

Global Credit Research - 15 Jul 2011

Paris, France

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Baa3/P-3
Bank Financial Strength	D-
Baseline Credit Assessment	Ba3
Adjusted Baseline Credit Assessment	Baa3
Ult Parent: Bank VTB, JSC	
Outlook	Negative
Bank Deposits	Baa1/P-2
Bank Financial Strength	D-
Baseline Credit Assessment	Ba3
Adjusted Baseline Credit Assessment	Ba3
Sr Unsec Bank Credit Facility -Dom Curr	Baa1
Senior Unsecured	Baa1
Subordinate MTN	(P)Baa2
Other Short Term	(P)P-2
Parent: VTB Capital plc	
Outlook	Stable
Bank Deposits	Baa3/P-3
Bank Financial Strength	D-
Baseline Credit Assessment	Ba3
Adjusted Baseline Credit Assessment	Baa3

Contacts

Analyst	Phone
Eugene Tarzimanov/Moscow	7.495.228.6060
Olga Ulyanova/Moscow	
Yves Lemay/London	44.20.7772.5454
Victoria Voronina/Moscow	

Key Indicators

VTB Bank (France) SA(Unconsolidated Financials)[1]

	[2]12-10	[2]12-09	[2]12-08	[2]12-07	[2]12-06	Avg.
Total Assets (EUR million)	1,378.3	1,055.2	1,020.5	1,132.4	1,301.5	[3]1.4
Total Assets (USD million)	1,849.1	1,514.0	1,418.5	1,655.6	1,716.3	[3]1.9
Tangible Common Equity (EUR million)	139.8	139.6	99.6	99.3	99.7	[3]8.8
Tangible Common Equity (USD million)	187.6	200.3	138.5	145.2	131.5	[3]9.3
(Market Funds - Liquid Assets) / Total Assets (%)	58.5	46.2	54.1	43.2	29.6	[4]46.3
Core Deposits / Average Gross Loans (%)	4.5	2.1	5.4	3.8	4.2	[4]4.0
Cost / Income Ratio (%)	51.5	47.7	54.7	40.0	10.4	[4]40.8

Source: Moody's

[1] All ratios are adjusted using Moody's standard adjustments [2] Basel I; LOCAL GAAP [3] Compound Annual Growth Rate based on LOCAL GAAP reporting periods [4] LOCAL GAAP reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a bank financial strength rating (BFSR) of D- to VTB Bank (France) SA (VTBF), which translates into a Baseline Credit Assessment (BCA) of Ba3. The BFSR is underpinned by VTBF's membership in the large Bank VTB group (VTB), which supports the former through funding and facilitates client origination, and its good capitalization. Negative rating drivers include the bank's modest niche business franchise, and its exposure to higher risk Russian and CIS counterparties.

VTBF's long-term global local currency (GLC) deposit rating is Baa3, based on the bank's own BCA of Ba3 and the parent's supported rating (Baa1; this rating incorporates Moody's view of the very high likelihood of support for VTB from the Russian government). According to Moody's joint default analysis (JDA) methodology, in most cases when incorporating parental support into bank ratings of a foreign subsidiary, we use the parent's stand-alone rating (Ba3 in case of VTB) - that is, the rating without benefit of any systemic support - to determine the parent's ability to support its foreign bank subsidiaries. However, in case of VTBF, we used the parent's supported rating (Baa1), to reflect our opinion that VTBF as a foreign subsidiary is very likely to indirectly benefit from systemic support provided by the Russian government to VTB in case of need. We base our opinion on a track record of support to VTBF from the Russian government and its bodies.

As a result, VTBF's Baa3 deposit rating benefits from three notches of uplift above the stand-alone BCA of Ba3. Moody's also notes that VTBF is unlikely to receive any systemic support from the government of France, its domicile country.

Credit Strengths

- Membership in VTB group facilitates business development and access to key Russian companies
- Good capitalization and core profitability
- Supervision by the banking regulator in a developed economy (French Prudential Control Authority- ACP)

Credit Challenges

- Modest niche franchise focused on corporate lending and trade finance
- Focus on Russian clients exposes the bank to high credit risks
- Significant borrower concentration in loans and a legacy of non-performing assets
- Insufficiently diversified funding base

Rating Outlook

The outlooks on all ratings of VTBF are stable.

What Could Change the Rating - Up

Improvements in VTBF's BFSR could stem from a greater diversification of the bank's asset and funding mix.

