Fitch Takes Various Rating Actions on Kazakh Banks and Their Russian Subsidiaries

Ratings Endorsement Policy

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Fitch Ratings-London/Moscow-16 April 2013: Fitch Ratings has taken various rating actions on Kazakh banks and their subsidiaries' Long-term Issuer Default Ratings (IDRs) including the following:

- Halyk Bank's 'BB-' IDR placed on Rating Watch Evolving (RWE)
- BTA Bank's IDR upgraded to 'CCC' from 'RD', placed on Rating Watch Positive (RWP)
- Kazkommertsbank's (KKB) IDR affirmed at 'B' with a Stable Outlook, and its Russian subsidiary, CB Moskommertsbank (MKB), downgraded to 'CCC' from 'B-'
- Bank CenterCredit (BCC) and its Russian subsidiary, Bank BCC-Moscow (BCCM), affirmed at 'B+' with a Stable Outlook.

A full list of rating actions is at the end of this document.

KEY RATING DRIVERS - IDRs, VRs and Senior Debt of reviewed Kazakh banks

Kazakh banks have in general continued to benefit from a steadily growing economy, which has provided some opportunities for business growth, supported the quality of recently issued loans and enabled banks to rebalance funding bases towards domestic sources. GDP growth was a solid 5% in 2012, and Fitch forecasts similar rates in 2013-2014.

Real estate market indicators suggest incremental recovery both in prices and liquidity of residential and commercial property. This trend has helped banks to achieve some limited improvements in the performance of their legacy real estate exposures. However, the stock of excess supply (including of uncompleted property) still considerably outweighs demand volumes, hampering any more tangible progress with loan workouts.

Banks' funding bases have benefited from continued inflow of retail deposits (up by 24% in 2012), which has helped to offset some volatility in corporate balances. The net loans/deposits ratio remained close to 100% in 2012, suggesting that the sector has been sticking to a more sustainable domestically-funded model. At the same time, funding at some banks (in particular, KKB, Halyk and BTA) is weakened by significant reliance on concentrated corporate deposits placed by state-controlled entities. External debt repayment schedules are currently comfortable for each of the reviewed banks, with no large near-term spikes in redemptions.

Internal capital generation has been moderate at most banks, with the notable exception of Halyk. However, current capital bases and impairment reserves allow for the absorption of the majority of currently recognised non-performing and restructured loans. The extent to which banks can absorb losses on reported and potential additional problem loans remains a key part of Fitch's assessments.

Plans to consolidate the private pension system under the aegis of the National Bank of Kazakhstan would materially affect Halyk and KKB (managing the largest and the fourth largest funds in the country). The potential impact on profitability will be more significant for Halyk, whose asset management fees accounted for 12% of pre-tax profit in 2012 (less than 1% for KKB, based on 9M12 data). However, Fitch does not currently expect any significant overall negative credit impact for the banks, given initial reports that these businesses will be bought at a significant premium to book value, resulting in an upfront boost to capital.

KEY RATING DRIVERS - BTA's IDRs, VR and Senior Debt
The upgrade of BTA Bank follows the completion of Fitch's review of the bank, initiated after the completion of its restructuring in January 2013. The 'CCC' Long-term IDRs reflect BTA's still weak asset quality, capital, performance, franchise and business prospects. However, weaknesses in both solvency and profitability have been considerably reduced as a result of the restructuring.
BTA's reported Basel I Tier 1 and Fitch Core Capital (FCC) ratios were a solid 33% at end-2012. However, non-performing loans (NPLs, 90-plus days overdue; 68% of the loan book) and restructured exposures (22%) still comprised, net of impairment reserves, 1.4x FCC. Furthermore, 65% of BTA's FCC results from fair value adjustments (reductions) to the bank's (low rate) liabilities, which will have to be accrued back through the income statement in future years, pressuring internal capital generation.

In Fitch's view, pre-impairment profit, net of interest income accrued but not received in cash, is likely to be at best moderately negative in 2013, even if BTA is successful in sharply reducing operating expenses. The lack of a clear development strategy makes significant near-term improvements in performance unlikely, the agency believes, meaning that continued, slow erosion of capital is our base case expectation.

