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Lead analysts:

Valeriy Piven, Senior Director
+7 (495) 139-0493
valeriy.piven@acra-ratings.ru

Suren Asaturov, Associate Director
+7 (495) 139-0480, ext. 130
suren.asaturov@acra-ratings.ru

ACRA upgrades PJSC Sovcombank to AA-(RU), changes outlook to Stable, upgrades bond issues RU000A0ZYJR6, RU000A100DZ5, RU000A101MB5, XS2291914971, RU000A102G01 to AA-(RU), RU000A0ZYWZ2, XS2010043656 to A-(RU), and affirms BB+(RU) to RU000A0ZYG28

The credit rating of [PJSC Sovcombank](#) (hereinafter, Sovcombank, or the Bank) has been upgraded due to a change in the assessment of the Bank's systemic importance as part of the financial system of the Russian Federation. Since the last rating action, Sovcombank considerably increased the volume of funds raised from clients, which allowed it to become one of the ten largest Russian banks in terms of this indicator. In addition, the Agency expects the merger with PJSC "Orient Express Bank" (hereinafter, Orient Express Bank) to result in the total volume of Sovcombank's liabilities approaching RUB 600 bln and the Bank strengthening its presence in a number of Russian regions. Additionally, the Bank of Russia has included Sovcombank in its list of systemically important credit organizations. The Bank's systemic importance for the Russian banking system is reflected in the addition of two notches to its standalone creditworthiness assessment (SCA).

The SCA is based on the Bank's strong capital position, and adequate assessment of the business profile, risk profile, funding and liquidity.

The upgrade of the Bank's credit rating is grounds for the upgrade of the credit rating of the bond issues RU000A0ZYJR6, RU000A100DZ5, RU000A101MB5, XS2291914971 and RU000A102G01, which represent senior unsecured debt, to AA-(RU), and the rating of the subordinated bond issues RU000A0ZYWZ2 and XS2010043656, which are additional capital instruments, to A-(RU). The Bank's unchanged SCA is grounds for the affirmation of the credit rating of the subordinated bond issue RU000A0ZYG28, which is an additional capital instrument, at BB+(RU).

Sovcombank is a universal bank that occupies a sustainable position in both retail lending (including car loans, mortgages, and classic consumer loans) and lending to legal entities. The Bank is one of the ten largest credit institutions in the Russian market in terms of equity and assets and ranks eighth by volume of private deposits. According to data as of April 2021, Sovco Capital Partners S.à.r.l. accounted for around 86.5% of the Bank's shares (37% of which belong to Dmitry and Sergey Khotimskiy), while the remaining shares are divided among minor shareholders, including foreign sovereign and investment funds.

Key rating assessment factors

The adequate business profile assessment is determined by Sovcombank's strong franchise in consumer lending and stronger competitive positions in lending to the large business and SME sectors. The Bank is one of the ten largest credit institutions in the Russian Federation in terms of available equity capital. Sovcombank continues to grow its market positions, including by actively carrying out M&A deals; the acquisition of Orient Express Bank in 2021 will lead to Sovcombank's assets increasing by more than 10%. ACRA notes a fairly high diversification of operating income (the Herfindahl-Hirschman index for 2020 was 0.12), at the same time, about 50% of all revenues come from transactions with individuals. Taking this into account, as well as Orient Express Bank's specialization in lending to individuals and Sovcombank's plans to develop a number of products, the Agency expects the operating result to remain highly dependent on the retail segment in the medium term.

The Bank's strong capital position is confirmed by sufficiently high capital adequacy ratios and indicators. According to audited data, N1.2 amounted to 11.92% as of March 1, 2021, and Tier 1 capital amounted to 13.43% as of December 31, 2020. The capital

adequacy assessment is also supported by the Bank's strong capacity to generate internal capital: the averaged capital generation ratio (ACGR) is 300 bps for the last five years. According to ACRA's estimates, the Bank is able to withstand an increase in the cost of risk of over 500 bps without the RAS capital adequacy ratio falling below 6%. Operational efficiency is also at a sufficiently high level. In the Agency's opinion, although the merger with Orient Express Bank will have a certain influence on capital adequacy, it will not lead to a change in the assessment of this sub-factor.

