BANK
SAINT PETERSBURG

Bank Saint Petersburg

Investor Day 2018

Moscow, April 19, 2018

Konstantin Noskov, Vice President, Head of Strategy:

— Good afternoon, dear colleagues! We are happy to see you at Bank Saint Petersburg Investor Day. This celebration has become our good tradition, and we are aimed to continue it in the future. Now, as you know, the markets are volatile, but we assure that the Bank overcame all the previous crises of 2008–2009 and 2014–2015 and never stopped its development. As the representatives of the Bank's management, we realize that our key objective is to provide the efficient performance of the Bank, as it will lead to the long-awaited increase in the price of shares.

Now we are really in a good shape, demonstrating sustainable, good results. For us, it is very important that the reliability of the Bank and its financial stability are unquestionable among the market players. Yes, there is a question: when will our shares grow? Today's event is a step to achievement of this goal. We realize that we have to demonstrate good return on equity and to decrease the cost of risk, but the most important thing for us is that you believe we can achieve this goal, and that is why today, on the Investor Day, we will answer your most frequent questions.

To make you believe in our potential, we will demonstrate, why we are so sure that the cost of risk will be lower than 2%. This is not a dream, but a close future of the Bank. We will speak about stability of trading and will explain why it comprises a major share in our balance compared to our competitors. We will demonstrate you how to create a revenue model of the Bank using the core banking margin – an indicator that we presented a few years ago, which serves to evaluate the results of our core activity being very important for us as trading accounts for a major part, and not so relevant for our competitors. Today we will answer all these questions.

I would like to introduce my colleagues that will make reports today, from left to right: Alexey Teploukhov, Director of the Financial Market Operations Department. You have already got acquainted with him as he made speeches at similar Investor Days. Konstantin Balandin, the Deputy Chairman of the Management Board, head of the financial unit. You have known him for more than 10 years. In addition to that, for the first time, we have invited Kristina Mironova, the Deputy Chairperson of the Management Board, head of the banking risks unit, who will be the one speaking about the most relevant topics, including the cost of risk, which is to bring us to high profitability.

Now I give the floor to Konstantin Balandin with his report on 2017 Financial Performance and our development prospects.

Konstantin Balandin, the Deputy Chairman of the Management Board, CFO, presentation 2017 Financial Performance:

– Good afternoon! It's my pleasure to welcome you all here. Today we will answer many questions indeed. Many interesting things happened over a year both in the country and in the banking system, in our Bank's life, so we certainly have plenty to talk about. I traditionally open this event and will provide you with information, which you mainly have already seen as we have disclosed it earlier, but still.

We are very satisfied with our performance in 2017. In 2017, we increased profit by 75% against the previous year and demonstrated RUB 7.5 billion of the net income, which is a record for the Bank corresponding to the return on equity of 11.4%. It is more than we have expected as the annual forecast was approximately 10% and this result brings us closer to our strategic target of 15%. That is why 2017 is a year, which we estimate to be very positive for us, especially against the background of the events in the country and other banks. The key factor of such profitability is a considerable reduction of the cost of risk to 269 b.p. against the previous years.

The retail banking remains the main growth point: we have increased our retail loan portfolio by 31% and continue growing and observing the business, which is very attractive for us, already from a rather significant basis and not from a low one.

As of January 1, 2018, the Bank's assets amounted to RUB 607 bn with the growth of around 5% per year. The capital increased to RUB 89 bn both at the expense of good financial performance and share issue conducted in the previous year.

In 2017, we earned RUB 20.5 bn of the net interest income, which was approximately RUB 1.5 bn less than in the previous year. Net trading income, in its turn, increased by more than RUB 2 bn. As you know, trading accounts for a part of interest expenses, I will provide more details a bit later, but in general, we are very satisfied with both our trading and bank books from the point of yield.

An additional important factor is that we have earned additional RUB 500 mln of the net fee and commission income – it increased to RUB 5.2 bn with the growth of more than 10%.

The Bank's annual revenue amounted to RUB 33.2 bn with the growth of 7%. It is not that much, but against the background of stagnating economy 7% is a very good result, and we are very satisfied with it. Our operating expenses grew at almost the same rate and reached RUB 13.5 bn.

The most important in 2017 financial performance is considerable reduction of provision charges to RUB 9.6 bn – approximately RUB 3 bn less than in 2016.

If we switch to key financial indicators, the total net interest margin amounted to 3.5%, the cost-to-income ratio remained at the level of 41%, and we continue maintaining it at the level being of strategic importance for us.

In general, once again, we earned RUB 7.5 bn of the net income corresponding to 11.4% of the return on equity. Yes, the total net interest income decreased, but for us the most important is that the net interest income in our bank book remained strong. As you know, a couple of years ago we introduced a new indicator of the net interest core banking margin in order that you understand better what happens in core banking and what is related to trading instead of core banking. Throughout 2017 the core banking margin remained at the record level of around 6%, while the trading margin demonstrated serious fluctuations over a year. The main idea of this indicator is to differentiate volatile trading and non-volatile core banking. After a while, I will answer one question being of interest to many of you, namely how to use this indicator.

Throughout the year we observed a reduction of interest rates both for assets and liabilities, but it should be noted that liability interest rates, in general, demonstrated quicker reduction than asset ones. Liabilities have a shorter duration and are revaluated quicker, for which reason we could win and maintain the net interest income and margin at a very good level during 2017.

If we consider core banking and trading separately, the core banking revenue increased by some RUB 800 mln and slightly exceeded RUB 27 bn against the background of more or less stable interest income: the core banking interest income increased by 1.3%. Looking at the shocks taking place against the background it is a positive result and it was mainly achieved due to the fact that we managed to maintain the high margin level of that very 6%.

In general, over a year we demonstrated stable trading performance with the total trading income of RUB 4.9 bn in 2017 against RUB 4.7 bn in 2016. In 2015, the income was higher, however, we try to make maximum use of the opportunities generated by the financial market during the last 3 years.

The main and most interesting fact of our business is retail lending growth. In 2017, we increased our retail loan portfolio by 31%. Mortgage increased by 27%, and we demonstrated outperforming rates close to 50% in consumer loans, while car lending increased by 23%. This is the main growth point, and we see many good borrowers and strong demand. The number of borrowers, who can afford mortgage and loans is certainly growing against the reduction of rates, and we are pleased to add such borrowers to our portfolio. We expect growth in 2018 as well and consider retail banking as our main growth point for the upcoming years.

It is important to note that the quality of our portfolio remains the same and even improves due to such growth. As you can see, the credit quality of all retail products improved in 2017.

If we look at the loan portfolio in general, in 2017 it increased by RUB 3 bn, from RUB 354 bn to RUB 357 bn – growth of approximately 1%. Some 3% of the portfolio has already been written-off, thus the loan portfolio growth in 2017 amounted to approximately 4% without write-offs. For sure, total growth was mainly caused by retail lending, while in corporate banking we did not observe any increase last year and do not see it still. It is important to note that retail loans exceeded 20% of the loan portfolio for the first time, while loans to individuals accounted for 21% in 2017.

Reduction of the cost of risk being of major importance for the last year decreased in 2017 to 269 b.p. It amounted to 340 b.p. for the previous two years due to the complicated situation both in economy and among the Bank's customers. However, as we can witness its constant recovery and positive trend this year, in our opinion, peak values of the cost of risk, which we observed, are left behind.

Now it is my turn to answer a number of relevant questions related to the Bank's performance and our financials.

First of all, let me show you the only slide, which we did not translate into Russian, as you are anyhow used to English indicators in models. The first question that we would like to answer is how to use the Core Banking Margin Indicator. We use it in our management reporting and would like to share information with you on how to multiply it and what to add in order to build the Bank's financial model.

You can see the known three elements in the first part of the formula. The first summand is the most important one – it is that very net interest core banking margin. In order to build the model, the core banking margin, which we provide to you as guidance or which you can actually see in our reporting, shall be multiplied by the maximum value of two indicators, namely interest income earning assets and interest expense bearing liabilities.

Asset/liability calculation is provided at the bottom of the slide. We do not include assets formed on the financial market: trading securities portfolio, interbank lending, etc. in asset calculation, but only loans and correspondent accounts. Liabilities also include only banking liabilities without liabilities formed on the financial market.

Multiplying the core banking assets by the core banking margin offered to you as a predictable metric, through which we can communicate our expectations to you, you can obtain the net interest income of core banking. After that, the aggregated trading result shall be added, which is certainly volatile and which accounted for 20% of revenues in good years and sometimes for 0% of revenues, however, our strategic benchmark of some 10% of revenues remains in force. Thus, using guidance for core banking margin and the trading result expected by you from our side, you can build a model and make a forecast of the Bank's performance.

If you have questions on how to use this approach or you are concerned about indicators to be used, our IR Department will be happy to answer your questions and provide a model guidance for you. Please feel free to contact us.

The second question I would like to answer as this is the question, which I have often heard, is as follows: how should we treat acquisition of Pulkovo Cargo Terminal? To put it shortly, Pulkovo Cargo Terminal is the only cargo terminal in St. Petersburg. It is an infrastructural facility processing all cargo traffic of the airport. You can find detailed information about it on its website following the link provided here. For example, the similar infrastructural business is available in seaports: with a stable infrastructural revenue flow from cargo handling and traditionally high EBITDA profitability, it is a very clear infrastructural business. The terminal generates around USD 10 mln of revenue per annum with the average EBITDA margin of 30-40%.

We acquired 51% of this asset as we considered the price to be cheap. This is basically the reason of this acquisition. If you ask whether search of such assets and portfolio growth is our strategy, we will say that it is not. It is a single transaction, we gave it a try and it turned out to be non-productive for the Bank's assets as it accounted for less than 0.1% of assets. We understand how we can withdraw from this asset and which dividend flow the company will generate for us. This is a minimum deal for the Bank from the financial point of view, it is not strategic or income-generating, but meanwhile, we are very satisfied with it.

The last interesting question, which I would like to answer is the introduction of IFRS 9 to be used in our financials starting from 1Q 2018. In our annual financials and presentation for disclosure, you have already seen the expected effects, how the application of IFRS 9 will transform our financials. First of all, using a different approach to the provisioning the Bank will generate approximately RUB 2.4 bn of additional reserves directly through the capital and not through PnL. Secondly, we will revaluate the fair value of balance assets, mainly the loan portfolio value by approximately RUB 800 mln. Thirdly, approximately RUB 600 mln will return to the capital with an advantage of a deferred tax asset. You can see the total effect on the capital here. The only thing, which will witness more or less serious changes in the financials is the ratio of provisions to the loan portfolio to be increased by approximately 70 b.p. per date, up to 11.7% of the loan portfolio. All this information will be disclosed in the financials for 1Q 2018 with no other material effects expected.

What can be expected from us in the near future, in 2018? Today's program will include a presentation on strategy regarding the long-term perspectives to be made for you in the end by Konstantin. As for me, I would like to speak about closer events. The Annual General Shareholders Meeting of the Bank will take place on May 24th, and the register for the right to vote at this meeting will be closed on April 29th.

The Shareholders Meeting will make a resolution on the distribution of dividends. The Supervisory Board recommended to allocate for dividends 20% of the net income under the Russian Accounting Standards for 2017 in compliance with the Bank's Dividend Policy, so the total amount of dividends will be approximately RUB 811 mln. Dividends to be paid per ordinary share will amount to RUB 1.62, which corresponds to approximately 3% of the dividend yield. Last year this indicator amounted to 2%, in other words, last year we paid approximately 1.5 times less dividends. Taking into account that the financial performance under the Russian Accounting Standards is also considerably higher than in 2016, the dividend yield will also grow. The dividend record date is June 4th. We expect the Shareholders Meeting to make these resolutions.

