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# Fitch Affirms 6 Small Foreign-Owned Turkish Banks

Fitch Ratings-London-26 January 2018: Fitch Ratings has affirmed the Long-Term IDRs of six foreign-owned small Turkish banks: Alternatifbank A.S. (ABank), BankPozitif Kredi ve Kalkinma Bankasi A.S. (BankPozitif), ICBC Turkey Bank A.S. (ICBC Turkey), Turkland Bank A.S (T-Bank), Burgan Bank A.S. (Burgan), and Odea Bank (Odea). The Outlooks on the banks' Long-Term ratings are Stable, except for T-Bank which is Negative.

At the same time, Fitch has downgraded Turkland's Viability Rating (VR) to 'b' from 'b+'. All other banks' VRs have been affirmed. A full list of rating actions is at the end of this commentary.

KEY RATING DRIVERS
IDRS AND SUPPORT RATINGS
Institutional support drives the IDRs, National Ratings and Support Ratings of ABank (100% owned by The Commercial Bank (Q.S.C.) (CBQ, A/Negative) and its leasing subsidiary Alternatif Finansal Kiralama (ALease; 100% owned by ABank), BankPozitif (69.8% owned by Bank Hapoalim, A/Stable), T-Bank (50% owned by Arab Bank Group, BB+/Negative), ICBC Turkey (92.8% owned by Industrial and Commercial Bank of China, ICBC, A/Stable) and Burgan Bank A.S. (99% owned by Burgan Bank Kuwait, A+/Stable).

Fitch considers ABank, Burgan and ICBC Turkey as strategically important subsidiaries for their respective parents and believes there is a high probability that support would be forthcoming to these banks, in case of need. As a result, the banks' Support Ratings have been affirmed at '2'. The Support Ratings also considers their majority ownership, integration, roles within their respective groups, and common branding (Burgan and ICBC Turkey). Nevertheless, the banks' Long-Term Foreign-Currency (FC) IDRs are constrained by Turkey's 'BBB-' Country Ceiling.

BankPozitif's IDRs are also constrained by the Country Ceiling. However, unlike ABank, Burgan and ICBC Turkey, Fitch views BankPozitif to be of limited importance to its parent considering its narrow franchise and lack of strategic fit. Nevertheless, a high level of integration and the bank's small size compared with the parent contribute positively to our assessment of support and we have affirmed the bank's Support Rating at '2'.

T-Bank's 'BB-' support-driven IDRs are notched twice from its parent Arab Bank Plc (BB+/Negative) and its Support Rating has been affirmed at '3'. The Negative Outlook on the bank's IDRs mirrors that on its parent. Fitch's view of support 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 T-Bank's small size relative to its parent and the 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.

Odea's IDRs and National Rating are driven by the bank's standalone creditworthiness, as reflected by its VR. Odea's Support Rating of '5' and Support Rating Floor of 'No Floor' reflect Fitch's view that support from the Turkish state cannot be relied upon. This reflects the bank's lack of systemic importance in Turkey. Support from the bank's shareholder cannot be relied upon given the weak ability of Bank Audi S.A.L. (76.4% stake) to provide support based on its current rating (B-/Stable).

Odea is rated three notches above Bank Audi S.A.L., whose ratings are capped by the Lebanese sovereign rating. Fitch sees limited contagion risk for Odea from its parent, based on i) limited group funding; ii) the fact that Odea has not paid any dividends to date, while Bank Audi has contributed about USD1.2 billion in equity; and (iii) the relatively strong Turkish regulator, which Fitch believes would seek to limit transfers of capital and liquidity to the parent in case of stress at the latter. However, Odea's investments in Lebanese sovereign debt (equal to 34% of Fitch Core Capital (FCC) at end-9M17) weigh on our assessment of the bank's asset quality.

VRs
The banks' VRs of reflect their small absolute size (combined assets amounted to about 3% of sector assets at end-3Q17) and ensuing limited franchises and lack of competitive advantages. Most banks primarily offer commercial banking services with a historical focus on small and medium-sized companies (SMEs) and have limited retail loan books. However, banks are generally shifting their focus to larger commercial customers as SMEs have proven among the most sensitive to swings in the economy. Only some of the banks (including ABank and Burgan) have made material use of the Credit Guarantee Fund (CGF) stimulus, which boosted lending by the sector to SME customers in 9M17.