An upgrade of VTBF's debt and deposit ratings is unlikely at this stage, particularly because the parent Bank VTB has a negative outlook on its Baa1 ratings.

What Could Change the Rating - Down

Downward pressure on the BFSR of VTBF's would likely result from a substantial decline in capitalization, asset quality and liquidity.

A downgrade of the bank's deposit ratings could be triggered by a change in parental support assumptions. In addition, a potential downgrade of the parent VTB by one notch, to Baa2, is unlikely to affect VTBF's Baa3 supported deposit ratings.

Recent Results and Company Events

At YE2010, the bank reported total assets of EUR1.37 billion under French GAAP, a 30% increase from 2009. Most of this growth was in loans (+33%) and debt securities (x2.2 increase). The bank made a EUR22.4 million pre-tax ordinary income (net of one-offs) for 2010 (2009: EUR18.3 million).

DETAILED RATING CONSIDERATIONS

Detailed considerations for VTBF's currently assigned ratings are as follows:

Bank Financial Strength Rating

The D- BFSR is supported by the bank's membership in the large VTB group, which provides VTBF with funding and facilitates client origination; as well as the bank's good capitalization. Negative rating drivers include the bank's modest niche business franchise, and its exposure to higher risk Russian and CIS counterparties.

The assigned BFSR is two notches below the adjusted D+ outcome of Moody's bank financial strength scorecard. However, Moody's believes the D- rating is an appropriate measure of the bank's intrinsic financial strength given its strategic focus on the volatile emerging markets.

Qualitative Rating Factors (50%)

Factor 1: Franchise Value

Trend: Neutral

Originally established in 1921 as Banque Commerciale pour l'Europe du Nord (BCEN) and headquartered in Paris, VTBF is a bank with a historic niche focus of financing trade related to Russia. Until 2005, when VTB acquired a controlling stake, the bank - under the name BCEN-Eurobank - was majority owned by the Central Bank of Russia (before 1992 by the State Bank of the USSR). In 2006, the bank was renamed VTB Bank (France) SA. At the same time, VTB group announced that its London-based subsidiary, VTB Europe plc (VTBE) would consolidate some of VTB's banks in Western Europe. In December 2006 VTBF became a VTBE subsidiary.

In 2007, VTB changed its strategy and decided to transfer VTBF's ownership under VTB Austria (VTBA), in order to create a sub-group holding

responsible for corporate banking. This transaction was finalised in 2007, and VTBF is now 87%-owned by VTBA. Apart from VTBF, VTBA controls VTB Bank Deutschland (VTBD). There is a growing business and operational integration between VTBF, VTBA and VTBD, albeit from a low base.

Within VTB group, each European subsidiary became a centre of expertise and the exclusive intermediary of the group on specific products or activities. Under this strategy, VTBF focuses on club deals and structure finance, trade finance, and credit export agency deals. Despite its small size, VTBF has a relatively well-established niche franchise, its strength lying in its knowledge of the Russian market. VTBF actively participates in deals with Russia guaranteed by OECD export credit agencies, like COFACE or SACE.

VTBF competes in its core business with Russian banks and Russian subsidiaries of Western banks. The bank has plans to step up its activities in other regions apart from Russia / CIS, in order to become a more diversified institution. New countries of interest are mainly developed markets.

At YE2010, VTBF's credit risk exposure was around 60% composed of Russian (including loans to holding companies in on- and offshore zones) and other CIS countries, having decreased from around 70% in 2009. Although we still view VTBF's geographic concentration on emerging markets as significant, we view as positive that the bank is increasing its exposure to good-quality counterparties in advanced markets (Western Europe and the UK).

Earnings diversification has been relatively weak, due to concentrations on selected clients. VTBF's earnings are reliant on structured finance operations, guaranteed export loans, and trade finance documentary credit transactions, which Moody's regards as relatively recurrent.

The D- score for franchise value captures the strengths and weaknesses stated above.

Factor 2: Risk Positioning

Trend: Neutral

VTBF is controlled by VTB, a bank incorporated in Russia, and which ultimately owns 87% of ordinary shares in VTBF through VTBA, its 100% subsidiary. VTB, in turn, is majority owned by the government of the Russian Federation. As a French authorised and supervised bank, VTBF has to comply with the stringent regulatory requirements in the corporate governance area.

VTBF has a number of committees and tools in place to measure and control risks, particularly its exposure to credit, interest rate and market risks. Counterparty default risk and country risk are the chief risk drivers for VTBF. All credit decisions are taken by the bank's credit committee based on internal ratings. VTBF measures market risk based on value-at-risk calculations and stress tests.

