

Rating-Agentur Expert RA confirmed the credit rating of JSC CB Assotsiatsiya at 'BB-' according to the international scale. The rating outlook is stable.

Rating-Agentur Expert RA confirmed the credit rating of JSC CB Assotsiatsiya at 'BB-' (Sufficient 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 risk exposure to the banking system of JSC CB Assotsiatsiya is Moderate.

MAJOR FACTORS THAT INFLUENCED THE RATING:

Positive factors:

- The bank's provision policy remains favorable as the gap between the reserve ratio¹ and our internal assessment of the minimum possible reserve ratio stood at 2,2p.p. in 2018. We consider this gap to be conservative enough in accordance with the risk profile of the bank's counterparties;
- The concentration of credit risks on the largest customers remained moderate but increased slightly. The largest credit risks to total assets net of reserves amounted to 39,2% by end-2018. Moreover, the volume of the maximum credit risk from a single borrower to assets net of reserves remained stable at 2,4% as of the same date;
- Liquidity metrics remain positive. As of the end of 2018, the instant liquidity ratio and current liquidity ratio stood at 103,7% and 124,5% showing a decrease of 28p.p. and 24p.p. respectively from a year ago as a result of a decrease in liquid assets and an increase in short-term liabilities. Furthermore, the ratio of highly liquid assets to total deposits was 31% while the long-term liquidity ratio stood at 37% as of the end of 2018². Based on the historical movement of outflows and inflows of funds as well as the stability of assets, we do not anticipate liquidity metrics to suddenly deteriorate;
- Capital adequacy remains at acceptable levels despite having modestly deteriorated from a year ago. As of the end of 2018, the general capital adequacy ratio stood at 13,4%, while both Tier 1 capital and Common Equity Tier 1 (CET 1) ratios were 10,7%³ as of end-2018. The three ratios saw a decline of around 3p.p. y-o-y. Moreover, according to our internal assessment, the level of loans which would need to be impaired in order for the bank to breach the statutory capital adequacy level of 8%, was reduced down to 6,8% from 8,3% a year before. Nonetheless, in the mid-term perspective, we do not see a material risk of non-compliance with the required capital ratios;

¹ The reserve ratio is equal to the loan loss reserve divided by the total level of gross loans.

² The instant liquidity and current liquidity normative ratios were calculated on the basis of the entity's figures from its financial statements 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%).

³ These ratios were calculated on the basis of the entity's figures from its financial statements 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.

- The open currency position as a percentage of capital was as low as 0,4% and the highest single currency position, which was in USD, was 0,3% by end-2018 reflecting a low currency risk. Both figures are well below the 10% limit established by the bank;
- The loan portfolio remains well covered by both property collateral and guarantees. As of the end of 2018, property collateral and guarantees were 409% and 132% of the total loan portfolio (excluding interbank lending) respectively. Nonetheless, only 9% of collateral property is insured;
- The reliability of funds placed on correspondent accounts and issued interbank loans are favorable. The credit quality of the counterparties was assessed as positive; 84% of the total interbank balance belongs to VTB Bank (Europe) SE whose sole shareholder, JSC VTB Bank, is rated 'BBB-' by S&P and 'Baa3' by Moody's.

Restricting factors:

- Our banking system risk (BSR) score still shows a moderate level of systemic risk. The banking sector's concentration remains quite high as Sberbank accounts for 31% of total assets and the top-5 banks for about 61%. Moreover, credit conditions have subdued as private credit growth has stalled while, at the same time, NPLs are moderate and the regulatory quality is not optimal. Finally, negative demographic trends, structural imbalances and moderately low institutional development as well as relatively modest per capita GDP, hindered the BSR score;
- Profitability has remained fairly stable as ROE has averaged 11,7% for the past three years standing at 12% as of the end of 2018 slightly below the ROE figure of 13,8% for the whole Russian banking sector in 2018. In contrast, profitability figures excluding non-recurring items⁴ have remained extremely volatile reflecting the high reliance on profit generated by unrealized gains in currency fluctuations. Moreover, the ratio of net interest, commission and fee income to operating costs declined by around 20p.p. down to 92% as a result of a 24% increase in core operating expenses against a mere 4% hike in commission, fee and net interest income;
- The quality of the loan portfolio was acceptable and has improved as compared to 2017. The ratio of overdue debt on individuals stood at 4%, while the ratio of overdue debt on legal entities and individual entrepreneurs was 2,2%. Both indicators improved as they decreased by 1,6p.p. and 2,7p.p. respectively;
- Specific risk-analysis instruments and management procedures improved slightly. Risk management models (e.g. VAR) are implemented only to mitigate currency risks on a daily basis. However, given the size and business model of the bank, we do not expect it to implement highly developed risk monitoring models and, despite having plenty of room for improvement, we currently consider the existent procedures as sufficient. However, directives of mandatory insurance policy for collateral are still to be implemented;
- Strategy and budget planning is still short-term (one year) due to the unpredictable nature of the Russian regional banking sector. However, the strategy for 2018-2020 describes realistic goals in terms of assets and funding base growth, as well as specific steps to achieve them.

