
Rating-Agentur Expert RA confirmed the credit rating of JSC RUSNARBANK at 'B+' according to the international scale. The rating outlook is stable.

Rating-Agentur Expert RA confirmed the credit rating of JSC RUSNARBANK at 'B+' (Moderately low level of creditworthiness) according to the international scale. The rating outlook is stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

BANKING SYSTEM RISK ASSESSMENT:

The bank's operations are concentrated as follows: 100% in Russia. The banking system risk (BSR) of Russia is moderate. Therefore, the overall systemic risk of JSC RUSNARBANK was assessed as moderate.

MAJOR FACTORS THAT INFLUENCED THE RATING:

Positive factors:

- The bank continues to follow the mid-term business strategy 2017-2019, which aims to specialize on small and medium sized enterprises, guarantees business as well as mortgage loans. The ongoing strategy takes into account regulatory, political and financial risks and sets reasonable realistic goals. Moreover, all the risk indicators and limits established for 2018, RUSNARBANK was able to fulfill. The launch of the large mortgage project¹ in several locations in Russia is a significant signal that the bank adheres to the plan for its loans portfolio growth. However, under the very competitive market environment and current economic slowdown further execution of the strategy can be a challenge. Additionally, the bank's strategy so far remains limited to 2019;
- Capital adequacy was maintained at very high levels despite slight decrease as shown by the capital adequacy indicators: general capital adequacy ratio at 14,3% (7,9p.p. decrease y-o-y), Tier 1 Capital and Common Equity Tier 1 (CET 1) ratio both at 11,8%² (9,7p.p. decrease y-o-y), at the end of the 1Q 2019. Additionally, the capital adequacy ratios would remain above the minimum regulatory levels in case of a full impairment of 14% of the loan portfolio as of March 2019. The declining trend of the capital adequacy ratios is caused by guarantees portfolio growth (10x increase for the year 2018 or 3x increase from March 2018 to March 2019);
- Profitability indicators showed a stable dynamic over the past year remaining at acceptable levels according to the Agency's internal benchmarks: ROE calculated on the basis of Russian accounting standards (RAS) stood at 5,8% for the period from 01.04.2018 till 01.04.2019. Moreover, coverage of operating costs by net interest, fees and commissions income after provision for impairment of loans was favorable at around 160% as of March 2019. Nevertheless, the final results for the year 2018 according to the IFRS 9 standard showed net loss of RUB 26,4 m as compared to RUB 190 m profit in 2019 mostly as a result of operating expenses growth related to the implementation of the new bank's strategy and losses on trading of securities;

¹ "National mortgage fabric" - specialized financial service company for the Russian mortgage market (part of the group of companies "Region").

² These ratios were calculated on the basis of the entity's financial statement figures adjusted by the Agency and they are comparable with the Russia-specific prudential normative ratios: N1.0 - capital adequacy ratio (minimum required level is 8%); N1.2 - Tier 1 Capital ratio (minimum required level is 6%); N1.1 - Common Equity Tier 1 (CET 1) (minimum required level is 4,5%) ratio;

- Maturities of assets and liabilities continued to be on average well matched in the short and long run. While current liquidity and long-term liquidity ratios stood at prudent levels of 147,7% and 87,5% respectively as of April 2019, the instant liquidity ratio deteriorated through 2018, down to 26,1% in December 2018, but recovered to 62,9% in April 2019³. However, the instability of the indicator has limited impact on credibility, as bank can be supported by inflow of funds from shareholders in case of liquidity shortage;
- Additional liquidity source in the form of available loans collateralized by securities (excluding bills) and fund raising opportunities through REPO with securities rated at the sovereign grade of the Russian Federation which, despite a decrease during the year, remains substantial and accounts for 13% of raised funds as of 1Q 2019;
- The assets quality continue to be outstanding, with the level of non-performing loans less than 1% as of March 2019, way below the market average of 5,7% for the same period. The structure of the loans has shifted towards individuals, the total loans to individuals increased more than 7x during 2018, mainly due to the remarkable growth (32x y-o-y) of mortgage loans;
- Coverage of the loan portfolio (excluding issued interbank loans) by collateral on average remained favorable, as indicated by high coverage by collateral formed by securities, sureties and guarantees at 661% at the end of 1Q 2019 (according to RAS standards). Moreover, according to the IFRS 9 evaluation, 100% of total loans to legal entities and individuals were collateralized by end 2018;
- Investment portfolio reflects satisfactory quality and level of liquidity, with more than 96% of securities being rated not lower than 'BB' level (or equivalent rating in national scale) at the beginning of 2019;
- High level of credibility of the funds placed on the correspondent accounts in other banks, as shown by IFRS Report 2018 with 100% of interbank funds placed with banks rated 'BBB-' according to the international scale (the highest rating among Russian banks);
- The bank is characterized by favorable corporate governance and adequate risk management practices, that are fully correspond with the bank's size and its market position.

