FitchRatings

10 Sep 2020 | Upgrade

Fitch Affirms Credit Bank of Moscow at 'BB'; Outlook Negative

Fitch Ratings-Moscow-10 September 2020:

Fitch Ratings has affirmed Credit Bank of Moscow's (CBM) Long-Term Issuer Default Ratings (IDRs) at 'BB' with a Negative Outlook. The agency has also upgraded CBM's Viability Rating (VR) to 'bb' from 'bb-' and affirmed the bank's debt ratings. A full list of rating actions is at the end of this commentary.

The upgrade of the VR reflects the continued reduction in the volume of the bank's high-risk legacy assets, which are now moderate relative to capital and have become less of a drag on the bank's ratings.

The affirmation of the Long-Term IDRs, notwithstanding the upgrade of the VR, reflects the removal of the one-notch uplift of the IDRs over the VR due to the reduction in the buffer of qualifying junior debt (QJD; comprising Tier 1 and Tier 2 instruments). CBM no longer meets the criteria for the one-notch uplift, namely a QJD buffer clearly and sustainably above 10% of risk-weighted assets (RWAs). The QJD buffer was estimated at 9% at end-1H20.

The Negative Outlook on the IDRs continues to reflect potential pressure on the bank's financial profile from the health crisis, lower oil prices and the resulting economic downturn. We expect that despite recent improvements, the bank's asset quality could still be vulnerable in light of the challenging operating environment, while pre-impairment profit and core capital buffers to absorb potential losses are moderate, rather than strong.

Key Rating Drivers

IDRS, VR

CBM's asset quality is supported by a large volume of low-risk reverse repos (44% of total assets at end-2Q20) and mostly investment-grade liquid assets (21%), while most credit risk stems from the bank's loan book (32%). The bank's impaired loans (Stage 3 and purchased or originated credit-impaired (POCI)) were 4% of gross loans at end-1H20 and were reasonably covered at 70% by specific loan loss allowances (LLA). Stage 2 exposures made up an additional 5% of gross loans, but were lightly provisioned.

Stage 3 and Stage 2 loans largely overlap with our own assessment of the bank's high-risk assets. Positively, high-risk assets net of reserves notably decreased to RUB58 billion at end-2Q20 (0.3x common equity Tier 1 (CET1) capital) from RUB80 billion at end-2019 (0.5x FCC), as Fitch now considers some of the large loans less risky than before. At end-1H20, the high-risk assets included:

- RUB14 billion (equal to 8% of CET1) of net impaired loans;

- a RUB26 billion (15% of CET1) restructured Stage 2 loan to a highly leveraged car dealer;

- a RUB19 billion (11% of CET1) equity exposure to a loss-making pharmacy company.

Fitch no longer considers loans issued to another car dealer and related-party construction company (combined RUB17 billion, or 10% of CET1) to be of high credit risk, as the borrowers have managed to markedly improve their financial standing and reduce their debt to the bank since end-2019.

Pre-impairment profit (a significant 4.5% of average loans in 1H20) was supported by sizeable trading gains in 1H20. Recurring pre-impairment profitability, net of the trading results, was a much lower 2.5% of average loans (or annualised RUB23 billion). This has considerably weakened from 4%-6% in 2017-2019, due to the bank's more conservative risk appetite and a shift towards lower-risk/lower-margin lending, while funding costs have remained higher compared with other large Russian banks.

However, recurring pre-impairment profit is still sufficient to cover about 40% of the above high-risk assets on an annual basis. Conservatively assuming an extra 50% stress on the high-risk exposures, it would therefore require just over a year to reserve them sufficiently.

Return on average equity (ROAE) in 1H20 was a reasonable 11% despite higher loan impairment charges (LICs, equal to 2.8% loans, annualised). However, this was supported by the trading gains, and we expect ROAE to be in the low single digits for the full year 2020.

The bank's core capital is only moderate, with a CET1 ratio of 11% at end-1H20 and the regulatory core Tier 1 capital ratio standing at a lower 9.4%, due to higher loan provisioning under local GAAP. The bank's total capital is bolstered by a large junior debt cushion, including additional Tier 1 (AT1) perpetual debt and Tier 2 subordinated debt, which together equal RUB145 billion or 9% of the bank's RWAs. This is more than sufficient to fully absorb all of the above high-risk exposures and protect senior creditors in the worst-case scenario when large losses need to be recognised before the bank is able to absorb them through profits.