In addition to that, Pavel Kiryukhantsev, partner of the Ward Howell Company being one of the leaders of the Russian management consulting sector, was offered as a new independent candidate to members of the Bank's Supervisory Board. He has more than 10 years of top management experience in various Russian corporations and vast experience in implementation of programs and corporate governance practices. We expect that his expertise will allow the Bank gaining additional values and developing for the better, including in the strategic part.

What will happen to the Bank from the business point of view? Which key trends can we observe? Which key activities do we plan for this year? First of all, we expect considerable upgrade of the retail banking product range, primarily in card products. We will actually launch the new range of retail card products in line with the best market practice. We have been standing aside from many products currently available on the market for a long time, however, now we are overtaking and will catch up the whole product range offered by most market players.

One of the key corporate banking areas for us is the implementation of the *Easy Entry Project*, where we want to become the market leader by speed and comfortability of opening the accounts for small and medium enterprises. At the moment, this project is under active development. The customer is expected to open an account within 3-4 days with only one Bank visit. For banks working offline and not online it is such a leadership indicator and we believe that it will allow us developing actively in corporate banking, first of all, in serving small and medium enterprises.

We have already launched a very attractive service, including online guarantees for corporate customers. The decision to grant a guarantee is taken within 1 hour. The project was launched several weeks ago, and we expect it to reach a very good capacity within several months with the target of approximately 500 guarantees per month. This way we plan to boost the Bank's fee and commission income very actively. This year, we will update our online bank for retail and corporate customers. These are the main activities and interesting events in the framework of our business development planned for 2018.

In addition to that, this year, we started our branch network optimization. As you know, we have been expanding our network for many years and opened outlets under the new format. We are satisfied with the result and start to turn the wheel back. This year, we plan to close the total of 4-5 outlets. We are satisfied with our locations in St. Petersburg, with the outlets, which we have opened, but we certainly have space for optimization. The thing is that the banking sector is switching from offline to online more, and more and this is one of the trends forming the basis of our strategy, which we will start implementing in 2018.

If we look at balance indicators, we do not expect any breakthrough this year, the loan portfolio is planned to be increased by some 5%. Growth will be mainly caused by increase in retail banking, where we expect outperformance of 20%. We do not see any significant changes in the structure of operating expenses and expect them to grow up to 5% with the target cost-income ratio of 40%.

We definitely expect the reduction of the cost of risk. With 269 b.p. demonstrated last year the target for this year is 220 even if margin indicators remain unchanged. This is a guidance for net interest margin, however, as I have mentioned many times, the core banking margin indicator is more relevant for us as it is more stable, and we plan to maintain it. With the margin indicator maintained at the same level, we target return on equity growth up to 12-14%.

The year of 2018 will continue the trend for return on equity recovery and its approximation to the strategic level of 15%. We believe this target to be very close for us and offer you to look at our long-term performance from the perspective of this target. The Bank appears to have achieved this target on a permanent basis in non-crisis years. We had 2009, which was a very hard year for our country, we faced a man-made crisis in 2012, which we did not expect, we faced a crisis in 2014 and a very severe response for our Russian banking system, for our colleagues and competitors. And then there were tectonic events in the banking system of 2014-2016, which we overcame with dignity and demonstrated a very high sustainability, let me emphasize it, much better sustainability than in 2009 or 2012, very high shock sustainability. We believe that we have a lot to be proud of if we look at this performance.

Unfortunately, such results are not always converted into the share price and the market and maybe even you, who are present here today, cannot always give a correct appraisal. As you can see, although we generate value for our shareholders every year, improve the book value per share, the market has started to discount us approximately since 2012. We understand why the market discounted us in 2012, it is clear that 2013 was a hard year for the Russian stock market and then there were very few reasons to give us a high and fancy appraisal. Nevertheless, today we understand that the discounts applied to us by the market are overestimated and, honestly speaking, not really reasonable.

When analyzing the Russian banking sector, especially public banking players, you basically do not have anybody to compare us with. Let us face it, there are no proper public banks in Russia. There is Sberbank, which is in a unique niche and occupies a monopoly position on the market, it has state support, etc. There is Tinkoff, which we treat with a great respect, and it develops absolutely different business model. There are no banks involved in universal banking service, no public private banks available on the market, for which reason it is also difficult for you to estimate us by comparison with our competitive colleagues.
We suggest having a look at us in the framework of operation of a proper private bank in Russia and give an appraisal of everything we have reached for the past 5-6 years, to compare us with the banking sector in general. It would be incorrect to compare us with Sberbank and Tinkoff, as we try to set ourselves as a proper private universal bank within this framework. Just think if there are many of those, who stayed with us all the while that we are present on the market. In the course of our IPO we were compared to... I cannot even remember its name... was it SibAkadembank?

– Yes, it was.

– No, it was URSA.

Konstantin Balandin:
– Before it became URSA, it was named SibAkadem and then it became URSA Bank. Think it over, nobody can even remember the name!

– You were compared to Absolut.

– With Soyuz.

Konstantin Balandin:
– We were compared to URSA, Absolut, Soyuz and then with Vozrozhdenie. Then suddenly Otkritie, Nomos started to grow in 2011-2012... Who else can I name?

– Some are gone...

Konstantin Balandin:

– Well, who is actually left? If we think it over, there are two proper private universal banks in Russia: we and Alfa. There are still those, who survived, but if we look at who we are and which market position we currently occupy and deserve, just have a look at our picture above, make a step back and think, what we have achieved for 10 years, how we have transformed for the past 5-6 years and then you will understand that we are not Sberbank. There is only one such company in each sector. The unique state monopoly with a unique access to free resources, state subsidies, etc. We are not Tinkoff, a niche, good and very respected player. We are a private universal bank and today we do the best that a private Russian universal bank can do.

We are predictable. If you compare the guidances provided by us every year and look at the deviations in obtained results, what we promise and what we achieve, you will see that we provide a high-quality and reliable guidance. I admit that one year we may underestimate the cost of risk by 40 b.p. and another year overestimate it by 30 b.p. In 2016, our return on equity forecast was 10%, and we ended up with actual 9%, this year we promised 10% and received 11%.

We give you a clear and predictable result, we keep our word. We do not tell you some quick, uncontrolled, unclear, magic stories, which can look attractive as a model, when banks take over dozens of other banks and then end up with... How is it called? Consolidation Fund?

– Banking Sector Consolidation Fund.

Konstantin Balandin:

– You know better. We tell a very simple, clear story of a proper private universal bank. We are financially stable. You can imagine, which shocks have been faced in Russia for all these years, and we have never demonstrated losses, all these years we have generated profit. Even in 2009, we demonstrated 3% of return on equity. We remained financially stable during the last crisis as well. Our great respect to Sberbank with its unlimited access to cheap state resources, but if we look at the opportunities of a private bank, in our opinion, our performance deserves great respect today.

All our ratings assigned by rating agencies remain unchanged and were confirmed even in 2014, despite all shocks. As you know, last month we were inspected by the Central Bank of Russia, and nothing interesting was found in the course of this inspection. We comply with all requirements of the Bank of Russia.

In 1Q, we earned the RAS net profit of RUB 1.1 bn, which corresponded to the quarterly profit average in 2017, while last year the RAS net profit amounted to RUB 4.1 bn. We have strong balance without surprises.

We are transparent. We provide you, and not only you but the whole market with the communication level and information level about us, which many of our competitive banks, let alone public players, do not provide. Certainly, we cannot arrange presentation in London as Sberbank does, as our budget is different, but we are a private bank with different market position and we try to share with you maximum information about ourselves. We are transparent, we developed a high-quality corporate governance, we have an efficient Supervisory Board comprised of very dignified representatives, including both investment communities and Mr. Zvezdochkin, General Director of Aton Company, whom you know very well, as well as Mr. Germanovich acting as an independent director, who is one of the best independent directors in a number of Russian companies. Such a high-quality Supervisory Board certainly requires from us, from management, from majority shareholders responsible decisions and high-quality technologies. Frankly speaking, it is our IPO held 10 years ago that resulted in development of different requirements to corporate governance, to ourselves and our decision-making process. That is why today we are one of two surviving universal banks in Russia, if you ask me.

Healthy conservatism forms the basis of all that. Our funds are fully comprised by customers deposits, we have a moderate risk appetite and today we will tell you everything you want to know about risk management in Bank Saint Petersburg. No matter how much concerned you may be with our trading investments, our financial performance is low volatile. Who else can demonstrate such financial stability for the last 5 years, against the faced shocks? Our business model is the best evidence of sustainability of the Bank today. And of course, it is very important for us that the current geopolitical situation provides minimum impact on us.

The most important thing is that we are very cheap. This is the situation we are not satisfied with and we will struggle against it. We strongly disagree with such position and believe that our Bank is underestimated. Of course, we cannot generate return on equity of 25% or 60% as Sberbank or Tinkoff, but we are able to earn our solid 15% of return on equity and this is what a Russian private universal bank shall do.

Konstantin Noskov:

– Dear colleagues, please feel free to ask your questions.

Participant 1:

– As you have told us, you earn good money and will earn even more in future. Could you please inform about you plans of sharing the earnings with shareholders? 20% of the Russian Accounting Standards profit seem unclear if the IFRS profit is higher. I guess, many investors do not understand such approach.

Konstantin Balandin:

– Thank you for your question. At the moment we apply the same Dividend Policy in the Bank. To be honest, the Supervisory Board regularly discusses it, including consideration of investor recommendations, and independent directors promote the idea, in my opinion, more and more successfully, of adjustment of the Dividend Policy towards profit distribution under IFRS. Nevertheless, at the moment we continue applying the same Dividend Policy and we try to observe it consistently. We have been doing it for 4 years in a row. I understand that profit under Russian Accounting Standards is less predictable for you, as we provide more models and explanations for the IFRS profit. However, currently we are at the moment when IFRS profit is higher, but it can happen that it will be lower, as the reporting standards are different. I understand your concerns, but now we have what we have. We will think about it.

Participant 2:

– Market cap tripling and P/BV doubling are indicated among targets for 2020. Apart from possible changes in the Dividend Policy and ROE growth, what other actions do you plan to take to move towards the increase in market cap?

And my second question is more technical. With the retail loans growth of more than 30% you are one of the most dynamic banks in the country. Do you take part in discussions with the Central Bank of Russia with regards to planned introduction of DTI, PTI or this discussion is held only by Top 5-10 of banks? Thank you.

Kristina Mironova:

– Yes, you are absolutely right, such discussion is held by top banks. Unfortunately, we have not been invited to this discussion in St. Petersburg.

Konstantin Balandin:

– Answering your first question, we will struggle with you and the market, and we have means for the struggle. We certainly have the Dividend Policy as well. We are discussing buyback due to current share prices. This is the best scenario to send you and the market a signal that we believe our shares to be underestimated and that we disagree with such estimation. As for the rest, we will improve return on equity, we will keep interacting with the market and investors actively and we will search for new investors. As part of Investor Relations, we constantly find people, who are interested in buying underestimated shares. Everybody knows that our shares are underestimated, but not everybody is ready to invest in them, however, there is still plenty of those, who are ready. Our target is to find them, and I promise you that we will.

Participant 2:

– Thank you. What about liquidity?

Konstantin Balandin:

– Liquidity is self-reproducing. Today free-float accounts for some 38% of shares and to 51% of the controlling shareholder. No sale of additional shares to the market will improve liquidity, we have already checked it by own experience. In my opinion, the liquidity function is a share price function to a greater extent. The higher the share price is, the higher the turnover is in monetary terms, the higher the liquidity is in monetary terms, the more appealing the shares are for the next investors. This way to improve liquidity is much more efficient than issue of new shares. In the end, if we offer or sell new shares on the market, they are acquired by a very limited and concentrated circle of investors with each of them probably holding a small stock, maybe USD 5 mln or USD 10 mln, but these USD 5 mln or USD 10 mln account for some 1% of the Bank's shares, and this is liquidity.