The banks typically report below-sector-average performance metrics, reflecting a lack of economies of scale, limited pricing power, and, in some cases, high loan impairment charges relative to pre-impairment operating profit. Margins came under pressure in 3Q17 from higher funding costs, due to tighter sector lira liquidity, and further increases could weigh on banks' earnings. However, the availability of relatively cost effective parent funding, typically in FC, could reduce the extent of margin erosion.

Average loan growth for the peer group (16% in 9M17; including domestically owned small Turkish banks) was broadly in line with the sector average (15%). However, growth varies significantly across the banks depending on strategic objectives (BankPoz), asset quality concerns (T-Bank, Odea) and available related-party funding (ICBC Turkey).

The banks' asset quality metrics have generally held up, except for T-Bank and Odea, despite the challenging operating environment and significant lira depreciation. The average NPL ratio for the peer group increased slightly to 4.0% at end-3Q17 (end-2016: 3.7%) reflecting loan seasoning and, for some banks, loan book clean ups. Nevertheless, immediate risks to asset quality for most banks have moderated, in Fitch's view, given the supportive economic backdrop (FY17 GDP growth forecast: 5.5%). However, regulatory group 2 watch-list loans remain high at most banks and could contribute to NPL growth in the medium term. These ranged from 0.7% of loans at BankPozitif to a higher 21% at Turkland end-3Q17, a high proportion of which is generally restructured.

In addition, FC lending (including FC-indexed loans) at the banks, ranging from 31% (T-Bank) to 80% (BankPozitif) of total loans at end-3Q17, remains significant and heightens credit risk. Fitch believes FC loans could bring loan losses, particularly considering the depreciation of the Turkish lira in recent years and the fact that borrowers are typically smaller companies, which are likely to be more weakly hedged. Nevertheless, FC loans are typically long-term (albeit amortising) meaning any asset-quality problems should feed through gradually.

Fitch considers the peer groups' average FCC/risk-weighted assets ratio (end-3Q17: 15.8%) only adequate for their risk profiles considering modest internal capital generation, high loan book concentrations, and generally modest NPL reserve coverage. ABank, Burgan and Odea have FC subordinated debt (qualifying as Tier 2 capital), providing a partial hedge against FC risk-weighted assets.

The banks' funding and liquidity profiles are generally fairly reasonable. Banks have limited deposit franchises but benefit from varying degrees of access to funding from their respective parents. ABank, ICBC Turkey, and Burgan all have high loan-to-deposit ratios (above 150% at end-3Q17) given high usage of parent funding. BankPozitif does not have a deposit license and is therefore solely reliant on wholesale funding.

The downgrade of T-Bank's VR to 'b' from 'b+' reflects Fitch's view that the bank's weak asset quality is continuing to constrain performance, with loan impairment charges absorbing a high 97% of pre-impairment profits in 9M17, and putting pressure on capital ratios. Its NPL ratio increased to a high 7.3% at end-3Q17 (end-2016: 6.5%) as loans season following rapid loan growth between 2011 and 2015. More significantly, watch list loans amounted to a further 21% of loans at end-3Q17, the weakest ratio among peers, which could lead to further NPL growth. The bank is in the process of changing its target customer segment to larger commercials from SMEs, although it will take time for metrics to improve, in our view.

We consider T-Bank's FCC ratio of 15.0% at end-3Q17 modest in light of high net NPLs to FCC (20%), weak internal capital generation and planned growth. The VR is underpinned by T-Bank's reasonable funding and liquidity profile given a loan-to-deposit ratio of 102% at end-3Q17 (end-2016: 92%) which compares well with peers and the sector average.

Odea's VR reflects its limited franchise, deteriorating asset quality metrics and exposure to some high-risk sectors such as construction. However, the VR also factors in the bank's more conservative stance in growth, reasonable funding profile in light of the predominance of customer deposits in the bank's funding base and limited wholesale funding reliance. Odea's headline NPL ratio has increased since 2016 and was 4.3% at end-9M17. Watch-list loans (end-9M17: 7.7% of performing loans) have increased, as have watch-list restructured loans; at least some of which are likely to migrate to the NPL category as loans season, in Fitch's view. Odea's level of specific reserves coverage of NPLs is also fairly weak, albeit a more reasonable 70% after adjusting for available free provisions.

