Fitch Ratings

Banks
Universal Commercial Banks
Russian Federation

Joint Stock Company Alfa-Bank

Key Rating Drivers

Intrinsic Strength Drives Ratings: The ratings of Joint Stock Company Alfa-Bank (Alfa), which are among the highest for Russian privately owned banks, reflect a well-established domestic franchise, Alfa's access to top-tier Russian corporate clients, stable financial metrics and historically strong execution through the credit cycle. The ratings also capture high risks related to rapid growth in unsecured retail lending and tightly managed regulatory capital.

Risk Appetite Key: The Positive Outlook on Alfa's ratings reflects our expectation to upgrade Alfa to 'BBB-' in the next one to two years, in line with the recent improvement in the local operating environment. Such an upgrade is primarily sensitive to a moderation of retail loan growth and satisfactory retail loan quality as the portfolio seasons. Stable profitability will also be credit-positive if it is sufficient to support loan growth and capital adequacy.

Fast Growth in Retail Risky: The major rating constraint for Alfa is its fast growth in unsecured retail lending (annualised 40% in 3Q19 and 57% in 2018, which is well above the sector averages of 22% and 23%, respectively). The performance of the consumer finance segment in Russia has historically been very cyclical and we believe that there have recently been some signs of new overheating. Alfa's loan impairment in retail has been limited in the past few years, but there may be some deterioration in the medium term.

Resilient Corporate Loan Quality: Overall asset quality is currently reasonable with impaired loans (defined as Stage 3 loans under IFRS 9) equal to a moderate 5.1% of gross loans at end-2Q19 (end-2018: 3.5%) and 72% covered by total loan loss allowances. Impaired loans spiked in 2Q19 due to the impairment of one lumpy corporate exposure, but residual credit risks for this loan are limited due to the availability of hard collateral. We view the credit quality of Alfa's largest borrowers as generally strong, as these are Russian top-tier corporates.

Decent Profitability: Alfa's pre-impairment performance benefits from a wide and stable net interest margin (NIM; 4.8% in 6M19), underpinned by low funding costs and a growing share of higher-yielding retail loans in the loan book (24% in 2Q19). Judging by its interim bottom line, Alfa is on track to post a 15% return on average equity (ROAE) in 2019 and probably similar results in 2020, but longer-term performance is highly sensitive to retail loan quality.

Tightly Managed Regulatory Capital: Alfa's Fitch Core Capital (FCC) ratio was a high 15% at end-2Q19, supported by only moderate overall loan growth (annualised 14.5% in 1H19) and reasonable profit retention. Regulatory capital ratios are lower, with about 100bp-150bp headroom over statutory minimums, including fully loaded buffers applicable from January 2020. This is particularly risky in light of growing risk-weights in retail lending and potentially more significant volatility of regulatory performance due to Alfa's currency structure.

Strong Funding, Liquidity: Alfa is mainly deposit-funded (77% of end-2Q19 liabilities), and its funding mix benefits from a significant share of on-demand current accounts (42% of total liabilities), resulting in significant stability and granularity of the funding base. Alfa's contractual repayments of wholesale funding in 2020 are limited to about USD1.5 billion, while its liquidity buffer exceeded USD12 billion at end-2Q19, equal to a high 27% of total liabilities.

Rating Sensitivities

Retail Loan Quality and Growth: Fitch will likely upgrade Alfa's Long-Term IDRs and debt ratings to investment grade if the retail lending business performs satisfactorily, retail loan growth moderates and earnings are sufficient to support growth and maintain capital ratios at current levels. Conversely, weaker-than-expected retail loan quality, continued rapid growth or significant erosion of capital ratios could result in the Outlook being revised to Stable.

Ratings

Foreign Currency	
Long-Term IDR	BB+
Short-Term IDR	B
Local Currency	
Long-Term IDR	BB+
Viability Rating	bb+
Support Rating	3
Support Rating Floor	BB-
Sovereign Risk	
Long-Term Foreing-Currency IDR	BBB
Long-Term Local-Currency IDR	BBB
Country Ceiling	BBB

Outlooks	
Long-Term Foreign-Currency IDR	Positive
Long-Term Local-Currency IDR	Positive
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (October 2018)

Short-Term Ratings Criteria (May 2019)

Related Research

Russian Banks Datawatch 10M19 (December 2019)

Fitch Ratings 2020 Outlook: CIS, Georgian and Ukrainian Banks (December 2019)

Russian Banking Sector: Steady Stabilisation (November 2019)

Fitch Revises Outlook on Russia's Alfa-Bank to Positive; Affirms at 'BB+' (October 2019)

Fitch Upgrades Russia to 'BBB'; Outlook Stable (August 2019)

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Debt Rating Classes

Rating level	Rating
Debt issued by JSC Alfa-Bank and Alfa Bond Issuance plc	
Senior Unsecured Debt	BB+
Tier 2 subordinated debt	BB
Additional Tier 1 notes	B
Debt Issued by ABH Financial Limited (through Alfa Holding Issuance plc)	
Senior Unsecured Debt	BB