Participant 2:

– Thank you. With your permission, let me make a small comment regarding your answer. Over the past decade there were URSA minority shareholders, Nomos minority shareholders, Vozrozhdenie minority shareholders, and for an investor on the other continent, the story of these minority shareholders represents such a big picture of where a minority shareholder of another private bank of Russia may finally find himself. How do you address such questions from the investor side?

Konstantin Balandin:

– This is only education, only this slide, which tells about our differences from other banks. All these stories, which you have mentioned, somehow did not correspond to it, you know? And this is also your task to inform investors, where you meet them, that there are different banks present on the market.

I understand investors very well. Let me tell you, these are very different investors. Most investors, who keep a track on the market, understand the difference between Bank Saint Petersburg and, for example, Otkritie or B&N Bank. Most investors understand, so this is an educational issue, it is about the way how we provide information.

Participant 3:

– Thank you for your presentation. I have a question regarding the core banking margin of 6%. Do I understand it right that this is a delta between attracted liabilities and granted loans? For example, if you attract liabilities at 7-8% and grant loans at 13-14%, is this the delta?

Konstantin Balandin:

– No, these are different indicators. Delta, which you are talking about, is called "net interest spread". Margin is calculated not from interest rates fixed under the asset and liability contracts, but from net interest income and net interest expense. That is why you cannot obtain its net value from the spread, as there are many factors providing an impact on it. If we look at average rates dynamics, the average interest rate on loans is 9.6%, the average rate on interest expense bearing liabilities is 4.5%. Spread is at the level of 5%, but there are also the balance structure and current accounts, for which reason it is impossible to switch directly from spread to core banking margin. They certainly correlate with each other.

Participant 3:

– Do you expect the core banking margin to decrease in future?

Konstantin Balandin:

- Certainly, under pressure. It is important for us to show you that our core banking margin is more stable than our total net interest margin. As you can see from the chart, for a certain period of time it demonstrated very high stability of 4.5%, followed by 5% for many quarters, and now its stability amounts to 6%. It is much more predictable. It depends on the balance structure and the current market trends, so we do not expect any significant shocks. It will be under pressure, same as the margin of any bank nowadays, however in general we plan to maintain it at the level of 5.5-6% this year.

Participant 4:

– As for the Strategy 2020, the average growth is planned within 5%, at the inflation level, so actually it means absence of growth. At the same time, you expect profit growth, which means increase in the Bank's and Russian Accounting Standards total capital adequacy ratio (N1.0). Do you consider an option of a profound review of your Dividend Policy, same as in some other industries, when the company does not grow, generates a certain stable income and pays the whole cash flow, which is not distributed for other purposes?

Konstantin Balandin:

– I completely agree with you. We need to earn more money and return it to shareholders through dividends, buyback or other methods. We should not keep our money, we should earn it for shareholders, but for this purpose we need to implement our strategy first. At the moment you can see a positive trend, the Bank's profitability increases, and we will work on it.

Participant 4:

– In general, I would like to join the previous question. It is not important whether 20% are under RAS or IFRS, however if the Bank considers such profitability to be stable, when it is RUB 8-10 bn per year, why not to raise the bar drastically? If you do not see any points of growth for yourself.

Konstantin Balandin:

– I agree with you absolutely. The question is which instrument of return on equity to shareholder is more efficient. Sometimes it is buyback and sometimes – dividends. Both of them increase the value for the shareholder, that is why we do not need any extra free capital and why should we? There are regulator's requirements, there are benchmarks for rating agencies, so if we have any free capital, we will be happy to return it.

Konstantin Noskov:

– Another important point. Let me add. Capital adequacy is important. We have run ahead – on the very last page of the strategic presentation there is a financial model 2020, where Tier I capital adequacy is 10.8% and this is not an excessive level, as the loan portfolio grows at the rate of 20% in 3 years.

In addition to that, the Bank of Russia has tightened regulation and introduced a special buffer. With the minimum RAS core capital adequacy ratio (N1.2) level of 6%, it will approach 8% by the end of 2018, and if you become systematically important, the requirement grows by another 1%. We are not systematically important yet, however, given our development rates, we have a potential of being included in the list of systematically important banks, so we need to have a reserve.

Konstantin Balandin:

– If you fail to comply with the buffer requirement, you cannot pay dividends.

Konstantin Noskov:

– Yes. And we do not need extra capital indeed.

Participant 4:
– Why do you consider both dividends and buyback? Buyback is not very clear from the point of share liquidity.

Konstantin Balandin:
– If our share price were not RUB 50, I would probably not discuss buyback with you. What else can we do to send a signal to the market that they should cost 2 times more? Today this is the most efficient investment of money for the Bank and for the shareholder, as we can buy for 35 kopecks the thing, which costs RUB 1.

Participant 4:
– Partially yes. OK, thank you.

Participant 1:
– For controlling shareholder, maybe yes. But for shareholders at the stock exchange – no.

Konstantin Balandin:
– For the bank in general.

Participant 1:
– As long as we do not have a proper Dividend Policy, buyback of shares will not have any effect, as it is only a temporary solution.

Konstantin Noskov:
– Any more questions?

Participant 5:
– What is your opinion about digital banking, for example, the express payment system, a kind of marketplace for the banking products? What is the opinion of Bank Saint Petersburg in the framework of the Strategy 2020, as part of digital development?

Konstantin Balandin:

– Thank you very much. Konstantin will inform you a bit later in the framework of the Strategy, I will not go into details with your permission. We did not include this slide into my presentation this time, however, we have been there for a long time already, we have been in digital banking, we have advanced online banking both for legal entities and individuals. A vast majority of transactions are made by customers in electronic environment nowadays. For us, this is one of the key development focuses, one of the key focuses of our investment program.

I have mentioned briefly that we reduce our offline network. We do it in order to redistribute investment and current resources to support the online banking model. We will never turn into a completely online player as Tinkoff, however, it is our focus in the past, present and future. We will never become a leader in this sector as we cannot compete with Sberbank by resources, however, our target is to become a good second-level player. At the moment our online banking complies with all industrial standards and occupies stable leading positions in the ratings of usability and functionality. This area remains one of the focuses in our Strategy.

Participant 5:

– What will be the outlet closure rate? You have told about approximately 5 outlets in 2018. What is your plan for the upcoming years?

Konstantin Noskov:

– We determined in our Strategy that we plan to close 20% of outlets in St. Petersburg. It means approximately 13-15 outlets in the next 3 years, so 5 outlets per year exactly correspond to this rate.

Konstantin Balandin:

– Let me tell you, we have taken a very careful approach to this topic as the physical outlets today are a very efficient sales channel for the services, which you will never sell online. There is a number of services, which simply cannot exist online. A person on the street will not come to exchange currency online – they will come to the Bank instead. This is the most illustrative example, however, there is plenty of such services. Any cash transactions can be made in ATM or payment kiosks; however, you will be provided with a very limited service. The physical office network today provides for generation of the high and sound flow of operations and income.

Participant 3:

– Could you please tell about current competitive advantages of Bank Saint Petersburg? Sberbank and VTB can obviously compete by rates, brand, products. What are your strong sides, in your opinion?

Konstantin Balandin:

– We compete by rates, brand, products – by all criteria. We are a very strong brand in St. Petersburg, a decent high-quality product range with the high service level. Today our service level is higher than that of our competitors, irrespective of the channel you choose, and our customers are ready to pay more for high service quality. I assure you, our mortgage is more expensive than in Sberbank or VTB. Sometimes the difference makes up to 100 b.p.

Participant 3:

— If so, why do people choose you?

Konstantin Balandin:

— For quality, for the brand; we make decisions quicker and we are more flexible. Why is Apple more expensive than Samsung? It is the same product, but there are those who go for Apple.

Participant 6:

– Could you please provide more details about such part of your balance as investments on the securities market? It is a considerable part of your balance. How do you see development of this business division of the Bank in future? How much income will it generate, how will it effect the profit?

Konstantin Balandin:

– Today we have planned a separate presentation and even invited a chief trader for you today.

Konstantin Noskov:

– Yes, colleagues, thank you for your questions. As there are many questions related to the next presentations, let us move forward.

Konstantin Balandin:

– Dear colleagues, it is my pleasure to introduce to you my close friend, my colleague at the Bank, a charming woman, an outstanding professional, Chief Risk Officer of Bank Saint Petersburg and, in my opinion, it is very symbolic and interesting that this is the first IR of Bank Saint Petersburg. It was her who built Investor Relations in the Bank 10 years ago and I am sure that today she will be more than happy to answer all your questions. Please welcome Kristina Mironova.

Kristina Mironova, the Deputy Chairman of the Management Board, CRO, presentation From Risks to Opportunities:

– Thank you very much, Konstantin, for such presentation.

Good afternoon, dear colleagues! Let me pass to my presentation. I would like to start with a classic presentation of risk management and tell you that today we comply with the best banking sector practices. Risk Management is traditionally divided into several levels.

Firstly, this is a professional Supervisory Board. We always occupy a very proactive position with regards to our Supervisory Board and submit new offers and ideas. We receive a great feedback from the Supervisory Board on procedures applied in the world practice (we have representatives of the American banking sector) and in the largest Russian banks (we have such representatives as well). The risk appetite is determined by the Supervisory Board and the Risk Management Committee based on the risk map developed by the Bank for the fourth year in a row, followed by distribution by limits, restrictions of the Bank's policy and management tools.

Credit risk, market risk, including interest risk, and liquidity risk are among the most significant risks. The operational risk is less significant from the point of its impact on PnL and the Bank's capital, as losses are very low here, nevertheless it is under permanent control and we need to constantly improve the processes from the benchmark perspective.

So, first of all, it is a credit risk. Let us have a look at development of the credit risk assessment approach in the Bank.

For ten years after IPO, the Bank's risk management system has undergone significant changes addressing new challenges.

The period from the early 2000s until 2008 was marked by absence of any considerable defaults in the market and the resulting lack of the required statistics for development of efficient risk management models, that is why there was no regular risk management in Russia in those years. The Bank created major part of its provisions on the growth of the loan portfolio, which doubled every year until 2008. High net interest margin excessively covered any risks, for this reason the provisions did not put pressure on the Bank's financial results.

The crisis of 2008-2009 demonstrated existing problems and the necessity of changes to be introduced into the risk management approach. Problem loans provisions started to contribute a major part of created provisions.

Starting from 2009, a significant work has been carried out for building a new risk management culture, including implementation of the corporate customers' ratings model. Within a few years, the best practice was implemented in the daily risk management procedure of Bank Saint Petersburg and started to be used for evaluation of each loan project.

After implementation of the advanced risk management practice based on the accumulated expertise and loss record, since 2013 a "new" quality of the loan portfolio has been established with an integrated risk assessment system.

Due to consistent building of the new risk management culture, starting from 2013 the Bank has obtained a "new" quality of the loan portfolio, which accounted for 80% of the loan portfolio as of January 1, 2018. "Old" problem loans granted before 2013 continued to contribute a major share to the total cost of risk for the last 5 years and kept providing a significant negative impact on the Bank's financial results.

Why do we believe in a rather conservative level of the cost of risk below 200 b.p.? We tried to make some rather deep analytics, as you can see.

In 2017, the problem loans granted before 2013 contributed 160 b.p. out of 269 b.p. to the cost of risk. The share of problem loans granted after 2013 in the cost of risk became much lower and did not exceed 0.8%. It means that the new practice, the new risk management culture is effective, and the "new" loan portfolio of Bank Saint Petersburg does not have those extensive problems which could be faced in the previous portfolio.

The Bank is well on the way to considerable reduction of the cost of risk and respective growth of ROAE, taking into account the fact that due to both repayment and writing off of problem loans granted before 2013, their share in the total loan portfolio is decreasing every year (accounted for less than 10% as of January 1, 2018), and the remaining problem loans were covered by provisions to a great extent.

