Request for comments

Bank methodological cycle – August 2016

Rating-Agentur Expert RA GmbH invites market participants to provide comments on the proposed changes in the Bank credit rating methodology (hereinafter – the Methodology). During the methodological committee meeting held on the 26th of July 2016 a package of changes in the Methodology was discussed and approved by the independent members of the Advisory board which will lead to the following changes in the short version of the Methodology:

General definitions

1) **By applying corrections (regarding specific local banking system regulations and local market indicators) this methodology is applicable for banks operating outside Russia**.

   Rationale:
   From all sources of information used to populate the calculation file, "Forms of reporting according to the national accounting standards for the last two years" (RAS forms) is the only one used solely by Russian banks.
   If the rated bank is not Russian, the responsible expert works with information provided in the IFRS forms and obtained from the other sources mentioned in the methodology. Additionally, the benchmarks for the factor assessment are recalculated on the basis of the local regulation and banking system data of the country.

2) **We propose to make our methodology more transparent by including definitions for each of the factors under section 4. "System of indicators" in the methodology.**

   Rationale:
   We improve the transparency of our methodology by including a detailed explanation of the meaning and importance of each factor in the rating assessment. In this way, it will be more understandable how the rating assessment was carried out as well as which features of the factors influenced the final rating.

3) **We propose to change the name of the factor group "Stress factors of the resource base" to "Stress factors of the funding base" and to change the name of the factor "Resource base structure" for "Funding base structure).**

   Rationale:
   The expression "resource base" is not frequently used among market participants and could lead to confusion about which factor our methodology is intended to assess. "Funding base" is a clearer term which refers to all the sources of funds which are available for the bank, and therefore can be interpreted by market participants more easily.

4) **We propose to change the name of the factor "Quality of assets and off-balance sheet liabilities at risk" for "Quality of assets and contingent liabilities at risk".**

Rationale:
The expression "off-balance" is not usually used among market participants and is not reflecting the full meaning of what the factor is intended for as not all the off-balance sheet liabilities are contingent. "Contingent" is more commonly used among market participants and exactly captures the features of what we intend to assess with this factor.

5) **We propose to change the name of the factor group "Concentration of active operations on large customers" to "Concentration of credit risks on large customers".**

Rationale:
The term "active operations" is not used among market participants and could lead to confusion about the actual term we intend to use; the risk derived from the concentration of credit instruments on large customers. Instead, "Credit risks" is a clearer term which captures exactly what the assessment is intended for, and therefore can be interpreted by market participants more easily.

Financial risks

6) **We propose to add a new factor called "Sensitivity of the capital to credit risks realization".**

Rationale:
This factor assesses how "far" are the bank's "safety buffers" from the benchmarks of the stress factor of active-passive operations. The stress-testing of "safety buffers" on all kinds of capital is undertaken and based on different scenarios of assets' impairment, considering credit risk concentration and credit quality of counterparties in order to test the sensitivity of capital adequacy against the credit risk. As the basis of stress-testing, the Agency assesses the most likely level of impairment of granted loans and other assets of credit nature, realization of which is possible in the short-run for banks with similar specialization and risk profiles.

7) **We propose to add a new factor called "Provision policy".**

Rationale:
In our view, by considering "provision policy" as a new factor we will be able to have a more accurate evaluation of the risk policy of the bank as it assesses the coverage level of the loan portfolio. The creation of excess reserves can be regarded as a positive factor in relation to creditworthiness, as the bank can have a certain degree of credit strengths in periods of asset quality deterioration. It can be positively evaluated if a bank does not decrease the actual reserves by using collateral from I and II quality category (high liquid collateral) when it is available.

Internal support factor

1) **We propose to replace the support-factor called "covering assets under stress" with the support-factor called "Safety buffer".**

Rationale:
The support factor "Safety Buffer" is applied only for banks having simultaneously enough capital to cover potential large credit risks and enough "liquidity" buffers to cover potential funds withdrawal. This factor is applicable only for banks having no stress-factors of active-passive operations and stress-factor of funding base.
In our view, the factor "covering the assets under stress" has a number of negative characteristics, which are overtaken by the new factor proposed. Such negative features are the following**:**

- "Covering the assets under stress" underestimated the risks of concentration;
- Banks heavily exposed to credit risks were often assessed with a support-factor for "Covering the assets under stress";
- "Covering of the assets under stress" didn't exclude assets/ borrowers with high credit ratings (rating equal to or higher than A++ according to RAEX-Moscow (national scale) or BB according to S&P (foreign currency)).

External stress factor

1) **We propose to introduce the stress-factor for banks involved in the "Official procedure of financial recovery as an investor bank".**

Rationale:
This stress factor captures the risks associated with the process of financial recovery of a troubled bank (operational, regulatory and reputational). When a rated bank (investor bank) acquires a bank involved in the official procedure of financial recovery (troubled bank), the merged capital of the investor bank could be harmed as a result. In our view, by assessing the aggregated capital adequacy of the investor bank after the acquisition of the troubled bank, we could account for the risks involved in the process of acquiring and merging the balance sheets of both banks.

Please submit your comments to: info@raexpert.eu or compliance@raexpert.eu by the 15th of September 2016. Your response to this consultation will be published unless confidentiality is requested.