ABank's 'b+' VR reflects the bank's weak core capitalisation, reasonable performance metrics and narrow franchise. ABank's FCC ratio increased to 8.3% FCC ratio at end-3Q17 but is considered low in light of large unreserved NPLs (end-3Q17: equal to 13% of FCC), weak internal capital generation and high FC lending. However, the bank's capital ratios were supported by additional Tier 1 capital by its parent and subordinated debt issues. The bank's total regulatory CAR stood at 18% at end-9M17. The bank plans a USD100 million equity increase from its shareholder in 2018. The bank's profitability improved in 9M17 following lower loan impairment charges and volume growth. ABank's funding costs are also at the lower end compared with peers thanks to access to group funding, which is supporting margins.

ICBC Turkey's 'b+' VR reflects the bank's improved ability to execute its newly deployed strategy, reasonable, albeit improving, financial metrics and growing franchise. ICBC Turkey has grown rapidly since acquisition in 2015 thanks to the availability of cheap, long-term funding from its parent (about TRY4 billion at end-3Q17) and a TRY440 million capital injection in 2Q17. Nevertheless, the VR also captures the bank's appetite for rapid growth and the risks this could bring to asset quality and capitalisation. ICBC Turkey's NPL ratio fell to 1.4% at end-3Q17, although watch list loans have risen, as for the sector.

Burgan's 'b+' VR considers its reasonable asset quality metrics, high risk appetite and weak core capital ratios. The bank's 2.3% NPL ratio was broadly stable at end-3Q17, and compares well with peers, but recent rapid loan growth could increase

NPLs as loans season. Credit risk is heightened by high concentrations, sizeable project finance exposures and elevated level of regulatory group 2 watch-list loans (6.2% of loans at end-3Q17). The bank also has the second highest share of FC loans (62% at end-3Q17) among the banks. Fitch considers Burgan's FCC ratio (7.8% at end-3Q17) weak for its risk profile, but it is set to moderately improve following a TRY285 million capital injection from its parent in December 2017. Parent funding, including subordinated debt, provides uplift to the total capital ratio (15.5%) and underpins the bank's relatively low cost of funding (on a swap adjusted basis).

BankPozitif's 'b+' VR reflects its small absolute size, narrow franchise and sole reliance on wholesale funding resulting from the absence of a deposit license. The bank is deleveraging, in line with the parent's strategy, and therefore the loan book shrunk by 24% in 9M17. The NPL ratio remained broadly flat at 6%, reflecting the lumpy loan book. The FCC ratio was above peers at 26.4%, but should be viewed in light of high concentrations, small absolute size and low provision coverage (40%). Refinancing risk is mitigated by access to parental funding and committed lines and by the bank's deleveraging plans.

NATIONAL RATINGS
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.

BANK SUBSIDIARY - ALTERNATIF FINANSAL KIRALAMA
ALease's ratings are equalised with those of ABank, reflecting Fitch's view that it is a highly integrated, core subsidiary of the parent. ALease is 100% owned by ABank and offers core products and services (leasing) in the parent's core market (Turkey) which reflects the key role in the group. ALease is small relative to its parent (9% of ABank's total assets at end-3Q17). Fitch believes that support for ALease, if needed, would ultimately also come from CBQ via ABank

RATING SENSITIVITIES
IDRS, NATIONAL RATINGS, SENIOR DEBT RATINGS AND VRs
The IDRs, National Ratings, Support Ratings and debt ratings of ABank, Burgan, ICBC Turkey, BankPozitif, T-Bank and Alternatif Finansal Kiralama could be downgraded in case of a marked weakening of the ability or propensity of parent institutions to provide support. With the exception of T-Bank, the banks' ratings are also sensitive to changes in the Country Ceiling.

The Negative Outlook on T-Bank's ratings reflects that on Arab Bank, and a downgrade of the parent would likely result in a downgrade of the subsidiary. Any other material change in Fitch's view of support available to the bank from its parents would also result in rating action.