Negative factors:

- The diversification of the funding base remains subdued. Even though the share of the 10 largest creditors in gross assets remains acceptable at 26%, the concentration on the single largest creditor was still quite high at 11% at the end of 2018. Additionally, the share of the key source of funding in gross liabilities was around 55,3% for the same period (funds from individuals and individual entrepreneurs);
- The concentration of the loan portfolio by types of industries remains relatively high. Loans to the three largest industries (manufacturing, agriculture and wholesale and retail

⁴ In the case of JSC CB Assotsiatsiya we mainly refer to net income from foreign exchange transactions.

trade) were equivalent to 79% and 76% of total loans as of 3Q 2018 and end-2018 respectively. While the largest industry (manufacturing) accounted for 40% of total loans by the end of 2018;

- The bank's market position remains fragile. The market share of JSC CB Assotsiatsiya was as low as 0,02% in terms of total assets and accounted for only 0,01% of total loans in the Russian banking sector in 2018. Despite assets and loans having increased by 29% and 19% respectively y-o-y in 2018, both remain quite low relatively to the global and regional level; as of 2018, assets were RUB 14 065 m and loans equaled RUB 9 663 m. Furthermore, most of the bank's operations are located in one single region of Russia - Nizhny Novgorod oblast. Despite this, we consider that the risks related to the low market share are somewhat mitigated by the long-term relationships between the bank and its clients, as well as the bank's deep understanding of the local market.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Substantial increase in the bank's market share in terms of loans and assets both regionally and at the country level;
- Diversification of the loan portfolio and sources of funding in terms of entities and industries;
- Significant and sustainable improvements of the bank's profitability indicators which would mean a decrease in the profit dependence on FX revaluation.

The following developments could lead to a downgrade:

- Significant decrease of the bank's profitability excluding non-recurring items, combined with instability of the bank's financial results;
- Tightening of the CBR policy regarding loans to related parties, given elevated share of related parties in the bank's assets;
- Deterioration of the bank's financial soundness indicators as a result of an unexpected withdrawal of short-term customer's funds.

JUSTIFICATION OF THE RATING:

The Agency confirmed at 'BB-' the credit rating of JSC CB Assotsiatsiya with a stable outlook. The affirmation of the creditworthiness level mainly reflects the sluggish market position of the bank combined with a moderate systematic risk for the sector and high concentration of the funding base and loan portfolio in terms of industries, counterparties and geography. However, the rating also shows acceptable liquidity, capitalization and profitability metrics as well as adequate asset quality.

The banking system risk (BSR) score for Russia keeps showing a moderate risk level for the system. The sector remains highly concentrated in a few banks which reduces competitiveness and especially affects smaller regional banks such as JSC CB Assotsiatsiya. Our BSR also reflects the fact that credit to the economy has been growing at a slower pace and that the banking system's regulatory quality index remains depressed. Finally, we believe that the tight regulatory measures issued by the Central Bank of Russia expose small private banks to license revocation risk. Despite this, we don't see this risk materializing for JSC CB Assotsiatsiya as the bank complies with all regulatory metrics by a comfortable margin.

The competitive position of the bank remains hindered as most of the bank's operations are located in one single region of Russia - Nizhny Novgorod oblast. Moreover, the market share in the Russian market in terms of assets and loans is still substantially low. However, the level of loans has increased at a fast pace showing potential to gain additional market share in the region. We also recognize that these risks are partially mitigated by the bank's thorough knowledge of the local market as well as its long-standing relations with its stakeholders.

In our view, capitalization and liquidity remain steady and at satisfactory levels. First of all, liquidity indicators, despite decreasing from a year ago, remain quite solid. In our view, the bank was more aggressive in its maturity structure by issuing more long-term assets with short-term funds while, at the same time, maintaining adequate liquidity levels. In addition, we believe the metrics will remain quite stable as the bank has no history of sudden withdrawal of the short-term funding. In terms of capitalization, all ratios saw a decline as compared to 2017 but remain at comfortable levels and we do not see a material risk of non-compliance with the required capital ratios. As Tier 1 and Tier 2 capital levels have remained quite stable and risk-weighted assets have increased at a higher pace than total gross loans, we attribute the decrease in the capitalization metrics to a less conservative approach by the bank in terms of asset allocation as the quality of the assets has slightly declined. This can be partially explained by the decline of interbank loans and deposits by almost 10p.p. y-o-y and an increase in corporate loans by 11p.p. y-o-y in 2018. Still, in our view, this does not represent a material risk for the bank as metrics remain adequate.

