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Key rating assessment
factors

ACRA assigns BBB+(RU) to Sviaz-Bank, outlook Negative

The credit rating of [Sviaz-Bank](#) (hereinafter – Sviaz-Bank or the Bank) is based on a high likelihood of extraordinary shareholder support by Vnesheconombank (VEB). The Bank is marked by a relatively low standalone creditworthiness assessment (SCA) that hinges on an adequate business profile, and a moderate capital adequacy position. Risk profile and funding and liquidity position are negative factors for the Bank's rating.

Sviaz-Bank is a universal bank with vast federal network. The Bank is equally focused on both, operations in corporate, and retail segments. As of the beginning of June 2017, the Bank ranked 26th in terms of own capital nationwide. The Bank's business and management principles have drastically changed since the completion of financial recovery procedures carried out by VEB in 2011. Currently, VEB retains its control over the Bank.

High likelihood of shareholder extraordinary support. The updated VEB strategy (adopted in December 2016) defines the Bank as a non-core asset, which determines the target for its sale in the medium term. ACRA believes that given the state of private equity market pertaining to the banking sector and VEB's conservative approach to transaction terms, it is rather unlikely that on the 12-month horizon VEB will sell the Bank and as a result lose control over it.

In this regard, and due to (1) existing significant shareholder support (placement of funds by VEB Group, and capital replenishment at end-2016); (2) serious reputational risks for VEB arising from a potential default of the Bank; (3) pronounced operating control; (4) existing sizeable unconditional credit lines for supporting the Bank's liquidity; (5) motivation for maximization of the Bank's market value, ACRA believes that VEB (the Bank's supporting organization marked by a high creditworthiness level) is ready to provide Sviaz-Bank with financing in a sufficient amount, and, if necessary, to replenish its capital. Taking into account all the facts listed above, the Bank's SCA (bb) gets four additional notches of support.

At the same time, we would like to point out a significant uncertainty about the sale of the Bank and the new owner whose creditworthiness is also uncertain, logistics of such sale and transfer of control, which determines the "Negative" outlook for the Bank's credit rating.

Satisfactory business profile. Currently, Sviaz-Bank is a universal bank with rather good market positions in lending to medium and large businesses, large retail customer base, and strong mortgage franchise. In the absence of an explicit development strategy of Sviaz-Bank, its management is focused on improving the Bank's operating efficiency and optimizing its cost of funding. The Bank's operating income is characterized by an acceptable diversification without an apparent anchor source. Sviaz-Bank's ownership structure is transparent, its corporate governance is additionally strengthened by VEB management involvement in the Bank's operating activity.

Significant loss absorption buffer, but weak capability of capital generation. Taking into account additional capitalization (in the form of converting subordinated bonds into the Bank's shares in December 2016), Sviaz-Bank shows high core capital level by both, international standards (Tier-1 equaled 11.2% as of end-2016) and Russian regulatory requirements (N1.2 amounted to 13.43% as of early August 2017), which allows the Bank to withstand a significant (over 500 bps) increase in the cost of credit risk without breaching the established minimum levels. At the same time, the Bank's internal capability to generate new capital is defined as very weak: due to losses of previous years (on the back of problem loan provisioning), the average capital generation ratio (ACGR) for the period of 2012-2016 was significantly below zero. Operating efficiency is low too

(the average cost-to-income ratio exceeds 100% for the past three years). ACRA base case scenario assumes that the Bank's 2017 financial result will be around zero.

Improving, but still relatively low asset quality. By ACRA estimate, as of mid-2017, over 15% of the Bank's loan portfolio are overdue loans and loans pertaining to potentially troubled borrowers. We would like to note that the Bank is working on making loan loss provisions, however, specific claims under loan agreements are still particularly sensitive to economic and financial performance of largest creditors. As a positive sign, we note that the scope of lending to affiliates and construction and real estate companies is low (57% and 26%, correspondingly, at the beginning of 2017).

Risk management system and procedures are in the process of modernization, which may result in formation of a higher quality asset portfolio in the medium term.

Satisfactory funding and liquidity assessment. Given the uncertainty about the future owner and strategy of the Bank, at present its corporate funding base is mostly short-term, and its stability depends on the efficiency of the client's management work. Therefore, at the beginning of 2017, the short-term liquidity shortage indicator (STLSI) was positive under the base case scenario, but under the stress scenario its deficit amounted to 7% of the Bank's liabilities. In the long-term, the Bank's liquidity position is assessed as adequate but close to a weak level: the long-term liquidity shortage indicator (LTLSI) equaled to 58% at the beginning of 2017. ACRA also highlights a persistently low liquidity coverage ratio (LCR) in comparison with peer banks. As of early August 2017, 49% of liabilities accounted for corporate funds, while 31% was formed by individual accounts and deposits.

Key assumptions

- Operating activities on a break-even level (or minimal loss) as of end-2017;
- Tier-1 capital adequacy (N1.2) over 10% on the 12 to 18-month horizon;
- Retaining the current volume of the Bank's loan portfolio;
- Maintaining the current funding structure.

Potential outlook or rating change factors

The **Negative outlook** takes into account the possibility of significant changes in the Bank's ownership structure, and the vagueness of its long-term development strategy.

A negative rating action may be prompted by:

- Forfeiture of shareholder or operating control over the Bank on the part of Vnesheconombank;
- Capital adequacy deterioration on the back of the increase in the cost of risk or more aggressive asset growth.

A positive rating action may be prompted by:

- Asset quality improvement;
- Development of a more balanced funding structure;
- Transfer of shareholder control to an owner with a comparable level of creditworthiness in relation to Vnesheconombank, and a growing strategic importance of the Bank for the new shareholder.

Rating components

Standalone creditworthiness assessment (SCA): bb.

Adjustments: none.

Support: 4 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 the [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](#), and the [Key Concepts Used by the Analytical Credit Rating Agency Within the Scope of Its Rating Activities](#).

A credit rating has been assigned to Sviaz-Bank for the first time. The credit rating and its outlook are expected to be revised within one year following the rating action date (August 25, 2017).

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

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

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

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