Restricting factors:

- Moderate level of macro risks according to the Agency's assessment of the country's Banking Sector Risk (BSR). The Russian banking system remains highly concentrated with a high share of government owned banks, combined with a volatile national economy which heavily depends on commodities' price dynamics;
- Large credit risks⁴ (LCR) to assets stood at more than 40% by the end of 2018, the concentration of credit risks on the largest customers remained substantial, as the share of the maximum credit risk from a single borrower to assets stood at 3,3% as of end-2018;
- The share of assets attributed to related parties, despite being 3x lower than a year before, remains elevated at 11% at the end of 2018 according to RAS. Such significant decrease was driven by termination of the REPO deal at the beginning of the year. Nevertheless, according to the IFRS 9, the share of interest income attributed to related parties in the total interest income increased by 17,7p.p. up to 19,3%, while the share of fee income almost disappeared at the year end;

³ The instant liquidity and current liquidity normative ratios were calculated on the basis of the entity's financial statements figures adjusted by the Agency. These ratios are comparable with the Russia specific prudential normative ratios N2 (minimum required level is 15%) and N3 (minimum required level is 50%) respectively; the long-term liquidity ratio is fully comparable with the Russia specific prudential normative ratio N4 (maximum required level is 120%);

⁴ Large credit risk (LCR) is the sum of all loans, guarantees and sureties towards one client exceeding 5% of own funds (capital) of a bank.

- Operational risk practices have a capacity to improve. The bank still lacks certificates of management quality.

Negative factors:

- We assess competitive position of the bank as relatively weak, as total assets and total loans to customers according to RAS drop off by 24% and 19,6% respectively during the period of 2018, and remained less than 0,1% of total indicators for the Russian market. At the same time, while the number of SME borrowers continues to decrease until 49 entities by end 2018, we observed exceptionally high growth of borrowers-individuals in 2018 (30x till 1 963 individuals) associated with the mortgage project launch. There are potential diversification and growth of sales channels through the newly opened digital platform aimed to online guarantees contracts settlement;
- Still moderately low diversification by clients and increased volatility of the funding base, mainly caused by funding base growth. The share of the group of the largest creditors in the gross liabilities gradually decreasing according to RAS, however remained moderately high at 16% as of March 2019. At the same time, the largest creditors are affiliated with the bank's shareholders, that significantly decreases the possibility of the sudden withdrawal of the funds;
- In our view, the provision policy is still not conservative enough, taking into account the size of the bank, as well as high share of SME-borrowers in its loan portfolio; this is evidenced by the difference between the calculated and actually created loan loss reserves (LLR), that mostly related to the use of collateral in order to reduce the amount of LLR according to the RAS;
- Geographical distribution of the business remains narrow, with 100% of the bank's credit portfolio being concentrated in a limited number of Russian regions. However, we observed gradual increase of the geographical diversification of the bank's operations over the last year, mostly due to the launch of large mortgage project servicing as a sales channel for the bank's operations in the largest Russian cities;
- Rather complicated ownership and control structure with several intermediate companies, including offshore companies, between the bank and the individual exercising ultimate control over the bank.

