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ACRA affirms the credit rating of LLC CBED «THE BANK OF KAZAN» at BB+(RU), changes outlook to Negative

The credit rating outlook of LLC CBED «THE BANK OF KAZAN» (hereinafter, the Bank) has been changed from Stable to Negative due to the risks of deteriorating quality of the loan portfolio and guarantees issued, which may push down the Bank's capital metrics in the next 18 months.

Currently, the credit rating of the Bank is based on the satisfactory business profile, adequate capital adequacy, weak risk profile, and adequate assessment of funding and liquidity.

The Bank is a credit institution operating primarily in the Republic of Tatarstan (ACRA rating: AAA(RU), outlook Stable, hereinafter, Tatarstan). As of March 1, 2020, the Bank ranked 167th in equity and 166th in assets in the Russian banking sector.

Key rating assessment factors

The satisfactory business profile assessment (bb+) reflects a minor market share held by the Bank in the banking sector of both Russia and Tatarstan. Aside corporate banking, guarantee issuance is another major business line of the Bank, which contributes to higher diversification of its operations. However, a strong competition in this segment will continue hampering the Bank's revenue.

Last year, the Bank started to apply more cautious risk-taking approach, which somehow mitigates potentially negative effects stemming from possible long-term economic slowdown. In particular, the Bank has revised its capital adequacy policy and decided to reduce the loan portfolio (by about a quarter in the last 14 months) in order to keep stronger capital adequacy metrics. We expect that in the next 18 months, this approach will remain unchanged and the Bank will keep the lending growth relatively flat. At the same time, the Bank is striving to increase the granularity of its loan portfolio and is taking measures to reduce single-name concentrations, shifting the focus towards smaller enterprises. The share of top 10 borrowers in the shrinking loan portfolio has declined to 26% by March 1, 2020 against 30% a year ago.

The capital adequacy assessment is adequate due to a significant loss absorption cushion accumulated by the Bank through restrained active transactions in 2019–2020, so that the N1.2 ratio reached 12.8% by early March 2020 against 9.7% as of January 1, 2019. As a result, the Bank is able to withstand the growth in the cost of risk as part of the ACRA's stress test relative to the base case scenario (in which the indicator is about 150 bps in 2020) in the range of 300–400 bps without violation of the N1.2 ratio.

Although the ACRA's base case scenario assumes the N1.2 ratio to stay above 10%, the negative scenario does not exclude it falling below 9% and/or the capital stress test results may worsen on the backdrop of an unfavorable operating environment in the next 18 months, which currently justifies the negative outlook.

Over the past five years, the averaged capital generation ratio has remained satisfactory (about 69 bps). A relatively low operational efficiency continues to put pressure on the Bank's profitability: according to our estimates, the three-year average CTI is close to the critical level and amounts to 74%.

The weak risk profile assessment is due to an increase in the share of potentially problem loans and unsecured loans in the Bank's total loan portfolio. These negative developments occurred on the backdrop of shrinking loan portfolio over the past 14 months.

According to ACRA's estimates, the share of potentially problem loans is 15–17% of the Bank's loan portfolio. The associated risks are somewhat mitigated by the impairment reserves, which cover almost 78% of the total problem loans. The share of unsecured loans is close to the threshold value of 60% of the loan portfolio, which, in our opinion, could become a source of unforeseen credit losses amid complex operating environment.

The portfolio of guarantees may exert an additional pressure on capital. According to ACRA's estimates, the share of potentially problem guarantees is 11% of the total guarantees issued or about 40% of the Tier-1 capital (as per local regulation). Moreover, the Agency notes that a significant number of principals operates in such sectors as construction (approximately 30% of guarantees), services (approximately 20%) and trade (approximately 20%), and the express guarantees segment accounts for about one third of the total portfolio. In our opinion, the abovementioned business lines may be increasingly vulnerable to the slowing down business environment.

The adequate funding and liquidity position. The Bank continues to maintain a sufficient liquidity buffer while the funding comes mainly from deposits dominated by the retail customers, and we assess it as relatively stable. As of March 1, 2020, the short-term liquidity shortage indicator was positive in both the base case and the stress scenarios of ACRA. The long-term liquidity shortage indicator was 111%.

Key assumptions

- The Bank will adhere to the current business model;
- Tier-1 capital adequacy ratio (N1.2) above 9%;
- The Bank can withstand the growth in the cost of risk in the range of 300–400 bps above the base case results without violation of the N1.2 ratio;
- Cautious loan portfolio growth;
- Strong liquidity indicators.

Potential outlook or rating change factors

The Negative outlook assumes the possibility of a negative rating action over the next 12–18 months.

A positive rating action may be prompted by:

- Easing economic risks;
- A substantial growth in capital adequacy ratios;
- A sustainable decline in the volume of problem loans and guarantees.

A negative rating action may be prompted by:

- A sustainable decline in the N1.2 ratio below 9%;
- A sustainable growth in the CTI ratio above 75%;
- A sustainable growth in the share of unsecured loans above 60% of the loan portfolio;
- Further growth in the potentially problem assets and off-balance sheet commitments, which may trigger material credit losses and worse ACRA's capital stress test results.

Rating components

Standalone creditworthiness assessment (SCA): bb+.

Adjustments: none.

Support: no.

Issue ratings

No rated debt securities.

Regulatory disclosure

The credit rating was assigned under the national scale for the Russian Federation and is 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.

The credit rating of LLC CBED «THE BANK OF KAZAN» was published by ACRA on May 11, 2017 for the first time. The credit rating and credit rating outlook are expected to be revised within one year following the publication date of this press release.

The assigned credit rating is based on the data provided by LLC CBED «THE BANK OF KAZAN», information from publicly available sources, and ACRA's own databases. The rating analysis was performed using IFRS consolidated statements of LLC CBED «THE BANK OF KAZAN» and statements of LLC CBED «THE BANK OF KAZAN» composed in compliance with the Bank of Russia Ordinance No. 4927-U dated October 08, 2018. The credit rating is solicited, and LLC CBED «THE BANK OF KAZAN» participated in its assignment.

No material discrepancies between the provided data and the data officially disclosed by LLC CBED «THE BANK OF KAZAN» in its financial statements have been discovered.

ACRA provided no additional services to LLC CBED «THE BANK OF KAZAN». No conflicts of interest were discovered in the course of credit rating assignment.