Fitch Ratings

Banks
Universal Commercial Banks
Russian Federation

PJSC Sovcombank

Ratings

Foreign Currency

Long-Term IDR	BB+
Short-Term IDR	B

Local Currency

Long-Term IDR	BB+
Viability Rating	bb+
Support Rating	5
Support Rating Floor	NF

Sovereign Risk

Long-Term Foreign-Currency IDR	BBB
Long-Term Local-Currency IDR	BBB
Country Ceiling	BBB

Outlooks

Long-Term Foreign-Currency IDR	Negative
Long-Term Local-Currency IDR	Negative
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (February 2020)

Related Research

Fitch Revises 15 Russian Banks' Outlooks to Negative on Coronavirus Disruption and Oil Price Slump (April 2020)

Russian and CIS Banks Pressured by Coronavirus and Oil Price Slump (March 2020)

Fitch Ratings Publishes 1M20 Russian Banks Datawatch (March 2020)

Russia (February 2020)

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Key Rating Drivers

Negative Sector Outlook: Fitch Ratings revised the Outlook on the ratings of PJSC Sovcombank (SCB) to Negative from Stable in April 2020 to capture the emerging pressures on the broader banking sector, stemming from coronavirus outbreak, lower oil prices and the resulting economic downturn. While the ultimate economic and financial-market implications of the coronavirus pandemic are unclear, Fitch considers the risks to SCB's credit profile to be skewed to the downside and this resulted in the revision of the Outlook.

Significant Resilience Remains: SCB's Issuer Default Ratings (IDRs) are driven by its intrinsic credit strength as expressed by the Viability Rating (VR) of 'bb+'. The ratings continue to capture a record of exceptionally strong profitability in the last few years, strong asset quality and reasonable capital and liquidity buffers. In Fitch's view, SCB's financial profile, and therefore its ratings, could probably tolerate a short-lived, sharp economic contraction in 1H20 if this is followed by stabilisation in 2H20.

Impaired Loans May Increase: SCB's impaired loans (defined as Stage 3 and purchased or originated credit impaired loans under IFRS 9) amounted to a low 3% of gross loans at end-2019. But we expect impaired loans to increase this year, especially in unsecured consumer finance (22% of gross loans) and SME lending (11%). However, SCB's loan book is fairly small, and credit risks outside the loan book are moderate. At end-2019, over 55% of SCB's assets were represented by corporate bonds (mostly rated 'BB' or higher) and liquidity placements.

Pressure on Profitability: SCB's bottom line performance has been exceptionally strong in recent years, and its pre-impairment profit (PIP) in 2019 amounted to a high 10% of gross loans. Near-term pressures on SCB's pre-impairment performance primarily stem from weaker transactional income and lower growth, and profit should additionally be subject to higher loan impairment charges, but we expect SCB to stay profitable in 2020.

Adequate Capital Position: SCB's IFRS-based Basel III CET1 ratio was a moderate 11.7% at end-2019, but capital adequacy is supported by moderate loan growth and healthy profit retention. As is typical for Russian banks, regulatory Tier 1 capital ratio is lower, reflecting tighter statutory risk-weighting. We believe that SCB can absorb additional loan impairment through the income statement and do not expect any sharp near-term capital pressure.

Granular Funding, Ample Liquidity: In Fitch's view, the economic downturn will not result in material pressure on SCB's funding and liquidity profile. At end-2019, SCB was 78% deposit-funded, and its liquidity buffer (including cash, short-term interbank and bonds, most of which are eligible for repo with the central bank) covered over 60% of total liabilities.

Rating Sensitivities

Operating Environment: The ratings could be downgraded if the economic contraction caused by the pandemic turns out to be significantly sharper or more prolonged than anticipated, and this results in a material weakening of asset quality and performance at SCB. The ratings could be affirmed, and the Outlook revised to Stable, if the economic downturn does not result in significant erosion of SCB's financial profile, and if the Russian economy stabilises.

