FitchRatings

Joint Stock Company Alfa-Bank

Key Rating Drivers

Negative Sector Outlook: The revision of the Outlook on Joint Stock Company Alfa-Bank's (Alfa) ratings to Negative from Positive captures the emerging pressures on the broader banking sector stemming from the coronavirus outbreak, lower oil prices and the economic downturn. While the ultimate economic and financial-market implications of the coronavirus pandemic are unclear, Fitch Ratings considers the risks to Alfa's credit profile skewed to the downside, which resulted in the revision of the Outlook on Alfa's ratings to Negative.

Significant Resilience Remains: Alfa's IDRs are driven by its intrinsic credit strength, as expressed by the 'bb+' Viability Rating (VR). The ratings continue to capture Alfa's well-established domestic franchise, historically strong execution, low impaired loan ratios, healthy bottom line performance in the past several years, and reasonable capital and liquidity buffers. In Fitch's view, Alfa's financial profile, and therefore the ratings, could probably tolerate a short-lived, sharp economic contraction in 1H20 if this is followed by stabilisation in 2H20.

Asset Quality to Weaken: Alfa's impaired loans (defined as Stage 3 loans under IFRS 9) amounted to a moderate 4% of gross loans at end-2019. Fitch expects asset quality to deteriorate in the medium term, particularly in unsecured retail lending (21% of gross loans), as Alfa's unsecured retail loan growth was significantly above the sector average in 2018-2019. Some corporate loans may also generate impairment losses. Risks are higher for foreign currency loans (26% of gross loans) due to a 20% devaluation of the Russian rouble in 1Q20.

Pressure on Profit: Fitch expects Alfa's total comprehensive income (2019: 15% of average equity) to fall in 2020 due to higher loan impairment charges. Alfa's pre-impairment profit amounted to 5% of average gross loans in 2018-2019, providing the bank with significant capacity to absorb losses. Pre-impairment performance in 2020 will, however, moderately deteriorate due to weaker transactional income and lower loan growth.

Moderate Regulatory Capital Ratios: At end-2019 Alfa's Fitch Core Capital (FCC) ratio was a reasonable 14%, but regulatory capitalisation is weaker due to tighter statutory risk-weights. At end-1Q20 Alfa's regulatory core Tier 1 ratio was 8.75%, which is just 75bp higher than the statutory minimum, including fully loaded buffers. However, the core Tier 1 ratio should increase by 230bp after the audit of regulatory 1Q20 profit, which includes large FX gains.

Strong Funding, Liquidity: We believe that the current economic downturn will not result in material pressure on Alfa's funding and liquidity profile. It is mainly deposit-funded and its funding mix benefits from a high share of on-demand current accounts, resulting in significant stability and granularity of the funding base. Alfa's contractual repayments of wholesale funding in 2020 are a moderate USD1.5 billion, while Alfa's liquid assets, including cash, interbank and bonds, exceeded USD17.4 billion or a high 34% of total liabilities at end-2019.

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 currently anticipated, and results in material weakening of Alfa's asset quality and performance. Conversely, the ratings could be affirmed, and the Negative Outlook removed, if the economic downturn does not result in significant erosion of Alfa's financial profile, and if the Russian economy stabilises after a short-lived contraction.

Risk Appetite in Retail: Upside potential for Alfa's ratings is limited in the near term, given the negative outlook on the Russian banking sector. However, in the medium term, stabilisation of the economy, with satisfactory performance of retail lending and moderation of retail loan growth, could result in an upgrade.

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 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)

Fitch Ratings Publishes 2M20 Russian Banks Datawatch (April 2020)

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

Russia (February 2020)