The calculation method can be demonstrated on the basis of the example of vintage 2013. In 2013, the Bank granted RUB 95 bn and created 2.5% of provisions at the moment of issue, after that one-third of the vintage was repaid in average every year with RUB 22 bn remaining on results of 2017.

The most important metric for the vintage quality analysis is an average cost of risk for vintage 2013, which amounted to 1.0% for 5 years of its existence. It means that the new technologies, the new risk management culture are effective, and the new loan portfolio of Bank Saint Petersburg does not have those extensive problems, which could be faced in the previous portfolio.

In the year of vintage building, in accordance with IFRS, the Bank shall establish the industry average reserves for all loans, which are rather high 2.5%, high compared to the subsequent actual average annual cost of risk of 1.0%. In the course of repayment, the provisions, which we established when building a vintage, are dissolved resulting in the negative cost of risk for standard loans.

The similar method was applied to the next "new" vintages 2014, 2015 and 2016 with the average annual cost of risk for all of them amounting to less than 200 b.p. as well.

How does our loan portfolio look like now, on results of 2017? It amounts to RUB 358 bn with standard loans of the "new" vintages 2013-2017 accounting for 75%. The majority of non-performing loans, some 3/4, falls at "old" loans granted before 2013. In the total cost of risk of 2.7% the majority of 1.6% falls at non-performing loans granted before 2013.

Based on new approaches, new risk appetite and new rules, which we observe when estimating all loan projects in Bank Saint Petersburg, the current loan portfolio has a rather strict industrial diversification. At that, we have often heard questions from you about concentration in construction. As you can see, the considerable concentration in the construction and real estate sectors of 23% is our response on the gross regional product, which the construction and real estate sectors contribute to the economy of St. Petersburg and we need to have such share in our portfolio to be competitive.

Coming back to the main assessment metric, on the next slide the cost of risk for construction and real estate is presented for the next 10 years compared to the cost of risk of the total portfolio – 2.0% for construction and real estate against 2.9% for the total portfolio. Thus, the construction industry does not bear any additional or sudden defaults compared to the general default of the loan portfolio. Why does this happen? All these years we have been studying this sector in detail and used the default experience of the sector.

Below you can see the analysis by vintages and sectors. In each sector, we witness the growth of investments one day and reduction of investments another day, and although the cost of risk is rather volatile, it is still within the clear range for each economic sector and each vintage. We certainly build every next vintage with consideration of mistakes made in the previous vintages.

At the moment we pay special attention to retail lending, we have accumulated vast experience here as well, both in the building of own score model and adoption of the score models available on the market and their adaptation to our needs and our risk appetite. We certainly have our own anti-fraud system, which has been in operation for many years, we also use the additional fraud risk control instruments offered on the market. We have introduced the risk-oriented pricing, for which reason different interest rates will be offered to customers with different solvency level or different credit record for the same loan types.

We need to constantly monitor our loan portfolio. Any serious deviations in volume or quality of the portfolio become a signal for us for additional analysis, if required, even with suspension of granting loans for the product until the situation is clarified.

The major share in the retail portfolio falls at mortgage. This is a low-risk and low-default sector and even for those few non-performing loans, which can occur, we always have recovery at the minimum level of 90 %. You can see confirmation of the high quality of mortgage loans on the chart, while the recovery rate below 100% is caused by foreign currency loans granted in the past, however, they all have been absorbed already and nowadays the total portfolio is in RUB.

As for car lending, the cost of risk in some vintages was high and these were rather challenging vintages, when lending volumes and car sales in Russia were low and there were problems with solvency of customers. However, today the market is different and the recovery rate even for those non-performing loans of vintages 2015-2016 is 50-70% due to work carried out with non-performing loans. Such rate is also caused by restrictions on certain car brands and prices. In particular, we have completely refrained from luxury brands, which caused us rather significant losses in those vintages.

Consumer loans increased considerably in the past years, and the growth appetite remains the same. These are mainly loans and credit cards issued to payroll customers. We are confident in our score models and anti-fraud systems for the development of offers for our non-payroll customers. Last year we actively tested this base and determined restrictions to be introduced into the score model.

Financial market transactions. Today Alexey will provide more details about the volumes. As for me, I would like to speak about the way we control the market risks. Certainly, everything is divided into control levels of portfolio, risk factors, financial market instruments. We use classic capital risk assessment tools, Stop-Loss limits. We apply strict control to issuers, sometimes we even limit certain issues by each particular name or by total portfolio duration.

The next slide is related to Alexey's presentation and is intended to show that despite the significant volume of reverse REPO transactions, the Bank makes all transactions with reliable counterparties and performs an assessment of security issues, which we are ready to use for REPO. We did not face losses in this business over the last decade due to careful approach to risk assessment and development of the limit system.

We apply the same approach to our securities portfolio, which are on balance with 98% being bonds, top names with investment ratings from BB- and higher and no open positions in shares.

We perform constant analysis of counterparties in the inter-banking sector and try to reduce the volumes on time together with trading or refrain completely from dealing with the names, about which we have concerns. Due to such proactive approach, we did not face any losses in this trading area last year, despite the strict cleaning-up the banking sector.

As for operational risks, you can see in the middle of the slide, that our losses were very low. Many analysts and auditors were partially suspicious of these values, when we presented them, however, they always

agreed with us on results of the additional analysis. We apply rather strict and sometimes maybe even excessive control at each level and neutralize any internal and external fraud attempts. Major part of the risks is insured. Nevertheless, the benchmark requires the operational risk to be calculated not on the basis of potential income losses, with such approach being applied by many banks, including us, but with setting a requirement for restriction of the operational risk capital. In 2019, we plan to switch to the advanced approach to the operational risk assessment from the perspective of the capital limit.
To sum up, I would like to draw attention once again to the risk management of Bank Saint Petersburg today. It is close interaction with the market and the Bank's Supervisory Board, it is application of the best world practices and trends in risk management with their adaptation to our Russian specifics, it is an undertaking to ensure predictable performance of the Bank both for management and its shareholders and you, dear colleagues. Thank you very much. I am ready to answer your questions.

Konstantin Noskov:
– Please feel free to ask your questions.

Participant 7:
– Could you please explain, why the cost of risk for construction and real estate is not matching on slides 14-15. Maybe it is a separate construction segment, when an average indicator for 10 years was calculated.

Kristina Mironova:
– The average annual cost of risk on the first slide was calculated on an accrual basis, while on the second slide it was calculated separately by loan issue vintages of each year.

Participant 7:
– Understood. Can we make a conclusion from slide 15 that in fact the quality of assets in the construction segment reduces in the course of time? That is true, we do not have 2017 here.

Kristina Mironova:
– We do not experience reduction of the asset quality as we do not have defaults. We take part in project financing of construction companies, participate in residential construction, and have already commissioned real estate items, shopping centers, business centers with lease flow as a collateral for our real estate lending. We are impacted by IFRS requirements to a greater extent, which are industry average provisioning level.

Konstantin Balandin:

– Yes. Can I add a couple of words here? The calculation method demonstrated on the example of vintage 2013 shows indeed that we form many provisions at the entrance, in the loan issue and vintage building year.

Kristina Mironova:

– These are exactly 2.5% on results of 2013.

Konstantin Balandin:

– Later on, they are spread as we have to wait until the vintage lives its life period to reach the proper vintage assessment indicator. When you look at vintage 2015 or 2016, who are only one or two years old, the cost of risk will be overestimated in accordance with this method, the initial provisions accumulated at the entrance are included into the calculation method, but the vintage has not served its term yet. With the maturity of the vintage, the cost of risk will reach its actual level. This is why the cost of risk is absolutely irrelevant in the year of issue.

Participant 7:

– In other words, slide 15 shows the annual cost of risk, am I right?

Konstantin Balandin:

– Slide 15 shows an average annual cost of risk for the vintage 2013, vintage 2014, vintages 2015-2016 during the life of the vintagen in one or another sector.

Kristina Mironova:

– Vintage 2013 has repaid almost completely, same as vintage 2014, that is why it has a low cost of risk. While in 2015-2016 the pressure of the industry average rate of provisions under IFRS was mathematically higher than real default or non-default rate of vintages.

Participant 8:

– Did I understand you right that you planned to switch to an advanced approach in 2019? Have you discussed it with the Central Bank yet?

Kristina Mironova:

– We did not discuss it with the Central Bank as there was no such requirement from it. This is the intent of the Bank's Risk Management to switch to such calculation method as we want to divide the impact of each risk on the Bank's capital and determine maximum possible limit. In 2019, we plan to determine the amount of working capital for each risk, the amount of available free capital with consideration of all required buffers, return on equity to shareholders, etc.

Konstantin Noskov:

– Dear colleagues, please ask your questions.

Kristina Mironova:

– Dear colleagues, thank you. If you have any additional questions, please feel free to contact the Risk Management of Bank Saint Petersburg. We will be happy to receive your questions through our IR. It is very important for us to know that we are transparent for you, that our actions and our risk appetite is clear for you from the perspective of the business volume and the cost of risk. Thank you very much. I am delighted to meet you.

Konstantin Balandin:

– Thank you very much. Dear colleagues, I have one more request for all of you, who are present here today. For many years indeed, you have been asking us questions stating that you want more information about the cost of risk and loan portfolio quality. We understand that today we have provided many different cross-sections, values and so on, and maybe it is difficult for you to give the proper wording of your questions immediately. On results of the event, we will send you a feedback questionnaire. Please indicate which values you have come short of. Will you?

Konstantin Noskov:

– Please ask if you need to clarify anything with regards to this method. We have developed it and communicated it to you, we have fallen into it and strongly believe that it is a real guarantee for our future, that the cost of risk will be really lower by objective indicators, as we have such portfolio now.

Participant 3:

– Can I ask a question? When you speak about the cost of risk below 2%, where do you expect the standard level to be achieved, is it in 2020, for example?

Konstantin Noskov:

– First of all, we have demonstrated that the cost of risk for the vintages of the last 5 years was from 1.0% to 1.9% with two vintages having shown 1.4%. It means that our current portfolio and our approach to risk management allow us staying at this level even in a weak economy.

Secondly, we determined the cost of risk of 2020 at the level of 1.7% in our strategic model. And such cost of risk of 1.7% allows us generating 15% of return on equity. That is why the level of 1.7-1.8% is achievable, in our opinion.

Konstantin Balandin:

– Our task is as follows:

A. To demonstrate that we have a model as the basis.

B. We believe in this model and want to share our confidence with you.

C. This model guarantees results. Certainly, it may generate better results one day and worse results another day. Meanwhile, even in poor periods, it has generated results, which were significantly better than this 2 %. The last vintages, which we have demonstrated to you, generate the average cost of risk from 1.0% to 1.9%, only one vintage.

The risk management model and system generate indicators, which perfectly fit our strategic benchmark of less than 2% in a rather shocking period (maybe it is not the most shocking one, we are not in 2009, but it is certainly challenging for the economy). Does it mean that it can be lower? We are probably scared to speak loudly about it yet. But, certainly, it can.

Kristina Mironova:

– Let me add a couple of words? Certainly, it can be lower. The problem is that the lower the set cost of risk is, the more pressure will be put on corporate lending. So, we have to choose and this is my catch phrase when working and talking with my colleagues, that we do not need a minimum cost of risk, but the optimal one in order that our expected losses correspond to the actual ones.

Konstantin Balandin:

– And if we speak in model terms, it means that the cost of risk can be lower, but then the net interest margin will be also lower, because you sell such risk. You grant a loan and the risk premium is included in the rate. It may be one or two percent. If you want a lower cost of risk, your yield will be lower as well. This is another business model and it has also the right to exist. The lower cost of risk means the lower margin.

Konstantin Noskov:

– We mean that in the end, we need to increase margin with consideration of the risk.