The RWP on BTA's ratings reflects its potential acquisition by Halyk, following a proposal made to the latter by the national welfare fund Samruk Kazyna. Consolidation of BTA by Halyk would likely result in moderately improved support prospects for BTA, in Fitch's view. However, considerable uncertainty still exists as to whether the transaction will take place, how it might be structured, and to what extent Halyk would be able and willing to support BTA, should the sale go through.

KEY RATING DRIVERS - Halyk's IDRs, VR and Senior Debt
The RWE on Halyk's ratings reflects (i) Fitch's opinion that the bank's stand-alone profile has continued to strengthen, to the extent that this would now warrant a one-notch upgrade to 'BB'; and (ii) the potential negative impact of the proposed acquisition of BTA, which may result in a significant weakening of the profile. Halyk will likely be upgraded to 'BB' if the BTA acquisition does not go through. The rating could be affirmed at 'BB-' if an acquisition of BTA is structured so as to be only moderately negative for Halyk, or downgraded if an acquisition is sharply detrimental.

Fitch's assessment of Halyk's stand-alone profile reflects the bank's strong performance, comfortable liquidity, solid capitalisation and strong franchise. However, the assessment also considers still sizable asset quality problems and significant dependence on lumpy corporate deposits.

Profitability has been consistently strong in recent years, with a pre-impairment return on average assets close to or above 4% (above 6% relative to average gross loans) underpinned by low funding costs, sizable commission income and reasonable cost control. Non-interest income has fully covered operating expenses, meaning that net interest income is available in its entirety to absorb credit losses. The quality of interest revenues is also reasonable, with only 8% accrued, but not received in cash, in 2012.

The combined volume of NPLs and restructured loans fell to 29% of the loan book at end-2012 from 36% at end-2011, supported by some notable recoveries, as well as loan growth. At end-2012, Halyk could have fully reserved NPLs and restructured loans, and still reported capital ratios in excess of 10%, Fitch calculates. The agency believes risks in the performing part of the loan book are still significant, given some borrowers' weak transparency and profitability, and the long-term bullet structures of some exposures. However, in the agency's view, pre-impairment profitability should provide sufficient capacity to absorb any further losses without impacting capitalisation.

KEY RATING DRIVERS - KKB's IDRs, VR, Senior Debt and Subordinated Debt
The affirmation of KKB's ratings reflects limited recent changes in the bank's credit profile. The ratings continue to reflect the bank's weak asset quality. However they also consider KKB's significant loss absorption capacity, positive pre-impairment profitability (net of accrued interest income), manageable refinancing schedule and currently comfortable liquidity.

Reported NPLs were a high 29% and restructured exposures 19% of gross loans at end-Q312 (the latest publicly available data). In addition, Fitch understands that land/real estate exposures not classified as either non-performing or restructured were also sizable.
Based on regulatory data, Fitch calculates that KKB could have increased its impairment reserves to 39% of the loan book, as of end-2012, before its regulatory capital ratio would have fallen to the minimum 10% level. This represents significant loss absorption capacity relative to currently reported NPLs and restructured loans, but could be insufficient in case of recognition of further problems. At end-2012, KKB's land exposures, net of specific reserves, were substantial relative to regulatory capital, and an eventual exit from these investments, as well as from some of the real estate loans, is highly dependent on cooperation with local authorities, in particular in the city of Almaty.

KKB's regulatory ratios (12.3% Tier 1 and 16.2% total at end-2012) were significantly below those reported under Basel (Tier 1 18.2%; total 22.0% at end-Q312, the latest publicly available data) largely as a result of different impairment provisions calculated in accordance with local GAAP and IFRS requirements. However, even if KKB decides to increase its IFRS impairment reserves up to the level currently reported in its statutory financial statements, Fitch would regard such accounting changes as credit neutral, as they would not impact the bank's aggregate IFRS loss absorption capacity, as measured by capital and reserves combined.

KKB's subordinated debt issues are notched once off its VR.

KEY RATING DRIVERS - BCC's IDRs, VR, Senior Debt and National Ratings
BCC's ratings reflect its weak performance, asset quality metrics and capital quality. At the same time, the ratings also consider BCC's established franchise, robust liquidity and reasonable overall loss absorption capacity. BCC's risk profile benefits moderately from oversight by its major shareholder, Korea's Kookmin Bank (KMB, 'A'/Stable; 42% stake); however Fitch does not expect KMB to provide significant financial support to BCC prior to consolidation of a controlling stake. KMB has an option, valid until 2017, to purchase the IFC's 10% stake, but in Fitch's view is unlikely to exercise this in the near term.

