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Key rating assessment factors

ACRA downgrades Modulbank to BB(RU), outlook Stable

ACRA has downgraded the credit rating of [Modulbank](#) (hereinafter, the Bank) due to a deterioration in the Bank's capacity to absorb potential risks using its capital and the corresponding change in the capital adequacy assessment to satisfactory. The Bank's standalone creditworthiness assessment (SCA) is primarily based on the satisfactory market position coupled with the pronounced concentration of the business strategy, as well as the satisfactory risk profile and the adequate liquidity and funding position.

Modulbank is a small bank that is focused on servicing small and micro-sized businesses via its own online platform. As of April 1, 2020, the Bank ranked 171st in terms of capital in Russia. A. D. Avetisyan is the main beneficiary of the Bank, with a 90.8% share (previously he held a 68.3% share). In December 2019, Mr. Avetisyan received the share of top managers after they left the bank. S. I. Yusupov holds a 2.2% share, and the remaining 7.7% share is made up of stocks that were bought back by the Bank. Changes were made to the senior management of the Bank in late 2019 and early 2020, including the appointment of a new chairman of the Bank's management board.

The satisfactory business profile assessment reflects the low share of the Bank in the Russian banking market and its stronger positions in the small business segment.

The Bank's strategy assumes that it will continue to moderately develop its business with a focus on providing integrated services to small and micro-sized businesses (bank account services, acquiring, accounting, guarantees under 44-FZ, etc.), which allows the Bank to sufficiently diversify its operating income. In 2019, the Herfindahl-Hirschman index was 0.29.

The capital adequacy assessment has been downgraded to satisfactory due to the Bank's moderate capital adequacy under national standards (N1.2 at 9.7% as of April 1, 2020). However, ACRA expects this indicator as a result of the sale of a company that belonged to Modulbank in April (due to the difference between its value and the value of the property that the Bank received as payment for the deal).

According to ACRA's calculations, the Bank's average capital generation ration (ACGR) has increased and amounted to 54 bps for 2017–2019. Prior to 2017, Modulbank was in the investment stage and recorded losses.

The stress test conducted by ACRA, which took into account changes to capital, the possibility of losses from one-off operations, and also potential impairment of loans, showed a deterioration in the Bank's capacity to sustain an increase in credit risk (ranging from 300 to 500 bps) without violating capital adequacy requirements. ACRA notes that in Q1 2020, the Bank's capital shrunk considerably due to losses from revaluation of securities and the buyback of a portion of shares belonging to a shareholder. The Bank's low operational efficiency continues to limit the capital adequacy assessment: the average net interest margin (NIM) under IFRS in 2017–2019 stood at 3.4%, while the cost-to-income ratio (CTI) was 78%.

The Bank's satisfactory risk profile assessment is based on the satisfactory quality of risk management, the good quality of other assets and the guarantee portfolio, and also takes into account the growing impact of lending to small businesses.

The portfolio of guarantees issued by the Bank is several times larger than its capital. ACRA assesses the credit quality of the guarantee portfolio as acceptable. The number of loans issued to companies and independent entrepreneurs more than doubled in the period from the start of 2019 until April 1, 2020. However, they continue to account for less than 10% of assets and are characterized by an enhanced level of problem debt (around 13% of the portfolio). The level of reserve coverage is high.

ACRA does not rule out the possibility of a considerable increase in the volume of loans provided by the Bank to small and micro-sized businesses as part of the implementation of its strategy or an increase in the size of the guarantee portfolio, the credit quality of which may influence the risk profile assessment.

Adequate funding and liquidity position. As of April 1, 2020, the Bank was able to withstand a significant outflow of client funds in both the base case scenario (up to RUB 10 bln) and the stress scenario (surplus of 15% of total liabilities) applied by ACRA. On longer-term horizons, ACRA sees no imbalances (the long-term liquidity shortage indicator, LTLSI, exceeds 75%), and no major redemptions or outflows of funds are expected in the next 12 months.

ACRA notes the Bank's increased concentration on funds raised from corporate clients and independent entrepreneurs, which is characteristic of its business model. As of January 1, 2020, their share exceeded 90% of the total liabilities. The high concentration of funding sources is counterbalanced by the low share of funds of the ten largest lenders (less than 2% of the total liabilities of the Bank).

Key assumptions

- Maintaining the current strategy and business model over the next 12–18 months;
- Maintaining the N1.2 capital adequacy ratio (CAR) above 12% in the next 12–18 months.

Potential outlook or rating change factors

The **Stable outlook** assumes that the rating will most likely stay unchanged within the 12 to 18-month horizon.

A positive rating action may be prompted by:

- Growth of the Bank's capacity to absorb potential risks;
- Higher operational efficiency of the Bank.

A negative rating action may be prompted by:

- Higher credit risk due to a substantial growth of the loan and guarantee portfolios;
- Deteriorating liquidity position;
- The N1.2 CAR falling below 12% for an extended period.

Rating components

SCA: bb.

Adjustments: none.

Support: none.

Issue ratings

No outstanding issues have been rated.

Regulatory disclosure

The credit rating has been assigned under the national scale for the Russian Federation based on the [Methodology for Credit Ratings Assignment to Banks and Bank Groups under the National Scale for the Russian Federation](#) and the [Key Concepts Used by the Analytical Credit Rating Agency within the Scope of Its Rating Activities](#).

The credit rating of Modulbank was published by ACRA for the first time on May 31, 2018. The credit rating and its outlook are expected to be revised within one year following the publication date of this press release.

The credit rating was assigned based on the data provided by Modulbank, information from publicly available sources, as well as ACRA's own databases. The rating analysis was performed using the IFRS financial statements of Modulbank and the financial statements of Modulbank drawn up in compliance with Bank of Russia Ordinance No. 4927-U, dated October 8, 2018. The credit rating is solicited, and Modulbank participated in its assignment.

No material discrepancies between the provided data and the data officially disclosed by Modulbank in its financial statements have been discovered.

ACRA provided no additional services to Modulbank. No conflicts of interest were discovered in the course of credit rating assignment.

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