Konstantin Noskov:

– I give the floor to Alexey Teploukhov, Director of the Financial Market Operations Department. He will tell us about trading sustainability.

Alexey Teploukhov, Director of the Financial Market Operations Department, presentation Bank's Operations on Financial Markets:

– Good afternoon once again, ladies and gentlemen. We would like to tell you a word about the Bank's business on the financial markets in the Q&A format. We selected those questions, which are most often asked to our IR. In this context, we would like to provide you with a simple and clear information about our activities, our position in the Bank's business, and our plans.

So, what is trading in Bank Saint Petersburg and what do we sell? Trading accounts for one thirds of the Bank's balance. The largest asset items are the securities portfolio, loans to banks, reverse REPO.

Funding is provided from core banking and the market, due to banks. At that, funds raised under direct REPO account for 80% of funding meaning that we finance our securities portfolio on our own under absolutely market conditions.

We are independent of the Central Bank and do not raise any funds from it. The new funds in the balance have been raised from the large Russian companies with own dealings and treasuries. Three major players, which had raised funds from such companies actively, withdrew themselves from the market (Otkritie, B&N Bank, and Promsvyazbank), the Central Bank provided full financial support to them, so, there was no more need for resources. It is the right moment for us, as those companies, which have dealt with them before, start dealing with us, and we consider this fact to be of great interest for us. It is diversification of the borrowing base under absolutely market conditions.

Below we provide a breakdown of the large balance sheet items.

Due from Banks. If we look at the reporting date, as of January 1, 2018, 79% accounted for funds placed in the Central Bank and 21% – for loans to state banks. We took funds from core banking and transferred part of them to the Central Bank. When core banking has an excessive liquidity, it allocates such liquidity to us. Being the only exit window to the financial market, we can make maximum efficient use of the resources. If the rate for such funds is considered unattractive for us, we place them into deposit accounts in the Central Bank.

This means that it is cheaper for us to attract from the market. Moreover, the reason is indeed in the fact that numerous lines have been opened for the Bank, we are an active participant of the money market and can use any inefficiency available at the market.

Reverse REPO. This is a rather serious business segment of the money market – allocation of securities-backed funds. Top-quality bonds, first of all, blue chips represent the collateral. As for counterparties, we always apply a rather strict selection process with more than half of our transactions being made with the central counterparty. Counterparty limits are set for the largest banks or financial companies with long and high-quality history. Even to financial companies with long and high-quality history we apply a very careful approach accepting only the most reliable and liquid bond issues from them for security purposes. We treat this business segment very reasonably and conservatively.

As for discounts, here we also have a reasonable policy. The average discount for the bond portfolio amounts to 10-15%, while the average share discount is 20%. The discounts are rather dynamic: as soon as there is any serious instability in the financial markets, the risk department immediately regulates these discounts upwards. As soon as the pressure goes down, discounts are adjusted back to their standard level.

As for the securities portfolio, it is mainly comprised of bonds accounting for 98% of the portfolio. This portfolio includes bonds of the top-rated Russian issuers. As you can see, almost total ruble portfolio is comprised of securities with the rating BB- and higher. The rest are also high-quality issuers, but some of them were simply not assigned with any rating. We provided Volkswagen Bank, Toyota Bank as examples.

As for Eurobonds, we apply the similar approach using only the high-rated and liquid securities. This market segment has recently faced a significant reduction. First of all, the reason is that there were much fewer issues of corporate securities over the last years; nevertheless, this business is rather interesting.

How do we make money? We make money on carry trade and revaluation on the securities market. Carry trade means that we buy a bond with a fixed bond yield to maturity and finance it with market money. This is delta, which forms the basis of our carry trade. The simplest example of making money on revaluation is as follows: throughout the year, the market expected reduction of ruble interest rates and the key rate of the Central Bank. When developing a portfolio at the beginning or the end of 2017 a relatively good revaluation could be obtained and fixed.

As for the money market, we perform active arbitration among various market segments, namely swaps, REPO, interbank lending, etc. Everything related to allocation and raising of monetary resources, as well as interest rates represents the subject of our arbitration. We are very active on this market, we monitor the interest risk and liquidity gaps actively and traditionally make good money from it.

As for derivatives, we have a highly developed access infrastructure to various trading platforms, both Russian and foreign ones. We have access to trading with a large volume of assets. This allows us developing various arbitration strategies generating flow income. We also make active use of options strategies, synthetic swaps, and various instruments available on the derivative market and generate rather good flow income with high return on equity.

We have a small volume of own speculations and a sound flow income from customer conversions on the foreign exchange market. This is one of our development priorities. Under given circumstances we introduce innovative products to the market in the form of platforms ensuring good quotations for our customers and plan to complete the project by the end of this year providing our customers with basically unlimited access to various financial instruments. In other words, everything listed on stock exchanges and organized trading facilities can be communicated to our customers, and they can use it both for hedging and foreign exchange operations, as well as create own strategies.

Flow income accounts for 40% of the revenue structure and is based on derivatives, operations on the foreign exchange and money markets, while 60% falls on the security market. At that, carry trade strategies are those, which generate a sound volume representing our main source of earning on the securities market, which is the sale of high-rated bonds with bond yield fixation for repayment and funding of such securities under lower rates throughout their life cycle.

What makes us different from others? First of all, as Konstantin has noted, it is healthy conservatism. We do not participate in operations with high risk. If we accept bonds to our portfolio, we do not take part in long durations. Historically, the portfolio duration has never exceeded 3 years and today it is at the level of 2.7 years with historical fluctuations within 1.5–2.5 years. In the course of portfolio development, we perform a strict selection of issuers.

This way we ensure stability. Yes, we do not receive excess profit in certain time periods but we ensure stability instead. Healthy conservatism allows us generating a certain stable income base in the long term. Another important thing is that we do not create a threat to the Bank's financial stability.

As for the expertise, there are relatively few teams with the similar high expertise level on the security market, derivative market, and money market. We are proud of our strong team. Many times our traders have been selected as the best dealers of the year on the money market and the best dealings of the year on the money market. Last year we were also awarded by Cbonds for analytics in macroeconomics.

Personnel, human resources are the functional basis of our division. We pay considerable attention to this aspect and always try to maintain a high expertise level. Our employees form part of various work teams and committees of National Finance Association (NFA), expert councils for interest rates. I am also the member of two committees at the Moscow Stock Exchange, namely the REPO and Security Lending Committee and the Foreign Exchange Market Committee. We take very active part in discussions held by the regulator with market players, for example, on changes in regulation and taxation, as well as discussions held by the stock exchange on tariff classification and the introduction of new products.

If you take the last report of the Moscow Stock Exchange on activity of operators on the REPO market, you will see that Bank Saint Petersburg has come to the third place and for a very long time we have been in the range of Top 3 – Top 5. We are very proud of that, as it is a good-sized piece of cake, which we use to make money on the financial markets.

We have a very well developed access infrastructure. In 2014, many Western contractors refrained from providing various services to Russian banks, including for access to foreign platforms, London Stock Exchange, Chicago Mercantile Exchange. We maintained all accesses.

In addition to that, we were one of the first Russian banks to build good relationship with Asian partners in both China and Singapore, who provide us with access to their platforms. Thus, our access is diversified through America, Europe and Asia. 2014 is a good example, when inefficiency on the strongly volatile foreign exchange market could be well used to take additional income due to simultaneous access to many trading platforms.

I could only name Metallinvest among banks, which try to maintain the similar infrastructure; however, it is absolutely incomparable with us both by scale and business volumes. It is a kind of a "dealing machine" but much smaller and with less opportunities.

As for organization, we enjoy the unique combination of factors, we are small. All our team, each desk, if we speak the trading language, is only 4-5 people. At that, we have an efficient structure, all required expertise, proper functioning and interchangeability when working on the financial markets.

We are the only window to the financial market for the Bank, and it is a great advantage. There are several examples on the market when a treasury enters the financial market, and an operating department on the financial market comes with own quotations. We have even performed an arbitration with numerous major banks between their two divisions: for example, we borrowed money from their treasury and allocated it to their dealing with the margin having reached up to 0.5%. It may sound funny, but actually major banks have problems with the proper structure. That is why our small dealing structure is also one of the success factors.

Let us once again have a quick look at our unique combination of the Bank's scale and the market scale. For example, we are in Top 3 by turnover at the REPO market. The market itself is not very big for such giants as Sberbank and VTB. For them, such volume is insignificant and unattractive; they use REPO as a liquidity management tool, more likely their treasuries and not their dealings use it. Nevertheless, for us, it is a source of profit, a specialized business division, and we are very active on this market. As a result, the market is big for us and allows us working efficiently on it, while for major participants it is not that interesting, as it is small for them.

The unique combination is reflected in the securities portfolio management as well. The portfolio is rather sound if we consider the volume of the Bank's balance sheet. At the same time, we manage it in an efficient and flexible way. In other major banks, it is mainly used as a treasury liquidity cushion and cannot be turned in an efficient and flexible way when expectations of the market participants suddenly change or when rates jump.

Meanwhile, we can handle all that efficiently. As our team is small, we can make decisions quickly. We do not have a long hierarchy, a long decision-making process to buy one or another security. We interact efficiently with the risk unit, which sets limits in the context of the risk appetite, and we manage portfolio within these limits.

Let me give you examples. What is the specifics of REPO operations? It is a flow arbitration; we raise funds and allocate them. Margin under REPO transactions amounts to 0.3-0.5% with the return on equity of 15-25%. The market is rather liquid with the stock exchange having made the most significant contribution, when it switched to the central counterparty providing for centralization of all risks on itself and minimizing the counterparty risks in given situation.

We have a very sound limit area: both our limit area for the market players even with consideration of its conservatism, and the limit area of the market participants for us. We deal with many of them, and plenty of them deal with us. We do not have any single loss in REPO. The Financial Market Operations Department was established in 2007. We have been operating for more than 10 years and have not lost anything yet. Taking into account that we manage this business the probability of future losses is low.

Direct REPO operations are carried out for funding. In the first part of the transaction, we sell the security and get money. In the second part, there is a reverse operation: we repay money and take the security back. The difference between the purchase price and the sale price is the interest rate. Generally speaking, it makes no difference for us, whether we use the interbank lending market or REPO market for funding. We choose the cheapest option, there is no strict system requiring, for example, to provide the whole portfolio for REPO. The large limit area for us under interbank lending and good opportunities on the REPO market allow us raising funds in cheaper places.

Reverse REPO operations are similar to lending money on securities. For example, we have purchased a high-rated security from Rosneft in the first part of the transaction. In the second part of the transaction, we have sold this security back and got money. The difference between the purchase price and the sale price is again the interest rate.

Derivatives. The market advantage is its large volume, the high liquidity of instruments and the wide range of assets, including goods, currencies to select from. We have a good access to the Chicago Mercantile Exchange, London Stock Exchange, and European stock exchanges. For example, we have purchased USDRUB futures with delivery after 5 months and sold the spot at the Moscow Stock Exchange. The difference between the future price and the spot price is the interest rate; it is a management tool for interest risk, interest gaps and the chance to make money.

Margin of such transactions is lower than for REPO operations, but their profitability is much higher. As an example, the profitability of current open positions exceeds 30%. At that, the market risk, the underlying asset position is closed. We have purchased one asset at one stock exchange and sold another asset at another stock exchange through futures, through an option; the position itself is closed, the difference is only in the interest rate, which we also immediately fix for the whole period.

Below you can see the impact that trading provides on the Bank's indicators.

Konstantin Balandin:

– Dear colleagues, trading means that traders accept positions right there and then, depending on what is profitable on the market at that very moment. The conditions change many times over a year. The structure of assets and liabilities changes by currencies, time periods, in any cross-sections depending on the market situation and the Bank's balance status. There are many cycles, interrelations, inequalities.