Source: Fitch Ratings

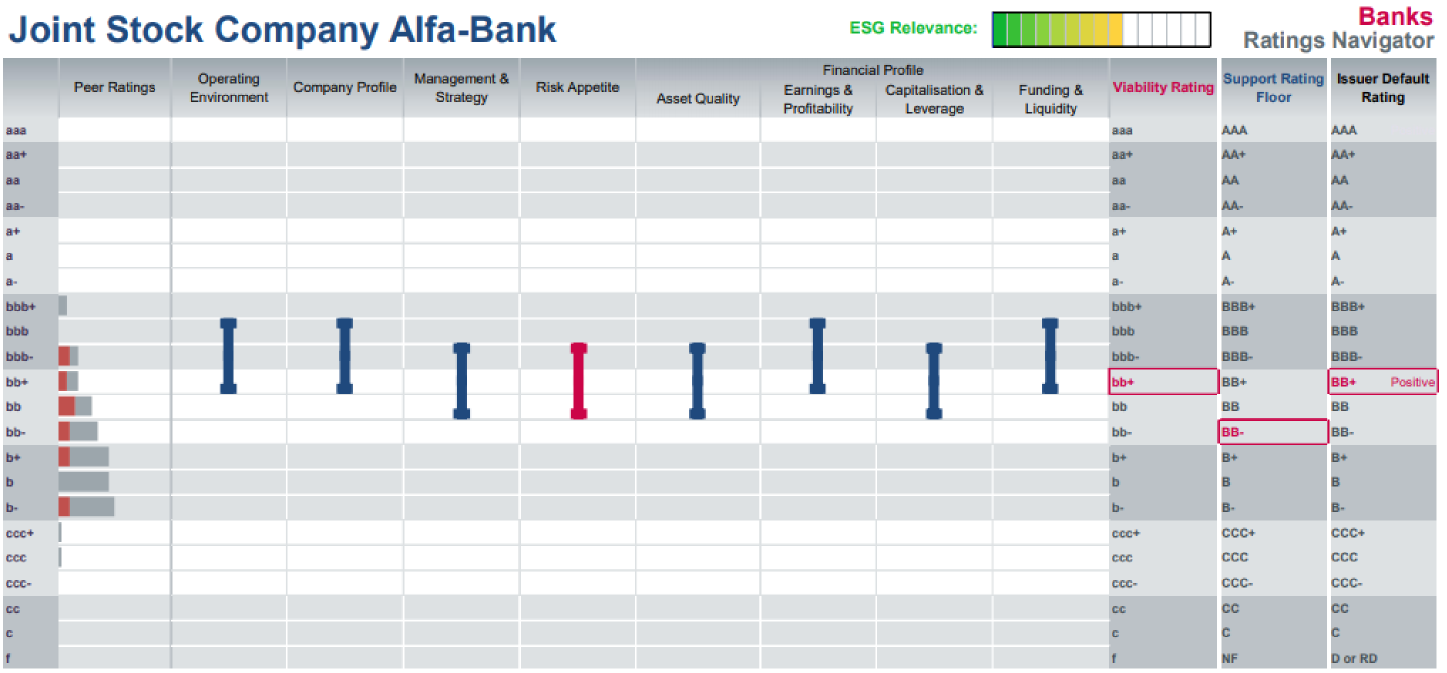
The senior unsecured debt issued by Alfa is rated in line with Alfa's IDRs, assuming average recovery prospects in case of default.

Alfa's 'BB' subordinated debt rating is notched down once from its VR, reflecting higher loss severity relative to senior unsecured creditors.

Alfa's perpetual notes, which qualify as additional Tier 1 (AT1) capital, are rated at 'B', four notches lower than the bank's VR. The notching reflects (i) deep subordination of the perpetual notes relative to senior unsecured creditors, resulting in higher loss severity; and (ii) Alfa's option to cancel coupon payments at its discretion, resulting in additional non-performance risk. The latter is more likely if capital ratios fall into the capital buffer zone, although this risk is somewhat mitigated by Alfa's stable financial profile.

Senior unsecured debt issued by ABH Financial Limited (ABHFL), Alfa's holding company, is rated at 'BB', which is in line with ABHFL's IDRs. We notch ABFHL down once from Alfa's IDRs to capture the absence of any consolidated regulation for the two entities due to them being incorporated in different jurisdictions.

Ratings Navigator – Standalone Assessment



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:			**BB-**
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		✓	
Policy banks			
Policy role			
Funding guarantees and legal status			
Government ownership			

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

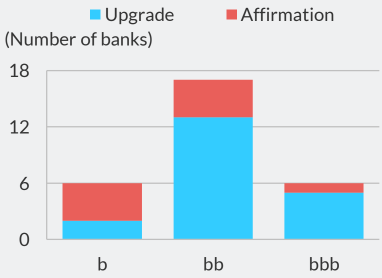
Significant Changes

Operating Environment Improved

The revision of the Outlook on Alfa's ratings to Positive in October 2019 reflects an improvement of the operating environment, which should be viewed in the context of an upgrade of Russia's sovereign ratings in August. In Fitch's view, the Russian banking sector is benefiting from consistent and credible policy and regulatory frameworks that should deliver improved macro stability and better resilience to shocks. Sector-wide asset-quality risks moderated over recent years resulting in lower sector average loan impairment charges (LICs; about 2.2% of average gross loans in 9M19) and we do not expect these to increase.

