

August 9, 2019

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Key rating assessment
factors

ACRA upgrades PJSC Sovcombank to A+(RU), outlook Stable, upgrades bond issues RU000A0ZYJR6, RU000A100DZ5 to A+(RU), bond issue RU000A0ZYWZ2 to BBB+(RU), and bond issue RU000A0ZYX28 to BB+(RU)

The credit rating of [PJSC Sovcombank](#) (hereinafter, Sovcombank, or the Bank) has been upgraded due to a change in the market risk assessment, which led to an upgrade in the Bank's SCA to "a." The Bank's systemic importance for the Russian banking system is reflected in one additional notch up to its SCA. The credit ratings of the BO-05 bond issue (ISIN RU000A0ZYJR6), the BO-P01 bond issue (RU000A100DZ5), the 2B03 bond issue (ISIN RU000A0ZYWZ2), and the 1B02 series bond issue (ISIN RU000A0ZYX28) have been upgraded to A+(RU), A+(RU), BBB+(RU), and BB+(RU) respectively.

Sovcombank is a universal bank that occupies a sustainable position in both retail lending (including car loans, mortgages, and classic consumer loans) and lending to legal entities. The Bank is one of the twenty largest credit institutions in the Russian market in terms of equity and assets and ranks 8th in volume of private deposits. According to the data as of June 2019, Sovco Capital Partners N.V. accounted for 87.1% of the Bank's shares (38% of which belong to Dmitry and Sergey Khotimskiy), while the remaining shares are divided among shareholders and minor shareholders, including foreign sovereign and investment funds.

The Bank's adequate business profile assessment is determined by its historically strong franchise in consumer lending and stronger competitive positions in lending to the large businesses and the SME sector, including due to the acquisition of [The joint-stock Bank "ROSEVROBANK" \(ACRA credit rating — A\(RU\), outlook Stable, withdrawn on November 1, 2018\)](#) in 2018. The Bank has consistently increased its share in the banking sector through both organic growth and active M&A transactions. The growth of Sovcombank's business over the last few years has also been oriented on asset universalization, which made it possible for the Bank's management to achieve significant operating income diversification (Herfindahl — Hirschman Index for 2018 amounted to 0.15).

The Bank's strong capital position is confirmed by sufficiently high capital adequacy ratios. As of July 1, 2019, N1.2 amounted to 10.5%, while the minimum required level is 8.125%, including capital conservation buffer. As of the end of Q1, 2019, Tier-1 amounted to 15.2%, while the minimum recommended level is 8.5%, including surcharges in accordance with Basel III requirements. The factors that contributed to the growth of Tier-1 from 12.2% as of September 30, 2018, up to 15.2% as of April 1, 2019, are as follows: 1) an additional issue of shares in the first quarter of 2019, which contributed to the increase of Tier-1 by nearly RUB 6 bln, 2) an increase in the volume of retained earnings thanks to a consistently high level of internal capital generation (the averaged capital generation ratio (ACGR) is 250 bps for the last five years, and 3) the transition of Sovcombank to Basel III starting from the beginning of 2019, which allowed to reduce the volume of risk-weighted assets by conveying the accepted market risk in a much smaller amount. According to ACRA estimates, Sovcombank is able to withstand an increase in the cost of risk of over 500 bps without a fall of N1.2 below 6%. Operational efficiency is also at a sufficiently high level.

The risk profile assessment has been changed from satisfactory to adequate as Sovcombank records the accepted market risk in a much smaller amount in accordance with Basel III requirements — 28% of fixed capital as of April 1, 2019, compared to 176% of fixed capital as of September 30, 2018 (in accordance with Basel I requirements, which was updated as far as market risk is concerned). At the same time, the volume of securities

on the Bank's balance sheet did not change dramatically (RUB 388 bln, or 41% of assets, as of April 1, 2019, vs. RUB 392 bln, or 45% of assets, as of September 30, 2018). Part of securities (22% of assets) is assessed at fair value and entails market risk, while the remaining securities (19% of assets) are assessed at amortised cost due to their planned holding to maturity (according to the Bank) and are not considered in market risk calculations. However, ACRA notes that the bonds assessed at amortised cost can be sold before maturity should the need arise, which can potentially entail additional market risk.

The quality of the loan portfolio (42% of assets, excluding bonds recorded as loans) is characterized by a relatively low level of problem and potentially problem loans, according to ACRA, i.e. 5.5% of the portfolio (including NPL 90+ at 2.6% of the portfolio, with the entire portfolio's coverage ratio for such loans at around 150%). ACRA estimates the level of potentially problem loans analyzing assets and contingent liabilities subject to credit risk. The concentration of lending on the ten largest groups of borrowers is acceptable (nearly 18% of loans), on related parties and high-risk industries is negligible. At the same time, the retail portfolio is growing proactively (up by 30% over the last twelve months to 21% of assets as of April 1, 2019).

Adequate liquidity and funding position. ACRA's base case and stress test scenarios showed that the Bank can withstand an outflow of client funds with a margin. The share of securities not encumbered by repurchase transactions exceeds half of the portfolio. ACRA assesses the Bank's long-term liquidity position as strong: the long-term liquidity shortage indicator exceeded 90% as of March 31, 2019.

The resource base of the Bank includes mainly retail deposits (47% of liabilities), and its concentration on the largest lenders is moderate. The Bank has not borrowed any funds from the Central Bank of Russia.