NPLs and restructured loans combined comprised a significant 22% of the portfolio at end-2012, although this is lower than at peers. Fitch calculates that the bank could have almost fully reserved these exposures while maintaining a Basel total capital ratio of 10%. However, the quality of capital, which includes significant non-common equity components, is weak, and at end-2012 the FCC ratio was a moderate 7.8%.

After improvement in 2011, BCC's profitability weakened somewhat in 2012, with the net interest margin shrinking to 2% in 2012 and pre-impairment results equal to a moderate 1.3% of assets. However, fee generation is robust, covering 75% of operating expenses in 2012, and cash interest income slightly exceeded accruals.

RATING SENSITIVITIES - Kazakhstan-based banks' IDRs, VRs, Senior Debt, National ratings (where assigned) and Subordinated Debt (for KKB)
The ratings of each of the four Kazakh banks could be upgraded in case of substantial progress with work outs of problem loans or significant recapitalisation measures which materially improve loss absorption capacity. However, Fitch currently views such developments as unlikely given the deep-seated nature of asset quality problems and the absence of any capital raising plans at the banks. A sharp slowdown in the economy driven by an oil price shock would put downward pressure on the ratings, but this is also currently not anticipated.

Halyk will likely be upgraded by one notch, to 'BB', if the BTA acquisition does not go through. The rating could be affirmed at 'BB-' if an acquisition of BTA is structured so as to be only moderately detrimental for Halyk, or downgraded if an acquisition is sharply negative for Halyk's credit profile.

BTA could be upgraded if the bank is acquired by Halyk, and in Fitch's view the new owner would be likely to help repair BTA's stand-alone profile or to provide support to BTA, in case of need. However, in considering any potential benefits to BTA, Fitch will bear in mind that Halyk would probably be a reluctant acquirer, and any uplift to BTA's ratings may as a result be limited. If no acquisition takes place, BTA's ratings would likely be affirmed at their current levels.

Fitch does not expect KKB's ratings to change in the near term, as reflected by the Stable Outlook. However, any further deterioration in asset quality or weakening of recovery prospects on the bank's problem loans would give rise to negative pressure on the ratings. Any indication from the Kazakh authorities and/or KKB's major shareholders that creditors might participate in actions to strengthen the bank's solvency (not the agency's base case at present) could also result in a downgrade.

BCC's ratings could be upgraded by several notches, potentially to investment grade, if Kookmin consolidates a majority stake in the bank and affirms its strategic commitment to BCC.

KEY RATING DRIVERS ANS SENSITIVITIES - Support Ratings and Support Rating Floors (SRFs) for reviewed Kazakh banks
Halyk (SRF 'B') and KKB's (SRF 'B-') Support Ratings and SRFs reflect the track record of (moderate) funding and capital support provided to these banks by the authorities during the crisis. Halyk's SRF is set one notch higher than KKB's, reflecting the former's wider retail deposit franchise, limited wholesale funding and strong political connections. At the same time, the SRFs remain considerably lower than the sovereign's Long-Term foreign currency IDR of 'BBB+'. This reflects the readiness of the authorities to let other leading Kazakh banks default during the past four years, and public statements in support of the principle of 'burden sharing' in case of bank insolvencies.

BTA Bank's '5' Support Rating and 'No Floor' SRF reflect Fitch's view that sovereign support cannot be relied upon in future following the bank's repeated default in 2012. BCC's '5' Support Rating reflects Fitch's opinion that support cannot be relied upon from either the bank's shareholders or the Kazakh sovereign.

KEY RATING DRIVERS AND SENSITIVITIES - MKB
The downgrade of MKB's Long-term IDR to 'CCC' reflects Fitch's view that capital support from KKB has become less reliable. This takes into account the fact that the parent has not provided capital to MKB in the recent past and has no current plans to do so in the future, notwithstanding MKB's consistently negative profitability and weak capital position (11.3% regulatory CAR at end-2M13). The Russian subsidiary is of low strategic importance to KKB, and MKB does not qualify as a 'material subsidiary' either, i.e. its default would not trigger the acceleration of KKB's eurobonds.