All banks' VRs are sensitive to a material weakening in the operating environment or in asset quality, profitability and the sufficiency of their capital and liquidity buffers. T-Bank and Odea's VRs (and the latter's IDRs) could be downgraded if asset quality materially weakened further, putting pressure on profitability and capital buffers. ICBC Turkey's VR could be downgraded if there was a sharp increase in risk appetite and this was not offset by material capital support from the shareholder.

Upside potential for the banks' VRs is limited in the near term, given current operating environment pressures. However, a significant improvement in Burgan's and ICBC Turkey's franchises, without a corresponding sharp increase in their risk appetite or a weakening of their underwriting standards, could result in upside potential for their VRs in the medium term. A track record of successful implementation of the new strategy at ABank, together with a strengthening of its core capital ratios, could lead to an upgrade of its VR.

Upside potential for Bank Pozitif's VR is limited given its narrow franchise and small size.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES
The 'B+' rating of Odeabank's subordinated notes is notched down once from the bank's 'bb-' VR. ABank's 'BB+' subordinated debt rating is notched down once from the bank's 'BBB-' IDR. The notching includes one notch for loss severity and zero notches for non-performance risk in the case of both banks.

The rating actions are as follows:

Alternatifbank A.S.
Long-Term FC IDR affirmed at 'BBB-'; Stable Outlook
Long-Term LC IDR affirmed at 'BBB-'; Stable Outlook
Short-Term FC IDR affirmed at 'F3'
Short-Term LC IDR affirmed at 'F3'
Viability Rating affirmed at 'b+'
Support Rating affirmed at '2'
National Long-Term Rating affirmed at 'AAA(tur)' Stable Outlook
USD250 million senior notes guaranteed by Commercial Bank of Qatar affirmed at 'A'
Subordinated debt rating affirmed at 'BB+'

Alternatif Finansal Kiralama A.S.
Long-Term FC IDR affirmed at 'BBB-'; Stable Outlook
Long-Term LC IDR affirmed at 'BBB-'; Stable Outlook
Short-Term FC IDR affirmed at 'F3'
Short-Term LC IDR affirmed at 'F3'
Support Rating affirmed at '2'
National Long-Term Rating affirmed at 'AAA(tur)' Stable Outlook

BankPozitif Kredi ve Kalkinma Bankasi A.S.
Long-Term FC and LC IDRs: affirmed at 'BBB-'; Stable Outlook
Short-Term FC and LC IDRs affirmed at 'F3'
Viability Rating affirmed at 'b+'
Support Rating affirmed at '2'
National Long-Term Rating affirmed at 'AA+(tur)' ; Stable Outlook
Senior unsecured debt: affirmed at 'BBB-

ICBC Turkey A.S.
Long-Term FC IDR affirmed at 'BBB-'; Stable Outlook
Long-Term LC IDR affirmed at 'BBB-'; Stable Outlook
Short-Term FC and LC IDRs affirmed at 'F3'
Viability Rating affirmed at 'b+'
Support Rating affirmed at '2'
National Long-Term Rating affirmed at 'AAA(tur)' Stable Outlook

Turkland Bank A.S.
Long-Term FC and LC IDRs affirmed at 'BB-'; Negative Outlook
Short-Term FC and LC IDRs affirmed at 'B'
Viability Rating downgraded to 'b' from 'b+'
Support Rating affirmed at '3'
National Long-Term Rating affirmed at 'A+(tur)'; Negative Outlook

Burgan Bank A.S.
Long-Term FC IDR affirmed at 'BBB-'; Stable Outlook
Long-Term LC IDR affirmed at 'BBB-'; Stable Outlook
Short-Term FC IDR affirmed at 'F3'
Short-Term LC IDR affirmed at 'F3'
Viability Rating affirmed at 'b+'
Support Rating affirmed at '2'
National Long-Term Rating affirmed at 'AAA(tur)' Stable Outlook

Odeabank A.S.
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 '5'
Support Rating Floor affirmed at 'No Floor'
National Long-Term Rating affirmed at 'A+(tur)'; Outlook Stable
Subordinated debt rating affirmed at 'B+'

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**Applicable Criteria**
Global Bank Rating Criteria (pub. 25 Nov 2016) (https://www.fitchratings.com/site/re/891051)
Global Non-Bank Financial Institutions Rating Criteria (pub. 10 Mar 2017) (https://www.fitchratings.com/site/re/895236)

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