It is very clear from this slide that throughout the year the trading balance dynamics changes drastically for assets and liabilities at different reporting dates from the point of the structure. On the next slide, we show the reasons for dividing the Bank's net interest margin into the core banking margin and the trading margin. We provide a very illustrative example to make you feel how trading would spoil this indicator if we remained in the previous terms of the net interest margin.

There is a liability structure of trading in a breakdown by quarters provided on the left side. You can see that depending on the market situation, on positions occupied by trading, the funding structure changes in the ruble-to-foreign currency cross-section. You understand that funding in foreign currency is almost free as the rate is around zero. The cost of funding in rubles was some 8% a year ago. In the right upper part of the slide, you can see how the net interest income of trading functions in that time period. At first, cheap liabilities in foreign currency account for a significant share, and trading generates the net interest income. Then funding in foreign currency shifts towards expensive rubles resulting in the net interest expense. In the year-end, the trend turns around and the net interest income is generated again.

This is the factor, from which we clean up the Bank's performance when providing the core banking margin for you, the net interest margin without interest income/expense of trading. We would like to study this case as the most representative and obvious one to make you feel where and why trading provides such a serious impact on the Bank's financial indicators.

The next slide shows the same quarterly dynamics but already in aggregated results of the core banking and in aggregated trading results. Here, the income and expense structure is presented even better. For example, trading is negative in the commission part as trading does not charge commissions from customers – it pays commission to trading authorities instead. When studying the Bank's indicators, it is important to take into consideration that the net fee and commission income, which we are used to treat as the core banking income shall actually be also divided into core banking and trading. Such a small note, with your permission.

Alexey Teploukhov:

– An addition should be made that the Moscow Stock Exchange as a market monopolist tries to increase commissions on a permanent basis, for which reason the share of commission expenses in the trading revenue structure will only grow. If we increase volumes and transfer them to the central counterparty, commissions paid to the stock exchange become higher and can provide stronger and stronger impact on the Bank's net fee and commission income in general.

How stable are the trading results? 60% of income from the securities portfolio and 40% of flow income in the revenue structure. At that, numerous securities in the portfolio had long-term funding. For example, when the dollar rate growth cycle only started, it was profitable for us to buy dollars at a fixed rate from European or American banks. We had certain expectations and the market had expectations as well. We negotiated a fixed rate with it, for example, for two-year REPO operations and maintained this rate. If we had raised overnights, we would have paid more. Such cases happen to take place, for which reason the income in the revenue structure is rather stable, even if we consider the income from the securities portfolio only.

Even if something negative happens on the market, there is a fixed yield to maturity. Now when we purchase a security, we fix this yield to maturity. Short-term duration. When making a purchase, we certainly take into close consideration our expectations for the funding structure and the rate dynamics. We will get this yield to maturity anyway. At a certain time period, we can have both negative and positive revaluation; however, for the long term we get the yield to maturity funded by current rates, even under a negative scenario.

Growth points. As the Bank in general and we, in particular, follow the sustainability strategy, we pay special attention to three main areas. The first area is customer sales, where we have started to develop actively only since late 2012–early 2013 and have already managed to solve many systematic issues. We keep moving in this direction strengthening our cooperation with corporate and retail businesses. In addition to that, as I have noted before, we are developing our high-tech platform to provide market access to our customers. At the moment, such platform is almost unparalleled on the Russian market.

The second area is algorithmic trading. We established the algorithmic trading division in late 2011–early 2012. Today we call it "football team" as there are 11 people representing the full cycle: mathematicians, programmers, design managers, testers and traders. We are constantly looking for algorithms, improve and use them. At that, we do not try to enter the high-frequency trading market, as there everybody fights for milliseconds, for a possibility to install a server and so on. Significant investments are required to get an additional 1% growth. We use lower-frequency strategies, and they have proven to be rather successful in the long term.

We have applied one of these strategies to overlap customer positions. We have developed a complicated major algorithm, which allows us overlapping the customer positions on the financial markets very efficiently. It is not even a common pot principle, where everybody puts purchase and sales calls and then makes an analysis. It is a more complex organization providing for rather good earnings.

The third area is asset management. Last year, BSPB Capital, the Bank's 100% subsidiary, was granted a license for trust management of assets. In 2017, we launched a pilot project and this year have already achieved a commercial scale of sales of these products to customers. The dynamics is rather good, the sales growth rate is high and such dynamics is maintained at the moment. Under given circumstances we interact actively with Private Banking, which has joined us very closely, and we also expect high synergy from it.

This is asset management as part of the banking group. As for the customer perception, it is the same Bank as this entity is the Bank's 100% subsidiary. When ruble interest rates reduce and customers actively look for alternatives to ruble deposits, such project allows maintaining the customer loyalty. If customers want to leave the Bank, they will not go too far, they will withdraw their deposit and allocate it in a managing company with the Bank receiving fee and commission income. In addition, here again we return to our key task being increase in the fee and commission income, flow income share.

Below you can see the strategic value of trading...

Konstantin Balandin:

– If we look at this trading from a long-term perspective as a supplement to core banking, it has a very important advantage of countercyclicity. It works when the market situation is challenging. And it demonstrates the best results when the market experiences shocks (both the banking and financial markets). When the banking market experiences interest rate shocks, the net interest margin reduces; there are defaults – in any crises trading works.

The reason is that trading receives new opportunities during such periods. Increased volatility results in expanded margin of one or another trading operation. Even 2009, 2014 were the best years for trading, as you can see. You are well aware that these years were very challenging for the banking system in general.

That is why trading is a kind of buffer for us helping to overcome bad periods, from which we would certainly, expect miracles in good times as well. However, in good times trading makes a sound, quiet and standard flow. It accounts for the average of 10% of revenue with the average return on equity of 48% for the last decade.

Alexey Teploukhov:

– Key conclusions. I will once again repeat myself that we try to generate a stable source of income with flow income to account for a half of it or so. We develop synergetic interaction with other banking units, namely corporate banking, retail banking and Private Banking.

A well-balanced business model is based on reasonable conservatism and well-established infrastructure, which makes you, be ready for any troubles or surprises or opportunities provided by the market any time.

We certainly use high technologies to manage positions and risks, as well as to develop our own infrastructure.

A strong team and high technologies represent two cornerstones forming the business basis, particularly for Bank Saint Petersburg. When you have qualified and experienced employees with good opportunities, this really makes you ready even in the most challenging market situations. We certainly cannot protect ourselves from everything by 100%, but such combination allows minimizing considerably negative impacts for the Bank, as well as expectations when the market changes its direction and allows us making good money of it.

Protection from negative impact on retained earnings. We perform flexible management of our securities portfolio dealing with top-rated issuers and using our investment portfolio. If we want to hold a security to its maturity, we place it in the investment portfolio as it is overestimated on the books, and fix the yield to maturity against funding for the period. All these actions result in efficient operation on the financial markets and ensure stability of the Bank's income.

Konstantin Noskov:

– Please feel free to ask your questions.

Participant 3:

– A short question: which duration do you take as a guidance when buying bonds?

Alexey Teploukhov:

– At the moment, average portfolio duration is 2.4 years. Over the last decade, our portfolios existed for the period from 1.5 to 2.5 years. We reached 3 years in peak periods, while the minimum period was even 1 year, but in general, the average duration was 2 years.

Participant 3:

– What is the structure of the securities portfolio at the moment?

Alexey Teploukhov:

– Approximately 50% of issuers in the ruble securities portfolio are banks with this fact reflecting the structure of the Russian market, for example, there are such issuers as Sberbank, VTB. There are certainly companies with public ownership such as Gazprom and Rosneft. There are also other major issuers, such as Novatek and NLMK. As for credit quality, our approach is rather conservative and here our position matches that of the risk unit – we do not take part in operations with high risk with a lower rating and higher yield.

Participant 4:

– Could you please tell about ROAE: while REPO indicators are 15-25% and derivatives are 30%+, the average value for the decade is 48%. How are they related to each other?

Alexey Teploukhov:

– There is a strong dependence on a particular balance structure at a certain moment. The average return on equity for a 10-year horizon is 48%.

As for derivatives, the transaction amount is reflected off the books, the position is closed, and the net market risk, which is very low, is entered in the books. At that, the margin can reach 1-1.5%, and the profitability can even exceed 150% respectively. I indicated 30%+ as an average profitability value for derivatives. We are very active on this market, we perform operations with both small margin and larger values, but in general, it is around 30%.

As for REPO operations, we speak about the money market, the margin is 0.5% indeed, sometimes it is 1%, sometimes it is 0.2% with the resulting average profitability of 25%.

We have certainly demonstrated good performance in customer flow operations, in foreign currency operations, and in the securities portfolio. If we put all these bricks together, we will receive an average of 48% on the 10-year horizon.

If we study these indicators separately year-by-year, the picture will be very different: one time securities made a considerable contribution, while another time derivatives did. If we look at 2014, our closing balance was positive due to derivatives, as the securities slumped, especially on a peak day of December 16, when the key rate increased to 17%, the securities yield jumped drastically, and portfolio revaluation resulted in significant loss. However, we had hedge through derivatives, including for interest rates, and this way we could make very good money.

To summarize, the profitability dynamics varies a lot year-by-year but, in general, it amounts to 48%.

Participant 4:

– Does ROAE for the securities portfolio correspond to 25-30%?

Alexey Teploukhov:

– It depends on the time period but in average, it certainly does. If you are interested in a certain time period, we can discuss one or another year, but the average value will be 48%.

Participant 4:

– How much is the regulated weighted average of securities?

Alexey Teploukhov:

– The capital load is not very high and ranges within 10-20%. It is not high, because our portfolio includes only top-rated issuers. Capital requirements have recently increased only for Eurobonds. The ruble bond portfolio gives low load, as this portfolio is rather reliable, with short duration. In due time we selected whether to take a credit risk or a market risk for calculation, we checked values in different time period and the load turned out to be equally low for us.

Participant 7:

– I looked at the last page of your presentation on strategy, where 2020 model is presented, and there the trading income is lower than in 2017. As far as I remember, you said that the trading share in the Bank's revenue was reducing, and the trading impact on margin was reducing as well. Am I right that you do not target boosting the trading income but aim to reach a certain stability?

Konstantin Noskov:

– We actually target reducing the trading share in the Bank's revenue, but this does not mean the trading volumes should go down. The target trading income for 2020 is lower in the model than in 2017 simply because 2017 was a super-successful year for trading with good market conditions, expected reduction of the interest rate, all of which worked for our trading benefit.

We do not expect similar conditions for the upcoming three years, for which reason our target is RUB 4 bn. In the next presentation, I will show that our expectations from trading are RUB 3-4 bn per year in average, and we consider such amount to be a good result.

Alexey Teploukhov:

– If we look from the trading income perspective, our task is shifting towards flow and stable income gradually reducing the share of the rest. Changes in the structure do not necessarily result in reduction of income.

Participant 8:

– Could you please inform about REPO operation with shares of Vozrozhdenie Bank. You closed this transaction in November. Was it a market transaction? Could you please disclose the second party? Moreover, please share information about investments into RUSAL bonds.

Alexey Teploukhov:

– As for Vozrozhdenie, it is the question, which we often answered to journalists last year. It was an absolutely standard market transaction, which we made on the stock exchange with the central counterparty. National Clearing Centre (NCC) as the central counterparty guarantees performance of obligations, there is no counterparty credit risk, we did not hold any limits for Vozrozhdenie. NCC will indemnify everything to us in case of default, so this is a standard REPO transaction. We did not have any investment tasks; we were not shareholders. In this case, shares are only a security, one of the numerous securities, which we had, and our REPO portfolio is rather big. The transaction amount was from RUB 600 mln to RUB 1 bn that time with the total value of the REPO portfolio of about RUB 50-60 bn.

