Rating-Agentur Expert RA confirmed the credit rating of JSC RUSNARBANK at 'B+' according to the international scale. The rating outlook changed from stable to developing.

Rating-Agentur Expert RA confirmed the credit rating of JSC RUSNARBANK at 'B+' (Moderately low level of creditworthiness) according to the international scale. The rating outlook was changed from stable to developing which means that in the mid-term perspective there is an equal probability of downgrade, upgrade or maintenance of 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:

- After the successful implementation of the mid-term business strategy for 2017-2019, which aim was to change the Bank's specialization towards lending to small and medium sized enterprises, business guarantees as well as mortgage loans, the Bank implemented the long-term strategy for 2020-2025 with clear targets and qualitative metrics to be achieved, as well as corporate governance and risk management improvement. However, the new long-term strategy was introduced in December 2019 and did not take into account the scenario of global recession caused by COVID-19 crisis;
- Capital adequacy was maintained at very high levels despite slight decrease as shown by the capital adequacy indicators: general capital adequacy ratio at 12,3%, Tier 1 capital and Common Equity Tier 1 (CET 1) ratio both at 10,5%[1], at the end of the 1Q 2020. Additionally, the capital adequacy ratios would remain above the minimum regulatory levels in case of a full impairment of 11,7% of the assets and off-balance liabilities as of March 2020;
- Profitability indicators showed a stable dynamic over the past year remaining at acceptable levels according to the Agency's internal benchmarks: ROE calculated on the basis of Russian Accounting Standards (RAS) stood at 14,3% for the period of 01.04.2019 till 01.04.2020. Moreover, coverage of operating costs by net interest, fees and commissions income after provision for impairment of loans was favorable at around 164% as of March 2020. However, the Agency expects significant deterioration of the profitability metrics in the following quarters due to needs of additional impairment reserves creation, taking into account the fact that significant part of the Bank's balance sheet is exposed to current macroeconomic risks (car loans, lending to SMEs and guarantees);
- Maturities of assets and liabilities continued to be on average well matched in the short and long run. Instant, current and long-term liquidity ratios stood at prudent levels of

[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;

233%, 212% and 58% respectively as of March 2020[2]. In addition, the bank can be supported by inflow of funds from shareholders in case of liquidity shortage;

- Additional liquidity source in the form of available loans collateralized by securities (excluding bills) and fund raising opportunities through REPO with highly rated securities which, remains substantial and accounts for 17% of raised funds as of 1Q 2020;
- The assets quality remained acceptable, with the level of overdue loans at 1,5% for retail loans and 8,9% for loans to legal entities and individual entrepreneurs. The latter partially mitigated by the fact that the share of this type of loans decreased to 17% of total assets as of March 2020. In addition, the Bank was not using collateral for the largest credit risks objects in order to reduce the amount of loan loss reserves according to the RAS as of March 2020. At the same time, the Agency can expect deterioration of the Bank's loans portfolio quality, taking into account the fact that up to 70% of the retail loans represented by car loans, while up to 50% of the corporate loans were concentrated in real estate and construction sectors. In addition, the Agency assesses the rapid growth of the guarantees portfolio (by 70% from 1 April 2019 to 1 April 2020) as an additional risk factor, only partly mitigated by additional insurance coverage;
- Investment portfolio reflects the satisfactory quality and level of liquidity, with 100% of securities represented by the federal government bonds of Russia as of 1Q 2020 ('BBB-' according to RAEX-Europe);
- High level of credibility of the funds placed on the correspondent accounts in other banks, as shown by the IFRS Report 2019 with 100% of interbank funds placed with banks rated 'BBB-' according to the international scale (the highest rating among Russian banks);
- The Bank is characterized by favorable corporate governance and adequate risk management practices, that are fully correspond with the bank's size and its market position.