MKB's 'ccc' VR reflects deep-seated asset quality problems (NPLs and restructured loans of 22% and 20%, respectively, at end-2M13) and limited loss absorption capacity (statutory reserves were equal to 21% of the loan book at the same date, but the bank's capitalisation didn't allow for further provisioning). In Q411 the regulator banned MKB from accepting retail deposits and, although that ban has now been lifted, regulatory risk remains rather high, in Fitch's view.

MKB's ratings could be downgraded further in case of a further weakening of asset quality or regulatory intervention. MKB's ratings could be upgraded if the bank is sufficiently recapitalized and a viable strategy is implemented.

KEY RATING DRIVERS AND SENSITIVITIES - BCCM
BCCM's IDRs are equalized with those of BCC given the high operational and management integration of the two entities and strong track record of capital support. The small size of the bank (around 3.5% of BCC's assets at end-2012) and its moderate growth plans limit the cost of potential support, thus also increasing its probability. The IDRs are likely to move in tandem with those of BCC; however, reduced operational integration and/or a weaker track record of support could result in BCCM being notched off BCC.

The 'b-' VR reflects BCCM's weak performance and asset quality and limited franchise, but also takes into account the currently solid capital ratio. Upside to the rating is limited given current weaknesses. A marked increase in asset impairment could result in a downgrade.

The ratings actions are as follows:
BTA
Long-Term foreign and local currency IDRs: upgraded to 'CCC' from 'RD'; RWP
Short-Term foreign and local currency IDRs: upgraded to 'C' from 'RD'; RWP
Viability Rating: upgraded to 'ccc' from 'f'
Support Rating: '5', placed on RWP
Support Rating Floor: affirmed at 'No Floor'
Senior debt rating on old notes: withdrawn at 'C', Recovery Rating 'RR5'
Senior debt rating on new notes: assigned at 'CCC'/RWP, Recovery Rating 'RR4'
Subordinated debt rating; withdrawn at 'C'; Recovery Rating 'RR6'

Halyk
Long-term foreign and local currency IDRs: 'BB-', placed on RWE
Short-term foreign and local currency IDRs: affirmed at 'B'
Viability Rating: 'bb-', placed on RWE
Support Rating: affirmed at '4'
Support Rating Floor: affirmed at 'B'
Senior unsecured debt: 'BB-', placed on RWE

KKB
Long-term foreign and local currency IDRs: affirmed at 'B', Outlook Stable
Short-term foreign and local currency IDRs: affirmed at 'B'
Viability Rating: affirmed at 'b'
Support Rating affirmed at '5'
Support Rating Floor: affirmed at 'B-'
Senior unsecured debt: affirmed at 'B'; Recovery Rating 'RR4'
Subordinated debt: affirmed at 'B-'; Recovery Rating 'RR5'

BCC
Long-term foreign currency IDR: affirmed at 'B+', Outlook Stable
Short-term foreign currency IDR: affirmed at 'B'
Long-term local currency IDR: assigned at 'B+', Outlook Stable
National Long-term Rating: assigned at 'BBB(kaz)', Outlook Stable
Viability Rating: affirmed at 'b+'
Support Rating affirmed at '5'
Senior unsecured debt affirmed at 'B+'; Recovery Rating 'RR4'
National senior unsecured debt rating: assigned at 'BBB(kaz)'.

MKB
Long-term foreign currency IDR: downgraded to 'CCC' from 'B-'
Short-term foreign currency IDR: downgraded to 'C' from 'B'
National Long-term rating: downgraded to 'B(rus)' from 'BB-'(rus);
Viability Rating: affirmed at 'ccc'
Support Rating: affirmed at '5'

BCC-Moscow
Long-term foreign and local currency IDRs: affirmed at 'B+'; Outlook Stable
Short-term foreign currency IDR: affirmed at 'B';
Viability Rating: assigned at 'b-'
National Long-Term Rating: affirmed at 'A-(rus)'; Outlook Stable;
Support Rating: affirmed at '4'

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Applicable criteria, 'Global Financial Institutions Rating Criteria', dated 15 August 2012, 'Recovery Ratings for Financial Institutions', dated 15 August 2012 ,'Assessing and Rating Bank Subordinated and Hybrid Securities', dated 05 December 2012, 'National Ratings Criteria ', dated 19 January 2011, and "Rating FI Subsidiaries and Holding Companies", dated 10 August 2012, are available at www.fitchratings.com.

Applicable Criteria and Related Research
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Additional Disclosure
Solicitation Status