benefit from the availability of cheap, long-term funding from its parent.

KEY RATING DRIVERS
IDRS, SUPPORT RATINGS AND NATIONAL RATINGS
The IDRs and National Ratings of these five, small Turkish banks are driven by their Support Ratings reflecting Fitch's view of potential institutional support, in case of need, from their higher-rated foreign parents; namely, Alternatifbank (100%-owned by The Commercial Bank (P.S.Q.C.), A/Stable) and its leasing subsidiary Alternatif Finansal Kiralama (Alternatif Lease; 100%-owned by Alternatifbank), BankPozitif (69.8%-owned by Bank Hapoalim, A/Stable), T-Bank (50% owned by Arab Bank Group, BB/Stable), ICBC Turkey (92.8%-owned by ICBC, A/Stable) and Burgan Bank Turkey A.S. (99%-owned by Burgan Bank Kuwait, A+/Stable).

Fitch views Alternatifbank, Burgan Bank Turkey and ICBC Turkey as strategically important subsidiaries for their respective parents and believes there is a high probability of parental support, in case of need. As a result, the banks' Support Ratings have been affirmed at '3'. The Support Ratings also reflect their majority ownership, integration and roles within their respective groups, and common branding (Burgan Bank Turkey and ICBC Turkey).

Unlike Alternatifbank, Burgan Bank Turkey and ICBC Turkey, Fitch views BankPozitif to be of limited importance to its parent given its narrow franchise and lack of strategic fit. Nevertheless, a high level of integration within and the bank's small size compared with the parent contribute positively to our assessment of support, leading to the affirmation of the bank's Support Rating at '3'.

Nevertheless, the four banks' LTFC IDRs are constrained by Turkey country risks. Their 'BB-' LTFC IDRs, one notch below the sovereign 'BB' rating, reflect Fitch's assessment of the risk of marked deterioration in Turkey's external finances, and therefore of the risk of government intervention in the banking sector. We view the risk of restrictions that would prevent banks from servicing their obligations to be slightly higher than that of a sovereign default. This is in line with our rating action on 1 October 2018 (see Fitch Downgrades 20 Turkish Banks; Outlook Negative at www.fitchratings.com). The Negative Outlooks on the four banks mirror those on the sovereign ratings.

T-Bank's 'B+' support-driven IDRs are notched twice from parent Arab Bank Plc (BB/Stable). The Stable Outlook on the bank's IDRs mirrors that on its parent. The bank's '4' Support Rating is based on Arab Bank Group's only 50% ownership, which may complicate the prompt provision of solvency support, if required. It also reflects T-Bank's weak performance in recent years and non-core jurisdiction relative to Arab Bank's other strategically important subsidiaries. Nevertheless, the bank's Support Rating also takes into account a record of timely and sufficient provision of capital and liquidity support from both Arab Bank Plc and its other 50% shareholder, Lebanon's BankMed Sal.

The affirmation of the banks' National Ratings reflects Fitch's view that their creditworthiness relative to one another and to other Turkish issuers is unchanged.

VRs

The five banks' VRs reflect exposure to the high-risk Turkish operating environment. Their risk profiles, like those of other Turkish banks, have deteriorated significantly as a result of material local currency depreciation and higher interest rates, which put pressure on margins, asset quality and capitalisation. The risk of reduced access to foreign funding markets - albeit these banks have a lower reliance on external debt - and deposit instability has also increased, raising refinancing and liquidity pressures. The VRs also reflect the banks' limited franchises in the Turkish banking sector, and in most cases, weaker financial metrics than larger Turkish banks.

For ICBC Turkey, Fitch believes the improving franchise, where it has carved out a niche in financing Turkish and Chinese corporates, could alleviate the pressure on its standalone credit profile from the operating environment. The affirmation of its VR also reflects the bank's generally more reasonable financial metrics compared with peers'.

Asset quality risks for all five banks have increased significantly, as for the sector, given the weakening growth outlook (Fitch has revised downwards its GDP forecasts to 3.8% and 1.2% in 2018 and 2019, from 4.5% and 3.6%, respectively), high FC lending and the potential impact of local currency depreciation on often weakly hedged borrowers' ability to service their debt. Significantly higher interest rates following the increase in the policy rate are likely to negatively affect lira borrowers' debt service capacity, and also weigh on loan performance.

At end-1H18, FC lending (including FC-indexed loans) ranged from a moderate 20% at Turkland, to a high 59% (Alternatifbank), 58% (ICBC Turkey), 63% (Burgan Bank Turkey) and 80% (BankPozitif), levels that will have increased further given lira depreciation since June 2018.

