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Rating-Agentur Expert RA GmbH confirmed the credit rating of JSC CB Assotsiatsiya at 'BB' (Sufficient level of creditworthiness) according to the international scale. The rating outlook was changed from stable to negative which means that in the mid-term perspective the likelihood of a credit rating downgrade is high.

MAJOR FACTORS THAT INFLUENCED THE RATING:

Positive factors:

- Maturities of assets and liabilities are well matched in the short- and the long-run, as evidenced by the liquidity ratios: N2=308,7%, N3=378,8% and N4=21,0% as of June 2016¹;
- Sufficient capital adequacy as shown by the capital adequacy ratios: N1.0=16,1%, N1.2=12,8%, N1.1=12,8%² as of June 2016;
- Reduced currency risk as the maximum open currency position on one currency was equal to 0,7% of the bank's capital. Also, the open currency position in all currencies was equal to 0,8% of the bank's capital as of June 2016;
- High level of collateral to loan portfolio ratio. The coverage of the loan portfolio by collateral including and excluding collateral formed by guarantees and sureties were 424,7% and 135,9% as of June 2016 respectively.

Restricting factors:

- Significant geographical concentration of transactions. The share of funds raised in the base region was equal to 96%; the share of loans issued in the base region was equal to 92% as of January 2016. Nizhny Novgorod oblast is characterized by moderate level of investment risks³;
- Noticeable concentration of credit risks on the largest customers: the largest credit risks to the total assets net of reserves amounted to 36,1% as of June 2016;
- High level of restructured and rolled over loans in the total loan portfolio. As of January 2016, the share of loans reclassified as loans with better quality to total loan portfolio equaled 25,9%⁴. Additionally, the share of rolled over loans was equal to more than 13% of total loans;
- Deterioration of the loan portfolio quality over the 1H 2016, evidenced by the negative dynamics of overdue debt and the share of loans from low quality categories. The overdue debt on loans to individuals increased from 4,5% as of December 2015 to 8,5% as of June 2016, while overdue debt on loans to legal entities increased from 2,7% to 4,5% for the

¹ N2 – instant liquidity normative ratio; N3 – current liquidity normative ratio; N4 – long-term liquidity normative ratio.

² N1.0 – capital adequacy ratio; N1.2 - Tier 1 capital ratio; N1.1 - Common Equity Tier 1 (CET 1) ratio.

³ Nizhny Novgorod oblast was rated as the 2B "moderate potential - moderate risk" in the rating of investment attractiveness by RAEX-Moscow in 2015.

⁴ This figure refers to the indicator "the share of the loans classified in accordance with the paragraph 3.10 of regulation №254-P to total loans to individuals, legal entities, individual entrepreneurs and banks".

same period. In addition, the share of loans from the IVth and Vth quality categories increased from 3,0% to 4,6%;

- Decreasing profitability indicators as shown by negative dynamics of return on equity calculated without volatile components (net income from foreign exchange transactions and revaluation of it, etc.) (from 35% in 4Q 2015 to 6,5% in 2Q 2016) and net interest margin (from 4,5% in 4Q 2015 to 4,1% in 2Q 2016);
- Persistently higher concentration of the corporate loan portfolio among industries. Loans to the three largest industries equaled 59,4% of the total loan portfolio of legal entities and individual entrepreneurs as of 01.07.2016.

Negative factors:

- High concentration of funding on the largest creditors: the share of the 10 largest creditors in gross liabilities and equity was 21,3%; share of the largest creditor in gross liabilities and equity was 10,8% as of June 2016;
- Loose loan provision policy: the difference between calculated and minimum possible reserve ratio amounted to 1,1 p.p. as of June 2016;
- Lack of specific risk-analysis instruments and certificates of management quality. The bank's strategy planning is short-term oriented (the bank has only plans for cash-flow, capital and balance-sheet for 2016). Additionally, the bank does not have an obligatory policy of collateral insurance.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Normalization of the loan portfolio quality indicators and indicators of the bank's profitability;
- Significant reduction of the concentration of assets and liabilities transactions on the largest clients;
- Changes in the bank's provision policy evidenced by noticeable increase of the difference between calculated and the lowest possible reserve ratio;
- Consistent improvements in the bank's corporate governance and risk management procedures.

