25 May 2018

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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 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:

- In mid-2017 the bank 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. The ongoing strategy implementation path was assessed to be favorable, as the bank made good progress in terms of volume accumulation of loan and guarantee businesses, it opened new additional offices and received accreditation from the Federal Corporation for Development of SME. Nevertheless, given current industry economic developments, the Agency expects further execution of the strategy to be a challenge for the bank. Additionally, the bank's strategic planning remains short-term oriented, as it is limited to the end of 2019;
- Capital adequacy was maintained at very high levels throughout 2017 as shown by the capital adequacy indicators: general capital adequacy ratio at 24,2%, Tier 1 capital and Common Equity Tier 1 (CET 1) ratio both at 21,6%[1] as of end-2017. Additionally, the capital adequacy ratios would remain above the minimum statuary levels in case of a full impairment of 17,7% of the loan portfolio as of end-2017;
- Profitability indicators showed a stable dynamic over the past year remaining at acceptable levels according to the Agency's internal benchmarks: ROE calculated without volatile components (net income from foreign exchange transactions and revaluation of it, etc.) stood at 5,4% as of end-2017, while general ROE for the last 12 months was at 9,3%. Additionally, coverage of operating costs by net interest, fees and commissions income after provision for impairment of loans was favorable at around 1,6x as of end-2017;
- 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 very high levels of 113,8% and 32,3%[2] respectively as of the end of 2017, the instant liquidity ratio and the ratio of highly liquid assets (LAM) to raised funds have gradually deteriorated

[1] 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;
[2] 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%);

through 2H 2017 down to 20,2% and 4,9% respectively as of end-2017, however, it has a limited negative impact on the bank's credibility;

- Additional liquidity source in the form of available loans collateralized by securities (excluding bills) and fund raising opportunities through REPO with securities remains substantial which, after being discounted for its respective risk level, amounted to 21,6% of raised funds as of end-2017;
- The relative quality of the loan portfolio improved as the amount of loans to legal entities and individual entrepreneurs and to individuals increased in 2H 2017. The share of overdue loans in the portfolio of legal entities and individual entrepreneurs as well as in the portfolio of individuals was at 0,85%[3] and 4,72% as of end-2017 respectively;
- 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 214,9% and overall high share of collateralized loans to total amount of loans to legal entities and individuals at 87,9% as of end-2017;
- Quality and liquidity of the securities portfolio remain outstanding with no security investments being rated lower than BB level (or equivalent rating in international scale) as of March 2018;
- Funds placed on correspondent accounts continue on average to be highly reliable;
- The bank is characterized by favorable corporate governance practices, which are however negatively impacted by the absence of independent directors on the board.

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 risks[4] (LCR) to assets have increased up to 43,1% by the end of 2017, the concentration of credit risks on the largest customers improved, but remained substantial, as the share of the maximum credit risk from a single borrower to assets net of reserves stood at 2,9% as of end-2017;
- Increased signs of specialization and captivity. The share of loans in the total loan portfolio and the share of income in the total interest and fee income attributed to related parties increased from 0,2% and 0,1% as of end-2016 up to 66,1%[5] and 10,3% respectively as of end-2017 according to the annual IFRS financial statement. At the same time, the share of assets attributed to related parties in total bank's assets was around 39,1% as of end-2017, as compared to 2,4% a year ago. The above was mainly caused by the related party REPO deal[6], which carries a moderately low amount of credit risk given the more than substantial amount of very high quality collateral posted against it;
- Operational risk practices have a capacity to improve. The bank lacks certificates of management quality.

Negative factors:

- The bank continues to occupy a relatively weak competitive position in all sectors of the retail banking market on both national (Russian market) and international level reflected by the low amount of borrowers (68 legal entities and 56 individuals as of March 2018), the low amount of assets (RUB 2,9 bn attributed to legal entities excluding REPO deals and

[3] Calculation does not include REPO deals.
[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.
[5] More than 90% of loans with related parties attributed to the REPO deal with a professional participant of the financial market.
[6] On the 28th of April 2018 the bank has closed the REPO deal, however the Agency is uncertain about the fact that in the mid-term perspective there will be no high participation of related parties in the bank`s operations reversal.

individuals as of March 2018), narrow variety of sales channels, as well as limited branding and brand awareness;

- Low diversification by clients and increased volatility of the funding base, mainly caused by funding base growth. The share of the 10 largest groups of creditors and the largest creditor in the gross liabilities were as high as 32,8% and 16,2% respectively as of end-2017;
- In our view, the provision policy is still not conservative enough, taking into account the size of the bank; this is evidenced by the narrow and shrinking gap between the calculated and the lowest possible loan loss reserve (LLR) ratio at 0,3 p.p. as of end-2017;
- Geographical distribution of the business remains narrow (the bank has seven 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.

Internal stress factors:

- The Agency remains cautious about the successful implementation of the bank's business model and its sustainability. The bank employed a rather risk-averse business model along 2017 – dealing REPOs and investing in high quality securities, as it was going through a transition period due to a controlling shareholder change. The bank may face additional market positioning and regulation requirement challenges in the mid-term, given the 2017-2019 strategy focused on developing the bank as a multi-purpose retail and commercial bank servicing SME's and individuals.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

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

The following developments could lead to a downgrade:

- 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+' with a stable outlook. The rating continues to be restrained by the limited competitive position of the bank, low diversification of the funding base by clients, as well as challenges related to execution of the bank's new strategy. At the same time, the rating assessment was positively 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. Additionally, albeit relatively narrow client base, the bank has restarted servicing related entities in 2017, mainly through REPO transactions. As a result, the bank's profitability continues to depend on the state of the Russian market, as well as on the credit risk realizations of its key clientele. 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 rather high. On the positive side, the Agency ascertains presence of the longlasting relationship with the top non-related creditors, as well as very substantial amount of funds raised from the related entities.

The extent of the credit risk of the bank continues to be influenced by its asset allocation policy. The Agency observed a further expansion of security portfolio by 71,4% in 2H 2017 up to 33% of total assets, characterized however by a rather low credit risk. Loan portfolio size has also increased substantially in the same period up to 62% of total assets, driven mainly by loans to legal entities and REPO deals with related entities, which were assessed to carry a moderately low amount of credit risk, given low amount of overdue and more than substantial amount of high quality collateral posted against them. Despite a tangible positive effect on the bank's capital adequacy and liquidity position, the current asset allocation practices may keep the bank from reaching its year end 2019 ROE target of 15%, which given current banking market developments, set additional challenges towards bank's business 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 and is so far executed rather well, but the management of the bank is still expected to face challenges towards its implementation. Uncertain market positioning and operational risk practices with a capacity to improve will extend the bank's credit risk challenges within the next year. The Agency will closely monitor the efficiency with which the bank will continue to implement the current business strategy.

COMPANY PROFILE:

JSC RUSNARBANK has a general license N° 3403 issued on 11.04.2002. The bank had 62 SME borrowers and 56 individual borrowers as of 01.03.2018. The loan portfolio growth rate over the past 12 months was 119,3% as of end 2017. 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:

- 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
18.10.2017	Unscheduled review	B+	Stable
26.05.2017	Scheduled review	B+	Developing

Minute's summary:

The rating committee for JSC RUSNARBANK was held on 18 May 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 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 2013-2017;
- Audited annual report of JSC RUSNARBANK, according to RAS (including the auditor's report) for 2016-2017;
- 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.