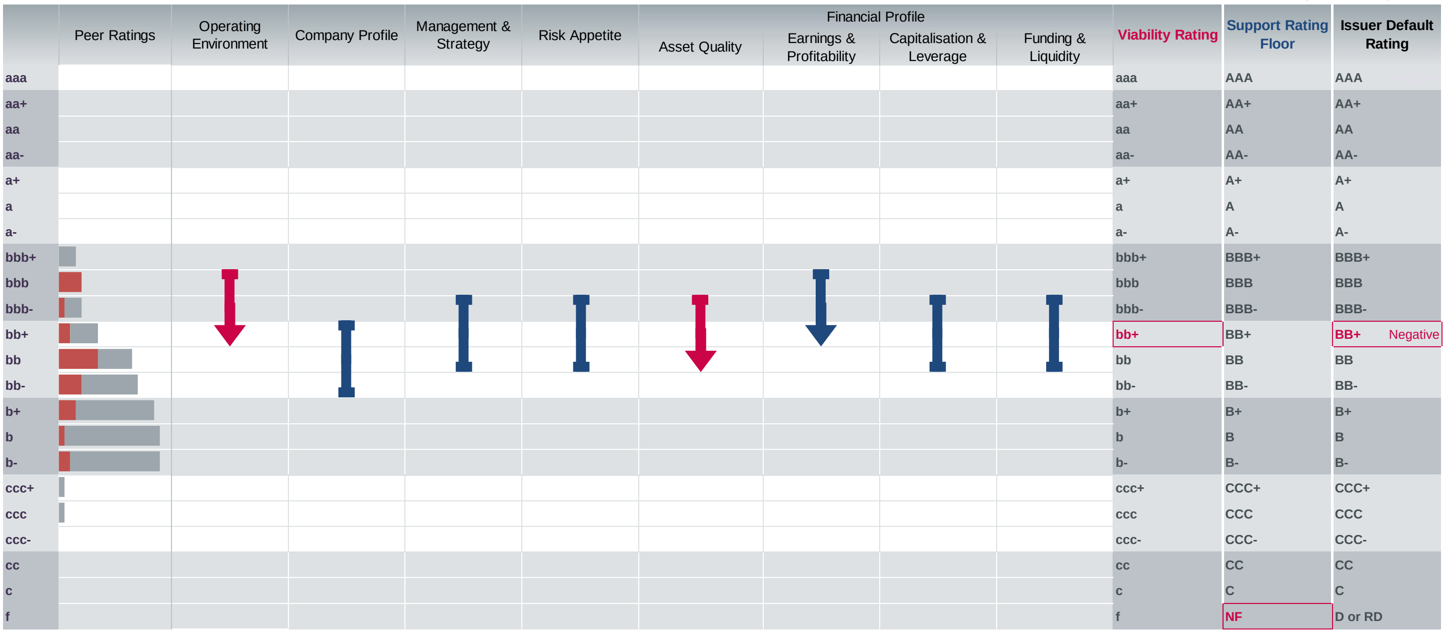
Company Profile, Franchise: Upside potential for SCB's ratings is limited given the negative outlook on the Russian banking sector, but in the longer term an upgrade of SCB's ratings would require meaningful business expansion and improvement in the bank's franchise. Lesser reliance on M&A activity, which we view as opportunistic, as well as an extended record with a strong financial profile, would also be credit positive.

Ratings Navigator – Standalone Assessment

PJSC Sovcombank

ESG Relevance:

Banks
Ratings Navigator



Sovereign Support Assessment

Support Rating Floor			Value
Typical D-SIB SRF for sovereign's rating level (assuming high propensity)			BBB to BB+
Actual country D-SIB SRF			BBB-
Support Rating Floor:			**NF**
Support Factors	**Positive**	**Neutral**	**Negative**
Sovereign ability to support system			
Size of banking system relative to economy		✓	
Size of potential problem			✓
Structure of banking system			✓
Liability structure of banking system		✓	
Sovereign financial flexibility (for rating level)	✓		
Sovereign propensity to support system			
Resolution legislation with senior debt bail-in		✓	
Track record of banking sector support		✓	
Government statements of support		✓	
Sovereign propensity to support bank			
Systemic importance			✓
Liability structure of bank		✓	
Ownership		✓	
Specifics of bank failure		✓	

