FitchRatings

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Fitch Upgrades Bank St Petersburg & Credit Bank of Moscow; Revises Sovcombank's Outlook to Positive

Fitch Ratings-Moscow-03 June 2019: Fitch Ratings has upgraded Bank Saint Petersburg PJSC's (BSPB) and Credit Bank of Moscow's (CBM) Long-Term Issuer Default Ratings (IDRs) to 'BB' from 'BB-'. The agency has also upgraded BSPB's and CBM's Viability Ratings (VRs) to 'bb' and 'bb-' from 'bb-' and 'b+', respectively. Fitch has also revised the Outlooks on PJSC Sovcombank's (SCB) Long-Term IDRs of 'BB' to Positive from Stable.

The upgrade of CBM mainly reflects a significant reduction in the volume of high-risk assets over the last two years due to active workouts, sales and provisioning, while preserving reasonable capital levels. In our view, the remaining volume of net high-risk assets is now more manageable, as risks are expected to be adequately covered by sound pre-impairment profit without impacting capital.

The upgrade of BSPB mainly reflects its extended record of stable performance and conservative risk appetite, as well as gradual improvement of the bank's core capitalisation. The ratings also factor in BSPB's established franchise in the bank's main region of presence, strong pre-impairment profitability mitigating manageable asset quality risks, and sound funding profile.

The revision of SCB's Outlook to Positive reflects our expectation that the rating could be upgraded within next 12-18 months, if the bank continues to broaden its franchise, while maintaining strong financial metrics.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS
IDRs

BSPB's and SCB's IDRs are driven by and aligned with the banks' respective VRs. The IDRs of CBM are notched up once from its VR, reflecting our view that the risk of default on senior obligations (which IDRs reference) is lower than the risk of the bank needing to impose losses on subordinated obligations to restore its viability (which the VR references). This is due to a large volume of junior debt (Tier 1 perpetual and the Tier 2 subordinated debt), which amounted to around 11% of end-2018 IFRS risk-weighted assets (RWAs) and could be used to restore solvency and protect senior debt holders in case of a material capital shortfall at the bank.

VRs

CBM

The bank's impaired loans (Stage 3 and purchased or originated credit-impaired (POCI)) were 5% of gross loans at end-1Q19 and were moderately covered at 52% by specific loan loss allowances (LLA). Stage 2 exposures made up an additional 5% of gross loans, but were lightly provisioned for. Stage 3 and Stage 2 loans largely overlap with our own assessment of the bank's high-risk assets. Positively, high-risk assets net of reserves significantly decreased to RUB76 billion at end-1Q19 (0.5x Fitch Core Capital (FCC)) from RUB149 billion at end-3Q17 (1.1x FCC). The net changes in this portfolio at end-1Q19 are as follows:

- RUB8 billion (5% of FCC) loan to a loss-making pharmacy company. The net risk significantly decreased by RUB31 billion compared with end-3Q17, due to a combination of provisioning and a sale of the exposure to investors who are potentially close to the bank's second-largest shareholder.

- RUB15 billion (10% of FCC) of loans to a financially weak related-party construction company for early-stage projects. These decreased by RUB10 billion due to some projects entering a more advanced completion phase where we no longer view them as high-risk. Mitigating the credit risk is the company's track record of operations with a number of completed projects and ability to refinance CBM's loans with third parties (including a large state bank) once projects have become more developed.

- RUB53 billion (36% of FCC) of large corporate loans to borrowers with high leverage or weak financial performance (eg auto dealers, oil refineries). The volume has decreased by RUB22 billion since end-3Q17, as the bank managed to work out and dispose of around RUB47 billion of these potentially problem exposures. At the same time Fitch has identified two other large loans where risk has increased. The bank has hard collateral against some of these loans, which mitigates the risk, although its repossession and sale could be challenging.

- Since end-3Q17, CBM has disposed of RUB11 billion of illiquid bonds and weak reverse-repo exposures with high counterparty risks and/or weak collateral.

We estimate that CBM's strong pre-impairment profit (RUB46 billion in 2018, or around 6% of average gross loans) is sufficient to cover about 60% of the above high-risk assets on an annual basis. Conservatively assuming an extra 50% stress on the high-risk assets, it would therefore require less than one year to reserve them sufficiently.

Net profitability in 2017-2018 was also strong with 17%-18% return on average equity (ROAE), albeit supported by moderate impairment charges.

The bank's core capital is only moderate relative to potential problems, with an FCC of 11% at end-2018 and regulatory core Tier 1 capital ratio of a lower 9% at end-1Q19, due to higher loan provisioning under local GAAP . However, the bank's capital is bolstered by a large junior debt cushion, including additional Tier 1 debt and loss-absorbing Tier 2 subordinated debt, which together equal RUB154 billion or 11% of the bank's RWAs. In our view, this is sufficient to fully cover all of the above high-risk exposures in the worst-case scenario when large losses need to be recognised before the bank is able to absorb them through profits.

