FitchRatings

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Fitch Upgrades Alfa-Bank to 'BBB-'; Outlook Stable

Fitch Ratings - Moscow - 01 Apr 2021: Fitch Ratings has upgraded Russia-based Joint Stock Company Alfa-Bank's (Alfa) Long-Term Issuer Default Ratings (IDRs) to 'BBB-' from 'BB+'. The Outlooks are Stable. Fitch has also upgraded the Long-Term IDR of Alfa's holding company, ABH Financial Limited (ABHFL), to 'BB+' from 'BB'. A full list of rating actions is below.

The upgrade reflects the following factors. First, Fitch has revised the outlook on Russia's operating environment score to stable from negative. The negative implications from the pandemic on the Russian economy resulted in an only moderate weakening of Russian banks' asset quality and profitability in 2020. We expect Russia's real GDP growth to recover to 3.3% in 2021 after a 3.1% contraction in 2020 and this should support sector performance in 2021.

Second, Alfa's ratings were already close to the 'BBB-' level prior to the pandemic, as indicated by the Positive Outlook on its 'BB+' IDR in 2019. We believe the bank's stable asset quality metrics and healthy bottom line results in 2020 imply strong execution through the credit cycle and warrant the upgrade. We also believe that Alfa is well-positioned to maintain stable asset quality and performance in the next couple of years.

Third, we believe that credit risks stemming from Alfa's rapid expansion into unsecured retail lending have moderated, leading to a lower rating impact from Alfa's elevated risk appetite and some shifts in its business model.

Key Rating Drivers

ALFA

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

At end-2020, Alfa's Stage 3 loans equaled 4.1% of gross loans (a 10bp reduction from end-2019) and were 85% covered with loan loss allowances (LLA). Stage 2 loans spiked to 11% of gross loans at end-2020 from 5.4% at end-2019, but most are corporate exposures, and the largest are of reasonable credit quality, in Fitch's view. We believe that Alfa's corporate loans (71% of the total portfolio) are of resilient credit quality, as the largest are extended to leading Russian companies, most of which are rated 'BB' and above. We believe that Alfa's corporate loan quality should stay strong in the next few years, and expect only moderate additional impairment in this book as a result of the pandemic-driven downturn.

In Fitch's view, Alfa's loan quality in retail remains reasonable. This view is supported by an only moderate 100bp increase in Stage 3 loans in retail lending in 2020, a manageable 4.6% cost of risk in retail, and the stable performance of retail loan vintages in 2020. Risks in retail increased as a result of fast and above-sector growth in recent years, with a CAGR in retail lending in 2017-2020 of 48% in rouble terms, with an emphasis on unsecured lending. However, at end-2020, Alfa's unsecured retail portfolio was still equal to only 20% of gross loans or 1.1x Fitch Core Capital (FCC), which we view as a moderate exposure. In addition, we do not expect this exposure to materially increase in the medium term, as retail loan growth over 2021-2022 is likely to be focused primarily on mortgages, which we view as a lower-risk product in Russia.

Another indicator of stable loan quality is Alfa's low ratio of loan impairment charges (LICs) divided by gross loans (1.6% in 2020 on the overall portfolio, which is a 30bp decrease compared with 2019). We expect LICs to stay around 2% in the next few years, allowing the bank to post reasonable double-digit returns on average equity (ROE). Alfa's pre-impairment profit was equal to 5% of average loans in 2020, providing the bank with significant loss absorption capacity. Pre-impairment performance is supported by wide margins, which benefit from low funding costs (3.1% in 2020) and the increase in higher-yielding retail lending. Alfa's ROE in 2020 was 12.2%, which is consistent with bottom line results in the past few years.

Alfa's Fitch Core Capital (FCC) ratio was a comfortable 14.7% at end-2020, but regulatory capitalisation was tighter, reflecting higher statutory risk-weights (in particular in unsecured retail lending) and deeper loan provisioning in regulatory accounts. At end-2020, Alfa's regulatory Core Tier-1 ratio (N20.1) was 9.7%. This is 170bp higher than the statutory minimum (including fully-loaded capital conservation and systemic importance buffers), which Fitch views as providing only moderate headroom. Fitch notes that in the past few years Alfa' headroom reduced to below 100bp in some reporting periods, and believes that Alfa manages its regulatory capital ratios rather tightly, compared with other highly-rated banks in Russia.

