

Rating Action: Moody's concludes review on SC Citadele Banka and Siauliu Bankas

Global Credit Research - 17 Jun 2015

Actions conclude methodology-related review

London, 17 June 2015 -- Moody's Investors Service has today concluded its rating reviews on SC Citadele Banka (Citadele) and Siauliu Bankas, AB (Siauliu). These reviews were initiated on 17 March 2015 following the publication of Moody's new bank rating methodology (see "Rating Methodology: Banks," 16 March 2015, available at moodys.com) and include revisions in Moody's government support assumptions for Citadele Banka only.

Moody's has affirmed SC Citadele Banka's b3 baseline credit assessment (BCA), its b3 adjusted BCA and the Not-Prime short-term deposit ratings and upgraded its long-term deposit ratings to B1 from B2. The outlook on the long term rating has been changed to positive. Moody's has also assigned Ba3(cr)/NP(cr) long- and short-term Counterparty Risk Assessments (CR Assessments) to the bank.

Moody's has affirmed Siauliu Banka's b1 BCA, its b1 adjusted BCA, and the Not-Prime short-term deposit ratings and upgraded its long-term deposit ratings to Ba2 from B1. The outlook on the long-term rating is stable. Moody's has also assigned Ba1(cr)/NP(cr) long- and short-term CR Assessments to Siauliu Bankas.

For more information on the new bank rating methodology, please see Moody's press release at https://www.moodys.com/research/Banks--PBC_179038.

The full list of affected ratings is provided at the end of the press release.

RATINGS RATIONALE

The new methodology includes a number of elements that Moody's has developed to help accurately predict bank failures and determine how each creditor class is likely to be treated when a bank fails and enters resolution. These new elements capture insights gained from the crisis and the fundamental shift in the banking industry and its regulation.

In terms of the application of the new methodology to these two Baltic banks, Moody's rating actions reflect (1) Moody's view of Citadele's "Moderate" and Siauliu's "Strong-" macro profiles; (2) the banks' improving financial fundamentals, mainly strengthening profitability and decreasing problem loans, balanced against weak capitalisation and a limited track-record of good profitability; (3) the protection offered to senior creditors by substantial volumes of bail-in-able securities, as captured by Moody's Advanced Loss Given Failure (LGF) liability analysis; and (4) a reduction in Moody's view of the likelihood of government support, which only impacts Citadele as Siauliu's ratings had not previously incorporated government support uplift.

1) Macro profiles

Siauliu Bankas "Strong-" macro profile is based on the macro conditions within Lithuania (A3 stable), as all the bank's lending is to customers in that country.

Citadele Banka's "Moderate" macro profile reflects the bank's much broader geographical coverage, as it collects deposits from multiple countries. In determining the macro profile, Moody's bases its analysis on Citadele's liabilities, around half of which are in Latvia to which Moody's assigns a country macro profile of "Moderate". A quarter of the liabilities (mainly deposits) are from other European Union member-countries. The remaining liabilities are from Commonwealth of Independent States (CIS) countries.

2) Improving financial performance

--Siauliu

Siauliu has gradually strengthened its profitability since the 2008/09 financial crisis. Moody's calculates that higher net interest income (NII) has driven a return on equity (ROE) of 7.3% for 2014 compared with 4.8% ROE three

years earlier. NII increased to \$54.6 million in 2014 compared with \$22.1 million in 2011, according to Moody's calculations. High impairment charges of \$22.8 million in 2014, as per Moody's calculations, mean that Siauliu's profitability is constrained. However, Siauliu's impairment charges decreased by around half in Q1 2015 compared with the same period a year earlier.

Capitalisation is a key weakness for Siauliu, with a reported 12.7% capital adequacy ratio at 31 March 2015. Weak capitalisation stems from the 2008-09 financial crisis that resulted in a severe economic downturn in all Baltic countries. However, economic growth has since been strong in Lithuania and Moody's forecasts 3.4% real GDP growth for 2016. This is likely to result in a gradual lowering of problem loan levels. Total reported past-due loans decreased to EUR64.0 million at 31 March 2015 compared with EUR84.3 million at year end-2014.

--Citadele

Citadele has also consistently strengthened its financial performance since it was founded five years ago (as a "good bank" following the failure of Parex Banka). Stronger net interest income (\$83.0 million for 2014 compared with \$60.8 million in 2011) and slightly higher fee income meant that reported ROE reached 16.8% at 31 March 2015, compared with a loss of 21.6% in 2010. In addition, over the next five years, Moody's believes that the bank's profitability will be supported by gradually lower impairment charges as the proportion of problem loans slowly decreases on the back of Moody's 3.2% real GDP forecast for Latvia in 2016. Moody's calculates that problem loans, as a proportion of gross loans, gradually decreased to 12.3% at year end-2014 from 15.1% four years earlier.

Capitalisation is a key weakness for Citadele, which reported a capital adequacy ratio of 12.0% at 31 March 2015. The bank was majority owned by the Latvian government until 20 April 2015 (the EBRD still hold 25% minus one share of Citadele), and public ownership meant that Citadele was prohibited from building capital in excess of 50 basis points above the regulatory minimum. However, that restriction no longer applies, owing to the recent privatisation (the government's stake was bought by a group of investors led by the private equity company Ripplewood Advisors LLC, based in the US (Aaa stable)). In addition, in association with the privatisation, the owners injected EUR10 million into the bank in addition to re-organising Citadele's subordinated debt. These measures strengthened the bank's regulatory capital by almost EUR19 million, thus strengthening the capital adequacy ratio by approximately one percentage point, according to Citadele.