Internal stress factors:

- The evidences presented in 2018 reports, show that the bank is able to follow the 2017-2019 strategy focused on developing multi-purpose retail and commercial bank servicing SMEs and individuals. Despite that, the Agency is still cautious about further possibility of substantial growth, as the market environment is very competitive and the bank may face regulatory challenges while implementing the business model (moderate stress-factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Full implementation of the bank's business strategy by the end 2019 with reaching key objectives and limits originally planned in 2017;
- Continued growth of the numbers of borrowers and enlargement of the loans portfolio together with significant improvement of the bank's market share on the mortgage and SME lending market in the target regions (subjects of the Russian Federation), as well as on a national level;
- Positive profitability indicators reached by end 2019, according to both RAS and IFSR 9 standards, confirmed by independent auditor.

The following developments could lead to a downgrade:

- Deterioration of the bank's loan portfolio quality, especially on the newly entered markets, which might negatively affect the profitability and capital adequacy figures;
- Deterioration of the bank's market position in terms of assets and loans due to the high competition from larger private and state-owned bank;
- Unexpected actions from the Central Bank of Russia in relation to the bank or overall stringing of the banking system supervision with adverse effects for small and medium-sized banks;
- Resume of the large share of the REPO deal associated with related parties in the bank's operations and total assets, that is not in line with the current business strategy of the bank.

JUSTIFICATION OF THE RATING:

The Agency confirmed the rating of JSC RUSNARBANK at 'B+' with a stable outlook. The rating continues to be restrained by the limited competitive position of the bank as compared to the whole Russian market, low diversification of the funding base, as well as challenges related to the execution of the bank's strategy taking into account current stance of the Russian banking system. At the same time, the rating assessment was supported by more than sufficient capital adequacy ratios, solid current and long-term liquidity figures, as well as by the sufficiently collateralized favorable quality loan portfolio and low credit risk security portfolio.

Being a small-scale Russian bank headquartered in Moscow and represented in Belgorod Region, JSC RUSNARBANK still exhibits a narrow geographical distribution, as well as very limited competitive position in the market where it operates, a limited variety of sales channels and low brand awareness. However, we observe that the bank keeps increasing its share on mortgage market of Russia after launching large mortgage project⁵ in several locations in Russia, as well as successfully implemented an additional financial product of guarantees provision for participation in government tenders. Additionally, albeit relatively narrow client base, the bank kept servicing related entities in 2018, despite gradual reduction of such operations (mainly through REPO transactions). The bank continues to be characterized by a rather concentrated funding base, as the share of the largest groups of creditors and the largest creditor in the gross liabilities remained elevated despite gradual decline. On the positive side, the Agency ascertains presence of the long-lasting relationship with the top non-related creditors, as well as substantial amount of funds can be raised from the related entities.

The bank's creditworthiness remains supported by the solid capital adequacy metrics by end of the 1Q 2019, with general capital adequacy ratio at 14,3% (7,9p.p. decrease y-o-y), Tier 1 Capital and Common Equity Tier 1 (CET 1) ratio both at 11,8% (9,7p.p. decrease y-o-y). Additionally, the capital adequacy ratios would remain above the minimum regulatory levels in case of a full impairment of 14% of the loan portfolio as of March 2019. The declining trend of the capital adequacy ratios is caused mostly by guarantees portfolio growth (10x increase for the year 2018 or 3x increase from March 2018 to March 2019). In addition, the assets quality continues to be outstanding, with the level of non-performing loans less 1% as of March 2019, way below the market average of 5,7% for the same period. However, the structure of the loans has shifted towards individuals, the total loans to individuals increased more than 7x during 2018, mainly due to the remarkable growth (32x y-o-y) of mortgage loans. We will keep on watch this part of the bank's balance sheet in terms of the share of potentially troubled loans.

