

CREDIT OPINION

7 April 2022

Update



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RATINGS

Converse Bank CJSC

Domicile	Yerevan, Armenia
Long Term CRR	B1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	B1
Type	LT Bank Deposits - Fgn Curr
Outlook	Negative

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Converse Bank CJSC

Update to credit analysis following change of outlook to negative

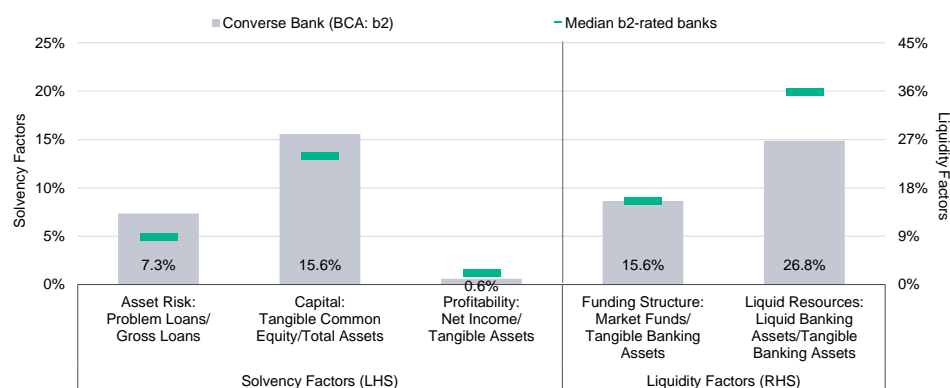
Summary

On 29 March 2022, we affirmed the B1 long-term local and foreign-currency deposit ratings and b2 Baseline Credit Assessment (BCA) of [Converse Bank CJSC's](#) (Converse Bank). We changed the outlook on its deposit ratings to negative from stable. The negative outlook reflects the negative outlook on the Armenian government issuer rating, which will result in a lower ability to support Converse Bank's b2 BCA, in the event of a downgrade of the Armenian government's issuer rating. Converse Bank's B1 local currency deposit rating benefits from a one notch of support uplift due to our assessment of moderate probability of government support for the bank's deposits.

Converse Bank's rating, especially its BCA, reflect our expectation of a difficult operating environment due to the on-going Russia-Ukraine crisis and increasing asset risks that will limit the bank's profitability growth this year. Converse Bank's solvency is, however, supported by its solid capital buffers. The ratings also reflects our view that, along with its domestic peers, Converse Bank's funding profile, in particular dollar deposits, will be challenged by lower remittance flows into Armenia. However, as of June 2021, Converse Bank increased its stock of liquid assets while reducing its loan-to-deposit ratio, which will help it withstand the expected funding challenges.

Exhibit 1

Key financial ratios As of 30 June 2021



Source: Moody's Investors Service

Credit strengths

- » Good loss absorption capacity, underpinned by solid capital buffers
- » Stable liquidity and moderate reliance on market funds
- » Moderate probability of government support, in case of need

Credit challenges

- » Operating in a challenging environment with rising asset risks
- » Low provision coverage of problem loans
- » High exposure to foreign-currency loans at around 60% of gross loans

Outlook

The negative outlook on Converse Bank's long-term deposit ratings is aligned with the negative outlook on the sovereign rating. The negative outlook on Armenian government debt rating indicates a lower ability to support the b2 BCA in the event of a downgrade.

Factors that could lead to an upgrade

Rating upgrades are unlikely in the next 12 to 18 months given the unfavorable operating conditions in the country and the negative outlook. However, the ratings can be stabilised if the operating environment improves, and Converse Bank maintains its resilient financial performance.

Factors that could lead to a downgrade

A downgrade of the credit rating of the Government of Armenia would exert downward pressure on Converse Bank's ratings, in view of the weakening capacity of the government to support the bank. Converse Bank's deposit and debt ratings could also be downgraded if the solvency or liquidity were to deteriorate materially beyond our current expectations amid further weakening of the operating conditions.