VTBF still has a limited funding profile in terms of diversification, as it relies mainly on syndicated and bilateral loans from financial institutions, and particularly from the parent bank. The bank's modest franchise still represents a barrier to its ability to access a wider range of capital markets funding instruments. To strengthen its funding profile, VTBF has launched in late 2010 an internet deposit taking product aimed at French residents, and already collected around EUR60 million of such deposits at Q1 2011. In addition, during 2010 the bank gained access to the TAGRET2 payment system, which gives access to refinancing operations with the European Central Bank. In the event of need, VTBF has also access to intra-group funding if needed.

Although the bank has a satisfactory level of industry concentrations, its counterparty credit risk concentration is high, with the aggregate of top 20 exposures to corporate customers representing around 440% of Tier 1 capital at Q1 2011. These high concentrations make the bank vulnerable to the financial standing of its large borrowers. Around 60% of VTBF's credit exposure is to Russian/CIS counterparties, while the rest is composed of E.U. companies.

VTBF is rapidly growing its securities portfolio, after its decrease in 2009. At YE2010 the bank had EUR201 million in bonds and EUR48 million in equities. Bonds are composed of good quality Russian sovereign, corporate and bank exposures. However, the equity investments are very concentrated and relatively illiquid, introducing a high risk particularly as these accounted for 30% of Tier 1 capital.

VTBF publishes its annual audited accounts under French GAAP on an annual basis, with moderate disclosure of main items.

VTBF's adjusted score for risk positioning is D-.

Factor 3: Regulatory Environment

For a discussion of the regulatory environment, refer to the most recent Moody's Banking System Outlook on France.

Factor 4: Operating Environment

Trend: Neutral

This factor is common to all banks in France. Moody's assigns an B+ score for the overall operating environment. Refer to Moody's Banking System Outlook on France for a detailed discussion of operating environment. However, given that VTBF derives substantial earnings through operations in Russia, we have assigned an adjusted score of D+ on the basis of the weighted average operating environment score of the disclosed global geographic regions in which it operates.

Quantitative Rating Factors (50%)

Factor 5: Profitability

Trend: Neutral

At YE2010, VTBF's core pre-tax income stood at EUR22.4 million (excluding one-offs), up from EUR18.3 for 2009. Net interest income is the biggest contributor to VTBF's operating income, accounting for around 90% of its total amount (excluding one offs). We note that the bank posted a large one off gain in 2009, for around EUR20 million, related to a very old court case.

With an ROAA of 1.8% for 2010, VTBF's profitability is adequate compared to Russian and European banks, and is in line with its risk profile.

In light of the above, the bank's score for profitability is B+.

Factor 6: Liquidity

Trend: Neutral

VTBF is mostly self-funded through capital funds, which funded around 70% of liabilities at YE2010. The bulk of those come from the EUR629 million perpetual subordinated loan (around 50% of liabilities). The other 30% are mostly short-term borrowings from a handful of banks, mostly sister institutions within the VTB group. In case of need, we expect that VTBF will receive additional liquidity support from the group.

A large share of equity and subordinated debt in the bank's funding base results in a good asset-liability maturity match which underpins the bank's liquidity position.

The bank aims to diversify its funding sources going forward, particularly through internet retail deposits which were recently launched. The bank has also a short-term CD programme for EUR350 million since 2008, however there's no issuance at present.

The bank's score of D- for liquidity primarily reflects the wholesale nature of its funding.

Factor 7: Capital Adequacy

Trend: Neutral

With capital funds covering 70% of assets at YE2010 (taking into account the subordinated debt), VTBF is well capitalized. The subordinated loan is perpetual and interest-free, and can be used to cover the bank's losses without the lender's prior consent. In addition, it cannot be withdrawn by the parent VTB without prior consent from the French banking regulator.

We note that the bank's Tier 1 capital is relatively small, only EUR163 million at Q1 2011. In line with the subordinated loan agreement that dates back to the early 1990s, the bank has to replenish this loan through retained earnings to the loan's original amount. The size of the initial loan granted in 1992 stood at EUR841 million; so far, EUR629 has been reconstituted. This is why all profits are channeled into Tier 2 capital, and not core equity.

The bank scores A for capital adequacy.

Factor 8: Efficiency

Trend: Neutral

VTBF's cost-to-income ratio stood at around 50% in 2010, a relatively high ratio for a niche bank with a limited amount of interest-paying liabilities. Efficiency is likely to improve in the medium term, supported by a lighter cost base following material staff cuts in during 2010.