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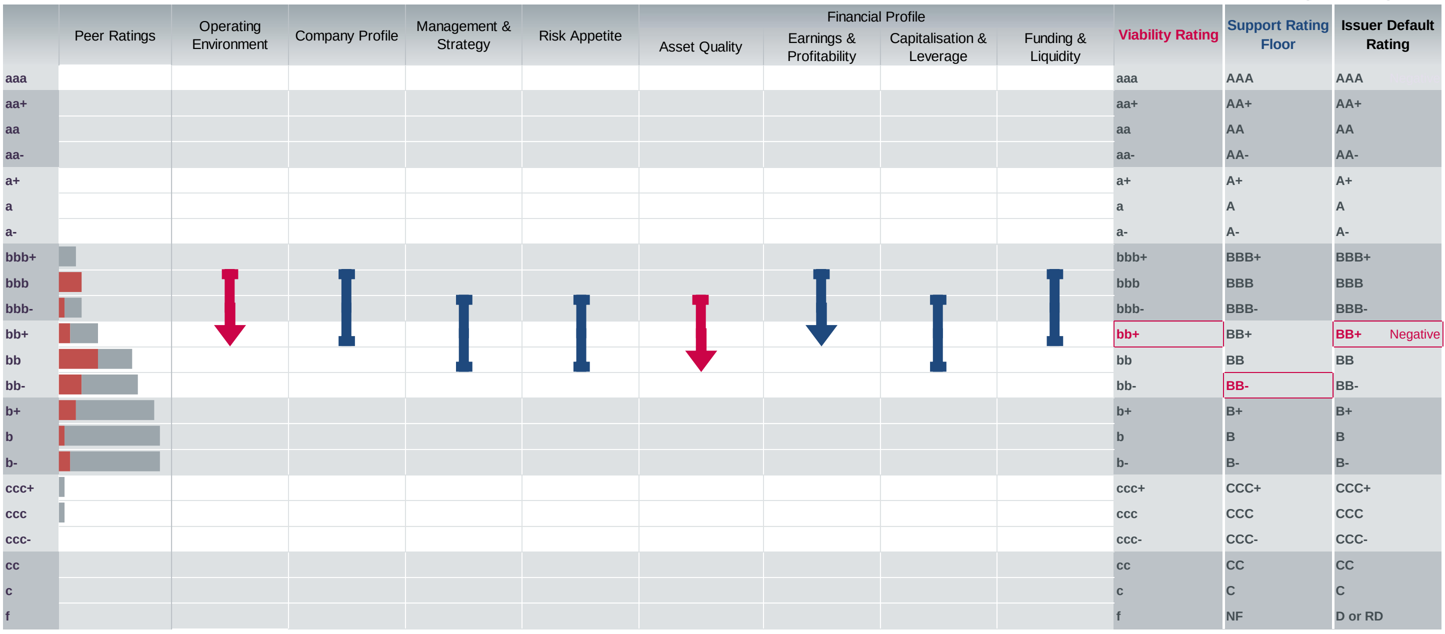
Ratings Navigator – Standalone Assessment

Joint Stock Company Alfa-Bank

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:			**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		✓	

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

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 reflects its moderate systemic importance as the fourth-largest bank in Russia with a 4% market share and substantial (in absolute terms) deposit base.

Significant Changes

Negative Outlook on Operating Environment

The economic pressure resulting from the spread of COVID-19 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.

Credit Risks Stem from Unsecured Retail Lending

Alfa's retail loan impairment charges amounted to a low 3% of average retail loans in 2019, but we expect these to increase as higher unemployment and unpaid leave could impair borrowers' capacity to service debt. Alfa's appetite for growth in unsecured retail lending was materially above the market average in 2018-2019, so additional risks come from potrfolio seasoning. As a mitigating factor, in 2019 Alfa's average gross interest income in retail was a high 22% of average retail loans, reflecting Alfa's business focus on higher-priced products. This provides a significant safety margin against potential spikes in impairment charges.

We view mortgage loans (5% of gross lonas) as generally low risk. Mortgages were growing fast in 2019, and the management plans to further expand their share in retail loan porftfolio.

Good Quality Large Corporate Loans, but Some Risks May Emerge

At end-2019 Stage 3 and Stage 2 exposures were a moderate 4% and 5%, respectively, of Alfa's gross corporate loans. In Fitch's view, these ratios will go up during the horizon of a Rating Outlook.

Alfa's corporate loan book is generally of sound quality, at least judging by the largest loans. The industry structure of Alfa's corporate book largely resembles that of the broader Russian economy. We believe that the economic downturn should primarily affect trade and commerce borrowers (7% of Alfa's gross loans), construction and real estate (7%) and transport (5%). SME borrowers are also risky, but although Alfa was growing fast in SME lending in 2018-2019, this portfolio remains relatively small (3% of gross loans). Oil and gas (12%) borrowers may also suffer, due to the slump in oil prices and weaker revenues, but these are among the largest borrowers in the country and should have at least some resilience.

Foreign currency (FC) loans (26% of gross loans) may be particularly vulnerable due to the 20% devaluation of the Russian ruble in 1Q20, but many of Alfa's largest corporate loans are among the largest Russian exporters, and so should still have access to FC revenues.

Reasonable Resilience Amid Operating Environment Shock

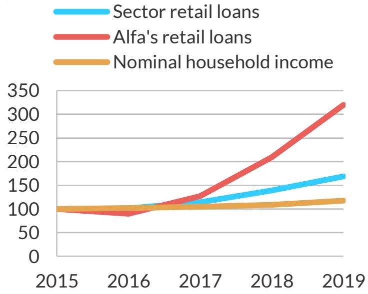
Although we expect Alfa's pre-impairment profit (PIP) to weaken in 2020, it should remain reasonable compared to additional impairment charges. Alfa's PIP amounted to a reasonable 5% of gross loans in 2018-2019. The recognition of losses in corporate lending should be gradual, as many corporate loans are secured with hard collateral, and Alfa has historically been one of the strongest Russian banks in terms of collateral foreclosure and problem loan recoveries. In addition, in the worst case scenario, Alfa's proven ability to de-leverage, supported by a generally short-term loan book, may ease the capital pressure if needed.

Regulatory Capital Ratios to Improve

In 1Q20 Alfa booked large FX gains; these are currently captured in Tier 2 capital, but will move to core capital after the audit of the regulatory accounts, resulting in a 230bp boost to regulatory core Tier 1 ratio by the end of April. This will bring the uplift of Alfa's regulatory capital ratios over statutory minimums (including buffers) in line with most higher-rated banks in Russia. Alfa's capital ratios are inversely correlated with the strength of the rouble, which reduces risks to solvency in a sharp economic downturn.