With regards to RUSAL, as of April 6th, we had USD 4.8 mln of investments in our bond portfolio. At the moment, our bond portfolio amounts to RUB 110 bn corresponding to approximately USD 2 bn. As you understand, the share of USD 4.8 mln in USD 2 bn is very insignificant.

Of course, we have negative revaluation at the moment, the quotation amounted to 45 from the nominal value, followed up with 40 and later 35. We will monitor the situation. The upcoming credit event is payment of the next coupon on May 3d. Although it will be related not to our issue but to another RUSAL issue, by that time the position of the issuer, the government will be clear: whether it is saved or nor, whether there is any restructuring or not. In addition to that, there is a technical default rule. May 3d is not a deadline; the issuer can communicate its additional requirements for debt restructuring or default within 30 days.

Therefore, we keep waiting. This is a very insignificant amount if we look at our portfolio volume. It is unpleasant for our PnL but still it is insignificant. And it is the only security in our portfolio, which is included into the sanction list. We have also analyzed our portfolio in the context of possible extension of sanctions. Although this policy is rather unpredictable, we can declare that our portfolio does not include issuers, who can be put under sanctions in the nearest future.

Konstantin Noskov, Vice President, Head of the Strategic Development Department, presentation Strategic Priorities for 2018-2020:

– The strategic priorities for 2018-2020 have been communicated in the last presentation in the framework of today's event. I guess many of you are already aware of our strategy approved by the Supervisory Board in February 2018. I would like to tell you why we have set such targets and what the Bank's competitive advantages are in our opinion.

This strategy sets absolutely real and achievable tasks at relatively moderate business growth. We cannot say that it is a breakthrough; however, it indicates the focuses, which we select for ourselves and is completely based on the Bank's strong sides. On the first slide, we have shown exactly those strong sides of the Bank, which form the basis for our strategy. I will not comment on each segment but will certainly turn my attention to some of them.

We consider the image of a reliable and financially stable bank to be the most valuable. Our customers do not have concerns with regards to our stability and reliability. We did not give reasons for such concerns even in years of the most serious crisis. We can dispute about our share price or our profitability, but the fact that money can be kept safe in our Bank is indisputable, and this is a priority for our customers, as well as our strong competitive advantage. The same is our name, our performance history, first of all, on the market of St. Petersburg.

We apply healthy conservatism and are always very responsible when making decisions, with this fact having been confirmed many times during today's speeches. Throughout its history Bank Saint Petersburg has never participated in high-risk projects, unreasonable M&As, etc. We had one transaction with Bank Evropeisky at the M&A market, which was very successful for the Bank.

We are stable against external shocks. The crises, which the Bank have overcome, as well as our financial performance in the most challenging periods serve as evidence. All that means that we can overcome challenges rather successfully. The Bank has never experienced losses.

In particular, we are independent of external funding. This makes us different from other major Russian banks. We raise funds exclusively from our customers with the loans-to-deposits ratio of less than 90%. This means that market closures will not provide a negative impact on us. Exactly at the end of 2014, the Bank won in this very context: yes, we suffered from the interest risk but we were liquid and did not have to refinance anything.

We are a public bank. Why is it good that we are a public bank? We always have access to the capital market. When a non-public bank faces challenges with capital, the owner has to invest additional money. A public bank can raise capital on the market any time. We have never had challenges with raising funds throughout our public history: we carried out SPO for different reasons and for small amounts, but it was always a success. This is a great advantage for a public bank.

As for work with customers, the Bank's strong competitive advantage is that we are a regional bank with strong positions in St. Petersburg and with a sound customer base. The Bank's engagement with customers, speed, and flexibility of the decision-making process are our doubtless strategic advantages on St. Petersburg market compared to other players, namely branches of Moscow banks. As a financially strong, stable and reliable bank, we have built good relationships with customers as well and a sound network in St. Petersburg.

As for digitalization, we are certainly in this trend. We try to switch operations from offline to online to a maximum extent and make a lot in this respect. In the upcoming three years, we plan to close 20% of offices in St. Petersburg but we also consider the opinion of those customers, for whom the contact is important, including the customers, who generate a major part of income for us.

We took all these strong sides of the Bank as the basis for our Strategy 2018-2020. Which strategic targets did we set for ourselves?

First of all – to reach high return on equity, to achieve the level of 15% by 2020. As our today's presentations have demonstrated, we are well on the way to this target.

Secondly, we target not simply reaching high return on equity, but also maintaining the business volume, maintaining the large scale of the Bank with good image, keeping our position in Top 20 of the Russian banks. Today this target may seem to be not very aggressive, as we are already in the 15th place. The reason is rather that the banks above us leave. However, we would like to declare the importance of the business scale for us.

Thirdly, we want to increase our transaction revenue. Moreover, this is the new focus of our strategy. We plan to go more into transaction banking to generate higher settlement account margin and higher fee and commission income. Both on the basis of our current customers and attracting new individuals and legal entities, including by means of improved service quality.

And fourthly, our most important target is to increase the Bank's market value 3 times, to RUB 75 bn. The target may really look aggressive but in P/BV terms, it corresponds to growth from 0.4 to 0.8, so it is not that aggressive anymore. We will certainly consider your opinion, the opinion of shareholders and investors when selecting actions to reach this target, as we all have a common target.

Key Strategic Issues.

We do not plan to expand the geographic coverage and hold a view that the Bank shall be present only in those regions, where it has certain competitive advantages.

The Bank does not plan new share issues and we will rely exclusively on profit generation. In compliance with the Dividend Policy, we will continue paying dividends of at least 20% of profit under RAS. At the same time, although our strategy is the core area of our activities, it is not a doctrine. If external conditions change and we understand that we need to act in a different way, it can be reviewed. So it would be wrong to declare that dividends of 20% of profit under RAS is what we will have until 2020.

As for mergers and takeovers, we follow the organic growth strategy but do not exclude the possibility of profitable M&A transactions. This way we want to say that we do not look for any facilities to take them over. Over the last 2-3 years, we have considered several times the offers made by other banks but failed to reach any result. As I usually say, better not to make a transaction than make a poor transaction. We had a very successful transaction with Bank Evropeisky, however, we do not see any other profitable transactions to be made at the moment.

With regards to staying public, we are with you and do not plan to leave you.

As for the customer base, we plan to increase the number of customers in mass segment, as it is the main category of customers currently generating income for us. For example, although we receive 50% of income from small and medium enterprises, which do not raise loans from the Bank, corporate banking was not in our focus. The Bank does not bear any credit risks for such customers as they are not borrowers, at that the Bank generates fee and commission income and margin from current accounts. That is why small and medium enterprises became our target customers in transaction banking and we will perform actively and focus on this area in the upcoming years.

Customer funds will still be the main funding source for the Bank and we will maintain the target credit-deposit ratio of less than 100%. As a reminder, today we have even less than 90%.

With regards to corporate lending, we will focus on customers in regions of our operations. The loan portfolio growth rates are not aggressive at all. Our model provides for increase in the corporate portfolio by 11% in 3 years.

As for retail lending, the Bank needs to remain one of the leaders in mortgage lending, however, we will also look for new segments. For example, until recently we have granted consumer loans mainly to payroll customers, however, last year we increased our risk appetite and started granting loans not only to payroll customers but also to those, who have accounts in our Bank. This is not the "street" yet, but we mean that we need to look for new segments for lending both in the form of consumer loans and credit cards. Credit card is exactly one of those products that we plan to develop actively starting from this year. It was included in our product range but was not sold actively.

How will development in these areas lead to profitability growth? We plan profitability growth, firstly, based on the corporate portfolio growth (growth compared to last years) and secondly, due to focus on transaction banking. We expect increase in current accounts at the level of 40% during the strategy period and more than 60% of non-interest income growth.

Another profitability growth factor will be reduction of the cost of risk, which amounted to 2.7% on results of 2017, while in 2020, we expect it to drop to 1.7%.

Moreover, there is no escaping from cost efficiency, where we have always applied a rather strict approach. Our target is the increase in operating expenses by more than 5% per year with the cost-income ratio maintained within the range of 40%. Such cost-income ratio is standard for us, and we are ready to maintain it.

How will we invest? Transaction banking requires additional Investments. The Bank shall reduce offline expenses and increase online costs. This is true not only for the closure of branches and transfer of transactions into digital channels but also for the operating technology, meaning a maximum reduction of "paper" use, where it is still left; although we do not use that much hard copies anymore, there is always a potential.

We have also said that the Bank does not have such resources to invest into innovations, as major players of the banking market have, for example, Sberbank, for which reason we will focus on quick and high-quality replication of digital solutions. And we manage to do it. As Konstantin has told earlier today, the quality of our products for customers is at rather high level. We occupy top positions in rankings by mobile banking and online banking. We will monitor what our competitors do and keep pace with them, while the priority for our investments will certainly become transaction banking.

A few words about transaction banking. Saying "transaction revenue" we mean the net fee and commission income excluding income from risk operations (for example, guarantee commissions) and plus the margin from current accounts. Transaction banking is the main potential source of the revenue growth, which will also make a significant contribution both to our interest income and interest margin. We plan to increase the annual transaction revenue from RUB 10 bn to RUB 15 bn resulting in growth of the Bank's revenue from 32% to 38%.

Income growth points in transaction banking are shown on the right chart. You can see that main growth rates fall at net fee and commission income in corporate banking and net fee and commission income in retail banking. Current accounts margin in retail banking does not demonstrate significant growth, mainly due to the fact that the account balance in retail transaction banking is not equal to zero, despite the expected increase in raising of current accounts: while corporate customers usually do not receive anything on their balance, retail customers are paid for their account balance and use loyalty programs, which also cost money and so on, for which reason the cost is a bit higher there.

How do we see the Bank's business model (Balance Structure and PnL) in 2020?

The first important thing is that we plan to increase the share of retail banking: we expect an increase in retail banking from 21% to 25% in our loan portfolio and from 57% to 65% in customer funds. This is an ongoing trend of the last few years, and we believe that it is the right area, as the retail banking is more marginal, stable and mass in many aspects.

Secondly, we plan to increase the percentage of current and settlement accounts from 30% to 35-40% as a consequence of our strategy's focus on transactions in order to increase the margin.

Sustainability is important for us in the revenue structure, for which reason the revenue structure 2020 includes the growth of the net fee and commission income and reduction of the share of income from operations on financial markets, which we have talked about: compared to current trading accounting for approximately 15% of the revenue we shall go down to 10% by 2020.

What actions do we plan to take and what are the key target indicators for different business divisions?

As for corporate banking, first of all we plan to increase the percentage of high-quality and low-margin loans. We follow the same path as we have done for the last few years. You have seen it in Kristina's presentation as well in the context of the cost of risk, when there are more low-margin loans, but they have higher quality, and we can see that positive impact is provided on profitability.

We develop an industry expertise; we have introduced certain structural changes in order to determine areas of expertise by divisions. Earlier customers got in contact with directors or managers in own office, irrespective of the sector they worked in but now they will communicate with certain experts in their sector. Tried and tested patterns and the best market knowledge provide for more efficient service to customers, which will finally contribute to the Bank's performance.

An important area of the transaction banking perspective is increased service quality and speed in the small business segment. We plan to attract 7,000 new customers of the transaction banking, i.e. those customers, who open accounts in our Bank, make settlements and pay commissions. At the moment, we have 43,000 active customers of this type in the Bank. I was talking about them, when I said that they generated approximately one half of our income.

For this purpose, we need to perform certain actions: firstly, we shall implement the "easy entry" technology. As we have noted earlier today, at the moment, it is not that easy to open an account in our Bank. It takes 1-2 weeks, a customer has to visit the Bank a couple of times and in this respect, we are behind our competitors. Despite our name and reliability privileges, we lose in this quality-related aspect. That is why "easy entry" of customers to the Bank is one of the most important strategic projects for 2018: opening a settlement account in 2-3 days with one customer visit is the target we have set. This is very similar to what major market players, such as Sberbank, Alfa, as well as Tinkoff with regards to speed, offer on the market now.