In 2010, VTBF completed an internal reorganization process aimed to optimizing its cost base by materially decreasing staff numbers - to 57 people from 111. We do not expect this staff cut to materially damage the bank's franchise; most business lines remain adequately staffed. VTBF's charges on gardening leaves are manageable. In the medium term, a lower cost base would translate in higher bottom-line profitability metrics.

The bank scored B for efficiency.

Factor 9: Asset Quality

Trend: Neutral

At YE2010, around 8% of the banks' loans to companies and banks were problematic. Although most problem loans to banks (or one-half of all problem credit exposures) relate to old legacy loans to a few Cuban banks, we saw a moderate increase in problem loans to Russian corporates. The credit quality of the new loans remains untested, however the growing share of loans to Western European companies should be credit positive for the bank. We note that the coverage of problem loans by provisions is adequate, at around 70-80%.

We assign a D for asset quality.

Global Local Currency Deposit Rating (Joint Default Analysis)

VTBF's long-term global local currency (GLC) deposit rating is Baa3, based on the bank's own BCA of Ba3 and the parent's supported rating (Baa1; this rating incorporates Moody's view of the very high likelihood of support for VTB from the Russian government). According to Moody's joint default analysis (JDA) methodology, in most cases when incorporating parental support into bank ratings of a foreign subsidiary, we use the parent's stand-alone rating (Ba3 in case of VTB) - that is, the rating without benefit of any systemic support - to determine the parent's ability to support its foreign bank subsidiaries. However, in case of VTBF, we used the parent's supported rating (Baa1), to reflect our opinion that VTBF as a foreign subsidiary is very likely to indirectly benefit from systemic support provided by the Russian government to VTB. We base our opinion on a track record of support to VTBF from the Russian government and its bodies.

Moody's assessment of the probability of parental support, as well as its exceptional use of the deposit rating (rather than Baseline Credit Assessment) of the parent as the basis of support, takes into account the following considerations:

- (1) VTBF shares the same name and brand as its parent bank
- (2) The parent's clearly demonstrated intention to deepen integration of its European subsidiaries, including VTBF, into VTB Group
- (3) A history of support provided to the foreign obligations of VTB, involving exceptions granted for foreign currency transfers during a moratorium
- (4) The continued likelihood of exceptions being extended during any future possible moratoria, given the importance of VTB and subsidiaries to

the economic functioning of the Russian Federation and the access to which VTB's subsidiaries provide to international financial markets.

Foreign Currency Deposit Rating

The foreign currency deposit ratings of VTBF are unconstrained given that the country ceiling for France is Aaa, thus the foreign currency deposit rating is, at Baa3, the same as the global local currency deposit ratings.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Risk Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

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Rating Factors

VTB Bank (France) SA

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (50%)						D	
Factor: Franchise Value						D-	Neutral
Market Share and Sustainability					x		
Geographical Diversification			x				
Earnings Stability					x		
Earnings Diversification [2]							
Factor: Risk Positioning						D-	Neutral
Corporate Governance [2]				x			
- Ownership and Organizational Complexity							
- Key Man Risk							
- Insider and Related-Party Risks				x			

Controls and Risk Management				x			
- Risk Management				x			
- Controls				x			
Financial Reporting Transparency			x				
- Global Comparability				x			
- Frequency and Timeliness		x					
- Quality of Financial Information			x				
Credit Risk Concentration						x	
- Borrower Concentration						x	
- Industry Concentration							
Liquidity Management							
Market Risk Appetite			x				
Factor: Operating Environment							D+
Economic Stability							
Integrity and Corruption							
Legal System			x				
Financial Factors (50%)							C
Factor: Profitability							B+
PPI / Average RWA- Basel I		2.50%					
Net Income / Average RWA- Basel I	2.00%						
Factor: Liquidity							D-
(Mkt funds-Liquid Assets) / Total Assets						47.85%	
Liquidity Management							
Factor: Capital Adequacy							A
Tier 1 Ratio - Basel I	13.00%						
Tangible Common Equity / RWA- Basel I	13.00%						
Factor: Efficiency							B
Cost / Income Ratio		47.42%					
Factor: Asset Quality							D
Problem Loans / Gross Loans						10.57%	
Problem Loans / (Equity + LLR)						32.02%	
Lowest Combined Score (15%)							D-
Economic Insolvency Override							Neutral
Aggregate Score							D+
Assigned BFSR							D-

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information [2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral



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