The banks have exposure, to varying degrees, to small and medium-sized companies (SMEs) (albeit limited at Burgan Bank Turkey), which are likely to be among the most sensitive to the weaker growth environment and to higher interest rates, putting pressure on their debt servicing capacity.

Asset quality metrics are mixed at the five banks but the impaired loans ratio (loans overdue by 90+ days/gross loans) at all five is above the sector average, except for ICBC Turkey. Impaired loans at T-Bank (19% of gross loans at end-1H18) are significantly higher than peers' reflecting the bank's weak asset quality, and this has been exacerbated by the bank's focus on cleaning up its portfolio and a significant reduction in the loan book since 2016. BankPozitif's impaired loans ratio (15% at end-1H18) has been inflated by deleveraging as the bank has been selectively winding down the loan book in recent years. Impaired loan ratios at the remaining banks were a more reasonable 1.1% (ICBC Turkey), 3.3% (Alternatifbank) and 3.4% (Burgan Bank Turkey). ICBC Turkey's asset quality ratios should be viewed in light of the bank's recent years of rapid loan growth under new ownership.

Growth in reported stage 2 loans (partly explained by banks' transition to IFRS9 in 1Q18), except at ICBC Turkey, also suggests the potential for increases in non-performing loans (NPL) ratios. These ranged from a high 23% (BankPozitif) and 21% (Turkland) to a more moderate 12% (Alternatifbank), 9% (Burgan Bank Turkey) and 4% (ICBC Turkey) at end-1H18. Loan migration to the non-performing category could also be influenced by a new framework to facilitate loan restructuring in Turkey, potentially delaying recognition of asset-quality problems by banks.

The banks typically report below-sector-average profitability metrics, reflecting a lack of economies of scale, limited pricing power and high impairment charges (except for ICBC Turkey). Profitability is set to weaken at the banks given higher funding costs, slower credit growth and higher impairment charges from asset quality deterioration. Operating profit to risk-weighted assets (RWAs) at the five banks ranged from a weak -8.2% (T-Bank) to a more reasonable 1.3% (BankPozitif), 1.4% (Alternatifbank), 1.5% (Burgan Bank Turkey) to a stronger 2.2% (ICBC Turkey). We expect T-Bank's weak profitability to continue over the rating horizon as a result of high impairment charges arising from the bank's focus on cleaning up the loan portfolio.

Capital ratios have come under pressure from lira depreciation (which inflates FC RWAs) and, to a lesser extent, higher interest rates (which result in negative revaluations of the banks' generally small government bond portfolios). Potential asset-quality deterioration also represents a risk to capital positions. The Fitch Core Capital (FCC)-to-RWAs ratio of Alternatifbank stood at a low 5% at end-1H18, significantly weaker than peers', reflecting weak core capitalisation, which constrains its VR. The FCC ratios of other banks were more reasonable at 9.6% (Burgan Bank Turkey), 11.3% (Turkland), 12.1% (ICBC Turkey) and a high 32% (BankPozitif) at end-1H18.

Total capital adequacy ratios across the banks were above the 12% recommended regulatory minimum although they currently benefit from capital relief from regulatory measures, as at other Turkish banks, and therefore limits the risk of regulatory breaches, in our view. Total capital ratios at Alternatifbank and Burgan Bank Turkey are significantly higher than their FCC ratios due to issued FC tier 2 subordinated debt, which also is somewhat of a hedge against lira depreciation.

Refinancing risks for the banks have also increased as a result of their weakening credit profiles, recent market volatility and tightening global conditions driven mainly by an increase in USD interest rates. However, excluding related-party funding, the banks typically have lower wholesale funding reliance than large bank peers and reasonably diversified funding maturities. Refinancing risks are less pronounced at these foreign-owned banks, given potential FC liquidity support from shareholders. Nevertheless, liquidity profiles of the banks could come under pressure if there were to be a prolonged market closure or material deposit outflows, given the banks' limited franchises and less flexible pricing powers.

SUBORDINATED DEBT RATING
The subordinated notes rating of Alternatifbank - which is notched down once from the support-driven LTFC IDR - has been affirmed in line with the affirmation of the anchor rating.

GUARANTEED DEBT RATING
Alternatifbank's guaranteed debt rating of 'A' is equalised with the rating of the bank's Qatari guarantor, The Commercial Bank (P.Q.S.C.).

BANK SUBSIDIARY - ALTERNATIF FINANSAL KIRALAMA
Alternatif Lease's ratings are equalised with those of Alternatifbank, reflecting Fitch's view that it is a highly integrated, core subsidiary of the parent. Alternatif Lease is 100% owned by Alternatifbank and offers core products and services (leasing) in the parent's core market (Turkey), which reflects its key role in the group.

