FitchRatings

15 Sep 2020 | Rating Changed Outlook to Stable

Fitch Revises Alfa-Bank's Outlook to Stable; Affirms IDR at 'BB+'

Fitch Ratings-Moscow-15 September 2020:

Fitch Ratings has revised Russian-based JSC Alfa-Bank's (Alfa) Outlook to Stable from Negative while affirming the bank's Long-Term Issuer Default Rating (IDR) at 'BB+'. Fitch has also affirmed the Long-Term IDR of Alfa's holding company, ABH Financial Limited (ABHFL), at 'BB'. A full list of rating actions is provided below.

The Outlook revision reflects reduced pressure on Alfa's credit profile from the pandemic, lower oil prices and the resulting economic contraction in Russia. Pre-impairment profitability has remained robust, which supports the bank's loss absorption capacity and, in Fitch's view, would be sufficient to provide for further credit losses even in the event of a longer and more severe downturn than currently anticipated. Asset-quality erosion has also been limited to date.

Alfa's ratings could be upgraded to 'BBB-' if the Russian economy stabilises in line with Fitch's base case, and credit losses from the downturn and from expansion into retail lending remain manageable. A more severe economic contraction than anticipated by Fitch or larger-than-expected credit losses could result in the ratings remaining at their current level, rather than negative rating action, given the bank's loss absorption capacity and strong record in managing problematic assets.

Key Rating Drivers

KEY RATING DRIVERS

The IDRs of Alfa are driven by its intrinsic credit strength, as expressed by its Viability Rating (VR), and continue to capture its strong franchise, a record of strong performance and resilient asset quality to date, and reasonable liquidity and capital buffers.

Alfa's Stage 3 loans were a moderate 4.4% of gross loans at end-1H20 (a 20bp increase versus end-2019) and were 88% covered with total loan loss allowances (LLAs). Stage 2 loans increased sharply to 13% of gross loans at end-1H20 from 6% at end-2019, but most of these reside in Alfa's corporate portfolio, and we believe that the largest are mostly of reasonable credit quality and carry only a moderate risk of further impairment. Alfa's largest Stage 1 loans are extended to leading Russian corporates, most of which have international credit ratings of 'BB' and above. We continue to view Alfa's corporate loan quality as resilient and do not expect significant impairment losses in corporate lending.

Risks in retail are driven by a considerable share of unsecured lending (77% of retail loans) in Alfa's retail loan portfolio and the bank's fast retail loan growth in 2018 and 2019 (66% and 53%, respectively), which gives rise to seasoning risks. However, loan restructuring in retail was only moderate (about 5%) at end-2Q20, and we do not expect this to increase sharply in 2H20. A further mitigating factor is the only moderate overall share of retail loans (27% of gross loans or 1.5x CET1 capital at end-2Q20) in Alfa's assets. In addition, retail growth is likely to moderate in 2020 and 2021, which Fitch views as positive. If adjusted for foreign-currency moves, unsecured retail loans and mortgages expanded by 5% and 39% respectively, in 1H20, resulting in an overall 11% retail loan growth.

Alfa's annualised pre-impairment profit was a high 5% of average gross loans in 1H20, providing the bank with significant loss absorption capacity, while loan impairment charges (LICs) were only 2.7% (annualised) of loans, allowing Alfa to post a moderate 7% return on equity. Alfa's pre-impairment performance is supported by wide margins, which benefit from low funding costs (3.5% in 1H20) and reasonable cost control. Fee income was under some pressure in 1H20, but not enough to dent the bank's overall profitability.

Alfa's Fitch Core Capital (FCC) ratio was a comfortable 15.6% at end-2Q20, but regulatory capitalisation was tighter, reflecting higher statutory risk-weighting (particularly on Alfa's retail loans) and deeper loan provisioning in regulatory accounts. At end-2Q20 Alfa's regulatory Core Tier-1 ratio was 9.9%, which is 190bp higher than the statutory minimum (including fully-loaded capital conservation and systemic importance buffers), which Fitch views as providing only moderate headroom. Alfa's regulatory capital ratios were supported by a sector-wide relaxation of risk-weighting on lower-risk corporate loans in January, and by the bank's significant one-off foreign-currency gains.

Alfa's funding profile remains robust. Alfa was 80% deposit-funded at end-1H20 and we view its deposit base as stable and granular, due to a high share of retail on-demand accounts (28% of total liabilities at end-2Q20). Alfa's near-term wholesale-funding repayments are limited and the bank's liquidity buffer (consisting of cash and bonds) exceeded 25% of total liabilities at end-2Q20.

ABHFL

The 'BB' Long-Term IDR of ABHFL is one notch lower than Alfa's. Fitch expects that default risks for Alfa and ABHFL will be highly correlated due to high fungibility of capital and liquidity within the group, which is managed as a single entity.