Another important area is increased product quantity per customer, penetration. At the moment, in average, 3 products are sold throughout our customer base per customer, while our target is to sell 4. The growth rate seems to be low, as we sell 5-6 products to new customers upon their entry, however, covering the whole base and reaching 4 products throughout the base is a challenging task. If we reach it, our fee and commission income will grow very well. At that, we are interested not only in the settlement account with online banking and SMS but also in corporate cards, acquiring, payroll programs, deposits and so on.

Corporate lending is expected to increase by RUB 32 bn in 3 years, on-demand – funds to RUB 25 bn, and fee and commission income – to 50%.

In retail banking we keep doing what we did before, however, in certain areas our speed increased. The focus is still on switching sales and service operations to digital environment.

We increase the percentage of the most marginal divisions, namely consumer loans and credit cards from 20% to 28% of our loan portfolio. We understand how much their return on equity is. We understand that we have learned to develop proper score models. And the last year demonstrated that we really reached good results. We are ready to move this way.

Mortgage remains our flagship, and we have built a perfect lending factory. We are highly competitive on the St. Petersburg market and, as we have noted earlier these results in the market premium, which we get granting more expensive loans compared to Sberbank. Why did not we expand our mortgage banking to

Moscow? Because we understand that, we do not have such competitive advantages in Moscow and we would have to compete with Sberbank by rate. And if our payments become equal to payments of Sberbank, our mortgage banking becomes unprofitable, so meanwhile we stay in St. Petersburg.

We focus on main profitable segments, namely payroll customers and individual customers of the settlement bank, i.e. customers, who generate a major part of income for us at the moment. As you understand, our main inflow of payroll customers comes from corporate customers. At the same time, we would like to focus more on commercial entities, as we have enough public-sector customers at the moment.

Individual customers of the transaction banking are those, who learn about the Bank from advertising, upon recommendations, and they are the most profit-making customers. Until recently, we have not been very active in this individual attraction of customers but we hope that we will be able to develop this area in the upcoming years.

Quality is still very important for us. We focus on customer loyalty and NPS index, which we have been calculating since 2017, and which became KPI of the first management level. So, quality is important, without quality we cannot reach our targets.

Retail lending is expected to increase by RUB 40 bn in 3 years, current accounts – by RUB 15 bn, and fee and commission income – by 64%.

Financial markets. We have discussed this topic earlier today; however, I would like to repeat that the main target of trading is profit generation. RUB 3-4 bn per year is the amount, which we objectively expect them to do. At that, the main qualitative task is change in the income structure in order that income from flow low-risk operations reaches 50%.

With regards to own operations, proprietary trading certainly depends completely on the current market situation. I will not comment on this, trading knows better when to enter the market and when to exit it, and if the security yield grows now, it is probably the right moment for entrance.

Cost management. Today we have spoken about optimization of the sales channels. In our strategy, we declare reduction of the physical network in St. Petersburg to 20%; although we continue our operations in the city, continue to communicate with customers. At that, we will actively develop remote sales channels, namely online banking and a call center. We have already launched pilot projects of the courier service, home delivery service for bank cards, same as in Tinkoff. We just want to provide our customers with the opportunity to make a choice. We will not be a completely offline bank or solely online bank; our customers will be able to choose, whether they come to our outlet and receive their cards there or order a courier delivery.

As for optimization of operating expenses, we are planning and have already been performing audit of the Bank's functions and processes with further potential optimization of the headcount. We did not opt for simple headcount cutting, as it is inefficient. In our opinion, all problems and losses result from wrong process organization. We took time to analyze the processes and here we see the potential for cost reduction.

It is also very important that we declare our intent for redistribution of saved expenses into IT development.

In support of transaction banking, we declare that marketing expenses shall grow. At that, total growth of expenses shall not exceed 5% per year, while the cost-income ratio shall be maintained at the level of 40%.

And finally, it is important that we want to increase the cost of our investment program from current RUB 1.5 bn to RUB 2.5 bn per year.

The strategic financial model includes all our actions listed above. Our loan portfolio is expected to grow by 20% in 3 years, with 11% accounting for corporate lending and 52% – for loans granted to individuals. Customer funds will increase at higher rates, by 33%. As for the revenue, we would like to reach RUB 40 bn by 2020 against current RUB 33 bn, meaning growth of 22%. Increase in operating expenses amounts to 5% per year. Reserves formed for 2020 amount to RUB 7 bn corresponding to the cost of risk of 1.7%.

These indicators result in net income for 2020 at the level of RUB 13.5 bn corresponding to the target return on equity of 15%. Capital adequacy standard under RAS amounts to 10.8%. Core banking margin, which we have actively discussed today, reduces insignificantly from 6.0% to 5.9%. For example, reduction of current account margin is planned at the level of around 1% for this time period, however, increased volume of such operations results in growth of the total margin as well. Please feel free to ask your questions.

Participant 3:

– I have three questions regarding the banking system. My first question is as follows: all banks rely on retail lending development, which is logical, as it is the only growing sector. Nobody expects growth in corporate lending in the upcoming years, although the rates in this sector will slump. Why does it happen?

Konstantin Noskov:

– I do not think that the rates will keep slumping. In our opinion, we are approaching a certain minimum, maybe we will face reduction by another 100 b.p., however, we believe that further reduction is hardly probable.

It is true that demand is currently low and companies are not ready to invest money, however public involvement grows. The reason may be that actual personal income is not that high, and people need to raise more loans. In addition to that, many people move both to St. Petersburg and Moscow, many residential houses are being built and people need money to settle down. That is why there is a considerable demand in the retail sector.

We have a low base in our consumer loan portfolio, from which we will grow.

Participant 3:

– My second question: what is an average current interest rate for the loan portfolio?

Konstantin Noskov:

– In part of mortgage loans, the rate is about 10.5% for new loans, and the average portfolio rate is some 1% higher and amounts to 11.5%. For consumer loans, the rate is around 15% for new loans, and the average portfolio rate is approximately 16%. In corporate lending the rate is around 10%.

Konstantin Balandin:

– Financial Performance presentation includes the chart with average rates, you can rely on this information. This rate is certainly comprised of many factors, including both NPL and the foreign exchange structure of the loan portfolio. That is why it is better to rely on this chart. The average rate is around 10%.

Konstantin Noskov:

– 9.6%.

Konstantin Balandin:

– Corporate banking currently enjoys considerable growth, for example, in Money Market. There is Money Market in part of liabilities, about which Alexey has informed earlier, and the same Money Market is available in part of assets. It makes pressure on the average weighted rate (low-risk – low-margin); however, it is the segment, where there is at least some demand.

Participant 3:

– And my last question is about B&N Bank and Otkritie, which passed to the Central Bank. Are they present in St. Petersburg? Do you consider them a threat? How do you estimate the situation in the upcoming 3 years for yourself and the region, considering entry of a new bank of the Central Bank?

Konstantin Balandin:

– Both of them operate in St. Petersburg. Otkritie is historically better marked, as once there was Petrovsky Bank, which became part of the group. And from that group Otkritie actually started. And the main question shall be addressed not to us but to the Central Bank. How does it see this situation? Does this mean that startup banks appeared which were clear of bad assets and had a free capital and now they can develop, as they want? Or is it rather a banking sector curing foundation?

Meanwhile, I do not have the answer to this question, because figuratively speaking the Central Bank established a new bank using funds of taxpayers and this bank will be fully competitive. On the one hand, it is an unclear story; on the other hand, it is also surprising. However, I leave open the possibility of similar projects and if so, it is our competitor. I do not know whether it is good or bad for the banking sector, but it is a competitor. And if the purpose is as it should be, providing for curing, settlements and business closure, then it is another story. However, such question should not be addressed to us.

Konstantin Noskov:

– We do not feel any threat or any aggressive actions drawing over our customers yet. The situation is more likely to be quite the opposite.

Participant 5:

– My question is related to attraction of new customers, who are not payroll customers. Could you please clarify which approaches you plan to apply for the attraction of new customers?

Konstantin Noskov:

– We use the same methods that other banks use on the market, namely high-quality product and advertising. There is no other way to attract new individual customers.

Participant 5:

– At that, you do not plan to expand to new geographical regions, do you?

Konstantin Noskov:

– No, we don't.

Konstantin Balandin:

– Actually, there is no point to enter the new regions for this purpose. We have such a strong brand in our region and such a substantial potential here that it is unreasonable to enter another market using the same customer attraction mechanism. Why should we?

Participant 5:

– Do you have any particular plans to increase marketing costs?

Konstantin Noskov:

– We do; growth of marketing costs is actually in advertising intended for attraction of individual customers. We plan to increase investment costs by RUB 1 bn, from RUB 1.5 bn to RUB 2.5 bn. RUB 1 bn is certainly not only advertising. We understand that for transaction banking we also need IT development, this and that, but the growth of marketing costs is included in this one billion. And increase from RUB 1.5 bn to RUB 2.5 bn is a significant growth.

Participant 6:

– Could you please inform if you have any plans to enter the bond market in order to expand financing, improve the liquid balance structure and the market presence?

Konstantin Noskov:

– As I have told earlier, at the moment, customer deposits represent our only funding source. We certainly used such funding methods in the past, when it was necessary. We placed both Eurobonds and Russian bonds; however, we are not interested in this area at the moment. We apply an opportunistic approach to such possibility: if the market offers us an attractive rate corresponding to the rate at which we raise customer funds, then why not? However, we will not issue Eurobonds at 6%, when we pay 2-3% to our customers.

Konstantin Balandin:

– With one proviso, that we are going to do mortgage loan portfolio securitization.

Participant 9:

– Taking into account that the strategy sets rather ambitious targets for the management, will there be any changes in the incentive system? Will there be an incentive options program for the management? How can it be structured?

Konstantin Noskov:

– There is no options program at the moment indeed. At the same time, incentives of top management depend both on the share price and return on equity. An options program is what we are currently thinking about in the Bank. I cannot set any particular deadline at the moment, but your question is clear and we will answer it in the near future.

Konstantin Balandin:

– The whole top management holds shares; it is not an options program by format, as an incentive program but this is the way it is done in our Bank.

Participant 9:

– How does the current incentive program work, if it depends on the share price? Does it include comparison with analogs, which is taken into consideration when calculating the remuneration amount?

Konstantin Balandin:

– Our incentive system has been established in KPI style. The Supervisory Board approves it, while the HR and Remuneration Committee takes an active part in its development. The main KPI is return on equity. There is a set of bank-wide KPIs, which includes the share price. Every top manager has own personal KPIs, depending on his area of responsibility in the Bank.

Participant 9:

– And the last question: you have recently launched a venture capital fund. Could you please share the results of these projects? How big is the fund? You have noted that you need to invest in digitalization in future. Did you manage to find any promising area?

Konstantin Balandin:

– We have invested less than USD 10 mln into our venture capital fund, so the amounts are small. For us, this is mainly a tool ensuring our permanent market presence and providing us with an understanding of the situation in the innovation sector. When you really go through the sector's "filter", you understand what innovations are available, whether you should be afraid of the fintech sector or not, and what to develop. It is a kind of an educational program to a great extent.

The fund includes different project – some of them may be a success and some not. We do not expect to earn or lose a lot here, but for us, this is a tool to understand the development course of the sector, innovation trends in the banking sector, near-banking sector, and customer service sector. So, I would rather say that it is more a tool than a business division. And this tool is immaterial for the Bank's balance.

Konstantin Noskov:

– Dear colleagues, do you have any questions? If there are no more questions, I would like to thank you for your attention! We are happy that our tradition is held up. See you next year; however, I guess we will meet many times this year as well. Thank you!

Konstantin Balandin:

– Thank you very much! We highly appreciate your feedback. Thank you!