

December 29, 2017

ACRA assigns 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) stems from strong business profile, adequate capital adequacy, risk profile, and funding and liquidity assessments. In addition, the rating is supported by medium systemic importance of SME Bank for the Russian economy and moderate state influence on its creditworthiness according to the ACRA methodology.

SME Bank is a medium-size Russian bank in terms of capital (ranking 46th based on the results for the nine months of 2017). The key activities of the Bank are lending to small and medium enterprises (SMEs) as part of SME Bank's participation in the Government Financial Support Program as well as providing support in securing obligations under contracts (Federal Law No.223-FZ dated July 18, 2011 "On procuring goods, works, and services by specific types of legal entities"; No.44-FZ "On contracting procurement for goods, works, and services to meet government and municipal demands") both within the National Guarantee System and beyond it. The Bank is a 100% ownership of Joint Stock Company "Federal Corporation for Development of Small and Medium-Size Business" (hereinafter, SME Corporation). Shareholders of SME Corporation are the Russian Federation represented by the Federal Agency for State Property Management (67.7%) and State Corporation "Bank for Development and Foreign Economic Affairs (Vnesheconombank)" controlling 32.3% of shares.

Business profile of the Bank (bbb) is moderate and takes into account its franchise specifics. Currently, the Bank's business model is in transformation: transitioning from a two-tier product distribution system through a partner network (banks, leasing and factoring companies, microfinancing institutions) to direct communication with SMEs on a competitive basis. For the nine months of 2017, SME Bank has cut funding of its partners providing support to SMEs (from RUB 80.6 bln to RUB 42.1 bln).

The Bank's business exhibits a relatively low diversification (the Herfindahl-Hirschman Index measuring the operating income diversification equals 0.43). Over 60% of operating income generated in the nine months of 2017 is interest income from banks and financial institutions. ACRA increases the diversification assessment in view of the changing strategy of SME Bank.

Implementation of the Bank's 2018-2019 strategy faces additional risks: the new business model involves running the business in a highly competitive environment.

Strong capital adequacy of the Bank stems from core capital adequacy ratio (Tier-1 calculated in line with the Basel standards) standing at 26.9% for the nine months of 2017. In 2018, the target N1.0 ratio would change from the current 25.25% to 13% by virtue of the loan portfolio aging and planned growth of business. The Bank recorded a loss in 2016, which affected the final figure of the averaged capital generation ratio (ACGR) at 12 bps. As projected, the Bank would demonstrate a weakly positive financial result in 2017. According to the ACRA stress test, SME Bank is capable of withstanding a change in the cost of risk of over 500 bps without breaching the N1.2 capital adequacy ratio (6%).

Adequate risk profile. A substantial independence of the risk management division of SME Bank and sufficient competence of the division's employees let the division play an important role in the Bank's strategy implementation. The Agency assesses risk management quality in the credit institution as adequate.

The loan portfolio quality is determined by an acceptable level of problem debt on the balance sheet of SME Bank (by ACRA estimates, it stood at 5.9% of the total corporate loans portfolio as at September 30, 2017) and low risk concentration. The share of the top ten groups of related borrowers equaled 28.6% of the Bank's total loan portfolio as at the above date.

Strong liquidity position is based on a large amount of liquid and high-liquid assets allowing SME Bank to demonstrate short-term liquidity surplus in both ACRA's base case and stress scenarios. The key drivers of the liquidity position assessment are (1) the amount of deposits placed with the Bank of Russia (RUB 9 bln), (2) the amount of Russian government bonds (RUB 10.2 bln), and (3) available credit facilities opened by the Bank of Russia (RUB 21 bln).

The current funding structure is assessed as satisfactory, which corresponds to the basic level of this factor. Although the share of regulatory funding is fairly high (39.8% in the total liabilities), ACRA makes no negative adjustments, as the Bank utilizes these funds to finance government programs aimed at SME development rather than for adjusting its liquidity indicators. Insufficient diversification of the liquidity sources is offset by positive resource base concentration figures.

Potential extraordinary support of the Bank from government authorities. The medium systemic importance of SME Bank (according to the Methodology for Analyzing Relationships between Rated Entities and the State) is expressed in assessing the Bank as a prominent player in a strategically important market having, however, an insignificant impact on the economy and representing moderate risks for the state budget. Moderate assessment of the state's influence on creditworthiness of SME Bank is based on its shareholding control prevailing over the operational control, the Bank's participation in the government projects (development of the Far East, female entrepreneurs support, and cooperative farming development programs), and past cases of extraordinary support from the shareholder. Going forward, the shareholder may provide the Bank with extraordinary support by placing deposits (after making respective amendments in the investment declaration of SME Corporation). Considering this factor, ACRA makes an upward adjustment to SCA by one notch.

Key assumptions

- SME Corporation keeps the shareholding control;
- Business diversification indicator is below 0.35.

Potential outlook or rating change factors

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:

- Higher systemic importance of the Bank for the national economy and the society;
- Improved business positions of the Bank following successful implementation of the new strategy.

A negative rating action may be prompted by:

- Capital adequacy indicators declining below 12%;
- A substantial worsening of the Bank's asset quality.

Rating components

SCA: a.

Adjustments: SCA +1.

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 Relationships between Rated Entities and the State](#) as well as the [Key Concepts Used by The Analytical Credit Rating Agency Within the Scope of Its Rating Activities](#).

The credit rating has been assigned to SME Bank JSC for the first time. The credit rating and its outlook are expected to be revised within one year following the rating action (December 28, 2017).

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. 4212-U dated November 24, 2016. 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 no additional services to SME Bank JSC. No conflicts of interest were discovered in the course of credit rating assignment.

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