SCB's Support Rating of '5' and Support Rating Floor of 'No Floor' reflect our view that support from the Russian authorities, although possible given the bank's significant deposit franchise, cannot be relied on due to the bank's still small market shares and lack of official domestic systemically important bank (D-SIB) status. If SCB becomes designated as a D-SIB, Fitch could revise its SRF upwards, at least to the level of 'B', and upgrade its Support Rating to '4'. However, official D-SIB status would not have any impact on SCB's VR or its IDRs.

Bar Chart Legend

Vertical bars – VR range of Rating Factor

Bar Colors – Influence on final VR

- Higher influence
- Moderate influence
- Lower influence

Bar Arrows – Rating Factor Outlook

⇧ Positive ⇩ Negative

⇳ Evolving ▫ Stable

Significant Changes

Negative Outlook on Operating Environment

The economic pressure resulting from the spread of the coronavirus and the lower oil price are credit negative for banks in Russia. Fitch's baseline is for Russia's GDP to contract by 3.3% in 2020 before returning to 2.5% growth in 2021. In March 2020, Fitch revised the sector outlook for Russian banks to negative.

Weaker asset quality will be the main source of pressure on Russian banks' credit profiles. We expect increases in Stage 2 and Stage 3 exposures in corporate lending at most banks due to the drop-off in economic activity and weaker consumer demand in most sectors. Higher loan impairment charges will weaken banks' bottom line performance in 2020. Additional pressures on performance come from weaker commission income, lower lending growth and potentially also some margin compression.

Most Credit Risks Reside in the Loan Book

We believe that SCB will have to absorb additional impairment losses related to some of its loans. Risks are the highest for unsecured retail loans (22% of gross loans) and SME lending (11%). This is because of the quarantine and the lockdown measures resulting in higher unemployment, forced unpaid leave, lower household disposable incomes, and a slump in revenues for SME businesses.

As a moderate mitigating factor, SCB's unsecured retail loans have very low average size, while many peer banks issue larger ticket consumer finance loans. Most instalment cards are interest-free for borrowers, as the interest is paid by the retail chains, and this further reduces the average monthly instalment for the borrower and facilitates loan repayment. Mortgages and car loans are extended with low average loan-to-value ratios. According to the management, over 70% of SME loans are also secured with real estate or vehicles, so even in the event of impairment, most secured retail loans and SME exposures should generate significant recoveries.

The quality of SCB's largest corporate borrowers is reasonable, in Fitch's view, as these are top-tier/rated Russian corporates, although single borrower concentrations are quite high. However, at least some of the largest corporate borrowers may generate additional loan impairment. Construction and real estate (4% of gross loans), transportation and infrastructure (4%) and trade (3%) borrowers will likely be more vulnerable. Positively, foreign currency lending is limited compared to other Russian banks (less than 10% of gross loans).

Limited Risks from SCB's Bond Portfolio

SCB's overall asset quality is supported by a favourable asset structure. At end-2019, liquidity placements of mostly investment-grade credit quality and bonds comprised over 55% of SCB's total assets. Fitch views the credit quality of SCB's bond porfolio as reasonable. Most of the bonds have a credit rating in the 'BB' category or above and are of low-to-moderate credit risk in the context of the Russian market.

In 1Q20, SCB carried out a reclassification of most of its bonds to the 'measured at amortised cost' category in both regulatory and IFRS accounts, so there should not be any significant volatility in the form of marked-to-market gains and losses in the income statement.

Reasonable Loss Absorption Capacity

Even though we expect some pressure on SCB's PIP this year, it should remain strong. In 2019, PIP equalled a high 10% of average gross loans, providing the bank with considerable loss absorption capacity.