Key indicators

Exhibit 2

Converse Bank CJSC (Consolidated Financials) [1]

	06-21 ²	12-20 ²	12-19 ²	12-18 ²	12-17 ²	CAGR/Avg. ³
Total Assets (AMD Million)	359,915.9	332,436.9	325,628.5	281,119.4	252,735.9	10.6 ⁴
Total Assets (USD Million)	725.8	636.1	678.8	581.1	522.1	9.9 ⁴
Tangible Common Equity (AMD Million)	46,075.5	44,952.9	39,626.7	34,028.6	30,396.7	12.6 ⁴
Tangible Common Equity (USD Million)	92.9	86.0	82.6	70.3	62.8	11.8 ⁴
Problem Loans / Gross Loans (%)	7.7	6.2	4.3	4.2	5.0	5.5 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	13.7	13.6	13.1	11.8	12.4	12.9 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	31.4	27.5	22.2	22.0	24.2	25.4 ⁵
Net Interest Margin (%)	4.3	4.4	4.5	4.4	4.3	4.4 ⁵
PPI / Average RWA (%)	2.1	3.0	2.8	2.8	2.8	2.7 ⁶
Net Income / Tangible Assets (%)	0.6	0.8	1.7	1.7	1.4	1.3 ⁵
Cost / Income Ratio (%)	61.3	50.6	55.0	55.5	58.4	56.1 ⁵
Market Funds / Tangible Banking Assets (%)	18.7	15.6	14.8	16.5	13.4	15.8 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	37.1	26.8	25.9	26.1	30.7	29.3 ⁵
Gross Loans / Due to Customers (%)	92.2	104.6	104.0	107.2	97.7	101.1 ⁵

[–] Further to the publication of our revised methodology in July 2021, for issuers that have "high trigger" additional Tier 1 instruments outstanding, not all ratios included in this report reflect the change in treatment of these instruments. [1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel I; IFRS. [3] May include rounding differences

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because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel I periods.

Sources: Moody's Investors Service and company filings

Profile

Converse Bank CJSC (Converse Bank) is a universal commercial bank that ranked seventh among 17 Armenian banks by assets as 30 September 2021 with a consolidated asset base of AMD369.4 billion (\$760 million). Headquartered in Yerevan, the bank operates through a network of 35 branches.

Converse Bank's ultimate beneficiary shareholder is an Argentine businessman, Eduardo Eurnekian, who is Armenian by origin. He owns the holding company Corporacion America Group, which includes a conglomerate of different companies that are active in the administration and operation of airports in Latin America and Europe, and in the agriculture, energy and infrastructure sectors. Corporacion America Airports S.A. is listed on the New York Stock Exchange since 2018.

Detailed credit considerations

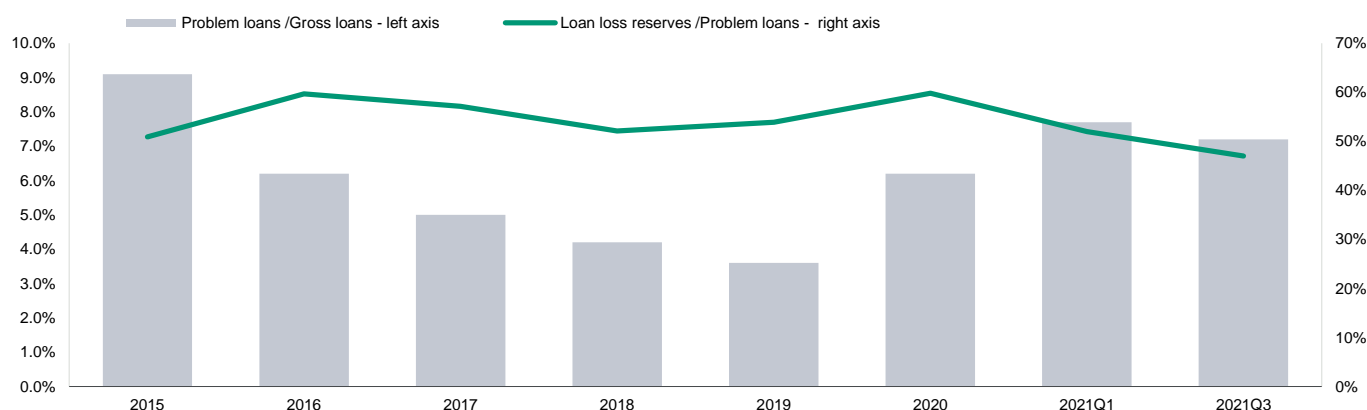
A difficult operating environment, per our expectations, will increase asset risks in the next 12 months

We expect Armenia's near- and longer-term growth outlook to deteriorates materially due to the impact of a sharp weakening of prospects for the Russian economy, which Armenia is linked to. In turn, weaker economic growth will have a negative impact on banks' business generation capacity and their asset quality.

