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## ACRA affirms 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 based on a satisfactory business profile, strong capital adequacy, weak risk profile, and adequate funding and liquidity assessment of the Bank, as well as support by the Federal Corporation for Development of Small and Medium Business ([AAA\(RU\)](#), [outlook Stable](#); hereinafter, the SME Corporation).

SME Bank is a medium-size Russian bank in terms of capital, ranking 45<sup>th</sup> based on the results for the ten months of 2019, engaged in lending to small and medium-size enterprises (SMEs) as part of its participation in the government financial support Programs. The Bank is a 100% subsidiary of the SME Corporation, which is a government-owned entity.

**The Banks' business profile (bbb) is satisfactory** and takes into account its specifics and risks of activities, which largely corresponds to the operational model of a development institution. Development of the SME segment, which, in ACRA's view, exhibits high credit risks, is its primary focus. The inherent risks, however, are partly mitigated by a substantial ongoing support from the government and its involvement in the Bank's activities. In addition, the Bank's operational stability is largely secured by a strong funding base primarily comprising government money.

The Bank has accumulated a substantial amount of problem assets that primarily originated prior to 2016. In particular, ACRA notes a substantial size of toxic exposure to banks, which is the reason behind the operational transformation of the Bank's business model: direct financing of SMEs replaces the previous two-tier distribution system through partner banks. In the period from the beginning of 2017 through nine months of 2019, SME Bank has cut the funding of partner banks from RUB 81 bln to RUB 12 bln.

**ACRA assesses the capital adequacy of the Bank as strong**, although its profitability figures are weak. The capital position is maintained primarily by injections from the government. The most recent capital injection of RUB 5 bln made in August 2019 increased the Bank's authorized capital by roughly 20%, which helped improve the N1.2 ratio to 17%. However, ACRA expects this ratio to decline in the next 12 months as the Bank may grow its active operations aggressively, while its profitability remains limited. Despite that, ACRA believes SME Bank will be able to withstand an increase in the cost of risk of more than 500 bps without breaching the N1.2 capital adequacy ratio (6%) in the next 18 months.

The Bank's profit generation ability remains weak, which is typical of a development institution's business model. Amid limited interest and fee income, administrative expenses pressure the profitability: CTI (cost to income) averaged 70% over the last three years.

**The risk profile assessment is downgraded from adequate to weak** as the Bank has been aggressively expanding its lending (the loan portfolio increased by around 63% over the last twelve months), while the share of the potentially problem loans, estimated by ACRA at 13% of the total consumer lending, saw no change.

The Agency also notes a substantial amount of problem exposure to banks. However, ACRA believes the respective reserves for impairment are adequate and largely offset the related credit risks.

**The funding and liquidity factor is assessed as adequate** due to the high volume of liquid assets, which allows SME Bank to have a short-term liquidity surplus in both ACRA's base case and stress scenarios. The long-term liquidity shortage indicator (LTLSI) equaled 111% as of October 1, 2019. The Bank's funding base primarily comprises stable government-related financing.

**High probability of extraordinary support from the parent entity.** ACRA takes into account the long relationship history, strong integration, and the important role of the Bank for the SME Corporation. Therefore, the Agency has added three notches to the Bank's SCA. In ACRA's opinion, the SME Corporation will be able and willing, if needed, to provide the Bank with both short-term and long-term funding as well as make capital injections based on the following factors:

- Significant legal, reputational, and operational interrelationships between the Bank and the SME Corporation;
- The Bank is regarded as an important part of the SME Corporation performing unique functions for the SME Corporation;
- The share of Bank's obligations covered by guarantees from the SME Corporation was 17% as of October 1, 2019;
- The Bank's size is material for the SME Corporation totaling around 28% of the SME Corporation's consolidated equity and half of its total assets.

ACRA earlier assigned AAA(RU), outlook Stable to the SME Corporation. The Agency assesses the degree of relationships between the Bank and the SME Corporation as strong.

- The Bank maintaining its current business model within the 12 to 18-month horizon;
- High probability of extraordinary support from the SME Corporation.

**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:**

- A substantial improvement in the quality of assets.

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

- A decreased importance of the Bank for the SME Corporation;
- A substantial asset quality deterioration;
- N1.2 ratio declining below 8% while CAGR remains below 50 bps.

## Key assumptions

## Potential outlook or rating change factors

## Rating components

**SCA:** bbb+.

**Adjustments:** none.

**Support:** +3 notches 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 SME Bank JSC was first published on December 29, 2017. The credit rating and its outlook are expected to be within one year following the publication date of this press release.

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. 4927-U dated October 8, 2018. 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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