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DEMAND FOR VEB.RF BONDS WILL GROW AS REGULATIONS ON BANKS' CAPITAL ARE EASED

State Corporation VEB.RF: higher potential for raising funds

On August 16, 2021, the Bank of Russia published a press release in which it announced the approval of amendments to Bank of Russia Instruction No. 199-I "On Banks' Required Ratios and Capital Adequacy Buffers for Banks with a Universal License". The amendments concern regulatory requirements for assessing banks' risk in relation to State Development Corporation "VEB.RF" (hereinafter, VEB.RF, ACRA rating AAA(RU), outlook Stable).

According to the amendments, when calculating prudential ratios, the weighting of all ruble-nominated and funded credit claims against VEB.RF involves a risk ratio of 20%.

Given the fact that previously, according to VEB.RF, this risk ratio amounted to 100%[1], part of the capital of banks that have invested in bonds or provided financing to VEB.RF, will be released.

According to VEB.RF, it has 23 outstanding ruble-denominated long-term bond issues to a total of RUB 405.6 bln, investments in which the aforementioned regulatory amendments will apply. However, VEB.RF states that more than half of the holders of these securities are Russian banks. Taking into account the significant reduction of risk ratios for the ruble debt instruments of VEB.RF, and, as a result, the freeing-up of banks' capital, demand for these instruments may increase as banks will be able to purchase RUB bonds of VEB.RF worth about RUB 800 bln[2]. At the same time, the cost of VEB.RF's funding may decrease.

In view of the fact that, in accordance with its new development strategy until 2024, VEB.RF plans to disburse RUB 3 tln to finance projects with a total value of RUB 17 tln, the reduction of risk ratios looks timely and will help VEB.RF to raise funds in the market.

In ACRA's opinion, VEB.RF bonds will be in high demand among the largest Russian banks, especially those in which the state holds an equity share. Privately owned

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[1] Previously, a 20% ratio was only applied to short-term (up to 90 days) ruble-denominated claims on VEB.RF, as well as to ruble-denominated claims on third parties under guarantees (sureties) provided by VEB.RF.

[2] This assessment only takes into account amendments to Instruction of the Bank of Russia No. 199-I dated November 29, 2019. It does not include the effect produced by the Bank of Russia's plans to include VEB.RF's ruble bonds in the list of level 2A highly liquid assets as per of Bank of Russia Ordinance No. 421-P dated May 30, 2014 "On the Procedure for Calculating Short-Term Liquidity (Basel III)" and the list of low-risk securities as per Bank of Russia Ordinance No. 511-P dated December 3, 2015 "On the Procedure for Calculating Credit Risk by Credit Organizations".

banks seek higher margins, and therefore they are less interested in government and quasi-government instruments. Although the yield on VEB.RF bonds is higher than that on OFZ bonds, it is still less attractive compared to the yield on corporate securities.

The regulatory standards applicable to systemically important banks include a 3.5 p.p. add-on to the minimal mandatory ratios (2.5% is the capital adequacy maintenance add-on, 1% is the systemic importance add-on). A number of the largest banks, despite the need to comply with the standards (including add-ons), are nevertheless interested in such instruments as VEB.RF bonds. In addition, the presence of such bonds on banks' balance sheets increases capital adequacy ratios and liquidity indicators.

At the same time, VEB.RF may raise about RUB 800 bln only over a long-term horizon in view of the limited amount of free cash available to banks, their desire to maintain/increase margins, the absence of significant problems in terms of compliance with capital adequacy and liquidity ratios and indicators, as well as possibly a somewhat lower yield on VEB.RF bonds compared to the yields on bonds of other issuers.

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