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. Taking into account the current volatility at the oil market as well as expected recession in global and Russian economy the Agency can reassess the level of Banking Sector Risks in the country, which can affect the level of credit ratings for Russian financial institutions;
- High share of the Bank's loan portfolio is heavily exposed to macroeconomic shocks related to COVID-19 crisis, with 13,7% and 5,1% of total loans provided to real estate and construction sector, while 5,2% were provided to trade sector (loans outstanding as of end 2019 according to IFRS), while 64% of loans is presented by retail loans (mostly car loans and mortgage);
- Operational risk practices have a capacity to improve. The Bank still lacks certificates of management quality.

Negative factors:

- We assess competitive position of the Bank as relatively weak, despite the slight increase of assets by 6% over 2019 according to the IFRS, and remained less than 0,1% of total indicators for the Russian market. At the same time, while the number of SME borrowers continues to decrease until 47 entities by end 2019, we observed continuous growth of borrowers-individuals in 2019 (till 5 538 individuals) associated with the mortgage

[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%);

project launch, as well as car loans. The Agency also highlights the effectiveness of the online sales channels for retail banking products and guarantees in the regions outside the regions of the Bank branches location;

- Moderately low diversification of the funding base. The share of the group of the largest creditors in the net liabilities according to the RAS as of March 2020, was as high as 12,6%. At the same time, the largest creditors are affiliated with the Bank's shareholders, that significantly decreases the possibility of the sudden withdrawal of the funds;
- Geographical distribution of the business remains narrow, with 100% of the bank's credit portfolio being concentrated in a limited number of Russian regions. However, we observed the substantial increase of the geographical diversification of the Bank's operations over the last year, mostly due to the launch of large mortgage project servicing as a sales channel for the Bank's operations in the largest Russian cities;
- Rather complicated ownership and control structure with several intermediate companies, including offshore companies, between the Bank and the individual exercising ultimate control over the Bank.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Continued growth of the numbers of borrowers and enlargement of the loans portfolio together with significant improvement of the Bank's market share on the mortgage and car loans segments, as well as on a national level;
- Stable asset quality during the upcoming months combined with stable liquidity position, as well as stable financial stance of the Bank's shareholders;

The following developments could lead to a downgrade:

- Deterioration of the Bank's loan portfolio quality, which might negatively affect the profitability and capital adequacy figures;
- Deterioration of the Bank's market position in terms of assets and loans due to the high competition from larger private and state-owned banks;
- Unexpected actions from the Central Bank of Russia in relation to the Bank or overall stringing of the banking system supervision with adverse effects for small and medium-sized banks;

JUSTIFICATION OF THE RATING:

The Agency confirmed the rating of JSC RUSNARBANK at 'B+' and changed the rating outlook from stable to developing. The rating continues to be restrained by the limited competitive position of the Bank as compared to the whole Russian market, low diversification of the funding base, as well as narrow geographical diversification of operations. At the same time, the rating assessment was supported by sufficient capital adequacy ratios, solid liquidity position, as well as by the acceptable quality of the loan portfolio and low credit risk security portfolio.

The change of the rating outlook from stable to developing reflects uncertainty about the macroeconomic situation and systematic risks of the Russian banking system in the face of the crisis related to COVID-19; and on the other hand – reflects the Bank's vulnerable position on the market taking into account its size, brand awareness, moderately high share of risky sectors among the clients as well as financial stance of the Bank's shareholders. After the partially successful implementation of the mid-term business strategy for 2017-2019, which aim was to change the Bank's specialization towards lending to small and medium sized enterprises, business guarantees as well as mortgage loans, the Bank implemented the long-term strategy for 2020-

2025 with clear targets and qualitative metrics to be achieved, as well as corporate governance and risk management improvement. However, the new long-term strategy was introduced in December 2019 and did not take into account the scenario of global recession caused by COVID-19 crisis. In this regard the Agency will monitor closely the implementation of the business plans of the Bank, its financial stance as well as adaptation to new macroeconomic environment within the following months.