ACRA maintains its adequate assessment of Sovcombank's risk profile. The quality of the loan portfolio (which amounted to 42% of assets as of December 31, 2020, excluding bonds reported at amortized cost) is characterized by a relatively low level of problem and potentially problem loans, in ACRA's opinion. The share of Stage 3 loans under IFRS 9 was 3% as of December 31, 2020. Taking into account loans classified by ACRA as potentially problematic, the total volume of problem and potentially problem debt reaches 5.5%. In addition, ACRA notes that in 2020 the Bank wrote off loans worth around RUB 11.4 bln (about 1.6% of the total loan portfolio), which were mainly represented by claims on individuals.

The Agency notes that the level of collateralization of the loan portfolio fell in 2020, which is partially offset by the presence of guaranties and sureties provided by organizations with sovereign ratings. In addition, the merger with Orient Express Bank, whose assets mainly consist of unsecured consumer loans, as well as the implementation of the development strategy, may lead to further growth in the share of unsecured loans in Sovcombank's portfolio.

ACRA also notes the continued high rate of growth of the loan portfolio and expects active growth of lending to continue in 2021. In 2020, growth mainly took place in the corporate lending segment, but despite this, the concentration of the loan portfolio continued to be acceptable. The share of loans provided to the ten largest groups of borrowers amounts to around 20% of the loan portfolio.

The concentration of the Bank's assets on related parties and high-risk industries is still negligible. The securities portfolio is primarily made up of bonds with a high credit quality.

Adequate liquidity and funding position. Sovcombank can withstand an outflow of client funds with a margin in ACRA's base case scenario, and has ample opportunities to attract additional liquidity in stress situations. As of December 31, 2020, the share of securities not encumbered as collateral for repurchase transactions amounted to around 28% of the total assets. ACRA assesses the Bank's long-term liquidity position as strong: the long-term liquidity shortage indicator exceeded 85% as of December 31, 2020.

In 2020, Sovcombank substantially increased the volume of funds raised from legal entities and this has become its main source of financing. However, the concentration on this source remains moderate at 40.6% of all liabilities. In addition, the Bank's dependence on funds from major creditors (depositors) is relatively low. The share of the ten largest groups of creditors is 21.9%.

The improved assessment of systemic importance from local to moderate is a reflection of the growth in the volume of the Bank's operations in the context of Russia's financial system. Following the merger with Orient Express Bank, the volume of funds of individuals on Sovcombank's balance sheet will approach RUB 600 bln (almost 1.9% of all funds of individuals). In addition, the Bank will broaden its presence in a number of Russian regions, which will increase the importance of the stability of its functioning. In ACRA's opinion, the Bank's bankruptcy would lead to a shock scenario in the banking system for a relatively short period of time. Therefore, ACRA has added two notches to Sovcombank's SCA.

Key assumptions

- Maintaining competitive positions in key business segments;
- Loan portfolio growth rate within the range of 20–30%;
- Higher-than-expected growth in retail lending and high dependence of the Bank's profitability on transactions with individuals;
- Cost of credit risk at around 3%;
- Net interest margin within the range of 4–6%;
- CTI lower than 50%;
- Tier 1 capital adequacy above 9% within the 12 to 18-month horizon.

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:

- Moderate risk appetite in the mid- and long-terms amid reduced volume of problem and potentially problem loans;
- Growth of business diversification and reduced dependence of the Bank's revenues on operations with individuals.

A negative rating action may be prompted by:

- Deterioration of the Bank's capital position as a result of an increase in the cost of credit risk and/or a significant decrease in operating efficiency;
- Aggressive growth of retail lending and/or higher share of unsecured loans in the portfolio;
- Increased volume of accepted market risk;
- Deterioration of the Bank's liquidity position caused by a reduction in highly-liquid assets on its balance sheet;
- Loss of competitive advantages in key business segments.

Rating components

SCA: a.

Adjustments: systemic importance, +2 notches.

Support: none.

Issue ratings

Rationale. The issues listed below represent senior unsecured debt of Sovcombank. Due to the absence of either structural or contractual subordination of the issues, ACRA regards them as *pari passu* with other existing and future unsecured and unsubordinated debt obligations of the Bank in terms of priority. According to ACRA's methodology, the credit rating of the issues is equivalent to that of PJSC Sovcombank, i.e. AA-(RU).

[Certified exchange-traded interest-bearing non-convertible unregistered bond issued by PJSC Sovcombank, BO-05 series \(RU000A0ZYJR6\)](#), maturity date: November 25, 2027, issue volume: RUB 10 bln — **AA-(RU)**.

[Certified exchange-traded interest-bearing non-convertible unregistered bond issued by PJSC Sovcombank, BO-P01 series \(RU000A100DZ5\)](#), maturity date: May 17, 2029, issue volume: RUB 10 bln — **AA-(RU)**.