Alfa's funding and liquidity profile is a rating strength. Alfa is mainly funded with customer deposits (81% of total liabilities at end-2020) and we view its deposit base as stable and granular, due to a high share of on-demand/current accounts, equal to about a half of total liabilities at end-2020. Alfa's near-term wholesale-funding repayments are limited and the bank's liquidity buffer (consisting of cash and bonds) exceeded USD15 billion (28% of total liabilities) at end-2020.

ABHFL

The upgrade of ABFHL to 'BB+' from 'BB' mirrors the upgrade of the bank. Fitch believes that default risks for Alfa and ABHFL are 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-2020 from 156% in 2017, reflecting the entity's significant deleveraging in recent years. The currently moderate volume of ABHFL's third-party debt further supports the close alignment of its ratings with those of Alfa.

The one-notch difference 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

All debt ratings of Alfa and ABFHL have been upgraded by one notch.

Alfa's senior unsecured debt ratings (including on debt issued through Alfa Bond Issuance plc) have been upgraded to 'BBB-' from 'BB+', in line with the bank's IDRs. The senior unsecured debt issued by ABHFL (through Alfa Holding Issuance plc) has been upgraded to 'BB+' from 'BB', the same level as the holding company's IDR.

Alfa's dated subordinated debt issues (placed by Alfa Bond Issuance plc) have been upgraded to 'BB' from 'BB-' and are notched down twice from Alfa's VR, reflecting higher loss severity upon default than senior unsecured obligations.

The perpetual notes (placed by Alfa Bond Issuance plc) have been upgraded to 'B+' from 'B' and are 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 SRF of 'BB-' and its Support Rating of '3' reflect Fitch's view of a moderate of probability of support from the Russian authorities, in case of need. This view is based on the 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:

A further upgrade of Alfa's ratings would require (i) an improvement of the operating environment for banks in Russia and an upgrade of Russia's sovereign ratings; and (ii) an extended record of stable asset quality and performance at Alfa, and probably somewhat higher headroom of regulatory capital ratios over the statutory minimums, including buffers.

ABHFL's ratings would 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/downgrade:

Alfa's ratings would be downgraded if either (i) Russia's 'BBB' sovereign rating is downgraded, as Fitch is unlikely to rate Alfa at the same level as the sovereign; or (ii) if there was a material asset quality deterioration, with LICs exceeding 5% of average gross loans in two to three consecutive semi-annual reporting periods, resulting in negative or close to negative net income.

ABHFL would likely be downgraded if Alfa was 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.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
ABH Financial Limited	LT IDR	BB+	Upgrade		BB
	ST IDR	B	Affirmed		B
Alfa Holding Issuance plc					

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• senior unsecured	LT	BB+	Upgrade		BB
Alfa Bond Issuance Public Limited Company					
• senior unsecured	LT	BBB-	Upgrade		BB+
• subordinated	LT	B+	Upgrade		B
• subordinated	LT	BB	Upgrade		BB-
Joint Stock Company Alfa-Bank	LT IDR	BBB-	Upgrade		BB+
	ST IDR	F3	Upgrade		B
	LC LT IDR	BBB-	Upgrade		BB+
	Viability	bbb-	Upgrade		bb+
	Support	3	Affirmed		3

ENTITY/DEBT	RATING			RECOVERY	PRIOR
	Support Floor	BB-	Affirmed		BB-
• senior unsecured	LT	BBB-	Upgrade		BB+

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

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

Additional Disclosures

Solicitation Status

Endorsement Status

ABH Financial Limited	UK Issued, EU Endorsed
Alfa Bond Issuance Public Limited Company	UK Issued, EU Endorsed

Alfa Holding Issuance plc	UK Issued, EU Endorsed
Joint Stock Company Alfa-Bank	UK Issued, EU Endorsed

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