ABHFL's double leverage, defined by Fitch as equity investments in subsidiaries divided by the holding company's equity, fell to a moderate 108% at end-2Q20 from 156% at end-1H17, reflecting the entity's significant deleveraging in recent years. The currently moderate volume of ABHFL's third-party debt further supports close alignment of its ratings with those of Alfa.

The one-notch differential between the bank's and the holding company's ratings reflects the absence of consolidated regulation for the two entities due to them being incorporated in different jurisdictions. However, Fitch does not expect this to be a significant constraint on ABHFL's ability to benefit from the strong liquidity of the broader group, and of Alfa in particular.

DEBT RATINGS

Alfa's senior unsecured debt ratings (including on debt issued through Alfa Bond Issuance plc) are affirmed at 'BB+' in line with the bank's IDRs. The senior unsecured debt issued by ABHFL (through Alfa Holding Issuance plc) is rated 'BB', at the same level as the holding company's IDR.

Alfa's subordinated debt issues (placed by Alfa Bond Issuance plc) are rated 'BB-' and notched down twice from the bank's VR, reflecting higher loss severity than senior unsecured obligations.

The perpetual notes (placed by Alfa Bond Issuance plc) are rated 'B' and notched down four times from the VR, reflecting their deep subordination and fully discretionary coupon payments.

SUPPORT RATING AND SUPPORT RATING FLOOR (SRF)

Alfa's 'BB-' SRF and '3' Support Rating reflect Fitch's view a moderate of probability of support from the Russian authorities in case of need. This view is based on 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, and the absence of any current plans to introduce comprehensive senior creditor bail-in provisions into Russian legislation. Alfa's 'BB-' SRF also captures the bank's moderate systemic importance as the fourth-largest bank in Russia with a 4% market share and its sizable (in absolute terms) deposit base.

RATING SENSITIVITIES

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

Alfa's ratings could be upgraded to 'BBB-' if the Russian economy stabilises in line with Fitch's base case, and credit losses from the downturn and from expansion into retail lending remain manageable. In Fitch's view, some aspects of Alfa's credit profile (in particular, its franchise, track record and some of the financial metrics) are already consistent with a 'BBB-' rating.

ABHFL's ratings will likely be upgraded if Alfa is upgraded. An upgrade of ABHFL to the level of Alfa is unlikely, given that the entities are incorporated in different jurisdictions.

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

A more severe economic contraction than anticipated by Fitch or larger-than expected-credit losses are unlikely by themselves to result in negative rating action given the bank's healthy loss absorption capacity and strong record in managing problematic assets. However, if large credit losses are accompanied by a significant reduction in pre-impairment profit, resulting in tighter capitalisation, then ratings could come under pressure.

ABHFL will likely be downgraded if Alfa is downgraded.

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.

Public Ratings with Credit Linkage to other ratings

The ratings of ABHFL are linked to the ratings of Alfa.

ESG Considerations

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

ABH Financial Limited; Long Term Issuer Default Rating; Affirmed; BB; RO:Sta
; Short Term Issuer Default Rating; Affirmed; B
Alfa Holding Issuance plc
----senior unsecured; Long Term Rating; Affirmed; BB
Alfa Bond Issuance Public Limited Company
----senior unsecured; Long Term Rating; Affirmed; BB+
----subordinated; Long Term Rating; Affirmed; B
----subordinated; Long Term Rating; Affirmed; BB-
Joint Stock Company Alfa-Bank; Long Term Issuer Default Rating; Affirmed; BB+; RO:Sta
; Short Term Issuer Default Rating; Affirmed; B
; Local Currency Long Term Issuer Default Rating; Affirmed; BB+; RO:Sta
; Viability Rating; Affirmed; bb+
; Support Rating; Affirmed; 3
; Support Rating Floor; Affirmed; BB-
----senior unsecured; Long Term Rating; Affirmed; BB+

Contacts:
Primary Rating Analyst
Dmitri Vasiliev,
Director
+7 495 956 5576
Fitch Ratings CIS Ltd
Business Centre Light House, 6th Floor 26 Valovaya St.
Moscow 115054

Secondary Rating Analyst
Artem Beketov,
Associate Director
+7 495 956 9932

Committee Chairperson
Eric Dupont,
Senior Director
+33 1 44 29 91 31

Media Relations: Anna Bykova, Moscow, Tel: +7 495 956 9903, Email: anna.bykova@fitchratings.com
Louisa Williams, London, Tel: +44 20 3530 2452, Email: louisa.williams@thefitchgroup.com
Marina Vdovenkova, Moscow, Tel: +7 495 956 2404, Email: marina.vdovenkova@fitchratings.com

Additional information is available on www.fitchratings.com

Applicable Criteria

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

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Status
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