A stable macro picture and low inflation expectations at the Central Bank of Russia (CBR) are resulting in declining rouble interest rates, but banks have been able to preserve healthy NIMs (an average of 4.3% in 9M19) as deposit and loan rates have fallen roughly in tandem. Accordingly, banks generally show positive or stable trends in asset quality and profitability which, coupled with only moderate loan growth, result in stronger capitalisation. Fitch made positive rating actions on most of Russian banks' VRs in 2H19.

Rating Actions on Russian Bank VRs in 2019



Source: Fitch Ratings

Retail Loan Growth Risky

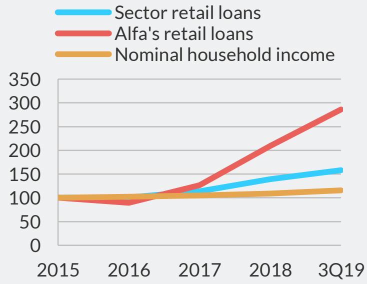
Due to weaker margins in corporate lending and limited credit demand from top-tier borrowers, Russian banks have been increasingly focused on expansion in the retail segment. Sector retail loan growth may reach 22% in 2019 and probably a further 15% in 2020. Alfa is growing considerably faster than this saturated and highly competitive market, with the emphasis on unsecured consumer finance loans and credit cards.

At end-2Q19, retail loans were a moderate 23% of gross loans, but we expect Alfa's retail loan growth to remain high in the next few years, although with somewhat more focus on mortgages, which currently comprise a moderate 11% of total retail loans. We view Alfa's high risk appetite in retail as the bank's major rating weakness, as the segment is already showing some signs of overheating. The latter is due to the fact that retail loan growth in recent years has been significantly above nominal household income growth, while the inflow of new retail borrowers in the banks is limited, meaning that existing ones are becoming increasingly leveraged. The risk of overheating in retail and some seasoning of Alfa's retail loan book may expose its asset quality and performance to some volatility.

The Positive Outlook on Alfa reflects our base case expectation that Alfa will be upgraded to 'BBB-' over the next one to two years, although this would require a moderation of retail loan growth rates and satisfactory asset quality in retail lending.

Retail Loan Growth in Russia

(2015 = 100)



Source: Fitch Ratings, Alfa, CBR, Rosstat

Changes in Regulatory Capital Rules

Fitch assesses Alfa's capitalisation primarily based on its consolidated core capital ratios at the level of ABHFL. We view positively the healthy FCC capital ratio and the fact that the group's IFRS capital is protected from Russian ruble devaluation (see *Capitalisation and Leverage*).

Alfa's regulatory capital ratios have only moderate cushions above the fully loaded statutory minimums (see *Regulatory Capital Ratios* table). The CBR is also exercising increased scrutiny of retail lending, and tightened the statutory risk-weighting on new retail lending twice in 2019. This may result in some consumption of regulatory capital for Alfa along with portfolio re-generation. In addition, Alfa's currency structure can result in the volatility of regulatory earnings with potential negative pressure on regulatory capital if the ruble significantly appreciates against the US dollar.

However, these potential pressures are at least partially offset by the following:

- The planned relief of statutory risk-weights in corporate lending (to 65% on better-quality corporate loans in 2020), which we estimate will boost Russian banks' capital ratios by more than 100bp in 1Q20;
- In the middle of 2020, Alfa plans to get CBR approval to adopt internal risk-based approach to risk-weights in corporate lending and this may also support regulatory capital ratios;

Regulatory Capital Ratios

		Statutory minimum (including buffers)	
	Alfa, end-11M19	At end-3Q19	At end-4Q19
Core tier 1	9.3	7.4	8.0
Tier 1	11.0	8.9	9.5
Total	12.3	10.9	11.5

Source: Fitch Ratings, CBR

- An increase in Alfa's total capital ratio should be 80bp in January 2020; due to the placement of subordinated Eurobonds in December 2019;
- Alfa's proven ability to de-leverage, supported by a generally short-term loan book and the high quality of its corporate loans;
- A higher loan impairment allowance in statutory accounts (7.8% of gross loans) than in IFRS statements (3.8%), which may be possible to partially release if needed to support regulatory capital.

Changes in Top Management Team

In 3Q18 Alfa's chief executive was replaced with Mr Verkhoshinsky, formerly a top-manager at state-owned bank VTB. Since then there have been various changes in the management board and other key management personnel. Six board members out of ten (including the chief executive) have joined Alfa relatively recently (2017-2019). We have previously viewed Alfa's management quality as a rating strength, but significant recent management turnover introduces some uncertainty to Alfa's execution in the future.