The following developments could lead to a downgrade:

- Further increase of overdue debt, especially in the loan portfolio to legal entities taking into account the high share of construction industry, and increase of the share of loans from the low quality categories;
- Further decrease of the bank's net interest margin and ROE calculated without reversible components combined with instability of the bank's financial results;
- Tightening of the Central Bank of Russia policy regarding loans to related parties, in particular the introduction of the normative ratio N25 (credit risk of one single related party to the bank's equity).

"The outlook downgrade for the credit rating of JSC CB Assotsiatsiya is mainly driven by a significant deterioration in the quality of the bank's loan portfolio as reflected by the latest financial statements. During the 1H 2016 the share of overdue debt on loans to individuals increased by 4p.p. up to 8,5%, while overdue debt on loans to legal entities increased from 2,7% to 4,5%. In addition, the dynamic of the bank's profitability was negative with declining returns on equity (calculated without volatile components, such as net income from foreign exchange transactions) and net interest margin.

The rating of JSC CB Assotsiatsiya remains unchanged at the BB level reflecting the same level of risks mentioned during the assignment in April 2016. A highly concentrated resource base combined with the bank's non-conservative provision policy were among the main factors that disfavored the rating during the initial assignment. Also, the creditworthiness of JSC CB Assotsiatsiya is still positively supported by solid liquidity ratios and sufficient capital adequacy as well as high levels of loan collateral and low currency risks." – clarified Vladimir Gorchakov, rating associate of Rating-Agentur Expert RA GmbH.

COMPANY PROFILE:

Joint-Stock Company Commercial Bank Assotsiatsiya (number of license - 732) specialized on issuing loans to SMEs and big local enterprises, raising funds from individuals and local big enterprises (current accounts and deposits). The head office of the bank and 24 additional branches are located in Nizhny Novgorod oblast, where the bank conducts the largest part of its operations. The bank also has one additional office in the Kostroma oblast. Assets of the bank was equal to RUB 9 099 m as of June 2016 (233th place in the ranking of Russian banks by assets), the bank's equity was equal to RUB 1 202 m as of the same reporting date. The bank had profit after taxes equal to RUB 89,1 m for the 2Q 2016.

Responsible expert: Vladimir Gorchakov, Rating Associate of Rating-Agentur Expert RA GmbH.

Reviewer: Gustavo Angel, Rating Associate of Rating-Agentur Expert RA GmbH.

Related research:

- ◆ Research Report on the Russian Banking Industry – 26.08.2016:
http://raexpert.eu/files/Industry_report-Banks_26.08.2016.pdf

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RATING HISTORY:

Date	Review reason	Rating Score	Outlook
DATE OF THE RATINIG ASSIGNMENT / REVIEW	DEFINE WHETHER THIS WAS THE FIRST ASSIGNMENT OR A REVIEW OF THE RATING	RATING GRADE	RATING OUTLOOK
26.04.2016	Initial assignment	BB	Stable

Minute's summary:

The rating committee for JSC CB Assotsiatsiya was held on the 30 August 2016. 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. Short Public Version (from April 2015) can be found under the following link: <https://raexpert.eu/files/methodology/Methodology-Short-Credit-Ratings-Banks.pdf>. Descriptions and definitions of all rating categories can be found under the following link: <http://www.raexpert.eu/banks/> 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.

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 CB Assotsiatsiya based on the form provided by the Agency;
- Financial statements from JSC CB Assotsiatsiya, following RAS form for the past 24 months: 101, (102, 806, 807, 808, 345)*, 110, 115, 116, 117, 118, 123, 125, 128, 129, 135, 155, 157, 202, 302, 501, 603, 634, 711;
- Audited annual reports of JSC CB Assotsiatsiya according to IFRS (including the auditor's report and notes to the accounts) for 2012-2015;
- Statute of JSC CB Assotsiatsiya;
- Documents regulating risk management of JSC CB Assotsiatsiya;
- Documents defining development plans of JSC CB Assotsiatsiya for 2016;
- Documents regulating corporate governance of JSC CB Assotsiatsiya;
- 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.

*On a quarterly basis.

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 review.

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

Risk warning

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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.