CBM's capitalisation should also be viewed in the context of significant 1.5x double-leverage at the level of the bank's holding company, Concern ROSSIUM, which also holds stakes in other businesses. The holdco had around RUB90 billion of debt at end-2018 and is largely reliant on upstreaming of liquidity and dividends to service this, potentially representing a significant burden for CBM. However, the bank's key shareholders currently hold most of the holdco's debt, which somewhat reduces this risk, although their funding sources are not fully clear to Fitch. The double leverage is expected to decrease to 1.4x after an expected sale of one of the holdco's businesses in 2019.

Liquidity risks are limited, despite a high funding concentration. The lumpy funding (direct repos and certain large corporate deposits) is well matched with a large reverse repo exposure collateralised by quasi-sovereign bonds. About RUB675 billion of such bonds received under reverse repos are currently unpledged and can be used to raise funding, if needed.

Excluding repos and dedicated funding, CBM's liquidity buffer (comprising cash and equivalents, short-term interbank and unencumbered on-balance-sheet securities repo-able with the central bank) at end-2018 covered customer accounts by a reasonable 30%, while refinancing risk for wholesale debt is limited for several years.

BSPB
Although BSPB's impairment numbers are somewhat elevated, our assessment of asset quality also considers high coverage by provisions and collateral. Impaired loans (Stage 3 and POCI) stood at 11% of gross loans and were well covered at 70% by specific LLAs at end-2018. Stage 2 exposures added a substantial 11% and are modestly provisioned for, but risks are well mitigated

by availability of hard collateral. Fitch estimates that the unreserved part of high-risk loan exposures (these include net impaired and certain Stage 2 loans) totalled a moderate 0.3x FCC at end-2018.

BSPB's FCC ratio improved to a solid 14% at end-2018 from 11% at end-2015, due to stable internal capital generation and conservative loan growth. However, regulatory Tier 1 ratio at end-2018 was a lower 9%, mainly due to larger provisions in local GAAP, but would be 10% if unaudited net profit is added to Tier 1 capital. This could allow reserving of 4% of gross loans or 62% of identified net high-risk exposures before breaching the capital conservation buffer.

Additional loss absorption capacity stems from BSPB's strong pre-impairment profit (6% of average gross loans in 2018 or 94% of high-risk assets), supported by strong net interest margin of about 4% and good cost efficiency. The bank's ROAE was a reasonable 12% in 2018. BSBP targets ROAE at 15% in the medium term, which seems achievable, but would require strong asset quality performance.

The bank's funding profile is a relative rating strength, as evidenced by a rather low 4% cost of funding, underpinned by a high 30% share of on-demand current accounts. The 20-largest deposits contributed to only 8% of total customer funding. At end-2018, BSPB's liquid assets (cash, short-term interbank loans and repo-able securities), net of 12 months' market repayments, covered customer accounts by 21%, while customer funding is highly sticky.

SCB
Fitch views SCB's asset quality as the bank's relative rating strength. This reflects its low credit impairment levels compared with peers', as indicated by impaired (Stage 3 and POCI) loans ratio of only 2.4% at end-2018, one of the lowest among larger Russian banks. These were 63% covered by specific LLA at end-2018. Stage 2 loans were a negligible 0.4% of loans, and 45% covered by LLA. Impairment charges have also been low, at slightly above 2% of average loans in 2018-2016, despite a sizable share of retail lending.

At end-2018, SCB's FCC was 11.6% of Basel III RWAs, down from 12.7% at end-2017, driven mostly by the acquisition of Rosevrobank in April 2018. The impact was partially offset by additional capital from a consortium of portfolio investors led by the Russian Direct Investment Fund (RUB6.6 billion) and ex-shareholders of Rosevrobank (a further RUB2.9 billion). Subsequently in April 2019 a RUB6.1 billion (0.7% of RWAs) capital injection was made by the same consortium to strengthen capitalisation.

SCB's stand-alone regulatory capital ratios were tighter (core Tier 1 of 9.9% at end-1Q19, adjusted for unaudited profits and subsequent capital injection), mostly due to the large amount of capital held at subsidiary Express-Volga Bank. The bank's regulatory Tier 1 (10.6%) and total (12.7%) capital ratios are supported by a number of qualifying subordinated instruments, including USD100 million Tier 1 eligible perpetual and USD150 million Tier 2 eligible subordinated bonds placed in March 2018, and RUB7 billion subordinated debt raised from Deposit Insurance Agency in 2015-2016 in the form of a coupon-bearing federal loan issued by the Russia's Ministry of Finance.

SCB's pre-impairment profitability before securities gain/loss is very strong (9% of average loans in 2018), providing a good buffer against potential losses. Net result, although also strong (ROAE of 22% in 2018), was negatively affected by securities loss following market volatility in April 2018 due to the imposition of US sanctions on some Russian individuals and corporates. On the other hand it was supported by a one-off RUB4 billion negative goodwill from the acquisition of Rosevrobank. The normalised ROAE is about 25%, Fitch estimates, which is more than sufficient to support planned growth without compromising capital ratios.