Company Summary

The Largest Privately Owned Bank in Russia

Alfa is the fourth-largest bank in Russia as of December 2019, although its market shares are only moderate, reflecting the highly concentrated nature of the Russian banking sector, which is dominated by state-owned banks. We view Alfa's market positions as strong due to its good access to top-tier Russian corporates and strong deposit franchise. The latter is reflected in a significant share of current/on-demand accounts in Alfa's deposits (over 50% at end-2Q19), reflecting its strong settlement business, translating into low customer funding costs, which are just marginally above Sberbank and some of the foreign-owned banks.

Alfa's business model is broadly typical for a Russian bank with a focus on lower-risk top-tier corporate clients complemented by higher-margin retail lending (mostly unsecured). The share of retail loans in Alfa's business mix is growing and we expect this to continue.

Transparent Banking Group; Reputable Shareholders

The below financial analysis is based on the IFRS accounts of ABHFL, which in addition to Alfa also consolidates a Cyprus-based investment-banking arm, Alfa Capital Holdings and a small bank in the Netherlands focusing on trade finance, Amsterdam Trade Bank. Alfa also has sister-banks in Ukraine, Kazakhstan and Belarus; each country's banking business is structured through a separate sub-holding. All three banks are smaller than Alfa and have weaker credit profiles, but they are managed separately, are not consolidated into ABHFL and not captured by the analysis provided in this report.

Alfa's private shareholders also have significant investments in non-banking businesses, including in the retail, telecom and IT sectors, which are reasonably profitable and only moderately leveraged. Alfa's reported related-party transactions are limited in volume, and are carried out on an arms' length basis, in Fitch's view. We believe that Alfa's corporate governance standards adequately protect the bank's creditors. Fitch believes Alfa's private shareholders are cash-rich and have a high propensity to support Alfa, in case of need, as they have done in the past, although such support cannot be relied upon and Fitch does not factor any support from private shareholders into Alfa's ratings.

Key Qualitative Assessment Factors

Conservative Underwriting Standards in Corporate Lending

In Fitch's view, Alfa's corporate loan book (51% of total assets at end-2Q19) is of moderate credit risk, at least judging by the quality of the largest corporate borrowers. Single-borrower concentrations are a bit higher compared with high-rated Russian peer banks, but Alfa is exposed to top-tier Russian corporates, and risks are also mitigated by fast corporate loan turnover (about 17 months) because most of the loans are short-term working capital facilities. Riskier project finance lending is limited. Foreign-currency lending (25% of gross loans) is slightly higher than the sector average, but some borrowers have access to export revenues and this reduces the risks.

Market Shares, End-2Q19

	(In %)
Corporate loans	4.7
Retail loans	3.2
Credit cards	10.7
Corporate deposits	4.0
Retail deposits	3.7
Retail on-demand deposits	10.0

Source: Fitch Ratings, Alfa

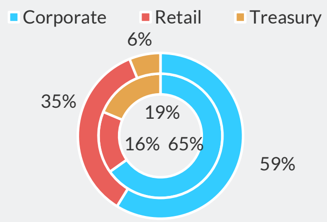
Shareholding Structure

	(%)
Mr Fridman	32.8
Mr Khan	21.0
Mr Kuzmichev	16.3
Mr Aven	12.4
Unicredit S.p.A	9.9
Other	7.6
Total	100.0

Source: Fitch Ratings, Alfa

Business Segments

Inner ring: Share in Alfa's assets
Outer ring: Share in Alfa's revenue



Data at end-2Q19 and for 6 months then ended
Source: Fitch Ratings, Alfa's IFRS accounts

Focus on Unsecured Products in Retail Lending

We believe that Alfa's risk appetite in retail lending is higher compared with rating peers. This is because of recently fast growth and the fact that most retail loans are unsecured (89% at end-2Q19), although, according to management, the share of mortgages reached 18% at end-2019 and is likely to increase further. Client acquision channels and average loan size, rates and contractual tenors are generally in line with the market. The average duration of unsecured cash loans is short at about 22 months, mitigating credit risks to an extent. However, 'refinancing' loans (about 17% of cash loan production) are particularly risky, as Alfa cuts rates and extends tenors in order to reduce the monthly installment.

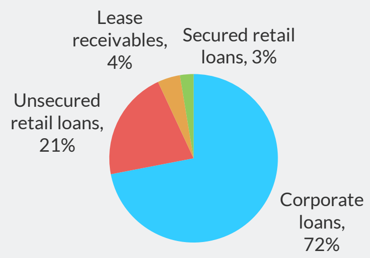
Market Risks Stem from Currency Structure

Alfa's currency position can result in significant volatility of regulatory earnings, and potentially pressure on capital if the ruble significantly appreciates against the dollar. Alfa's regulatory open currency position is in line with the CBR's requirements. Other than that, market risks are not material, in Fitch's view. Structural interest-rate risks are mitigated by Alfa's reasonable NIM (4.8% in 6M19), and short duration of assets and liabilities, allowing the bank to adjust quickly to changes in interest rates.