3) Advanced LGF analysis

Both Latvia and Lithuania are members of the EU and, given the implementation of the Bank Recovery and Resolution Directive (BRRD), Moody's applies its Advanced LGF analysis to banks' liability structures in both of these countries. This analysis results in a "Very Low" loss given failure for long-term deposits of both Siauliu and Citadele, taking into account the protection offered by the banks' sizeable volumes of junior deposits combined with some bail-in-able subordinated debt, thus more than offsetting the negative impact of less likely government support for Citadele.

4) Lower likelihood of government support

Moody's has lowered its expectations about the degree of support that a government might provide to banks in Latvia and Lithuania. The main trigger for this reassessment is the introduction of the BRRD. However, a decline in expected loss assumptions under the new LGF framework offsets the impact of less likely government support.

Following the introduction of the BRRD, Citadele is less likely to benefit from government support. Hence, Moody's has removed the one notch of government support from Citadele's deposit ratings. The ratings assigned to Siauliu do not benefit from government support.

RATIONALE FOR OUTLOOKS

Moody's has assigned a positive outlook to Citadele. Following its privatisation the bank is no longer prohibited from accumulating capital in excess of 50 basis points above the regulatory minimum. The bank's owners have already signalled their willingness to strengthen Citadele's capitalisation by injecting EUR10 million into the bank. In addition, Moody's has calculated that the bank's problem loans have gradually decreased to 12.3% at year end-2014 from 15.1% at year end-2011, and expect this trend to continue as Latvian real GDP is likely to grow by 3.2% in 2016.

Moody's has assigned a stable outlook to Siauliu owing to the stable operating environment in Lithuania which is the underlying driving force for why Moody's expects the bank's financial performance to be stable over the coming one to three years.

WHAT COULD CHANGE THE RATINGS UP/DOWN

Citadele's deposit ratings could come under upward pressure if (1) capitalisation strengthens, (2) problem loan levels decrease, (3) profitability remains at current adequate levels, and (4) the bank is able to defend its franchise given the competition from Baltic subsidiaries of Nordic banks. A weakening of any of the above measures and/or a smaller cushion of outstanding bail-in-eligible debt could result in a downgrade of Citadele's ratings.

Siauliu's deposit ratings could also come under upward pressure if (1) capitalisation strengthens, (2) problem loan levels decrease, (3) profitability continues to strengthen, and (4) the bank is able to defend its franchise given the competition from Baltic subsidiaries of Nordic banks. A weakening of any of the above measures and/or a smaller cushion of bail-in-eligible debt could result in a downgrade of Siauliu's ratings.

ASSIGNMENT OF COUNTERPARTY RISK ASSESSMENTS

Moody's has assigned Ba3(cr)/NP(cr) long and short-term CR Assessments to Citadele and Ba1(cr)/NP(cr) long- and short-term Counterparty Risk Assessments (CR Assessments) to Siauliu.

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails, and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than expected loss and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

The CR Assessment takes into account the issuer's standalone strength as well as the likelihood of affiliate and government support in the event of need, reflecting the anticipated seniority of these obligations in the liabilities hierarchy. The CR Assessment also incorporates other steps authorities can take to preserve the key operations of a bank should it enter a resolution.

The CR Assessments of Citadele and Siauliu are positioned, prior to government support, three notches above the banks' Adjusted BCAs, based on the cushion against default provided to the senior obligations represented by the CR Assessment by subordinated instruments. The main difference with Moody's Advanced LGF approach used to determine instrument ratings is that the CR Assessment captures the probability of default on certain senior obligations, rather than expected loss, therefore Moody's focus purely on subordination and take no account of the volume of the instrument class.

The CR Assessments do not benefit from any government support, in line with our support assumptions on deposits and senior unsecured debt for these banks. This reflects our view that operating activities and obligations reflected by the CR Assessment are unlikely to benefit from any support provisions from resolution authorities to senior unsecured debt or deposits.

The principal methodology used in these ratings was Banks published in March 2015. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

LIST OF AFFECTED RATINGS

..Issuer: SC Citadele Banka

....LT Deposit Rating, Upgraded to B1 Positive from B2 Ratings Under Review

.... ST Deposit Rating, Affirmed NP

.... Adjusted Baseline Credit Assessment, Affirmed b3

.... Baseline Credit Assessment, Affirmed b3

.... Counterparty Risk Assessment, Assigned Ba3(cr)

.... Counterparty Risk Assessment, Assigned NP(cr)

....Outlook, Changed To Positive From Rating Under Review

..Issuer: Siauliu Bankas, AB

...LT Deposit Rating, Upgraded to Ba2 Stable from B1 Ratings Under Review

.... ST Deposit Rating, Affirmed NP

.... Adjusted Baseline Credit Assessment, Affirmed b1

.... Baseline Credit Assessment, Affirmed b1

.... Counterparty Risk Assessment, Assigned Ba1(cr)

.... Counterparty Risk Assessment, Assigned NP(cr)

....Outlook, Changed To Stable From Rating Under Review

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