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Research Update:

Russia's Gazprombank Outlook Revised To Positive On Improving Risk Management; 'BB/B' Ratings Affirmed

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Research Update:

Russia's Gazprombank Outlook Revised To Positive On Improving Risk Management; 'BB/B' Ratings Affirmed

Overview

- The operating environment for financial institutions in Russia is gradually stabilizing.
- We are revising the outlook to positive from stable on Russia-based Gazprombank (GPB).
- We are also affirming our 'BB' long-term and 'B' short-term counterparty credit and 'ruAA' long-term Russia national scale ratings on GPB.
- We add three notches of uplift to the stand-alone credit profile of GPB, Russia's third-largest bank, because of its very important systemic role as a government-related entity (GRE).
- The positive outlook reflects our view that GPB's financial profile will continue to improve over the next 12 months.

Rating Action

On July 5, 2010, Standard & Poor's Ratings Services revised the outlook to positive from stable on Russia-based Gazprombank (GPB). At the same time, we affirmed the 'BB' long-term and 'B' short-term counterparty credit and 'ruAA' long-term Russia national scale ratings on GPB.

Rationale

The rating action reflects our opinion of the bank's strengthening risk management and control, reduced appetite for market risk and exposures, improved--albeit still low--capitalization, and better asset quality performance than the sector average.

The ratings on GPB, Russia's third-largest bank, are still constrained by what we see as a challenging operating environment; GPB's material market risk exposures, which have led to highly volatile financials; relatively weak, albeit improving, capitalization and core profitability; and high credit risk costs, resulting from deteriorated asset quality.

However, the ratings also continue to take into account GPB's status as a government-related entity (GRE), reflecting its high systemic importance to the Russian banking system. We believe that there is still a high probability that the bank would receive extraordinary support from the Russian Federation (foreign currency BBB/Stable/A-3; local currency BBB+/Stable/A-2; Russia national scale long-term 'ruAAA') as well as from the bank's main shareholder

OAO Gazprom (BBB/Negative/A-3). The ratings also benefit from GPB's below-market-average liquidity risk and moderate short-term foreign debt repayments.

We give the long-term ratings three notches of uplift above our assessment of GPB's stand-alone credit profile, which mainly reflects GPB's status as a GRE, and its parental support.

GPB is 42%-owned by Gazprom, the world's largest gas producer, which is majority-controlled by the Russian Federation. GPB is the main financial services provider for Gazprom and its related entities. Standard & Poor's classifies GPB as a "strategically important" but not "core" subsidiary of its controlling company, Gazprom. We therefore do not equalize the ratings on GPB with those on Gazprom.

In accordance with our criteria for GREs, our view of a "high" likelihood of timely and sufficient extraordinary government support is based on our assessment of GPB's:

- "Very important" role as a bank of high systemic importance, its significant role in the government's support initiatives for the domestic banking sector and economy, as well as its ongoing role in servicing Gazprom's operations; and
- "Strong" link with the Russian Federation through Gazprom's ownership, as demonstrated by a consistent track record of government support.

In our view, Russia's gradually stabilizing operating environment, coupled with the bank's more cautious risk management and controls, and greatly downsized market risk exposures should help it improve its risk profile and financial performance.

GPB estimates that the proportion of loans overdue for more than 90 days was 3.7% on March 31, 2010, and that the restructured loan portfolio was 6% of total loans. We calculated that GPB's ratio of adjusted total equity to assets increased to more than 8% on Dec. 31, 2009, from 4.7% a year earlier.

Outlook

The positive outlook reflects our view that GPB's financial profile will continue to improve over the next 12 months, because of its risk management and control enhancements. We believe that the bank's asset quality problems are stabilizing at the current fairly manageable levels and driving down credit costs. We believe that GPB will also manage to keep its loss-absorption capacity and liquidity at levels appropriate for the current ratings, despite the still-difficult operating environment.

We would consider an upgrade if we see continued improvement in asset quality that approaches pre-2008 levels. This is particularly with respect to the overall portfolio, including restructured loans, which we believe will lead to more robust profitability and capitalization. A reduction or loss of this positive momentum and of GPB's risk management focus would result in a revision of the outlook back to stable.

Although this is not our base case expectation, we would consider lowering the ratings if we were to see a substantial deterioration of the bank's asset quality or more aggressive market risk policy, which in turn would again erode capitalization. A lower probability of extraordinary state or parent support could also lead to a negative rating action.

Related Criteria And Research

- Enhanced Methodology And Assumptions For Rating Government-Related Entities, June 29, 2009
- Group Methodology, April 22, 2009
- FI Criteria: Bank Rating Analysis Methodology Profile, March 18, 2004
- Methodology And Assumptions: Risk-Adjusted Capital Framework For Financial Institutions, April 21, 2009
- The Heat On Russian Banks Is Lessening Somewhat As Loan Losses Stop Growing--But Sparks May Still Fly, May 18, 2010
- Updated Assumptions For Problem Assets And Credit Costs For Banks In Russia, May 18, 2010
- Recovery: Recovery Prospects From Bank Defaults In Kazakhstan, Russia, And Ukraine Are Still Uncertain, Jan. 19, 2010
- The Recent Slowdown In Russian Inflation Will Unlikely Trigger Fundamental Change Of The Banking Sector, Feb. 18, 2010

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Gazprombank		
Counterparty Credit Rating	BB/Positive/B	BB/Stable/B
Russia National Scale Rating	ruAA	
Certificate Of Deposit	BB/B	
Senior Unsecured	BB	
Senior Unsecured	ruAA	
Subordinated	B+	
GPB Eurobond Finance PLC		
Senior Unsecured*	BB	
GPB Finance PLC		
Gazprombank		
Commercial Paper¶	B	

*Borrower Gazprombank
¶Guaranteed by Gazprombank and borrower Gazprombank
N.B. This list does not include all ratings affected.

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