The risks related to the potential deterioration of the asset quality by the end of the year, partly mitigated by the current profitability indicators, that showed a stable dynamic over the past year

⁵ "National mortgage fabric" - specialized financial service company for the Russian mortgage market (part of the group of companies "Region").

remaining at acceptable levels according to the Agency's internal benchmarks: ROE calculated on the basis of Russian accounting standards (RAS) stood at 5,8% for the period of 01.04.2018 till 01.04.2019. Moreover, coverage of operating costs by net interest, fees and commissions income after provision for impairment of loans was favorable at around 160% as of March 2019. However, the final results for the year 2018 according to the IFRS 9 standard are worrisome, with a net loss of RUB 26,4 m as compared to RUB 190 m profit in 2019 mostly as a result of operating expenses growth related to the implementation of the new bank's strategy and losses on trading of securities.

The stable outlook reflects the Agency's opinion that there is a high probability of maintaining the currently assigned credit rating in the mid-term perspective. The development strategy implemented by the bank is set out rather clear and is so far executed rather well. JSC RUSNARBANK increased number clients-individuals more than 3 times over the last year, while its share in overall assets and loans on the Russian market remained almost unchanged. The Agency will closely monitor the efficiency of the bank's current business strategy implementation, and if the all objectives and limits originally planned are reached by end 2019, we can consider it as a basis for positive rating action with all other factors not deteriorated by that time.

COMPANY PROFILE:

JSC RUSNARBANK has a general license N 3403 issued on 11.04.2002. The bank had 48 SME borrowers and 1 919 individual borrowers as of 01.02.2018. The loan portfolio for individuals increased by more than 6x over the past 12 months while total portfolio for legal entities decreased by almost 50% as of end 2018. The bank is also a member of the Deposit Insurance System (DIS) since 11.06.2008.

Related research:

- ◆ Research Report on the Russian Banking Industry – 06.09.2017:
https://raexpert.eu/files/Industry_annual_report_Banks_06.09.2017.pdf

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RATING HISTORY:

Date	Review reason	Rating Score	Outlook
25.05.2018	Scheduled review	B+	Stable
18.10.2017	Unscheduled review	B+	Stable
26.05.2017	Initial assignment	B+	Developing

Minute's summary:

The rating committee for JSC RUSNARBANK was held on 20 May 2019. The quorum for the rating committee was present. After the responsible expert presented the factors which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Banks methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the rating class voting.

The rating was disclosed to the rated entity prior to the publication and was not changed during the process of coordination.

The following methodology was used for the rating assessment:

- [Methodology for Assigning Credit Ratings to Banks – Full Version \(from September 2018\)](#)
- [Methodology for Assigning Banking Sector Risk Score – Full Version \(from September 2018\)](#)

Descriptions and definitions of all rating categories can be found under the [Rating scale](#) section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

The definition of default can be found on the Agency's website in the section for [Internal policies](#).

This rating is solicited. The rated entity participated in the rating assignment process.

No other third party participated in the preparation of the rating.

Main sources of information:

- Questionnaire from JSC RUSNARBANK based on the form provided by the Agency;
- Financial statements from JSC RUSNARBANK, according to according to the Russian Accounting Standards for the past 24 months;
- Audited annual reports of JSC RUSNARBANK, according to IFRS (including the auditor's report and notes to the accounts) for 2013-2018;
- Audited annual report of JSC RUSNARBANK, according to RAS (including the auditor's report) for 2016-2018;
- Statute of JSC RUSNARBANK;
- Strategy of JSC RUSNARBANK;
- Documents regulating risk management of JSC RUSNARBANK;
- Documents regulating corporate governance of JSC RUSNARBANK;
- Answer for additional request based on the form provided by the Agency;
- Information received during the interview with the management of the bank;
- Information from media and other public sources.

Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information as well as non-public information (obtained from the rated entity and/or other third parties) which was considered to be reliable, complete and non-biased. The responsible expert performed rating assessment of the bank with information considered as the most reliable and up to date in accordance to the overall position of the bank and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

Conflict of interest

The responsible expert was neither influenced nor biased by third parties during the rating assessment. The experts involved in the rating assessment and revision of the rated entity showed no conflict of interests before initiation of the rating process.

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies from RAEX group.

Risk warning

The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's press-release.

This press-release represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

Office responsible for preparing the rating

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

Rating-Agentur Expert RA GmbH is a credit rating agency established in Germany and therefore shall comply with all applicable regulations currently in force in the European Union.

The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.