Key Financial Metrics – Latest Developments

The analysis of the financial metrics presented below is based on ABHFL's 2Q19 IFRS accounts. For the peer group, we use universal Russian banks with the highest VRs. These include privately owned PJSC Sovcombank (BB+/Stable/bb+); three foreign-owned banks (PJSC Company Rosbank (BBB/Stable/bbb-), Unicredit (BBB/Negative/bbb) and AO Raiffeisenbank (BBB/Stable/bbb)); and state-owned Sberbank (BBB/Stable/bbb).

Alfa's Loans, End-2Q19



Source: Fitch Ratings, IFRS accounts

Alfa's Retail Loans, End-2Q19

(%)	% of total	% of FCC	Growth in 2Q19[a]
Cash loans	56	69	28
Credit cards	32	39	9
Mortgages	11	13	57
Other	1	2	n.m.
Total	100	123	21

[a] Not annualised
Source: Fitch Ratings, CBR

Peer Group Summary

	Operating Environment	Company Profile	Management & Strategy	Risk Appetite	Asset Quality	Earnings & Profitability	Capitalisation & Leverage	Funding & Liquidity	Viability Rating
Alfa	bbb-	bbb-	bb+	bb+	bb+	bbb-	bb+	bbb-	**bb+**
Sberbank of Russia	bbb-	bbb	bbb	bbb-	bbb-	bbb	bbb-	bbb	**bbb**
AO Raiffeisenbank	bbb-	bbb-	bbb	bbb	bbb	bbb	bbb	bbb	**bbb**
AO UniCredit Bank	bbb-	bbb-	bbb	bbb	bbb	bbb-	bbb	bbb-	**bbb**
Rosbank	bbb-	bbb-	bbb-	bbb-	bbb	bb+	bbb-	bbb	**bbb-**
PJSC Sovcombank	bbb-	bb	bb+	bb+	bb+	bbb-	bb+	bb+	**bb+**

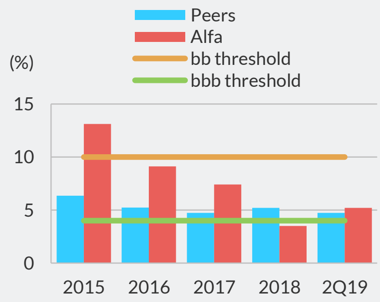
Asset Quality

Alfa's IFRS 9 metrics at end-2Q19 were decent with only moderate levels of impaired loans (Stage 3 loans under IFRS 9) in both corporate and retail lending. The headline 5.1% impaired loans ratio is below the sector average and is in line with peers, which have higher asset-quality mid-points. The impaired loans ratio is only marginally above the 'bbb' threshold and we believe that Alfa's asset-quality mid-point may be upgraded to 'bbb-' from 'bb+' in the medium term, although this would require an extended record of satisfactory credit quality in the unseasoned retail loan portfolio.

Coverage of impaired loans (49% in 2Q19) with specfic loan loss allowance is only moderate compared with peers, particularly in corporate lending. However, over the past several crises, Alfa has proven to be one of the strongest Russian banks in terms of collateral foreclosure and problem loan recoveries, so this slightly weaker coverage is of limited rating impact.

Impaired loans spiked in 2Q19 due to the impairment of one lumpy corporate exposure, which required additional provisioning, but residual credit risks are limited due to the availability of hard collateral. We view the credit quality of Alfa's other corporate loans as generally strong and consistent with peers, as the majority of its largest loans are to Russian top-tier corporates.

Impaired Loans Ratio



Source: Fitch Ratings, IFRS accounts

Asset-quality metrics in retail lending are sound at present, as loan impairment charges are well-covered by the margins. We expect at least some deterioration of retail loan quality along with porfolio seasoning. The loan vintages for loans issued in 1H19 showed a moderate upward trend but according to management in response to this trend the bank tightened its underwriting criteria in the second half of 2019 and the vintages for the most recent retail loan issuance indicate a stabilisation and/or a moderate improvement of the credit quality.

Credit quality of non-loan exposures is reasonable, in our view.

IFRS 9 Loan Quality at End-2Q19

		Retail loans					
(In %)	Corporate loans	Cash loans	Credit cards	Mortgages	Other	Total	Total loans
Stage 1 loans/gross loans	88.1	89.7	87.6	99.4	93.8	90.2	88.6
Stage 2 loans/gross loans	5.8	8.6	9.2	0.2	3.9	7.8	6.3
Stage 3 loans/gross loans	**6.1**	**1.7**	**3.2**	**0.3**	**2.3**	**2.1**	**5.1**
Specific LLA/stage 1 loans	0.4	1.6	2.4	0.6	1.7	1.7	0.7
Specific LLA/stage 2 loans	2.0	26.0	20.9	50.0	20.0	24.0	8.4
Specific LLA/stage 3 loans	45.3	91.0	89.3	66.7	33.3	88.9	49.5
Total LLA/stage 3 loans	**52.4**	**303.8**	**215.5**	**266.7**	**133.3**	**256.0**	**71.7**
Stage 3 loans less total LLA/FCC	**11.5**	**2.4**	**-1.5**	**-0.1**	**-0.0**	**-4.0**	**7.6**

