

# Credit risk

Credit risk is the risk of losses due to non-fulfillment, delayed or incomplete fulfillment of the financial obligations by borrowers, as stipulated by a credit agreement. The Bank bears credit risks in lending operations with all types of counterparties: corporate clients, financial organizations and individuals.

Bank Vozrozhdenie has a system of limits and authorities aimed to minimize risk and optimize the decision-making process. The system provides for a collective body or an official to be authorized to determine the maximum size of credit risk per borrower and the total volume of total credit exposure. The authorities, certain limits and lending terms and conditions are subject to quarterly review and approval by the Management Board.

The Credit and Investment Committee (CIC) is responsible for managing credit risk effectively and has the following structure:

- The principal membership is responsible for general issues relating to managing credit risk, defining and implementing credit policy as part of the Bank's approved development strategy;
- The small membership deals with issues relating to implementing credit policy when offering products that carry credit risk to clients and when making investments;
- The subcommittee on corporate clients is responsible for managing credit risk and implementing credit policy in the corporate segment;
- The subcommittee on lending to microbusinesses considers credit risk management issues and implements credit policy dealing with micro and small businesses in the context of the Microbusiness programme;
- The subcommittee on retail lending is responsible for managing credit risk and implementing credit policy in the retail segment;
- The subcommittee on bank cards is responsible for managing credit risk and implementing credit policy when offering bank cards products bearing credit risk.

The subcommittees, the CIC small membership and branches are authorized to make decisions on accepting

credit risk and limiting the maximum amount that a debtor can borrow. Subcommittee members include employees of business divisions (Credit, Retail and Bank Cards), depending on the issues under consideration, as well as employees of the Credit Risk Control, Legal and Economic Security Departments.

Alongside the system of decisions-making authorities, Bank Vozrozhdenie has a centralized system for setting and regulating interest rates and tariffs, as well as a system of credit risk limits. In addition to the limits, the Bank's credit policy sets planned qualitative and quantitative targets that determine the structure of the corporate loan portfolio by segment, sector and region as well as maturity and currency structure of the loan book.

## Credit risk



In 2012, a new edition of the Regulation on determining the independent credit limits of branches was approved. The following amendments were introduced:

- A unified methodology for delegation of lending authorities based on the level of credit risk. This methodology consists of two main components: the quality assessment of the branch's Credit Committee as a whole and evaluation of its work in different business segments.
- Procedures for adjusting lending authorities in case of the branch's loan portfolio quality deterioration and with the aim of improving the branch's performance and maintaining the Bank's competitive position in the region.

The branches' lending authorities are determined in accordance with the criteria stipulated by the Bank in respect of the level of credit risk and profitability of operations.

Bank Vozrozhdenie has developed and implemented policies and procedures to avert and minimize losses arising from credit risk. These measures include:

- Regular assessment of the financial standing of borrowers and the economic efficiency of their operations and projects financed;

- Assessment of the sufficiency and liquidity of collateral, adequate evaluation of collateral and its insurance by appraisal and insurance companies certified by the Bank;
- Ongoing monitoring of the borrower's fulfillment of obligations to the Bank and actual existence of collateral;
- Assessment of credit quality and the level of risk on loans issued;
- Procedure for creating provisions for possible losses on loans and other operations;
- Procedure for transferring non-performing loans to the Department for Legal Enforcement and follow-up work with them;
- Procedure for stipulating and controlling the lending authorities of branches and management bodies within the Bank depending on the loan size.

Bank Vozrozhdenie credit policy remained unchanged on all material issues in 2012. In the corporate segment, preference was given to small and medium-sized businesses. The criteria involved in the process of making a credit decision were:

- The importance, profitability and creditworthiness of the client for the Bank;
- The client's industry;
- The Bank's regional policy;
- The amount, type, form and purpose of the loan requested.

Throughout 2012, branches and internal divisions of the Head Office continuously monitored borrowers' activity, particularly their financial standing and turnover on current accounts.

In case of consumer lending, the Bank analyzes a borrower's financial standing, sources of income and credit history. Preference is given to the following types of clients:

- Employees and managers of large corporate clients of the Bank;
- Cardholders and depositors of the Bank;
- People with documentary proved high income, a high social status and a decent reputation

- Clients who regularly use Bank services to make payments;
- Clients with a positive credit record with the Bank.

Products bearing credit risk were provided to borrowers with sufficient and liquid collateral, taking into account the Bank's system of discounts. Branches conducted regular reviews for adequacy and liquidity.

RiskCalc software by Moody's Analytics was used to evaluate the creditworthiness of corporate borrowers and forecast probabilities of default. The product is designed to facilitate rapid assessment of the financial standing of borrowers, accelerate and improve the quality of the credit process by:

- allowing branches to respond promptly to customer applications within the low risk area;
- excluding insolvent clients within the critical risk area;
- focusing credit specialists attention on borrowers in the high-risk area.

In 2012, the Bank launched the Deductor support module, which automated the process of reviewing loan applications from individuals. The implementation of Deductor also enabled:

- reducing labor costs for processing loan applications: more than 50% of applications are processed automatically without losing decision-making quality;
- more rapid decision-making: decisions on "clear-history" clients taken in real-time mode;
- approaches to risk assessment and decision-making on consumer and mortgage loans formalized throughout the Bank within one information system of the Bank;
- flexible credit policy management: all decision-making rules are adjusted centrally.

Last year, authorities on issuing retail loans were transferred to the collegial bodies of the Bank's Head Office to centralize the decision-making process. These changes, in particular, improved the quality of the retail loan portfolio.

To reduce risks on mortgage lending in the primary market, the Bank has improved its risk assessment system for real estate developers. The following procedures were clearly defined to optimize risk assessment:

- procedure for work and interaction of the Bank's internal divisions when establishing and changing limits for the real estate developers and for construction projects;
- list of documents required from the construction company and the construction project to set the limit;
- procedures for assessing the level of risk for the construction company in order to establish the limit;

- control mechanism for current limits.

In 2012, the Bank maintained a conservative approach to credit risk assessment and applied a balanced policy when charging provisions for possible losses on loans and similar indebtedness. The volume of provisions for loan losses exceeded the amount in arrears.

Control over creating provisions on products bearing credit risk is carried out at the branch level and by the relevant internal divisions of the Head Office — the Credit, Retail, and Bank Card departments. The Department for Credit Risk Control provides overall supervision, while the Internal Control and Audit Service is responsible for subsequent control.

In 2012, the Bank took measures to expand its loan portfolio while ensuring an adequate balance between maintaining and improving of its quality, profitability and credit risks.

The introduction of international practices in the assessment and management of banking risks, developed by the Basel Committee for Banking Supervision (Basel II and Basel III) is necessary for the successful development of the Bank and is a top priority for its risk management. The Bank plans to achieve the following objectives to further improve credit risk management:

- build a system of internal credit ratings of legal entities;
- develop stress testing methods according to scenarios that imply the worsening of borrowers' internal ratings;
- create an automated system of early warning indicators, enabling prompt responses to the occurrence of risks in corporate borrowers' transactions;
- calculate the Bank's economic capital using an "advanced" approach (Basel II);
- continue automation of the corporate lending process (develop the middle and front office systems, automate the system for assigning ratings for corporate borrowers, automate the calculation of portfolio credit risk ratios).