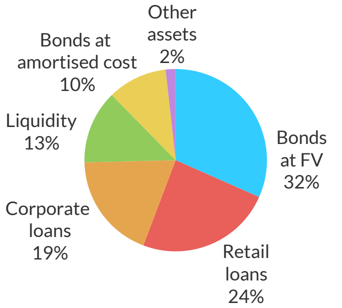
SCB's regulatory capital ratios have reasonable uplift (close to 300bp) over statutory minimums. We expect SCB to absorb most of impairment losses in 2020 through the income statement, without hitting capital, so capital ratios are likely to stay at current levels assuming very limited loan growth this year.

SCB's Gross Loans[a] (%)

	2019	2018
Retail loans, incl.	**55**	**51**
Car loans	21	19
Mortgages[b]	12	15
Consumer loans	13	12
Instalment cards	9	5
Corporate loans, incl.	**45**	**49**
SME	11	11
State-owned development institutions	8	6
Manufacturing	6	7
Construction and real estate	4	5
Transport and infrastructure	3	3
Trade	3	3
Metals and mining	2	4
Other	8	10
Total gross loans	**100**	**100**

[a] This industry breakdown excludes bonds at amortised cost, which are classified as loans in SCB's IFRS accounts
[b] Including home-equity loans
Source: Fitch Ratings, SCB's IFRS accounts

Asset Structure, 2019



Source: Fitch Ratings, SCB's IFRS accounts

Regulatory Capital Ratios

		SCB	
	Minimum[a]	4Q19	2M20
Core tier 1	7.00	9.25	9.92
Tier 1	8.50	9.83	10.59
Total	10.50	13.04	13.55

[a] Including fully loaded capital conservation buffer. SCB is not included in the list of D-SIBs and is not required to maintain a systemic importance buffer
Source: Fitch Ratings, CBR

Summary Financials and Key Ratios

		31 Dec 19	31 Dec 18	31 Dec 17	31 Dec 16
	Year end	Year end	Year end	Year end	Year end
	(USDm)	(RUBbn)	(RUBbn)	(RUBbn)	(RUBbn)
	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified
Summary income statement					
Net interest and dividend income	890	55.1	47.5	33.0	27.7
Net fees and commissions	403	24.9	20.0	18.1	12.8
Other operating income	147	9.1	-6.6	16.0	24.3
Total operating income	1,440	89.1	60.8	67.0	64.8
Operating costs	669	41.4	35.1	25.9	14.9
Pre-impairment operating profit	770	47.7	25.8	41.1	49.9
Loan and other impairment charges	146	9.1	9.9	3.2	12.4
Operating profit	624	38.6	15.9	37.9	37.5
Other non-operating items (net)	-5	-0.3	5.0	-1.2	4.1
Tax	132	8.2	3.3	7.1	8.0
Net income	487	30.1	17.5	29.6	33.6
Other comprehensive income	0	0.0	0.2	-0.7	1.7
Fitch comprehensive income	487	30.2	17.8	28.8	35.3
Summary balance sheet					
Assets					
Gross loans and bonds at amortised cost	9,823	608.1	558.4	275.3	246.1
- Of which impaired	273	16.9	12.0	6.4	5.8
Loan loss allowances	370	22.9	16.9	9.0	7.7
Net loans	9,453	585.2	541.5	266.2	238.4
Interbank	579	35.9	48.5	9.3	0.4
Derivatives	28	1.7	5.3	9.2	3.6
Other securities and earning assets	5,840	361.6	221.8	353.0	290.4
Total earning assets	15,901	984.4	817.2	637.9	532.8
Cash and due from banks	1,845	114.2	114.8	42.9	24.5
Other assets	592	36.6	35.4	8.7	8.1
Total assets	18,337	1,135.2	967.4	689.5	565.3
Liabilities					
Customer deposits	12,130	750.9	598.9	358.9	276.4
Interbank and other short-term funding	2,456	152.0	194.1	195.9	189.5
Other long-term funding	990	61.3	36.4	36.1	24.4
Trading liabilities and derivatives	107	6.6	6.8	0.3	0.0
Total funding	15,682	970.8	836.2	591.3	490.2
Other liabilities	408	25.3	17.1	12.8	10.7
Preference shares and hybrid capital	100	6.2	7.0	n.a.	5.8
Total equity	2,147	132.9	107.1	85.4	58.7
Total liabilities and equity	18,337	1,135.2	967.4	689.5	565.3
Exchange rate		USD1 = RUB61.9057	USD1 = RUB69.5218	USD1 = RUB57.6002	USD1 = RUB60.6569

Summary Financials and Key Ratios (Cont.)

