

**Rating-Agentur Expert RA GmbH confirmed the credit rating of JSC «RUSNARBANK» at 'B+' according to the international scale. The rating outlook was changed from developing to stable.**

Rating-Agentur Expert RA GmbH confirmed the credit rating of JSC «RUSNARBANK» at 'B+' (Moderately low level of creditworthiness) according to the international scale. The rating outlook was changed from developing to 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 has introduced a complete strategy containing a list of key market segments, an analysis of competitive and macro environment as well as an indication of the bank's strengths and weaknesses relative to the key competitors. Despite the detailed description of the potential goals, we expect the execution to be a challenge for the bank (see the stress factor below);
- Capital adequacy was maintained at very high levels throughout 2017 with the main capital adequacy indicators being as follows: N1.0=72,3%, N1.2=68,7%, N1.1=68,7%<sup>1</sup> as of July 2017. Additionally, in case of full impairment of 86,7% of the loan portfolio by July 2017, the capital adequacy ratios would remain above the minimum statutory levels;
- Maturities of assets and liabilities are well matched in the short and the long run, which is supported by the very favorable liquidity ratios: N2=154,7%, N3=248,4% and N4=2,2%<sup>2</sup> as of July 2017. Additionally, the bank has a solid share of highly liquid assets (LAM) to raised funds of 83,4% as of the same date;
- Substantial additional liquidity source in the form of available loans collateralized by securities (excluding bills) and fund raising opportunities through REPO with securities, which, after being discounted for their respective risk level, amounted to 42,8% of raised funds as of July 2017;
- Excellent coverage of the loan portfolio (excluding issued interbank loans) by collateral including and excluding collateral formed by securities and guarantees and sureties - 485,6% and 159,8% as of July 2017 respectively;
- Outstanding quality and liquidity of the securities portfolio with the share of highly liquid securities<sup>3</sup> (in security portfolio) at 62,4% as of July 2017;
- High reliability of funds placed on correspondent accounts;

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

<sup>2</sup> N2 – instant liquidity normative ratio; N3 – current liquidity normative ratio; N4 – long-term liquidity normative ratio.

<sup>3</sup> In this case, highly liquid securities include investments in securities included in the Central Bank of Russia (CBR) Lombard list and investment in securities that are not included in the CBR Lombard List, but are included in calculation of MICEX or RTS indexes, and the value (weight) of these securities in these indexes is 1% or more.

- The bank's profitability remained at an acceptable level with ROE at 8,35% in July 2017. Additionally, coverage of operating costs by net interest, fees and commissions income after provision for impairment of loans is favorable at around 1,4x in July 2017;
- Minor signs of specialization and captivity with the share of related parties' assets in total assets at 1,5% and almost no interest and fee income from related parties in July 2017.

#### Restricting factors:

- Average macro profile as the bank operates in a market characterized by a moderate level of banking sector risk (BSR);
- Large credit risks<sup>4</sup> (LCR) to assets have increased amounting to 39,2% by July 2017, the concentration of credit risks on the largest customers remains high, as the share of the maximum credit risk from a single borrower to assets net of reserves stood at 9% in July 2017;
- Overall high and growing share of overdue loans due to a shrinking loan portfolio of legal entities and individual entrepreneurs, and loan portfolio of individuals. The share of overdue loans in the portfolio of legal entities and individual entrepreneurs as well as in the portfolio of individuals at 13,3% and 15,1% as of July 2017 respectively;
- Operational risk practices have a capacity to improve. The bank lacks certificates of management quality.

#### Negative factors:

- Weak competitive position in all sectors of the retail banking market reflected by the low amount of borrowers (82 legal entities as of July 2017), the low amount of assets (RUB 0,3 bn attributed to legal entities as of July 2017), narrow variety of sales channels, as well as limited branding and brand awareness;
- Low diversification by clients and insufficient stability of the funding base. The share of the 10 largest groups of creditors and the largest creditor in the gross liabilities were as high as 50,5% and 24,7% respectively by July 2017. Additionally, the funding base growth dynamic remained rather volatile and was negative at -15% over the past 12 months as of July 2017;
- Provision policy, evidenced by the narrow and shrinking gap between the calculated and the lowest possible loan loss reserve (LLR) ratio at 0,23 p.p. as of July 2017, in the view of the Agency, is not conservative enough, taking into account the size of the bank;
- Narrow geographical distribution of the business (the bank has two separate business units in two federal states of Russia), with 100% of the bank's credit portfolio being concentrated in the region with moderately low level of investment risk;
- Rather complicated ownership and control structure with multiple intermediate companies, including offshore companies, between the bank and the individual exercising ultimate control over the bank. Additionally, the lack of independent directors on the board has a negative impact on the bank's corporate governance.