Local systemic importance. In ACRA's opinion, the Bank's bankruptcy may cause problems in the financial sector and the socio-economic situation in certain Russian regions (including the Volga region and some regions of Siberia). As of July 1, 2019, the share of retail deposits held with the Bank accounted for 1.4% of the total volume of deposits serviced by the Russian banking system. Therefore, ACRA has added one notch to the Bank's SCA.

Key assumptions

- The Bank will maintain its strong competitive positions in key business segments;
- Loan portfolio growth rate within the range of 20–25%;
- Cost of credit risk around 3%;
- Net interest margin within the range of 5–6%;
- Tier-1 capital adequacy above 10% within the 12 to 18-month horizon;
- The current funding structure will not change.

Potential outlook or rating change factors

The Stable outlook assumes that the rating will most likely stay unchanged within the 12 to 18-month horizon.

A positive rating action may be prompted by:

- Sustained organic growth in the market share of key business segments;
- Moderate risk appetite in the mid- and long-terms;
- Higher quality of the loan portfolio through a decrease in the share of problem and potentially problem loans and a significant growth in the share of secured loans in the portfolio.

A negative rating action may be prompted by:

- Deterioration of the Bank's capital position as a result of an increase in the cost of credit risk and/or a decrease in the operating efficiency;
- Aggressive growth of retail lending and higher share of unsecured loans in the portfolio;
- Deterioration of the Bank's liquidity position caused by a reduction in highly-liquid assets on its balance sheet;

- Loss of competitive advantages in key business segments.

SCA: a.

Adjustments: systemic importance, one notch up to the SCA.

Support: none.

Rating components

Issue ratings

[Certified exchange-traded interest-bearing non-convertible unregistered bond issued by PJSC Sovcombank, BO-05 series \(RU000A0ZYJR6\)](#), maturity date: November 25, 2027, issue volume: RUB 10 bln — **A+(RU)**.

[Certified exchange-traded interest-bearing non-convertible unregistered bond issued by PJSC Sovcombank, BO-P01 series \(RU000A100DZ5\)](#), maturity date: May 17, 2029, issue volume: RUB 10 bln — **A+(RU)**.

[Certified interest-bearing non-convertible unregistered bond issued by PJSC Sovcombank, 2B03 series \(RU000A0ZYWZ2\)](#), maturity date: February 21, 2029, issue volume: USD 150 mln — **BBB+(RU)**.

[Certified interest-bearing non-convertible unregistered bond issued by PJSC Sovcombank, 1B02 series \(RU000A0ZYX28\)](#), maturity date: n/a, issue volume: USD 100 mln — **BB+(RU)**.

Rationale. The BO-05 series bond issue (RU000A0ZYJR6), the BO-P01 bond issue (RU000A100DZ5), the 2B03 series bond issue (RU000A0ZYWZ2) and the 1B02 series bond issue (RU000A0ZYX28) have been upgraded at A+(RU), A+(RU), BBB+(RU) and BB+(RU) respectively based on the upgrade of the issuer's credit rating. The BO-05 series bond issue (RU000A0ZYJR6) and the BO-P01 bond issue (RU000A100DZ5) represent senior unsecured debt of the Bank. According to ACRA's methodology, the credit rating of the issues is equivalent to that of the Bank. The 2B03 series subordinated bond issue (RU000A0ZYWZ2) is a Tier 2 capital tool with a substantial level of subordination against priority unsecured creditors, which results in an issue rating three notches below the Bank's credit rating. The 1B02 series subordinated bond issue (RU000A0ZYX28) is an additional Tier 1 capital tool, which envisages a significant level of subordination against priority unsecured creditors and determines the credit rating of the issue five notches below the Bank's SCA (a).

Regulatory disclosure

The credit ratings were assigned to PJSC Sovcombank and the bonds (ISIN RU000A0ZYJR6, RU000A100DZ5, RU000A0ZYWZ2, RU000A0ZYX28) issued by PJSC Sovcombank under the national scale for the Russian Federation based on the [Methodology for Credit Ratings Assignment to Banks and Bank Groups Under the National Scale for the Russian Federation](#), and the [Key Concepts Used by the Analytical Credit Rating Agency Within the Scope of Its Rating Activities](#). To assign credit ratings to the bond issues above, ACRA also used the Methodology for Assigning Credit Ratings to Individual Issues of Financial Instruments under the National Scale of the Russian Federation.

The credit rating assigned to PJSC Sovcombank and the credit ratings assigned to the bonds (ISIN RU000A0ZYJR6, RU000A100DZ5, RU000A0ZYWZ2, RU000A0ZYX28) issued by PJSC Sovcombank were first published by ACRA on November 25, 2016, December 7, 2017, May 30, 2019, March 28, 2018, and March 28, 2018, respectively. The credit rating of PJSC Sovcombank and its outlook, as well as the credit ratings of the bonds (ISIN RU000A0ZYJR6, RU000A100DZ5, RU000A0ZYWZ2, RU000A0ZYX28) issued by PJSC Sovcombank are expected to be revised within one year following the publication date of this press release.

The credit ratings were assigned based on the data provided by PJSC Sovcombank, information from publicly available sources, as well as ACRA's own databases. The rating analysis was performed using the IFRS consolidated financial statements of PJSC Sovcombank and the financial statements of PJSC Sovcombank composed in compliance with the Bank of Russia Ordinance No. 4927-U dated October 8, 2018. The credit ratings are solicited, and PJSC Sovcombank participated in the rating process.

No material discrepancies between the provided data and the data officially disclosed by PJSC Sovcombank in its financial statements have been discovered.

ACRA provided additional services to PJSC Sovcombank. No conflicts of interest were discovered in the course of credit rating process.

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