RATING SENSITIVITIES
IDRS, SUPPORT RATINGS, AND NATIONAL RATINGS
[The LT IDRs and Support Ratings could be downgraded if the Turkish sovereign is downgraded, or if there is a sharp reduction in the ability or propensity of a parent bank to support its Turkish subsidiary. The IDRs are also sensitive to Fitch's view of the risk of government intervention in the banking sector.

T-Bank's support-driven ratings could be downgraded if the bank does not receive sufficient and timely support to offset the impact of the bank's weak asset quality and ensuing weak performance.

VRs
Further VR downgrades could result from i) a continued marked deterioration in the operating environment, as reflected in further adverse changes to the lira exchange rate, domestic interest rates, economic growth prospects, and external funding market access; ii) a weakening of the banks' FC liquidity positions due to deposit outflows or an inability to refinance maturing external obligations; or iii) bank-specific deterioration of asset quality leading to significant pressure on capital positions.

Further deterioration in T-Bank's asset quality or the inability to effectively improve the bank's weak performance that exposes the bank's capital position could lead to further downgrades of the VR.

Further weakening of Alternatifbank's core capital ratios, without timely and sufficient support from the bank's parent, could lead to a downgrade of the subsidiary's VR.

Upside for the banks' VRs is limited in the near term, given current pressures on the operating environment, asset quality and capitalisation.

SUBORDINATED DEBT RATINGS
Alternatifbank's subordinated debt rating is primarily sensitive to changes in the anchor rating LTFC IDR.

GUARANTEED DEBT RATING
Alternatifbank's guaranteed debt rating of 'A' is sensitive to a change in The Commercial Bank (P.Q.S.C)'s Long-Term IDR.

BANK SUBSIDIARY - ALTERNATIF FINANSAL KIRALAMA

The ratings of Alternatif Lease are sensitive to changes in its parent's ratings.]

The rating actions are as follows:

Alternatifbank A.S.
Long-Term FC IDR affirmed at 'BB-'; Negative Outlook
Long-Term LC IDR affirmed at 'BB'; Negative Outlook
Short-Term FC and LC IDR affirmed at 'B'
Viability Rating: downgraded to 'b-' from 'b+'; off RWN
Support Rating affirmed at '3'
National Long-Term Rating affirmed at 'AA(tur)'; Stable Outlook
USD250 million senior notes guaranteed by Commercial Bank of Qatar affirmed at 'A'
Subordinated debt rating affirmed at 'B+'

Alternatif Finansal Kiralama A.S.
Long-Term FC IDR affirmed at 'BB-'; Negative Outlook
Long-Term LC IDR affirmed at 'BB'; Negative Outlook
Short-Term FC and LC IDR affirmed at 'B'
Support Rating affirmed at '3'
National Long-Term Rating affirmed at 'AA(tur)'; Stable Outlook

BankPozitif Kredi ve Kalkinma Bankasi A.S
Long-Term FC IDR: affirmed at 'BB-'; Negative Outlook
Long-Term LC IDR affirmed at 'BB'; Negative Outlook
Short-Term FC and LC IDRs affirmed at 'B'
Viability Rating: downgraded to 'b' from 'b+'; off RWN
Support Rating affirmed at '3'
National Long-Term Rating affirmed at 'AA(tur)'; Stable Outlook
Senior unsecured debt: affirmed at 'BB-'

ICBC Turkey A.S.
Long-Term FC IDR affirmed at 'BB-'; Negative Outlook
Long-Term LC IDR affirmed at 'BB'; Negative Outlook
Short-Term FC and LC IDRs affirmed at 'B'
Viability Rating affirmed at 'b+'; off RWN
Support Rating affirmed at '3'
National Long-Term Rating affirmed at 'AA(tur)'; Stable Outlook

Turkland Bank A.S.
Long-Term FC and LC IDRs affirmed at 'B+'; Stable Outlook
Short-Term FC and LC IDRs affirmed at 'B'
Viability Rating downgraded to 'b-' from 'b'; off RWN
Support Rating affirmed at '4'
National Long-Term Rating affirmed at 'A(tur)'; Stable Outlook

Burgan Bank A.S.
Long-Term FC IDR affirmed at 'BB-'; Negative Outlook
Long-Term LC IDR affirmed at 'BB'; Negative Outlook
Short-Term FC and LC IDRs affirmed at 'B'
Viability Rating downgraded to 'b' from 'b+'; off RWN
Support Rating affirmed at '3'

National Long-Term Rating affirmed at 'AA(tur)'; Stable Outlook

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**Applicable Criteria**

Bank Rating Criteria (pub. 12 Oct 2018) (https://www.fitchratings.com/site/re/10044408)

Non-Bank Financial Institutions Rating Criteria (pub. 12 Oct 2018) (https://www.fitchratings.com/site/re/10044407)

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