Converse Bank's problem loans ratio was 7.7% as of March 2021, up from 3.6% before the pandemic in December 2019. More recently, the ratio reduced to 7.2% as of September 2021, but we expect the ratio to be negatively pressured by the now more difficult operating environment. In addition, Converse Bank, as is the case with its domestic peers, has large exposure to loans denominated in foreign currency at about 60% of its gross loans. We believe some of these loan were extended to unhedged borrowers, and a weakening of the local currency will negatively impact their repayment capacity. The bank's loan loss reserves to problem loans ratio is also modest at about 47% as of September 2021, way below the media of 86% for its global peers with BCA of b2.

Exhibit 3

Converse Bank's problem loans will likely increase amid falling loan loss coverage



Source: The bank and Moody's Investors Service

However, Converse Bank has a relatively diversified loan-book. Retail loans, including consumer loans and mortgages, accounted for 50% of total loans as of 30 September 2021 while corporate loans (including SME loans) accounted for the remaining 50%. The bank's net related-party exposure, a key credit consideration in the region, is not significant because most of the loans are collateralised by cash deposits.

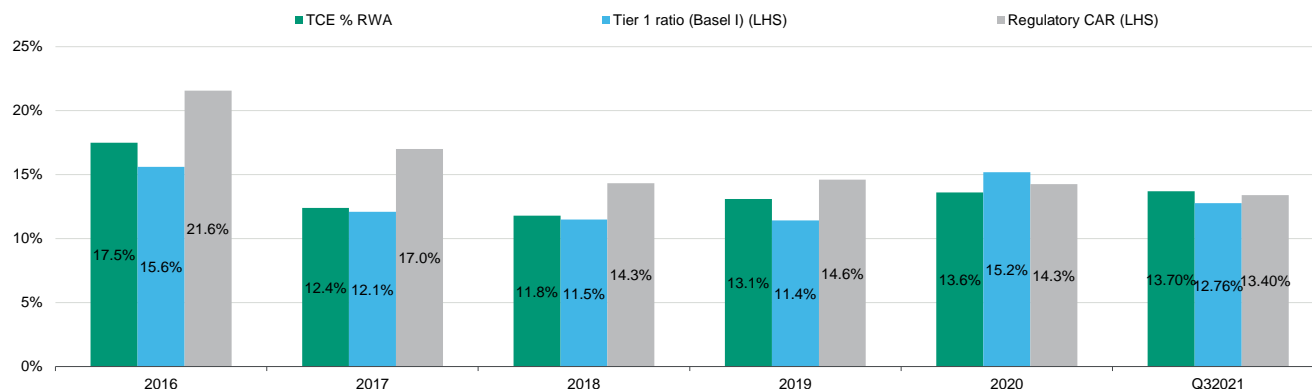
Solid capital position will provide good loss absorbance capacity

Converse Bank's capital position is robust with a tangible common equity to risk weighted assets ratio of 15.6% as of September 2021, compared to a median of 13.3% for banks with b2 BCA. The bank's leverage is also modest, with a shareholders' equity to total

assets ratio of 13.7% at end of third quarter. We expect Converse Bank's capital buffers to remain within the range of its global peers, although it will be vulnerable to unexpected losses, given the challenging operating conditions in Armenia.

Exhibit 4

Converse Bank's capital ratios have been stable but are vulnerable to higher unexpected losses this year



Sources: The bank and Moody's Investors Service

We expect limited retained profitability this year, which will constrain organic capital growth. As well, in the event of a sustained depreciation of the local currency, the bank's capital metrics would be strained, given the bank's large volume of loans denominated in dollars. These loans would translate into higher risk weighted assets, suppressing the capital metrics. However, revaluation gains from the bank's foreign denominated assets would moderate the negative pressures.