Retail Loan Growth in Russia

(2015 = 100)



Source: Fitch Ratings, Alfa, CBR, Rosstat

Alfa's Gross Loans (%)

	2019	2018
Retail loans, incl.:		
Cash loans	14	11
Credit cards	7	7
Mortgages	5	2
Other retail loans	0	1
Corporate loans, incl.:		
Oil and gas	12	13
Metals and mining	10	11
Food, agriculture	9	8
Finance	7	8
Trade and commerce	7	7
Constr. and real estate	7	9
Telecom	5	3
Chemistry	5	5
Transport	5	6
Other corporate loans	7	9
Total	**100**	**100**

Source: Alfa's IFRS accounts, Fitch Ratings

Regulatory Capital Ratios

		Alfa	
	Minimum[a]	4Q19	1Q20
Core tier-1	8.00	9.08	8.75
Tier-1	9.50	10.67	10.65
Total	11.50	12.65	15.21

[a] Including fully-loaded capital conservation and systemic importance buffers
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
	(USDm)	(USDm)	(USDm)	(USDm)
	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified
Summary income statement				
Net interest and dividend income	2,117	1,920	1,677	1,325
Net fees and commissions	1,044	978	846	634
Other operating income	-207	252	-271	63
Total operating income	2,954	3,150	2,252	2,022
Operating costs	1,318	1,236	1,203	957
Pre-impairment operating profit	1,636	1,914	1,049	1,065
Loan and other impairment charges	652	261	10	296
Operating profit	984	1,653	1,039	769
Other non-operating items (net)	-9	-19	72	-6
Tax	271	313	313	236
Net income	704	1,321	798	527
Other comprehensive income	324	-624	100	143
Fitch comprehensive income	1,028	697	898	670
Summary balance sheet				
Assets				
Gross loans	38,569	29,626	27,889	23,243
- Of which impaired	1,634	1,025	2,056	2,114
Loan loss allowances	1,197	888	820	1,139
Net loans	37,372	28,738	27,069	22,104
Interbank	1,208	1,703	1,922	712
Derivatives	490	800	485	606
Other securities and earning assets	12,077	10,300	8,825	9,346
Total earning assets	51,147	41,541	38,301	32,768
Cash and due from banks	6,872	4,669	5,441	4,607
Other assets	1,447	989	986	872
Total assets	59,466	47,199	44,728	38,247
Liabilities				
Customer deposits	41,422	32,106	29,552	21,721
Interbank and other short-term funding	2,943	2,359	2,484	3,925
Other long-term funding	5,417	4,334	4,935	4,940
Trading liabilities and derivatives	661	494	635	747
Total funding	50,443	39,293	37,606	31,333
Other liabilities	881	708	740	1,180
Preference shares and hybrid capital	966	943	695	701
Total equity	7,176	6,255	5,687	5,033
Total liabilities and equity	59,466	47,199	44,728	38,247

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	2.0	4.1	2.6	2.2
Net interest income/average earning assets	4.6	4.8	4.7	4.5
Non-interest expense/gross revenue	44.6	39.2	53.4	47.3
Fitch comprehensive income/average equity	15.9	11.7	16.8	14.3
Asset quality				
Impaired loans ratio	4.2	3.5	7.4	9.1
Growth in gross loans	30.2	6.2	20.0	10.7
Loan loss allowances/impaired loans	73.3	86.6	39.9	53.9
Loan impairment charges/average gross loans	1.9	0.9	0.0	1.4
Capitalisation				
Fitch Core Capital ratio	14.4	15.0	14.0	14.1
Tangible common equity/tangible assets	11.8	13.0	12.4	12.8
Net impaired loans/Fitch Core Capital	6.3	2.3	22.4	20.0
Funding and liquidity				
Loans/customer deposits	93.1	92.3	94.4	107.0
Customer deposits/funding	81.6	80.8	78.5	69.4

Source: Fitch Ratings, Fitch Solutions, Bank

Debt Ratings

Debt Issued by JSC Alfa-Bank and Alfa Bond Issuance plc

Debt Rating Class	Rating
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 the event of default.

Alfa's 'BB-' subordinated debt rating is notched down twice from its 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 (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 write-down trigger on the bank's AT1 securities is the regulatory core Tier 1 ratio falling below 5.125%. Alfa can omit coupons on these securities at its sole discretion. There is no specific trigger which would oblige Alfa to omit coupons before hitting the 5.125% core Tier 1 ratio. However, if the bank's capital ratios fell below minimum levels including buffers (e.g. 8% for core Tier 1) then the bank would be obliged to submit a capital recovery plan to the Central Bank of Russia (CBR). In Fitch's view there would be at least moderate risk that any such plan would include the omission of coupons on the AT1 securities.

Senior unsecured debt issued by ABH Financial Limited (ABHFL), Alfa's holding company, is rated at 'BB', which is in line with ABFHL'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.

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	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 right-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 some of the main 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 ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Priniciples for Responsible Investing (PRI) and the Sustainability Accounting Standards Board(SASB).

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.