

Rating-Agentur Expert RA GmbH confirmed the credit rating of JSC CB Assotsiatsiya at 'BB-' according to the international scale. The rating outlook is stable.

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 is stable which means that in the mid-term perspective the likelihood of the credit rating stability is high.

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 risk exposure to the banking system of JSC CB Assotsiatsiya is Moderate.

MAJOR FACTORS THAT INFLUENCED THE RATING:

Positive factors:

- The bank's provision policy is adequate according to the Agency's opinion, as the difference between calculated and minimum possible reserve ratio stood at 5,1 p.p. as of end 2017;
- The concentration of credit risks on the largest customers is moderate: the largest credit risks to the total assets net of reserves amounted to 27% as of December 2017;
- Maturities of assets and liabilities are well matched in the short- and the long-run, as evidenced by the liquidity ratios: instant liquidity ratio and current liquidity ratio stood at 131,7% and 148,1% respectively, while the long-term liquidity ratio was equal to 26,2% as of end 2017¹;
- Sufficient capital adequacy as shown by the capital adequacy ratios: general capital adequacy ratio was equal to 16,9%, while both Tier 1 capital and Common Equity Tier 1 (CET 1) ratios stood at 13,5%² as of end 2017; in addition, the level of capital adequacy ratios remains above the minimum statutory level in case of full impairment of 10% of the loan portfolio;
- 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 0,7% of the bank's capital as of end 2017;
- High level of collateral to loan portfolio ratio. The coverage of the loan portfolio (without taking into account interbank loans) by collateral including and excluding collateral formed by guarantees and sureties were 581% and 152% as of end 2017 respectively;
- High level of reliability of funds placed on correspondent accounts and issued interbank loans.

Restricting factors:

¹ 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%);

² These ratios were calculated on the basis of the entity's financial statements 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.

- 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;
- Profitability indicators, despite having shown a positive dynamic over the last year, remain moderately low according to the Agency's internal benchmarks: return on equity calculated without volatile components (net income from foreign exchange transactions and revaluation of it, etc.) stood at 3,8% in 2017, while general ROE for the last 12 months was equal to 10,9%. Additionally, the ratio of net interest, commission and fee income to operating costs was moderate at 153% in the last year;
- The quality of the loan portfolio remains deteriorated: the overdue debt on loans was equal to 5,0% as of December 2017, as compared to 3,3% a year before.

Negative factors:

- High concentration of funding on the largest creditors and sources. The share of the 10 largest creditors in the balance sheet remains high at 21,2%, while the share of the largest creditor in gross assets stood at 11,3% as of end 2017; Additionally, the share of the key source of funding in gross liabilities was around 60% for the same period (funds from individuals and individual entrepreneurs);
- High concentration of the corporate loan portfolio among industries. Loans to the three largest industries (manufacturing, agricultural and construction industry) equaled 71,2% of the total loan portfolio of legal entities and individual entrepreneurs as of end 2017;
- Weak market position of the bank on the national level combined with a high geographical concentration of operations. The size of the bank is very small in terms of assets at RUB 11,8 bn (equivalent to around EUR 171 m) relative to the global and regional market, as well as in the market where the bank operates (Russian market). The market share of the bank was as low as 0,01% of the total assets in Russia by end-2017. Moreover, the majority of the bank's operations is located in one single region of Russia - Nizhny Novgorod oblast. However, these risks are partly mitigated by the long-term relationships between the bank and its clients, as well as good knowledge of the local market;
- Lack of specific risk-analysis instruments and certificates of management quality. The bank's strategic planning is short-term oriented (the bank strategy is limited to 2018). Additionally, the bank does not have any mandatory policy for collateral insurance.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Reduction of the loan portfolio concentration on the largest borrowers, which would reduce the pressure on the bank's capital in case of credit risk materializations;
- Significant and sustainable improvements of the bank's profitability indicators combined with a sustainable increase of the bank's net interest income;
- Considerable and sustainable decrease of the share of overdue debt within the following quarters.