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. However, we observe that the Bank keeps increasing its share on mortgage market of Russia after launching large mortgage project[3] in several locations in Russia, as well as successfully implemented an additional financial product of car loans and guarantees provision for participation in government tenders. 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 elevated despite gradual decline. On the positive side, the Agency ascertains presence of the long-lasting relationship with the top non-related creditors, as well as substantial amount of funds can be raised from the related entities.

The Bank's creditworthiness remains supported by the solid capital adequacy metrics by end of the 1Q 2020, with general capital adequacy ratio at 12,3%, Tier 1 capital and Common Equity Tier 1 (CET 1) ratio both at 10,5%. Additionally, the capital adequacy ratios would remain above the minimum regulatory levels in case of a full impairment of 11,7% of the assets and off-balance liabilities as of March 2020. The assets quality remained acceptable, with the level of overdue loans at 1,5% for retail loans and 8,9% for loans to legal entities and individual entrepreneurs. The latter partially mitigated by the fact that the share of this type of loans decreased to 17% of total assets as of March 2020. In addition, the Bank was not using collateral in order to reduce the amount of loan loss reserves according to the RAS as of March 2020. At the same time, the Agency can expect deterioration of the Bank's loans portfolio quality, taking into account the fact that up to 70% of the retail loans represented by car loans, while up to 50% of the corporate loans were concentrated in real estate and construction sectors. In addition, the Agency assesses the rapid growth of the guarantees portfolio (by 70% from 1 April 2019 to 1 April 2020) as an additional risk factor, only partly mitigated by additional insurance coverage.

The risks related to the potential deterioration of the asset quality, partly mitigated by the current profitability indicators, that showed a stable dynamic over the past year remaining at acceptable levels according to the Agency's internal benchmarks: ROE calculated on the basis of the RAS stood at 14,3% for the period of 01.04.2019 till 01.04.2020. Moreover, coverage of operating costs by net interest, fees and commissions income after provision for impairment of loans was favorable at around 164% as of March 2020. However, the Agency expects significant deterioration of the profitability metrics in the following quarters due to the needs of additional impairment reserves creation, taking into account the fact that significant part of the Bank's balance sheet is exposed to current macroeconomic risks (car loans, lending to SMEs and guarantees).

In addition, the financial risks of the Bank are partially mitigated by the solid liquidity position: instant, current and long-term liquidity ratios stood at prudent levels of 233%, 212% and 58% respectively as of March 2020. Moreover, the Bank can be supported by inflow of funds from shareholders in case of liquidity shortage. Additional liquidity source in the form of available loans collateralized by securities (excluding bills) and fund raising opportunities through REPO with highly rated securities which, remains substantial and accounts for 17% of raised funds as of 1Q 2020.

[3] "National mortgage fabric" - specialized financial service company for the Russian mortgage market (part of the group of companies "Region").

COMPANY PROFILE:

JSC RUSNARBANK has a general license N 3403 issued on 11.04.2002. The Bank had 49 SME borrowers, 8 borrowers from large business and 6 515 individual borrowers as of 01.04.2020. The Bank is also a member of the Deposit Insurance System (DIS) since 11.06.2008.

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
24.05.2019	Scheduled review	B+	Stable
25.05.2018	Scheduled review	B+	Stable
18.10.2017	Unscheduled review	B+	Stable
26.05.2017	Initial assignment	B+	Developing

Minute's summary:

The rating committee for JSC RUSNARBANK was held on 18 May 2020. 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 2019)
- Methodology for Assigning Banking Sector Risk Score – Full Version (from September 2019)

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 RUSNARBANK based on the form provided by the Agency;
- Financial statements from JSC RUSNARBANK, according to according to the Russian Accounting Standards for the past 24 months;
- Audited annual reports of JSC RUSNARBANK, according to IFRS (including the auditor's report and notes to the accounts) for 2013-2019;
- Audited annual report of JSC RUSNARBANK, according to RAS (including the auditor's report) for 2016-2019;
- 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.