	31 Dec 19	31 Dec 18	31 Dec 17	31 Dec 16
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	3.6	1.8	5.9	8.6
Net interest income/average earning assets	6.5	6.6	5.9	6.0
Non-interest expense/gross revenue	46.6	57.9	38.7	23.0
Net income/average equity	25.2	18.3	41.8	75.8
Asset quality				
Impaired loans ratio	2.8	2.2	2.3	2.4
Growth in gross loans	8.9	102.9	11.8	33.0
Loan loss allowances/impaired loans	135.4	141.3	141.3	133.0
Loan impairment charges/average gross loans	1.6	2.3	1.8	2.4
Capitalisation				
Fitch Core Capital ratio	11.8	11.6	12.7	12.5
CET1 ratio (Basel III)	11.7	11.5	12.4	n.a.
Tangible common equity/tangible assets	11.1	10.4	11.9	9.8
Net impaired loans/Fitch Core Capital	-4.8	-5.0	-3.2	-3.5
Funding and liquidity				
Loans/customer deposits	81.0	93.3	76.7	89.1
Customer deposits/funding	77.4	71.6	60.7	55.7

Source: Fitch Ratings, Fitch Solutions, SCB

Debt Ratings

Rated Debt Instruments

Debt instrument	Debt level	ISIN	Long-Term Rating	Linkage to other ratings
Debt issued by PJSC Sovcombank				
RUB7 billion domestic bonds	Senior unsecured	RU000A0JWPA7	BB+	Equalised with SCB's Long-Term Local-Currency IDR
Debt issued by SovCom Capital DAC				
USD300m Tier 2 subordinated notes	Subordinated debt, Tier 2	XS2010043656	BB-	Two notches below SCB's VR
USD300m AT1 perpetual notes	Hybrid capital, AT1	XS2113968148	B	Four notches below SCB's VR

Source: Fitch Ratings

The senior unsecured rouble-denominated debt issued by SCB is rated in line with its Local-Currency Long-Term IDR, reflecting an assumption of average recovery prospects in the event of default.

SCB's 'BB-' subordinated debt rating is notched down twice from its 'bb+' VR, reflecting higher loss severity relative to senior unsecured creditors.

The additional Tier 1 (AT1) perpetual notes are rated at 'B', four notches lower than the bank's VR. The notching reflects deep subordination of the perpetual notes relative to senior unsecured creditors, resulting in higher loss severity, and SCB's option to cancel coupon payments at its discretion, resulting in additional non-performance risk.

The write-down trigger on the bank's AT1 securities is the regulatory core Tier 1 ratio falling below 5.125%. SCB can omit coupons on these securities at its sole discretion. There is no specific trigger which would oblige SCB to omit coupons before hitting the 5.125% core Tier 1 ratio. However, if the bank's capital ratios fall below minimum levels including buffers (e.g. 7% for core Tier 1) then the bank would be obliged to submit to the CBR a capital recovery plan. In Fitch's view there would be at least a moderate risk that any such plan would include the omission of coupons on the AT1 securities.

Environmental, Social and Governance Considerations

FitchRatings **PJSC Sovcombank**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

PJSC Sovcombank has 5 ESG potential rating drivers

- PJSC Sovcombank has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The left-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies the [number of] general ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector and sub-sector ratings criteria and the General Issues and the Sector-Specific Issues have been informed with SASB's Materiality Map.

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

CREDIT-RELEVANT ESG SCALE

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.