Source: Fitch Ratings, IFRS accounts

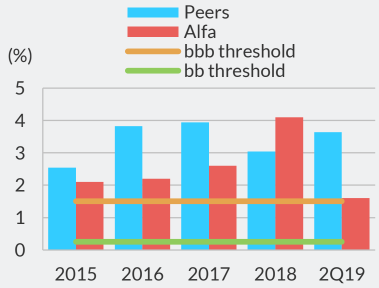
Earnings and Profitability

Alfa's core performance ratio (operating profit/risk-weigted assets (RWAs)) has consistently been within the 'bbb' threshold over the past several years. We believe that underlying earnings stability is strong, depite the performance ratio and net income being quite volatile, because overall profitability should be considered together with other comprehensive income. The latter includes gains less losses from foreign currency, which mostly stem from Alfa's long dollar position, protecting Alfa's IFRS earnings from currency devaluation. The ratio of total comprehensive income/RWAs was quite stable over the past five years, at 2%, which is well above the 'bbb' threshold.

Alfa's annualised pre-impairment profit was 5% of gross loans in 1H19, providing the bank with reasonable capacity to absorb impairment losses. Pre-impairment performance benefits from a wide and stable NIM (4.8% in 1H19), underpinned by low funding costs and reasonable operating efficiency. We believe that margins are likely to stay stable or even go up slightly, to above 5%, in the next few years, as gradual sector-wide interest-rate reduction should be compensated by the increased proportion of higher-yield retail loans in Alfa's business mix. Fee-generating capacity is strong: Alfa's net fee income equals 0.5x of its net interest income and covers its opex by 0.8x. The quality of interest income is also strong: 96% of interest income was received in cash in 6M19.

Decent bottom line results in the past couple of years were supported by low LICs. A spike in LICs in 2Q19 was related to an impairment of one lumpy corporate exposure (see *Asset Quality*) and this loss is likely to be a one-off item. However, in the longer term, Alfa's LICs may be more volatile, given higher exposure to retail lending. We believe that Alfa is well positioned to post a 15% ROAE in 2019 and, probably, in 2020, but longer-term performance would be sensitive to the credit quality of Alfa's retail loan book.

Op. Profit/RWAs[a]



[a] Operating profit/risk-weighted assets
Source: Fitch Ratings, IFRS accounts

Alfa's Profitability Ratios

(In %)	2Q19	2018	2017	2016
Operating profit/RWAs	**1.6**	**4.1**	**2.6**	**2.2**
Fitch comprehensive income/RWAs	**2.1**	**1.8**	**2.4**	**2.2**
Interest income/avg. % assets	9.0	8.7	9.1	9.2
Interest expense/avg. % liabilities	4.3	4.1	4.5	4.8
Net interest margin	**4.8**	**4.8**	**4.7**	**4.5**
Cost/income (incl. other comprehensive income)	41.2	45.3	49.9	48.9
PIP/avg. gross loans	**5.0**	**6.6**	**4.1**	**4.8**
LICs/avg. gross loans	2.8	0.9	0.0	1.4
Fitch comprehensive income/avg. equity	**13.6**	**11.7**	**16.8**	**14.3**
Fitch comprehensive income/avg. assets	1.8	1.5	2.2	2.0
Fitch comprehensive income (USDm)	435.0	697.0	898.0	670.0

Source: Fitch Ratings, IFRS accounts

apitalisation and Leverage

Alfa's FCC ratio is consistently above the 'bbb' threshold, and is in line with peers, most of which have 'bbb' mid-points for capitalisation and leverage. However, we score Alfa's capitalisation and leverage at 'bb+', because we adjust negatively for weaker regulatory capital ratios. At end-11M19, Alfa's regulatory capital ratios were 100bp-150bp above the fully loaded statutory minimums applicable from January 2020. We view such headroom as only moderate, particularly in light of (i) more punitive regulatory risk-weights on retail loans introduced from 1 April and additionally from 1 October; and (ii) potential volatility of Alfa's regulatory earnings and capital due to currency translation gains and losses.

The CBR tightened the risk-weights on retail loans twice in 2019, and this may result in additional capital consumption for Alfa along with retail porfolio re-generation. However, this should be partially compensated with reduced risk-weights on corporate loans, as the CBR plans to adopt a 65% risk-weight for lower-risk corporate exposures in 2020. Alfa's proven ability to de-leverage may ease any pressure on regulatory capital, in case of need.

