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Key rating assessment
factors

ACRA affirms A(RU) to PJSC Sovcombank, outlook Stable, affirms A(RU) to bond issue RU000A0ZYJR6, BBB(RU) to bond issue RU000A0ZYWZ2, and downgrades bond issue RU000A0ZYX28 to BB(RU)

The credit rating of [PJSC Sovcombank](#) (hereinafter, Sovcombank, or the Bank) is due to its adequate business profile, strong capital position, adequate liquidity and funding position, the reduction of the risk profile assessment to satisfactory, and the increasing level of systemic importance of Sovcombank for the Russian banking system. ACRA has lowered the Bank's standalone creditworthiness assessment (SCA) to 'a-'. This is reflected in the reduction of the credit rating of the Bank's bond issue (ISIN RU000A0ZYX28), which is additional Tier-1 capital. ACRA affirms the credit ratings of the Bank's bond issues BO-05 (ISIN RU000A0ZYJR6) and 2B03 (ISIN RU000A0ZYWZ2) at A(RU) and BBB(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. At the end of 2018, Sovco Capital Partners N.V. accounted for 91.7% of the Bank's shares – 37.3% of which belong to Dmitry and Sergey Khotimsky, while the remaining 8.3% is 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, its increasingly competitive positions in the large businesses and SME finance business, and is also due to the acquisition of [The joint-stock Bank "ROSEVROBANK" \(ACRA credit rating: A\(RU\), outlook Stable, withdrawn on November 1, 2018\)](#) in 2018.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 both through organic growth and through active M&A transactions. The growth of Sovcombank's business over the last few years has also been oriented on asset universalization, thanks to which the Bank's management achieved significant operating income diversification (Herfindahl - Hirschman Index for 9 months of 2018 amounted to 0.15).

The Bank's strong capital position is confirmed by sufficiently high capital adequacy ratios. As of February 1, 2019, N1.2 and Tier 1 amounted to 10.2% and 12.2%, respectively. The Bank's level of internal capital generation is high – the averaged capital generation ratio (ACGR) has exceeded 300 bps over the past five years. According to ACRA's assessment, Sovcombank is able to withstand an increase in the cost of risk of around 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 adequate to satisfactory due to the availability of securities (21% of assets, included in the trade portfolio), which are subject to market risk amounting to 1.8x of Tier 1 capital under IFRS. However, derivative transactions (interest rate swaps) mitigate this. According to the Bank's audited financial statements as of September 30, 2018, over the last 12 months, the risk-weighted assets grew up by 1.8 times to RUB 906 bln, which is mostly caused by the inclusion of market risk into such assets. The reason for such inclusion is that the Bank migrated to IFRS 9 and started to calculate its capital adequacy ratios in accordance with the requirements of Basel I updated in terms of market risk. Before September 30, 2019, the Bank excluded market risk from its capital adequacy calculations. Otherwise, the application of Basel I requirements might affect the capital adequacy, as the risk-weighted assets would amount to RUB 798 bln instead of RUB 509 bln (as indicated in the audited financial statements as of September 30, 2018) and to RUB 1,113 bln instead of RUB 772 bln by June 30, 2019.

Another 21% of assets are bonds estimated by amortized cost in view of their planned holding to maturity, according to the Bank's information. More information will be presented in our rating report on Sovcombank. Should the next audited financial statements be published by the date of the report, the credit rating of the Bank may be revised.

The quality of the loan portfolio (41% of assets less bonds indicated as loans) is characterized by a comparably moderately low level of problem and potentially problem loans in ACRA's opinion – around 6% of the portfolio (including 2.7% of NPL90+) with an acceptable concentration on the top 10 groups of borrowers, around 18% of loans. The concentration of loans issued to related parties and high-risk industries is negligible. Sovcombank continues to adhere to the policy aimed at diversifying the loan portfolio via the corporate sector and collateral retail lending. This increases the resilience of the Bank's business model to negative changes in the operating environment in terms of credit risks. ACRA assesses the quality of the Bank's risk management system as adequate.

Adequate liquidity and funding positions. ACRA's base case and stress test scenarios showed that the Bank is strong enough to withstand the outflow of client funds. The share of securities not encumbered by repurchase transactions exceeds a half of the portfolio. ACRA assesses the Bank's long-term liquidity position as strong: the long-term liquidity shortage indicator exceeded 85% as of September 30, 2018.

The resource base of the Bank includes mainly retail deposits (52% 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 February 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 10–15%;
- Cost of credit risk within 2–3%;
- Net interest margin within the range of 5–6%;
- Tier-1 capital adequacy (N1.2) above 9% 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 highly 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 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;
- 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.

Rating components

SCA: a-.

Adjustments: systemic importance, 1 notch up to the SCA.

Support: none.

Issue ratings

[Certified exchange-traded interest-bearing non-convertible unregistered bond by issued PJSC Sovcombank, BO-05 series \(RU000A0ZYJR6\)](#), maturity date: November 25, 2027, 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) and the 2B03 series bond issue (RU000A0ZYWZ2) have been affirmed at A(RU) and BBB(RU), respectively, based on the affirmation of the issuer's credit rating. The BO-05 series bond issue (RU000A0ZYJR6) represents senior unsecured debt of the Bank. According to ACRA's methodology, the credit rating of the issue is equivalent to that of the Bank. The 2B03 series bond issue (RU000A0ZYWZ2) is a Tier 2 capital instrument 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 bond issue (RU000A0ZYX28) has been downgraded to BB(RU) based on the downgrade of the issuer's SCA from 'a' to 'a-'. The 1B02 series bond issue (RU000A0ZYX28) is an additional Tier 1 capital instrument with a substantial level of subordination against priority unsecured creditors, which results in an issue rating five notches below the Bank's SCA (a-).

Regulatory disclosure

The credit ratings were assigned to PJSC Sovcombank and the bonds (ISIN RU000A0ZYJR6, RU000A0ZYX28, RU000A0ZYWZ2) 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, RU000A0ZYX28, RU000A0ZYWZ2) issued by PJSC Sovcombank were first published by ACRA on November 25, 2016, December 07, 2017, 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, RU000A0ZYX28, RU000A0ZYWZ2) 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 audited 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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