Our view of CBM's capitalisation also considers significant 1.6x double-leverage at the level of the bank's holding company, Concern Rossium, which also holds stakes in other businesses. The holdco had around RUB110 billion of debt at end-1H20 and is largely reliant on upstreaming of liquidity and dividends to service this, potentially representing a significant burden for CBM. Positively, the dividends already upstreamed from Rossium's non-bank subsidiaries in 2020 fully cover the holdco's interest payments for this year. Furthermore, the bank's key shareholders currently hold most of the holdco's debt, which somewhat reduces risks, although the funding sources for these debt purchases are not fully clear to Fitch.

Liquidity risks are limited, despite high funding concentrations. Lumpy funding in the form of direct repos and certain large corporate deposits is well matched with a large reverse repo portfolio collateralised by quasi-sovereign bonds. About RUB380 billion of such bonds received under reverse repos are currently unpledged and can be used to raise funding (equal to 27% of total deposits), if needed.

Excluding reverse repos and dedicated funding, CBM's liquidity buffer (comprising cash and equivalents, short-term interbank and unencumbered on-balance-sheet securities repo-able with the central bank) at end-1H20 covered customer accounts by a strong 60%, while refinancing risk on wholesale debt is limited for several years.

DEBT RATINGS

The ratings of senior unsecured debt issued through CBOM Finance PLC (special-purpose vehicle; SPV) are aligned with the bank's IDRs.

CBM's Tier 2 subordinated debt (placed by the SPV) has been affirmed at 'B+', two notches below the 'bb' VR, which is the baseline notching for loss severity for such instruments. We previously notched the bank's Tier 2 debt once, rather than twice, due to the junior debt buffer being consistently above 10% of RWAs, which according to Fitch's Bank Rating Criteria, reduces the risk of the Tier 2 debt being fully written off in a failure scenario.

CBM's perpetual notes (placed by the SPV) have been affirmed at 'B-'. The rating is four notches below the bank's VR, reflecting the perpetual notes' deep subordination relative to senior unsecured creditors, resulting in higher loss severity, and CBM's option to cancel coupon payments at its discretion, resulting in additional non-performance risk. The rating has been affirmed, notwithstanding the upgrade of the VR, as the minimum notching for these instruments increases to four notches for VRs of 'bb' and above, compared to three notches at 'bb-'.

SUPPORT RATING AND SUPPORT RATING FLOOR

The revision of CBM's SRF to 'B+' from 'B' reflects an upward reassessment of the probability of state support to privately-owned banks in Russia, as evidenced by recent bail-outs of senior unsecured creditors at larger Russian privately-owned banks and the absence of any current plans to introduce comprehensive senior creditor bail-in provisions into Russian legislation. CBM's 'B+' SRF also captures its moderate systemic importance (3% of system assets and 1.6% of system loans at end-1H20) but sizeable (in absolute terms) deposit base.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The Outlook could be revised to Stable if the economic downturn does not result in significant erosion of the bank's financial metrics, and if the Russian economy continues to stabilise after a short-lived contraction.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

CBM's IDRs could be downgraded in case of marked deterioration in its financial metrics, in particular asset quality, profitability and capitalisation. The ratings could also be downgraded if the economic contraction caused by the pandemic turns out to be significantly sharper or more prolonged than currently anticipated.

The debt ratings are primarily sensitive to changes in their respective anchor ratings.

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING
The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Credit Bank of Moscow: Governance Structure: 4, Group Structure: 4

CBM has ESG Relevance Scores of '4' for governance and group structures, which reflect a significant level of relationship-based operations, a lack of transparency with respect to ownership structure and significant double leverage at the level of the bank's holdco.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

CBOM Finance PLC
----senior unsecured; Long Term Rating; Affirmed; BB
----subordinated; Long Term Rating; Affirmed; B-
----subordinated; Long Term Rating; Affirmed; B+
Credit Bank of Moscow; Long Term Issuer Default Rating; Affirmed; BB; RO:Neg
; Short Term Issuer Default Rating; Affirmed; B
; Local Currency Long Term Issuer Default Rating; Affirmed; BB; RO:Neg
; Viability Rating; Upgrade; bb
; Support Rating; Affirmed; 4

; Support Rating Floor; Support Rating Floor Revision; B+

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Additional information is available on www.fitchratings.com

Applicable Criteria
Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

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