We estimate Alfa's FCC ratio at 15% at end-2Q19. Basel III RWA density (the ratio of RWAs divided by total assets) is reasonable, at 83%, which is in line with peers. Overall balance-sheet growth is unlikely to exceed Alfa's ROAE, and significant dividend payments are also unlikely, given the moderate cushion of regulatory capital ratios over the prudential minimums (including buffers). Accordingly, we can expect Alfa's FCC ratio to stay stable in the near term.

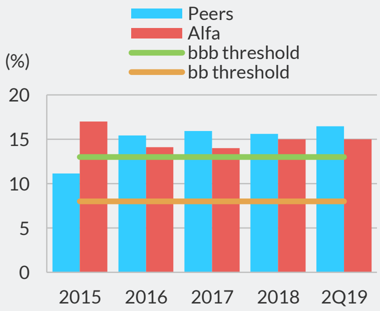
Alfa's junior debt buffers include AT1 perpetual debt (2.3% of RWAs), USD850 million Tier 2 debt (2.0% of RWAs) placed in 4Q19, and legacy subordinated Tier 2 debt (1.6% of RWAs) maturing in 2020. According to our criteria, the amount of these junior debt buffers relative to RWAs is not sufficient to warrant an uplift of Alfa's IDRs above its VR.

Funding and Liquidity

Alfa's funding and liquidity profile are Alfa's ratings strengths. The headline loans/deposits ratio lies in the 'bbb' territory and is very similar to peers. In addition to this, Alfa's 'BBB-' mid-point for funding and liquidity captures the bank's strong deposit franchise (particularly in retail and SME segments), as reflected by a stable and granular deposit base and low funding costs, which are comparable to peers.

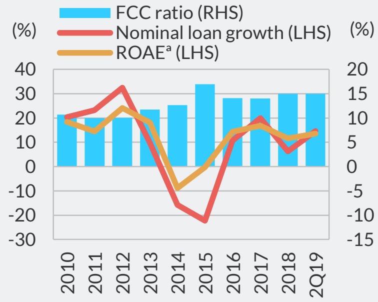
At end-2Q19, Alfa was 77% deposit-funded with the emphasis on retail customers. About USD11 billion of retail deposits (25% of total liabilities) are on-demand accounts, reflecting the significant number of salaried clients at Alfa and the bank's strong settlement franchise, mobile and e-banking for retail clients and other services. However, not all on-demand retail deposits are interest-free (the average funcing cost for retail current accounts equals to 2.7%, accoridng to Alfa). Corporate deposit concentrations are lower than sector averages.

Fitch Core Capital Ratio



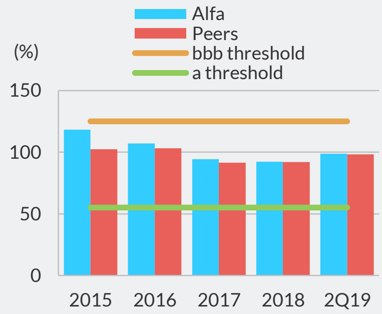
Source: Fitch Ratings, IFRS accounts

ROE and Growth



[a] Includes other comprehensive income
Surce: Fitch Ratings, Alfa's IFRS accounts

Loans/Deposits Ratio



Source: Fitch Ratings, IFRS accounts

Senior debt (8.5% of total liabilities) and subordinated debt (2.8%) placements mostly reflect legacy local and international placements, which are quite granular and well diversified by contractual maturity. Deposit Insurance Agency funding was utilised for the financial recovery of Baltiysky bank. Bank funding is very granular and represents mostly short-term money market and treasury operations. The contractual refinancing needs (including put options) of the wholesale funding are limited to about USD1.2 billion in 2020.

At end-2Q19, Alfa's liquidity buffer, consisting of cash and bonds, exceeded USD12 billion (27% of total liabilities). Interbank assets, most of which are short-term money market placements, added a further USD5 billion (7%). The size of Alfa's liquidity buffer supports our view of the bank's solid liquidity position. Fast all turnover also contributes to Alfa's strong liquidity position.

Funding Structure

	2Q19	2018
Retail deposits	41.7	41.1
Corporate deposits	35.7	39.1
Debt securities	8.6	8.1
Due to banks	6.6	4.7
Due to DIA	1.0	0.9
Subordinated debt	2.8	3.0
Other	3.6	3.0
Total	**100.0**	**100.0**
Memo		
On demand deposits	42.1	40.4
Ten largest deposits	9.3	12.6

Source: Fitch Ratings, IFRS accounts

Sovereign Support Assessment

In October 2019, Fitch revised Alfa's Support Rating Floor to 'BB-' from 'B', and upgraded its Support Rating to '3' from '4', to reflect an improved record of state support to privately owned banks in Russia, as evidenced by the bail-out of senior unsecured creditors at three medium-sized Russian private banks that failed in 2017.

The rating action also captures the absence of any current plans to introduce comprehensive senior creditor bail-in provisions into Russian legislation. Alfa's 'BB-' Support Rating Floor also captures its moderate systemic importance as the fourth-largest bank in Russia with a 4% market share and substantial (in absolute terms) deposit base.

