MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades GarantiBank International's deposit rating to Baa3 from Baa1

12 Sep 2018

Negative outlook assigned

London, 12 September 2018 -- Moody's Investors Service ("Moody's") today downgraded the long-term and short-term deposit ratings of GarantiBank International N.V. (GBI) to Baa3 and Prime-3, from Baa1 and Prime-2, respectively. The rating agency also downgraded the bank's Baseline Credit Assessment (BCA) and Adjusted BCA to ba1 and baa3, from baa3 and baa2, respectively. Moody's downgraded GBI's long-term and short-term Counterparty Risk Rating (CRR) to Baa2 and Prime-2, from A2 and Prime-1. The bank's Counterparty Risk (CR) Assessments were also downgraded to Baa1(cr)/Prime-2(cr) from A2(cr)/Prime-1(cr).

Moody's assigned a negative outlook to GBI's long-term deposit rating.

A list of all affected ratings is provided towards the end of this press release.

This rating action follows Moody's downgrade of the ratings of Turkiye Garanti Bankasi (TGB, B1 negative, b2), GBI's parent domiciled in Turkey (Ba3 negative), on 28 August 2018. It also results from the change of Turkey's macro profile to Weak-, from Weak.

This rating action also corrects a prior error in GBI's long-term deposit ratings, as well as in its CRR and CR assessment.

For further information on the rating action on Turkish financial institutions, please refer to Moody's press release published on 28 August 2018: https://www.moodys.com/research/--PR_388052.

RATINGS RATIONALE

GBI's rating inputs and long-term and short-term deposit ratings have been under review for downgrade since 13 June 2018 and the long-term and short-term CRR have been under review for downgrade since they were assigned, on 22 June 2018. The review was driven by both the bank's exposure to the weakening operating environment in Turkey and the contagion risk from its direct parent TGB. GBI's on and off-balance sheet exposures to Turkish counterparts amounted to €1.6 billion, as of December 2017, representing 34% of its total exposures, or 291% of its CET1 capital. This amount has been stable since 2016. Moody's notes that most of these exposures are to corporates and trade finance operations, which are short-term in nature, and can be terminated at relatively short notice. However, risks arising from these exposures have recently increased beyond Moody's expectations, as the operating environment and funding conditions have deteriorated in Turkey. These heightened risks are reflected in GBI's assigned macro profile of Moderate, which also takes into account the bank's exposures outside Turkey. Despite the short-term nature of most of GBI's assets, the bank faces an increase in its non-performing loans and cost of risk as the creditworthiness of its Turkish counterparts deteriorates. In addition, GBI's creditworthiness is also affected by the downgrade of TGB's BCA to b2 from b1, reflecting GBI's parent's weak operating environment, moderate capitalization and high reliance on wholesale funding. Both GBI and TGB have been subsidiaries of the Spanish bank BBVA since 2015.

GBI's rating also reflects the more limited risk of contagion from TGB to its Dutch subsidiary, resulting from the inclusion of GBI within the scope of the Single Supervisory Mechanism (SSM), the alignment of GBI's risk management practices with those of BBVA and the fact that GBI now operates under BBVA's trademark, increasing the reputational risk of a failure of GBI for its ultimate parent. This reduced contagion risk is reflected in the three-notch gap now prevailing between GBI's BCA of ba1 and TGB's Adjusted BCA of b1. The moderate likelihood of affiliate support from BBVA provides a one-notch uplift from GBI's BCA.

Moody's also corrected an error in GBI's long-term deposit ratings, as well as in its CRR and CR assessment: the bank's deposit ratings were previously one notch above its Adjusted BCA, at Baa1, while its CRR and CR Assessment were both three notches above its Adjusted BCA, at A2 and A2(cr), respectively.

These ratings did not properly reflect the risk of loss according to the agency's Advanced LGF analysis as applied to GBI. This was the result of an input error by Moody's, which recorded junior deposits forming 20% of the bank's total deposit base. In this rating action Moody's revised its LGF analysis to include 10% of total deposits as junior, based on an updated understanding of GBI's financial statements. This is in line with Moody's standard assumptions for similar banks whose deposit bases are essentially collected from retail customers, especially through internet and call centers.

GBI's deposit rating of Baa3 reflects (1) the bank's Adjusted BCA of baa3, (2) the application of Moody's Advanced LGF analysis, indicating a moderate loss-given-failure, and (3) a low probability of government support, leading to a rating in line with the bank's Adjusted BCA.

GBI's long-term CRR is Baa2, one notch above the bank's Adjusted BCA of baa3, reflecting low loss-given-failure, which results from the high volume of instruments that are subordinated to CRR liabilities. GBI's long-term CR Assessment of Baa1(cr) is two notches above the bank's Adjusted BCA of baa3, based on the cushion against default provided to the senior obligations by subordinated instruments. The bank's CRR and CR Assessment do not benefit from any uplift for government support, in line with Moody's assumption of a low probability of such support for GBI.

NEGATIVE OUTLOOK

The outlook on GBI's long-term deposit ratings is negative. This reflects the risk of a further deterioration in the macroeconomic environment in Turkey where the bank's parent is located and where it has material exposures. Further negative developments in Turkey could spill over on to GBI's customers and alter their creditworthiness. The negative outlook incorporates the risk of increasing financial stress that would lead to a further decline in GBI's asset quality and solvency. It also reflects the contagion risk from TGB to GBI. Although this risk has decreased, it still remains and a further downgrade of TGB's BCA and Adjusted BCA, resulting from a worsening of macroeconomic conditions in Turkey, could lead Moody's to revisit the notching difference between TGB's Adjusted BCA and GBI's own BCA.

WHAT COULD CHANGE RATINGS UP/DOWN

An upgrade of GBI's BCA and ratings is unlikely considering the negative outlook currently assigned to its deposit ratings.

A downgrade of GBI's BCA could result from increased asset risk and weakening solvency, mainly stemming from a deterioration of the creditworthiness of the bank's Turkish counterparties. A downgrade of the bank's BCA could also result from a downgrade of TGB's Adjusted BCA, resulting from heightened asset risk or a deteriorating funding profile, as well as a downward revision of Moody's support assumptions from BBVA to TGB. A downgrade of GBI's BCA could also result from increased contagion risk from TGB, which Moody's could consider to be no longer compatible with a three-notch difference between GBI's BCA and TGB's Adjusted BCA. A downgrade of GBI's BCA would likely result in a downgrade of all long-term ratings and assessments.

LIST OF AFFECTED RATINGS

..Issuer: GarantiBank International N.V.

Downgrades:

.... Adjusted Baseline Credit Assessment, Downgraded to baa3 from baa2

.... Baseline Credit Assessment, Downgraded to ba1 from baa3

.... Counterparty Risk Assessment, Downgraded to Baa1(cr) from A2(cr)

.... Counterparty Risk Assessment, Downgraded to P-2(cr) from P-1(cr)

....LT Counterparty Risk Rating (Local and Foreign Currency), Downgraded to Baa2 from A2

....ST Counterparty Risk Rating (Local and Foreign Currency), Downgraded to P-2 from P-1

....ST Deposit Rating (Local and Foreign Currency), Downgraded to P-3 from P-2

....LT Deposit Rating (Local and Foreign Currency), Downgraded to Baa3 Negative from Baa1 Rating Under

Review

Outlook Actions:

....Outlook, Changed To Negative From Rating Under Review

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in August 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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