

FITCH AFFIRMS CLEARSTREAM BANKING AND EUROCLEAR BANK; OUTLOOKS STABLE

Fitch Ratings-London-07 October 2016: Fitch Ratings has affirmed the Long-Term Issuer Default Ratings (IDRs) of Luxembourg-based Clearstream Banking SA (Clearstream) at 'AA' and Belgium-based Euroclear Bank at 'AA+'. The Outlooks are Stable. Clearstream's and Euroclear Bank's Viability Ratings (VR) have been affirmed at 'aa' and 'aa+', respectively. A full list of rating actions is at the end of this commentary.

KEY RATING DRIVERS

VRs, IDRS AND CLEARSTREAM'S COMMERCIAL PAPER RATING

Clearstream's and Euroclear Bank's ratings reflect the banks' leading position in the international post-trade securities services industry, in particular in settlement and custody services, resulting in a fairly resilient revenue base. The ratings also reflect a very low appetite for and exposure to credit risk, sound operational risk control frameworks, prudent liquidity management and sound capitalisation.

In our view, the Clearstream and Euroclear groups are well-placed to adapt to the evolving settlement industry, including regulatory changes and technological challenges. In recent years both groups have supplemented their strong core franchises by strengthening ancillary businesses, including fund management services and most notably collateral management. Clearstream's and Euroclear Bank's ratings assume that further diversification will be gradual, well-managed and supportive of the banks' profitability in the short term.

The banks' profitability is underpinned by their leading positions as Europe's main international central securities depositories (ICSDs) and depends to a large degree on transaction volumes, assets under custody and collateral volumes. Both Clearstream's and Euroclear Bank's profitability in 2015 and 1H16 was supported by generally favourable stock and bond markets although they remain susceptible to changes in market volatility and asset prices. The cost bases of the banks are well-managed, with investments largely targeted towards ensuring system resilience and developing profitable complementary business lines.

Clearstream and Euroclear Bank's risk profile and risk appetite are very low. Both banks are mainly exposed to operational risk including system failures and fraud. Risk controls are very strong and investments in risk management are a management priority. Management teams have a high degree of depth and relevant expertise for the banks' specialised businesses. Euroclear Bank has a strong corporate culture with high risk awareness. Clearstream is highly integrated into the Deutsche Boerse group, including in terms of the risk management framework, which we view as solid. To date, their track record of avoiding operational losses has been strong.

Credit risk is very low and largely relates to intraday, collateralised credit lines to facilitate settlement for clients. Uncollateralised credit exposure is small and largely relates to sovereign counterparties and to a lesser extent strongly-rated commercial banks. The latter will disappear with regulatory changes which will require ICSDs to collateralise all credit exposures with the exception of exposures to sovereign counterparties.

Liquidity management reflects the short-term nature of both banks' balance sheets and is prudent. The liquidity needs are largely intra-day and transaction driven.

The one notch rating differential between Clearstream and Euroclear Bank largely reflects Clearstream's capitalisation, which in our view is slightly weaker than Euroclear Bank's. Euroclear Bank's strong capitalisation has a high influence on its VR and IDRs. In addition, Clearstream's capital management has to be viewed within the context of Deutsche Boerse group, which in our opinion typically has a strong focus on returns to shareholders, resulting usually in relatively high dividend pay-out ratios at Clearstream. Regulatory capital at both banks is small in absolute terms considering their business volumes, but both banks maintain a healthy margin above minimum regulatory requirements.

Clearstream's commercial paper rating is aligned with its Short-Term IDR.

SUPPORT RATING AND SUPPORT RATING FLOOR

As licensed banks, both Clearstream and Euroclear Bank are subject to the EU BRRD, including bail-in requirements. As a result, we believe that while sovereign support for Clearstream and Euroclear Bank is possible, it cannot be relied upon. Consequently, we have assigned a sovereign-support driven Support Rating (SR) of '5' and Support Rating Floor (SRF) of 'No Floor' to Euroclear Bank.

In our view, Clearstream would first look to its parent, Deutsche Boerse AG, for support. We believe that support from Deutsche Boerse AG is extremely likely given Clearstream's core position within Deutsche Boerse group and Fitch's assessment of Deutsche Boerse group's ability to support Clearstream. This underpins the affirmation of Clearstream's SR at '1'.

RATING SENSITIVITIES

VRs, IDRS AND CLEARSTREAM'S COMMERCIAL PAPER RATING

The Stable Outlooks on Clearstream's and Euroclear Bank's Long-Term IDRs reflects our view that both banks' franchises are sufficiently strong and diversified to generate sound profitability while maintaining their current low risk profile and making appropriate investments in adapting their risk management systems to industry and market developments. Upside potential for the ratings is limited, given the already high ratings..

We would likely downgrade the ratings as a result of outsized operational losses, reputational damage causing a sustained drop in revenue, inability to adapt to regulatory changes, weakening capitalisation or a higher risk appetite.

Due to their high volume business models and considerable reliance on robust IT systems, operational risk is a key rating sensitivity, in particular considering the banks' low absolute volume of capital.

While maintaining sound risk-weighted capital ratios is relevant for the banks' ratings, a reduction in the banks' absolute capital base would put pressure on their ratings.

Clearstream's commercial paper rating would be downgraded if Clearstream's Short-Term IDR was downgraded.

Euroclear Bank's Long-Term IDR is above the Long-Term IDR of the Belgian sovereign (AA/Negative). Because there is little direct Belgian risk in the bank's balance sheet, Euroclear Bank is significantly less exposed to sovereign-associated reputation, business and operational risks than Belgian commercial banks. A downgrade of Belgium's ratings would not automatically trigger a downgrade of Euroclear Bank's ratings, but could do so in a more extreme scenario where, for example, Fitch believed higher sovereign risks might affect the bank's franchise.

SUPPORT RATING AND SUPPORT RATING FLOOR

Euroclear Bank's SR and SRF as are primarily sensitive to legislative changes at the national and European level, increasing the propensity of sovereigns to support institutions like Euroclear Bank without imposing losses on senior creditors. While not impossible, this is not expected by Fitch.

Clearstream's SR is primarily sensitive to any perceived change in the propensity and ability of Deutsche Boerse AG to support Clearstream.

Deutsche Boerse group's merger with London Stock Exchange Group (LSEG) is unlikely to affect Clearstream's ratings, in our view (see "Fitch: Clearstream Ratings Likely Unaffected by Potential Deutsche Boerse-LSE Merger", dated 24 February 2016 at www.fitchratings.com). As the only ICSD within the enlarged group, we would expect Clearstream's franchise, governance and risk control framework to remain broadly unchanged following the potential merger. We also anticipate that benefits from ring-fencing arrangements that protect Clearstream from potential issues in other parts of the group will continue to apply.

While not our base case, Clearstream's ratings could come under pressure should Deutsche Boerse's financial profile worsen markedly following the planned merger.

The rating actions are as follows:

Clearstream Banking

Long-Term IDR: affirmed at 'AA'; Outlook Stable

Short-Term IDR: affirmed at 'F1+'

Viability Rating: affirmed at 'aa'

Support Rating: affirmed at '1'

Commercial paper: affirmed at 'F1+'

Euroclear Bank

Long-Term IDR: affirmed at 'AA+'; Outlook Stable

Short-Term IDR: affirmed at 'F1+'

Viability Rating: affirmed at 'aa+'

Support Rating: affirmed at '5'

Support Rating Floor: affirmed at 'No Floor'

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Additional information is available on www.fitchratings.com

Applicable Criteria

Global Bank Rating Criteria (pub. 15 Jul 2016)

<https://www.fitchratings.com/site/re/884135>

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