Profitability metrics have been rather stable and in line with the sector's average. However, the bank's income is still highly dependent on profit generated by unrealized gains in currency fluctuations as can be observed by negative profitability figures when excluding non-recurring items. Going forward, and as a result of the aforementioned asset rebalance from interbank loans and deposits to corporate loans, we expect income from interest, fees and commission to increase; nonetheless, reduction of operating expenses will be a challenge since we have seen this figure increase substantially as of late.

Concentration of funding and loans remains a drag for the creditworthiness of the bank. Since JSC CB Assotsiatsiya operates mostly in Nizhny Novgorod oblast, geographic concentration of funds and loans is elevated. Moreover, the funding base is not diversified as 11% of the funds can be attributed to a single creditor; nonetheless, this and most of the bank's largest creditors are related parties, which can reduce the risks of sudden withdrawal of funds. In regard to the loan portfolio, the concentration in the manufacturing industry continues to be relatively high along with the concentration of credit risks on the largest customers, which remained moderate but increased slightly. The aforementioned concentrations expose the bank to potential sudden changes in their financial soundness indicators in case the quality of the single largest borrower were to deteriorate or in the event of a systematic issue in the manufacturing industry in the region.

The quality of the loan portfolio has improved and was moderate in 2018. The ratio of overdue debt on individuals and the ratio of overdue debt on legal entities and individual entrepreneurs remained acceptable. Both indicators improved as compared to a year ago. Moreover, we consider that the amount of loan loss reserves is adequate in relation to the characteristics of credit portfolio held by the bank. Also, the loan portfolio remains well covered by both property collateral and guarantees. In regard to the currency position, we do not see any risk as the open currency position by end-2018 was minimal and well below the bank's internal threshold.

Risk management procedures in the company have improved and, even though the bank could implement additional measures, we believe the policies and procedures in place are enough taking into account the size of the bank and the fact that most of its operations are secured. Furthermore, the strategy of the company remains short-term but is, at the same time, clear and realistic in terms of goals and objectives.

The stable outlook reflects our view that the bank's financial stance will most likely remain stable in the mid-term perspective. We expect the bank to remain exposed to risks related to market position and concentration of funds and loans.

COMPANY PROFILE:

JSC CB Assotsiatsiya (number of license - 732) is a bank specialized on issuing loans to SMEs and big local enterprises, raising funds from individuals and local big enterprises (current accounts and deposits). The head office of the bank and 29 additional branches are located in Nizhny Novgorod oblast, where the bank conducts the largest part of its operations. Assets of the bank were equal to RUB 13 846 m as of end-2018 (178th place in the ranking of Russian banks by

assets), the bank's equity was equal to RUB 1 371 m as of the same reporting date. The bank had profit after taxes equal to RUB 155 m for 2018.

Related research:

- ◆ Research Report on the Russian Banking Industry – 06.09.2017:
https://raexpert.eu/files/Industry_annual_report_Banks_06.09.2017.pdf
- ◆ Research Report on the Russia:
https://raexpert.eu/reports/Research_report_Russia_21.12.2018.pdf

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RATING HISTORY:

Date	Review reason	Rating Score	Outlook
26.04.2018	Scheduled review	BB-	Stable
04.05.2017	Scheduled review	BB-	Stable
28.11.2016	Unscheduled review	BB-	Stable
02.09.2016	Unscheduled review	BB	Negative
26.04.2016	Initial assignment	BB	Stable

Minute's summary:

The rating committee for JSC CB Assotsiatsiya was held on 17 April 2019. 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 – Full Version \(from September 2018\)](#)
- [Methodology for Assigning Banking Sector Risk Score – Full Version \(from September 2018\)](#)

Descriptions and definitions of all rating categories can be found 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.

The definition of default can be found on the Agency's website in the section for [Internal policies](#).

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 CB Assotsiatsiya based on the form provided by the Agency;
- Financial statements from JSC CB Assotsiatsiya according to the Russian Accounting Standards for the past 24 months;
- Audited annual reports of JSC CB Assotsiatsiya according to IFRS (including the auditor's report and notes to the accounts) for 2012-2017;
- Statute of JSC CB Assotsiatsiya;
- Documents regulating risk management of JSC CB Assotsiatsiya;
- Documents defining development plans of JSC CB Assotsiatsiya;
- Documents regulating corporate governance of JSC CB Assotsiatsiya;
- 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

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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.