Market Shares and Support Rating Floors

Bank	Support Rating floor	Ownership	Total assets, (RUBbn)	Share in sector assets, (%)	Total deposits, (RUBbn)	Share in sector deposits, (%)
Sberbank	BBB	State	27,583	32.3	21,379	34.4
Gazprombank	BBB-	State	5,798	6.8	4,714	7.6
Russian Agricultural	BBB-	State	3,032	3.5	2,461	4.0
Alfa	BB-	Private	3,236	3.8	2,401	3.9
Credit Bank of Moscow	B	Private	2,140	2.5	1,436	2.3

Source: Fitch Ratings, CBR. Data at end-2Q19.

Summary Financials and Key Ratios

	30 Jun 19	31 Dec 18	31 Dec 17	31 Dec 16
	6 Months - interim	Year end	Year end	Year end
	(USDm)	(USDm)	(USDm)	(USDm)
	Reviewed - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified
Summary income statement				
Net interest & dividend income	1,018	1,920	1,677	1,325
Net fees and commissions	469	978	846	634
Other operating income	-68	247	-271	63
Total operating income	1,419	3,145	2,252	2,022
Operating costs	622	1,236	1,203	957
Pre-impairment operating profit	797	1,909	1,049	1,065
Loan & other impairment charges	447	261	10	296
Operating profit	350	1,648	1,039	769
Other non-operating items (net)	0	-14	72	-6
Tax	101	313	313	236
Net income	249	1,321	798	527
Other comprehensive income	186	-624	100	143
Fitch comprehensive income	435	697	898	670
Summary balance sheet				
Gross loans	33,950	29,626	27,889	23,243
- O/w impaired	1,775	1,025	2,056	2,114
Loan loss allowances	1,272	888	820	1,139
Net loans	32,678	28,738	27,069	22,104
Interbank	3,288	1,703	1,922	712
Derivatives	424	800	485	606
Other securities & earning assets	8,075	10,299	8,825	9,346
Total earning assets	44,465	41,540	38,301	32,768
Cash and due from banks	6,191	4,669	5,441	4,607
Other assets	1,412	990	986	872
Total assets	52,068	47,199	44,728	38,247
Liabilities				
Customer deposits	34,361	32,106	29,552	21,721
Interbank and other ST funding	5,337	3,992	2,484	3,925
Other LT funding	3,121	2,701	4,935	4,940
Trading liabilities and derivatives	553	494	635	747
Total funding	43,372	39,293	37,606	31,333
Other liabilities	1,037	708	740	1,180
Pref. shares and Hybrid Capital	1,032	943	695	701
Total equity	6,627	6,255	5,687	5,033
Total liabilities and equity	52,068	47,199	44,728	38,247

Summary Financials and Key Ratios

	30 Jun 19	31 Dec 18	31 Dec 17	31 Dec 16
Ratios (annualised as appropriate)				
Profitability				
Operating profit/RWAs	1.6	4.1	2.6	2.2
Fitch comprehensive income/RWAs	2.1	1.8	2.4	2.2
Net interest income/average earning assets	4.8	4.8	4.7	4.5
Non-interest expense/gross revenues	43.8	39.3	53.4	47.3
Net income/average equity	7.8	22.1	14.9	11.3
Fitch comprehensive income/average equity	13.6	11.7	16.8	14.3
Asset quality				
Impaired loans ratio	5.1	3.4	7.4	9.1
Growth in gross loans	14.6	6.2	20.0	10.7
Loan loss allowances/impaired loans	71.7	86.6	39.9	53.9
Loan impairment charges/average gross loans	2.8	0.9	0.0	1.4
Capitalisation				
Fitch Core Capital ratio	15.0	15.0	14.0	14.1
Equity/total assets	12.7	13.0	12.4	12.8
CET 1 ratio	n.a.	n.a.	n.a.	n.a.
RWA/total assets	82.9	85.9	88.3	90.4
Net impaired loans/FCC	7.6	2.3	22.4	20.0
Funding & liquidity				
Loans/customer deposits	98.8	92.3	94.4	107.0
LCR (regulatory ratio N26)	128.2	110.0	n.a.	n.a.
Customer deposits/funding	78.4	80.8	78.5	69.4
NSFR (regulatory ratio N28)	122.8	119.5	n.a.	n.a.

Source: Fitch Ratings, Fitch Solutions

Environmental, Social and Governance Considerations

FitchRatings **Joint Stock Company Alfa-Bank**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Joint Stock Company Alfa-Bank has 5 ESG potential rating drivers

- Joint Stock Company Alfa-Bank 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
GHG Emissions & Air Quality	1	n.a.	n.a.
Energy Management	1	n.a.	n.a.
Water & Wastewater Management	1	n.a.	n.a.
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.
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

E Scale: 5, 4, 3, 2, 1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference
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
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
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy
Employee Wellbeing	1	n.a.	n.a.
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

S Scale: 5, 4, 3, 2, 1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference
Management Strategy	3	Operational implementation of strategy	Management & Strategy
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
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy

G Scale: 5, 4, 3, 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.