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## ACRA confirms A+(RU) to SME Bank JSC, outlook Stable

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### Key rating assessment factors

The credit rating assigned to [SME Bank JSC](#) (hereinafter, SME Bank, or the Bank) is due to a strong business profile, reasonable capital adequacy, the Bank's risk profile, and funding and liquidity assessments. In addition, the rating is supported by the medium systemic importance of SME Bank for the Russian economy and moderate state influence on its creditworthiness (according to ACRA's methodology).

SME Bank is a medium-size Russian bank in terms of capital, ranking 49<sup>th</sup> based on the results for the nine months of 2018. The key activities of the Bank are lending to small and medium-size enterprises (SMEs) as part of its participation in the Government Financial Support Program as well as providing support in securing obligations under contracts (Federal Law No.223-FZ "On procuring goods, works, and services by specific types of legal entities"; No.44-FZ "On contracting procurement for goods, works, and services to meet government and municipal demands") both within the National Guarantee System and beyond it. The Bank is wholly owned by [Joint Stock Company "Federal Corporation for Development of Small and Medium-Size Business"](#) (AAA(RU), outlook Stable; hereinafter, the SME Corporation).

**The Banks' business profile (bbb) is moderate** and takes into account its franchise specifics. Currently, the Bank's business model is in a transformation from a two-tier product distribution system through a partner network (banks, leasing and factoring companies, and microfinancing institutions) to direct cooperation with SMEs on a competitive basis. Over the course of 2017, SME Bank cut the funding of its partners providing support to SMEs from RUB 80.6 bln to RUB 34.2 bln, and in the nine months for 2018, from RUB 34.2 bln to RUB 26.3 bln.

The Bank's business exhibits relatively low diversification (the Herfindahl-Hirschman Index measuring the operating income diversification equals 0.40). Over 37% of the operating income generated in the nine months of 2018 is interest income from banks and financial institutions.

**The strong capital adequacy of the Bank** is due to the core capital adequacy ratio (Tier-1 calculated in line with the Basel standards) standing at 17.3% for the nine months of 2018. In 2019, the projected target N1.0 ratio will amount to 22-23%. Taking into account significant changes in the Bank's business model that could impact the structure of financial results in the future, ACRA assesses the Bank's possible generation of capital as neutral. According to ACRA's stress testing, SME Bank is able to withstand a change in the cost of risk of more than 500 bps without breaching the N1.2 capital adequacy ratio (6%).

**Adequate risk profile.** The substantial degree of independence of SME Bank's risk management division and the competence of the division's employees let the division play an important role in the implementation of the Bank's strategy. The Agency assesses the risk management quality of SME Bank as adequate.

The loan portfolio quality is determined by the acceptable level of problem debt on SME Bank's balance sheet (according to ACRA's estimates, it stood at 6.9% of the total corporate loan portfolio as of June 30, 2018, formed in accordance with the current strategy) and low risk concentration. The share of the top ten groups of related borrowers equaled 29.6% of the Bank's total loan portfolio as of the above date.

**The Bank's strong liquidity position** is based on the large amount of liquid and highly liquid assets allowing it to demonstrate short-term liquidity surplus in both ACRA's base case and stress scenarios. The long-term liquidity shortage indicator stood at 390% as of June 30, 2018.

**The current funding structure is assessed as satisfactory**, which corresponds to the basic level of this factor. Although the share of regulatory funding is fairly high (33.7% in total liabilities), ACRA made no negative adjustments, as the Bank utilizes these funds to finance government programs aimed at SME development rather than to adjust its liquidity indicators. The insufficient diversification of liquidity sources is offset by positive resource base concentration figures.

**Potential extraordinary support of the Bank from government authorities.** The medium systemic importance of SME Bank (according to the Methodology for Analyzing Relationships between Rated Entities and the State) is expressed in the Bank's assessment as a prominent player in a strategically important market having, however, an insignificant impact on the economy and representing moderate risks for the state budget. The moderate assessment of the state's influence on the creditworthiness of SME Bank is based on its shareholding control prevailing over its operational control, the Bank's participation in government projects (development of the Far East, support of female entrepreneurs, and cooperative farming development programs), and past cases of extraordinary support from the shareholder. Going forward, the shareholder may provide the Bank with extraordinary support by placing deposits. Considering this factor, ACRA makes an upward adjustment to the SCA by one notch.

## Key assumptions

- The Bank maintaining its current business model within the 12 to 18-month horizon;
- The SME Corporation maintaining shareholder control.

## 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:

- Higher systemic importance of the Bank for the national economy and society;
- Improved business positions of the Bank following the successful implementation of the new strategy.

### A negative rating action may be prompted by:

- Decrease in capital adequacy below 12%;
- Bank assets significantly deteriorating;
- Negative averaged capital generation ratio.

## Rating components

**SCA:** a.

**Adjustments:** SCA +1.

## Issue ratings

No outstanding issues have been rated.

## Regulatory disclosure

The credit rating has been assigned under the national scale for the Russian Federation and is based on [Methodology for Credit Ratings Assignment to Banks and Bank Groups Under the National Scale for the Russian Federation](#), the [Methodology for Analyzing Relationships between Rated Entities and the State](#) as well as the [Key Concepts Used by The Analytical Credit Rating Agency Within the Scope of Its Rating Activities](#).

The credit rating assigned to SME Bank JSC was published for the first time on December 29, 2017. The credit rating and its outlook are expected to be revised within one year following the rating action (December 27, 2018).

The credit rating is based on the data provided by SME Bank JSC, information from publicly available sources, and ACRA's own databases. The rating analysis is based on the IFRS consolidated statements of SME Bank JSC and financial statements of SME Bank JSC composed in compliance with the Bank of Russia Ordinance No. 4212-U dated November 24, 2016. The credit rating is solicited, and SME Bank JSC participated in its assignment.

No material discrepancies between the data provided and the data officially disclosed by SME Bank JSC in its financial statements have been discovered.

ACRA provided additional services to SME Bank JSC. No conflicts of interest were discovered in the course of credit rating assignment.

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