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Key rating assessment
factors

ACRA affirms BB+(RU) to Bank SOYUZ, changes outlook to Positive

ACRA has affirmed BB+(RU) to [Bank SOYUZ](#) (hereinafter, SOYUZ, or the Bank) and changed the credit rating outlook to Positive.

The Bank's credit rating stems from fairly high likelihood of financial support from its parent entity, "Ingosstrakh Insurance Company" (hereinafter, the Supporting Institution, or SI), if needed, and moderately low financial profile of the Bank. SOYUZ's standalone creditworthiness (SCA) is based on satisfactory business profile assessment, weak capital position and critical risk profile assessment on the back of adequate funding and liquidity position.

The rating outlook has been changed to Positive to reflect ACRA's expectations with respect to possible upgrade of the risk profile assessment in view of growing quality of the Bank's loan portfolio.

Bank SOYUZ is a universal bank holding medium positions (ranking 83 in terms of capital) in the Russian banking sector, with 95.9% of its shares controlled by the Supporting Institution. The Bank is present in six federal districts of Russia (with the highest concentration of the corporate segment in Moscow, while its retail business is geographically diversified). The primary activity is lending to both corporate (mainly medium-sized businesses) and individual clients (mostly mortgage and car loans) in virtually equal proportion, factoring services as well as transactional banking related to, among other things, the SI (payment and cash services, issuance of guarantees and sale of insurance products).

Fairly high likelihood of extraordinary support from the shareholder. The Supporting Institution has high creditworthiness assessment and, in ACRA's opinion, is willing to provide SOYUZ with sufficient long-term and short-term financing, if needed, as well as inject capital, considering:

- The degree of legal affiliation between the SI and the Bank and the SI's ability to exercise control over its operating activities;
- Financial aid provided by the SI to SOYUZ in form of non-repayable funds that totaled RUB 1.9 bln in 2015 and RUB 2.4 bln in 2016, which was recorded in the Additional Tier-1 capital;
- Potential reputational risks for the SI in case SOYUZ defaults.

In view of the above, the Agency assesses the degree of relationships between the Supporting Institution and the Bank as moderate. ACRA's opinion with regard to the extent of support from the SI is reflected in two notches added to the Bank's SCA (bb-).

Satisfactory business profile. The strategy of SOYUZ incorporates improvement of operational efficiency by virtue of optimizing business processes within the bank by way of centralization of some functions, which would drive the costs for maintaining the branch network lower, and improvement of existing IT systems in order to increase the speed of decision-making and servicing the clients. High diversification of the operating income (the Herfindahl-Hirschman Index equaled 0.16 as at September 30, 2018) based on the universal nature of the Bank's activities demonstrated overall positive dynamics over the last five years. The corporate governance quality is in line with the scope of the Bank's activities and is closely monitored by the management, and therefore, is assessed as satisfactory.

Weak capital position is primarily determined by very low capacity of the Bank to generate capital (the averaged capital generation ratio, ACGR, is negative over the last five years), which was driven by unprofitable activities in 2015-2017 resulting from substantial additional provisioning of the loan portfolio. Also, the operating efficiency of SOYUZ is still below the average among its peers: CTI (cost-to-income) and NIM (net interest margin) ACRA calculates for the last three years stand at 80% and 4.5%, respectively. At the same time, the Bank

complies with statutory capital adequacy ratios with a margin: as at November 1, 2018, N1.2 ratio equaled 10.1% and N1.0 was at 12.6%, while the minimum recommended figures are 7.875% and 9.875% (including the conservation buffer), respectively, which allows the Bank withstanding a moderate increase in the cost of risk in a stress scenario (above 400 bps) while staying compliant with statutory ratios.

Critical risk profile assessment of SOYUZ is determined by a high (through declining) share of problem and potentially problem loans in the loan portfolio: 16.1% (including NPL90+ totaling 8.1% of the portfolio, forcedly restructured loans accounting for 8%). At the same time, the provisioning ratio with respect to problem and potentially problem loans is low at 46%. The share of loans and other claims (guarantees) to companies affiliated with business of principle beneficial owners of the Bank may, in ACRA's opinion, be as high as 80% of the core capital; at the same time the aggregate coverage of loan claims exceeds 100%. At the same time, the portfolio concentration on the top ten groups of borrowers is assessed as acceptable (23.6% of the portfolio) and concentration on high-risk industries is assessed as moderate (43% of the core capital).

Investments into securities of SOYUZ account for around 26% of assets, with Russian government bonds and bonds of the Bank of Russia having a significant share (81%) in the securities portfolio.

On the other hand, SOYUZ has a number of non-core assets (during last 12 months their level decreased from 45% to 35% of core capital), most of which are represented by property collected from defaulted borrowers. The liquidity of these assets is assessed as limited.

Adequate liquidity and funding profile. The Bank is capable of withstanding a significant outflow of client funds in both base case (short-term liquidity surplus exceeds RUB 20 bln) and stress scenarios (7.5% of liabilities). At the same time, the average short-term liquidity indicator (STLI) in 2018 exceeded the minimum 250%. If necessary, Bank SOYUZ can also raise additional funds as part of repo transactions by virtue of low share (5%) of encumbered securities in its portfolio. We also observe no liquidity imbalances on the longer-term horizon (the long-term liquidity shortage indicator, LTLIS, was 80% as at September 30, 2018).

The diversification of the Bank's funding sources is assessed as acceptable: funds of legal entities account for 47% and those of individuals for 43% of total liabilities. Resource base concentration on creditors is very high, while the share of funds from related parties, including those regarded as such by ACRA, is around a half of total liabilities. In the next 12 months, no significant outflow of funds is expected. As at September 30, 2018, the Bank had no funds raised from the Bank of Russia.

Key assumptions

- The Bank's business model will remain unchanged within the 12 to 18-month horizon;
- NIM is maintained around 4%;
- Maintaining a relatively high core capital adequacy (N1.2) within the 12 to 18-month horizon.

Potential outlook or rating change factors

The Positive outlook assumes that the rating will most likely be changed within the 12 to 18-month horizon.

A positive rating action may be prompted by:

- Bank's activities generating sustainable profits, while dividend payout is minimal;
- A reduced share of problem loans and concentration of the loan portfolio on the largest groups of borrowers;
- A significant decline in non-core assets on the Bank's balance sheet;
- A significant increase in the resource base diversification by creditor.

A negative rating action may be prompted by:

- Increase in lending to the Bank's direct or indirect affiliates;
- Worsening liquidity position.

Rating components

Standalone Creditworthiness Assessment (SCA): bb-.

Adjustments: no.

Support: 2 notches up to SCA.

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 Member Company Relationships Within Corporate Groups](#) 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 Bank SOYUZ was published by ACRA on December 29, 2017 for the first time. The credit rating and its outlook are expected to be revised within one year following the rating action date (December 27, 2018).

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

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

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

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