The following developments could lead to a downgrade:

- Significant decrease of the bank's ROE (calculated without reversible components), combined with instability of the bank's financial results;
- Tightening of the CBR policy regarding loans to related parties, given elevated share of related parties in the bank's assets;
- Deterioration of the bank's financial metrics as a result of an unexpected withdrawal of short-term customer's funds.

JUSTIFICATION OF THE RATING:

The Agency confirmed the credit rating of JSC CB Assotsiatsiya at 'BB-' with a stable outlook. The rating remains restrained by highly concentrated funding base, weak market position and significant geographical concentration of transactions combined with deteriorated quality of the loan portfolio and moderately low profitability indicators. At the same time, the rating assessment was positively supported by solid liquidity ratios, sufficient capital adequacy as well as high levels of loan collateral and reliability of interbank assets.

As a small-sized Russian bank, JSC CB Assotsiatsiya has historically specialized on the provision of financial services (current accounts and deposits) to the group of industrial enterprises from its core region (Nizhny Novgorod oblast). This exposes the bank to a high concentration of its funding base on a reduced number of clients and geographical locations. The share of 10 largest creditors constituted for 21% of the balance sheet as of December 2017. However, most of the bank's largest creditors are related parties, which can reduce the risks of sudden funds withdrawal.

The asset transactions of JSC CB Assotsiatsiya are also exposed to the geographical and industry concentration risks, as the majority of loans are issued in Nizhny Novgorod oblast and loans to the three largest industries equaled 71% of the total loan portfolio of legal entities as of December 2017. This, combined with the significant share of corporate borrowers in risky segments such as local SMEs and construction businesses, contributed to the deterioration of the loan portfolio quality. This was evidenced by 5% of overdue debt by end 2017, as compared to 3,3% a year ago. Moreover, the Agency assessed the profitability indicators as a restricting factor as return on equity calculated without reversible components stood at 3,8% in 2017.

The aforementioned risks are partly mitigated by very high level of liquidity ratios, as well as sufficient capital adequacy ratios. These metrics resulted from the bank's policy, which was based on placing part of its funds in the short-term interbank loans and correspondent accounts in banks with high credit ratings (including foreign banks and Central Bank of Russia). The share of this type of assets increased over the past 12 months and reached more than 27% of total assets as of December 2017.

In addition, the deterioration of the loan portfolio is partially offset by a large coverage of loans by collateral which amounted to 581% as of December 2017. Moreover, the currency risk exposure of the bank is almost negligible, as the open currency position on all currencies was equal to 0,7% of the bank's capital as of December 2017.

The stable outlook reflects the Agency's opinion that the bank's financial stance is likely to remain unchanged within next 12 months with a high probability. We expect the bank to remain exposed to risks related to the funding base concentration, as well as geographical and industry concentration of assets. In addition, we do not expect significant changes in the levels of overdue debt and profitability indicators, taking into account the overall stance of the Russian banking system and entity's specific characteristics.

COMPANY PROFILE:

JSC CB 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 29 additional branches are located in Nizhny Novgorod oblast, where the bank conducts the largest part of its operations. Assets of the bank was equal to RUB 11 822 m as of 01.01.2018 (202nd place in the ranking of Russian banks by assets), the bank's

equity was equal to RUB 1 358 m as of the same reporting date. The bank had profit after taxes equal to RUB 120,7 m for 2017.

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 – 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 |
|-------------|----------------------|---------------------|----------------|
| 04.05.2017 | Scheduled review | BB- | Stable |
| 28.11.2016 | Unscheduled review | BB- | Stable |
| 02.09.2016 | Unscheduled review | BB | Negative |
| 26.04.2016 | Initial assignment | BB | Stable |

Minute's summary:

The rating committee for JSC CB Assotsiatsiya was held on 23 April 2018. 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 August 2017) can be found under the following link: https://raexpert.eu/files/methodology/Methodology_Short_Banks_August2017.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, 303, 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 2012-2017;
- Statute of JSC CB Assotsiatsiya;
- Documents regulating risk management of JSC CB Assotsiatsiya;
- Documents defining development plans of JSC CB Assotsiatsiya for 2016-2018;
- 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 process.

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.