SCB's funding and liquidity is a relative strength. Funding has improved since the last review, following the acquisition of Rosevrobank with its granular and cheap funding base. SCB's consolidated cost of funding decreased by about 1pp in 2Q18-4Q18 compared with 1Q18 and 2017, while the share of current accounts rose to 21% of total customer accounts. Liquidity is supported by a sizable liquidity cushion, consisting of cash and unpledged securities (covering 37% of end-2018 total liabilities) and part of the loan book (4% of liabilities), which could be pledged to raise funding from the Central Bank of Russia.

DEBT RATINGS

Senior unsecured debt of SCB and CBM (including that issued by CBOM Finance Plc), is rated in line with the banks' respective Long-Term IDRs.

The rating of CBM's Tier 2 eligible subordinated debt (issued by CBOM Finance) is notched down once from the bank's VR. This incorporates zero notches for incremental non-performance risk and one notch for below-average expected recoveries in case of default.

The rating of CBM's perpetual additional Tier 1 notes (issued by CBOM Finance) is three notches below the bank's VR. The notching reflects incremental non-performance risk relative to the bank's VR, due to the option to cancel coupon payments at CBM's discretion, and likely high loss severity in case of non-performance, due to the instrument's deep subordination.

SUPPORT RATINGS AND SUPPORT RATING FLOORS

CBM's Support Rating (SR) of '4' and the Support Rating Floor (SRF) of 'B' reflect Fitch's view of a moderate probability of support from the Russian authorities, given CBM's franchise size and recently acquired status of a systemically important bank (D-SIB), as well as the recent record of state support being provided to three failed systemic banks without losses being imposed on their senior creditors in 2017.

SCB's and BSPB's SRs of '5' and SRFs of 'No Floor' reflect that support from the Russian authorities, although possible given the banks' significant deposit franchise, cannot be relied upon due to the banks' smaller size and a lack of official D-SIB status.

RATING SENSITIVITIES

VRS, IDRS, SENIOR DEBT

SCB's VR and Long-Term IDRs could be upgraded within next 12-18 months if the bank demonstrates its ability to further scale up its business and franchise, while maintaining strong profitability, asset quality and capital metrics.

An upgrade of BSPB's ratings would require a significant strengthening of the bank's franchise and credit metrics, notably asset quality and capitalisation.

An upgrade of CBM's ratings would require a marked improvement in asset quality and a strengthening of capitalisation through additional reduction of high-risk assets, higher core capital ratios and reduced risks stemming from double leverage at the holdco level.

Negative rating pressure for all banks may stem mainly from sharp asset quality deterioration resulting in material capital erosion. CBM's Long-Term IDR and senior debt ratings may also be downgraded to the level of the VR if the combined amount of junior debt falls below the volume of net high-risk asset exposures or the bank's minimum total capital requirement, increasing the risk of losses for senior creditors in case of the bank's failure.

SRs AND SRFs

If SCB or BSPB become designated as D-SIB, we could revise their SRFs to 'B' and upgrade their SRs to '4', similar to CBM's.

The rating actions are as follows:

Bank Saint Petersburg PJSC

Long-Term Foreign- and Local-Currency IDRs: upgraded to 'BB' from 'BB-', Outlooks Stable

Short-Term Foreign-Currency IDR: affirmed at 'B'

Viability Rating: upgraded to 'bb' from 'bb-'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'

Credit Bank of Moscow
Long-Term Foreign- and Local-Currency IDRs: upgraded to 'BB' from 'BB-', Outlooks Stable
Short-Term Foreign-Currency IDR: affirmed at 'B'
Viability Rating: upgraded to 'bb-' from 'b+'
Support Rating: affirmed at '4'
Support Rating Floor: affirmed at 'B'
Senior unsecured debt: upgraded to 'BB' from 'BB-'

CBOM Finance Plc (Ireland)
Senior unsecured debt: upgraded to 'BB' from 'BB-'
Subordinated debt: upgraded to 'B+' from 'B'
Hybrid capital instrument: upgraded to 'B-' from 'CCC+'

PJSC Sovcombank
Long-Term Foreign- and Local-Currency IDRs: affirmed at 'BB'; Outlooks revised to Positive from Stable
Short-Term Foreign-Currency IDR: affirmed at 'B'
Viability Rating: affirmed at 'bb'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
Senior unsecured debt: affirmed at 'BB'

Contact:

Primary Analyst
Roman Kornev
Director
+7 495 956 7016
Fitch Ratings CIS Limited
26 Valovaya Street
Moscow 115054

Secondary Analysts
Ruslan Bulatov, CFA (SCB)

Director
+7 495 956 9982

Artem Beketov, CFA (BSPB, CBM)
Associate Director
+7 495 956 9932

Committee Chairperson
Mahin Dissanayake
Senior Director
+44 20 3530 1618

Media Relations: Julia Belskaya von Tell, Moscow, Tel: +7 495 956 9908, Email: julia.belskayavontell@fitchratings.com
Louisa Williams, London, Tel: +44 20 3530 2452, Email: louisa.williams@fitchratings.com

Additional information is available on www.fitchratings.com

Applicable Criteria

Bank Rating Criteria (pub. 12 Oct 2018)
Short-Term Ratings Criteria (pub. 02 May 2019)

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