#### Internal stress factors:

- There is an uncertainty about the future direction of the bank's business model and its sustainability<sup>5</sup>. The bank is currently going through a transition phase due to the recent controlling shareholder change, which is reflected in the current rather risk-averse business model of the bank – dealing CCP cleared REPOs. Given the newly implemented strategy focused on developing the bank as a multi-purpose retail and commercial bank servicing SME's and individuals, and dealing in the inter-bank market, we believe that the

<sup>4</sup> 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.

<sup>5</sup> The Agency acknowledges the positive influence of the new strategy introduction on the bank's creditworthiness.

bank may face additional market positioning and regulation requirement challenges within the next year.

#### SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- A successful and sustained implementation of the new business strategy.

The following developments could lead to a downgrade:

- Further deterioration of the bank's loan portfolio quality, which might negatively affect the profitability figures.

#### JUSTIFICATION OF THE RATING:

The Agency confirmed the rating of JSC «RUSNARBANK» at 'B+', however changed the outlook to stable. One of the key determinants of the credit outlook change was that in July 2017 the bank implemented a mid-term development strategy. The strategy considers current macroeconomic conditions, contains the analysis of competitive environment, indicates the bank's strengths and weaknesses in relation to the competitors and it is set to move the bank towards a defined target, enhance creditworthiness and strengthen the competitive position. However, the rating continues to be restrained by the limited competitive position of the bank, low diversification and insufficient stability of the funding base, as well as challenges related to execution of the bank's new strategy. At the same time, the rating is supported by a very good capital adequacy and liquidity position, outstanding quality of interbank loan and security asset portfolio and acceptable collateral coverage of the loan (ex-interbank) portfolio.

Being a small-scale Russian bank headquartered in Moscow and represented in Belgorod Region, JSC «RUSNARBANK» 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. Additionally, the bank has been historically specialized in servicing a limited amount of related entities and individuals, most of which were related to the former controlling shareholder. Consequently, the bank's profitability to a large extent depends on the state of the market, as well as on the credit risk realizations of its key clientele. After the change of the controlling shareholder in November 2016, the bank has been making attempts to diversify and redistribute the funding base, however the share of the largest groups of creditors and the largest creditor in the gross liabilities remained rather high, which exposed the bank to a significant solvency risk. On the positive side, the Agency ascertains a presence of long-lasting relationship with the top non-related creditors, as well as an increased (relative to the previous rating assessment) amount of funds raised from the related entities.

The extent of the credit risk of the bank is largely influenced by its current asset allocation strategy. The Agency observed a sharp increase in security portfolio at the expense of interbank loans and loans to customers, evidenced by a 42,6 p.p. increase in security portfolio to total asset ratio along 1H 2017. As of this date, around 90% of the bank's assets are allocated in interbank loans and investments in mostly liquid securities, which has a positive effect on the bank's capital adequacy and liquidity position and reduces counterparty risk. However, the current asset allocation practices may keep the bank from reaching its year 2019 ROE target of 15%, which given a continued non-interbank credit portfolio quality deterioration, indicate a rather questionable sustainability of the current business strategy and set additional challenges towards risk mitigation and the strategy implementation.

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, but the management of the bank is yet to face challenges towards its implementation. Uncertain market positioning, operational risk practices with a capacity to improve, as well as the new regulation requirements extend the bank's credit

risk challenges within the next year. The Agency will closely monitor the efficiency with which the bank is due to implement the new business strategy.

**COMPANY PROFILE:**

JSC «RUSNARBANK» has a general license N° 3403 issued on 11.04.2002. The bank had 83 SME borrowers and 91 individual borrowers as of 01.07.2017. The loan growth rate over the past 12 months was 4%. The bank is also a member of the Deposit Insurance System (DIS) since 11.06.2008.

Responsible expert: Ilya Makunin, Rating Analyst of Rating-Agentur Expert RA GmbH

Reviewer: Hector Alvarez, Rating Associate of Rating-Agentur Expert RA GmbH

**Related research:**

- ◆ Russian Bank Industry Research – 06.09.2017:  
[https://raexpert.eu/files/Industry\\_annual\\_report\\_Banks\\_06.09.2017.pdf](https://raexpert.eu/files/Industry_annual_report_Banks_06.09.2017.pdf)

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RATING HISTORY:

<b>Date</b>	<b>Review reason</b>	<b>Rating Score</b>	<b>Outlook</b>
26.05.2017	Initial assignment	B+	Developing

### **Minute's summary:**

The rating committee for JSC «RUSNARBANK» was held on 11 October 2017. 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](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 «RUSNARBANK» based on the form provided by the Agency;
- Financial statements from JSC «RUSNARBANK», 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 «RUSNARBANK», according to IFRS (including the auditor's report and notes to the accounts) for 2013-2016;
- Audited annual report of JSC «RUSNARBANK», according to RAS (including the auditor's report) for 2016;
- 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.