

11 Aug 2020 | Affirmation

Fitch Affirms Interstate Bank at 'BB+'; Outlook Stable

Fitch Ratings-London-11 August 2020:

Fitch Ratings has affirmed Interstate Bank's (IsB) Long-Term Issuer Default Rating (IDR) at 'BB+' with a Stable Outlook.

Key Rating Drivers

Fitch rates IsB as a supranational administrative body (SAB), given its unique business model as a multilateral settlement institution operating in the Commonwealth of Independent States (CIS) and Eurasian Economic Union (EAEU). IsB's ratings are support-driven and derived from the rating of its key shareholder, Russia (BBB/Stable). Fitch applies a two-notch downward adjustment from Russia's sovereign rating to reflect our assessment of the propensity of the key shareholder to provide support. The Stable Outlook mirrors that on Russia's Long-Term IDR.

The two-notch negative adjustment from Russia's rating reflects Fitch's assessment of the weak shareholder propensity to provide support. This primarily reflects the ease with which shareholders can leave the bank, as illustrated by the case of Uzbekistan in 2012. Ukraine, an inactive member of the bank for some years now, formally requested to withdraw from the bank's membership in 2019. The financial settlement resulting from Ukraine's eventual departure should not materially affect the bank's capital base or operations. The notching also factors in the limited size of the bank (total assets were RUB13.4 billion at end-1H20) and operations relative to the region's economy.

The bank's shareholders are nine CIS countries, represented by their central banks: Armenia (BB-/Negative; which owns 1.8% of the bank's capital), Belarus (B/Stable; 8.4%), Kazakhstan (BBB/Stable; 6.1%), Kyrgyz Republic (not rated; 1.5%), Moldova (not rated; 2.9%), Russia (50%), Tajikistan (not rated; 1.6%), Turkmenistan (not rated; 1.5%), and Ukraine (B/Stable; 20.7%).

In Fitch's view, IsB's financial profile is resilient to negative pressures stemming from the COVID-19 pandemic and oil price shock. The bank provides cash and settlement services to its clients, both in national currencies of CIS countries and in freely convertible currencies. Settlement volumes for 1H20 were down 20% compared with the same period last year, but this decrease will not materially impact the bank's financial results. The majority of the bank's income is derived from interbank placements and debt securities.

Treasury assets, comprised primarily of short-dated interbank placements with prime Russian banks and debt securities issued by the Russian sovereign or government-related entities, accounted for 99% of total assets as of end-1H20. The credit quality of treasury assets ranges from 'BBB+' to 'B-', with a weighted average rating of 'BBB-' as of end-1H20.

The bank's equity to assets ratio stood at 52% as of end-1H20, slightly below the five year average of 58%. Liabilities represent deposits from banks and international organisations, which are used to fund settlement operations and carry negligible rates.

IsB has no loans, it currently has not issued any guarantees, it does not provide trade financing, does not take part in any co-financing, and is not involved in concessional lending, project finance or loans to SMEs. We do not expect the bank's business model to change.

In 2019, the bank's Council approved its strategy through 2023, which envisages greater participation in integration projects and collaboration with central banks. The bank's usage and promotion of national currencies is increasingly relevant in the context of US sanctions against some Russian financial institutions and de-dollarisation efforts by shareholders.

The bank's risk management framework is prudent outside of its inherent concentration of Russian exposures. Liquidity management takes into account current and projected short-term cash outflows by currencies and maturities to ensure fulfilment of the bank's obligations, effect payments upon instructions, and funding for asset-related transactions. Liquid investment securities serve as an important buffer for the bank's demanding liquidity needs. Furthermore, the bank faces minimal FX risk as it does not hold open FX positions except for small cash balances. The bank transacts in the FX spot market to effect settlements in non-rouble currencies and passes along any cost incurred in the transaction to the payer.

RATING SENSITIVITIES

The main factors that could, individually or collectively, lead to positive rating action/upgrade are:

Shareholder Support (Capacity): An upgrade of the Russian sovereign rating or a revision of its Outlook to Positive.

Shareholder Support (Propensity): A positive revision to our assessment of Russia's propensity to support the bank, which may arise from increased importance of the bank in the CIS/EAEU economic framework.

The main factors that could, individually or collectively, lead to negative rating action/downgrade are:

Shareholder Support (Capacity): A downgrade of the Russian sovereign rating or revision of its Outlook to Negative.

Shareholder Support (Propensity): A negative revision to our assessment of Russia's propensity to support the bank, potentially stemming from additional departures by member states from the bank.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure 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 three 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>].

Key Assumptions

- Russia continues to own at least 50% of IsB's capital.
- No significant deviation from IsB's current strategy.
- Risk management policies remain prudent.

Sources of Information

The source of information used to assess these ratings were IsB's financial statements and other information provided by IsB.

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.

Interstate Bank; Long Term Issuer Default Rating; Affirmed; BB+; RO:Sta
---; Short Term Issuer Default Rating; Affirmed; B

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Applicable Criteria

[Supranationals Rating Criteria \(pub. 30 Apr 2020\) \(including rating assumption sensitivity\)](#)

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