[Uncertified exchange-traded interest-bearing non-convertible bond issued by PJSC Sovcombank, BO-P02 series \(RU000A101MB5\)](#), maturity date: April 17, 2030, issue volume: RUB 12 bln — **AA-(RU)**.

[Uncertified exchange-traded interest-bearing non-convertible bond issued by PJSC Sovcombank, BO-P03 series \(RU000A102G01\)](#), maturity date: December 7, 2021, issue volume: RUB 10 bln — **AA-(RU)**.

[Eurobonds issued by PJSC Sovcombank \(LPN, actual issuer: SovCom Capital D.A.C.\) \(XS2291914971\)](#), maturity date: January 26, 2025, issue volume: USD 300 mln — **AA-(RU)**.

Rationale. The bond issues listed below are Tier 2 capital instruments, which envisages a significant level of subordination against priority unsecured creditors and determines the credit rating of the issues at three notches below Sovcombank's credit rating — A-(RU).

[Certified interest-bearing non-convertible unregistered bond issued by PJSC Sovcombank, 2B03 series \(RU000A0ZYWZ2\)](#), maturity date: February 21, 2029, issue volume: USD 150 mln — **A-(RU)**.

[Subordinated Eurobonds issued by PJSC Sovcombank \(LPN, actual issuer: SovCom Capital D.A.C.\) \(XS2010043656\)](#), maturity date: April 7, 2030, issue volume: USD 300 mln — **A-(RU)**.

Rationale. The bond issue listed below is a Tier 1 capital instrument, which envisages a significant level of subordination against priority unsecured creditors and determines the credit rating of the issue at five notches below Sovcombank's SCA — BB+(RU).

[Certified interest-bearing non-convertible unregistered bond issued by PJSC Sovcombank, 1B02 series \(RU000A0ZYX28\)](#), maturity date: N/A, issue volume: USD 100 mln — **BB+(RU)**.

Regulatory disclosure

The credit ratings have been assigned to PJSC Sovcombank and the bonds (ISIN RU000A0ZYJR6, RU000A100DZ5, RU000A101MB5, XS2291914971, RU000A102G01, RU000A0ZYWZ2, XS2010043656, RU000A0ZYX28) issued by PJSC Sovcombank under the national scale for the Russian Federation based on the [Methodology for Credit Ratings Assignment to Banks and Bank Groups Under the National Scale for the Russian Federation](#) and the [Key Concepts Used by the Analytical Credit Rating Agency Within the Scope of Its Rating Activities](#). The [Methodology for Assigning Credit Ratings to Individual Issues of Financial Instruments Under the National Scale for the Russian Federation](#) was also applied to assign credit ratings to the above issues.

The credit rating assigned to PJSC Sovcombank and the credit ratings assigned to the bonds (ISIN RU000A0ZYJR6, RU000A100DZ5, RU000A101MB5, XS2291914971, RU000A102G01, RU000A0ZYWZ2, XS2010043656, RU000A0ZYX28) issued by PJSC Sovcombank were published by ACRA for the first time on November 25, 2016, December 7, 2017, May 30, 2019, April 28, 2020, January 25, 2021, December 7, 2020, March 28, 2018, October 25, 2019, and March 28, 2018, respectively. The credit rating of PJSC Sovcombank and its outlook, as well as the credit ratings of the bonds (ISIN RU000A0ZYJR6, RU000A100DZ5, RU000A101MB5, XS2291914971, RU000A102G01, RU000A0ZYWZ2, XS2010043656, RU000A0ZYX28) issued by PJSC Sovcombank are expected to be revised within one year following the publication date of this press release.

The credit ratings were assigned based on data provided by PJSC Sovcombank, information from publicly available sources, as well as ACRA's own databases. The rating analysis was performed using the IFRS consolidated financial statements of PJSC Sovcombank and the financial statements of PJSC Sovcombank drawn up in compliance with Bank of Russia Ordinance No. 4927-U dated October 8, 2018. The credit ratings are solicited, and PJSC Sovcombank participated in the rating process.

In assigning the credit rating, ACRA used only information, the quality and reliability of which was, in ACRA's opinion, appropriate and sufficient to apply the methodologies.

ACRA provided additional services to PJSC Sovcombank. No conflicts of interest were discovered in the course of credit rating process.

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Analytical Credit Rating Agency (Joint-Stock Company), ACRA (JSC)
75, Sadovnicheskaya embankment, Moscow, Russia
www.acra-ratings.com

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