Likely lower revenue growth and higher provisions will limit profitability growth

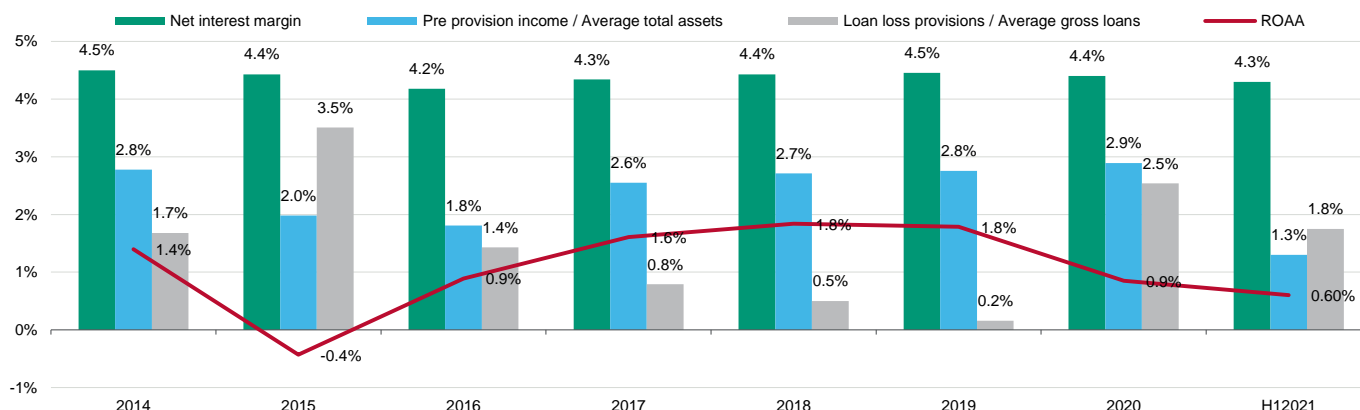
We expect the slower economic activity and lower remittance flows into Armenia to negatively impact the business generation capacity of Armenian banks, including Converse Bank. This challenging operating environment will also increase assets risks, and in turn provisions, eroding the bank's net profitability.

Converse Bank's pre-provision income benefits from its stable net interest margins (NIMs). The bank's NIM has been stable at about 4.3% since 2014, supporting the bank's net interest income. Non-interest income has been benefiting from large revaluation gains, given the bank's large stock of assets denominated in foreign currency. We expect slower economic activity to restrain loan growth, and with it interest income, while lower remittances will negatively pressure non-interest income. The bank's cost-to-income ratio has increased to 61% as of June 2021 from 50% at year-end 2020, and we expect it to increase again this year. However, the bank's pre-provision profitability will continue to benefit from foreign exchange translation gains.

We expect provisions set aside for loan losses to increase this year. Converse Bank's loan loss provisions have generally been high, compared to its global peers. The bank's loan loss ratio was 1.7% as of June 2021, and although this was an improvement from 2.5% at year-end 2020, it remained higher than the median of 1.2% for banks with BCA of b2. Rising asset risks, a result of the Russian-Ukraine crisis and lower remittances will mean that further improvements in provisioning costs are unlikely this year.

For the first nine months of 2021, Converse Bank reported net profit of AMD1.5 billion, which was 56% lower than the AMD3.4 billion reported for the first nine months of 2020. Annualised return on tangible assets was 0.6%, down from 0.8% in 2020, and substantially lower than the 1.2% median for banks with b2 BCA. However, we expect the bank's pre-provision income to remain sufficient to absorb some of the expected higher credit losses and the bank to remain profitable, although at lower levels.

Exhibit 5

Converse Bank's profitability will be negatively pressured by slower revenue growth and higher loan losses provisions

Sources: The bank and Moody's Investors Service

Lower remittances will harm dollar inflows but funding profile will remain in line with global peers.

Converse Bank's funding profile has been stable, but we expect lower remittances to create dollar deposit volatility this year. We expect remittance flows into Armenia to decline by 20-30% this year, amid an economic contraction in Russia and a depreciation of the ruble.

Converse Bank's loan-to-deposit ratio, while improving from 104% at year-end 2020, remained relatively high at 92% as of June 2021. We expect lower remittances and a slower economy to suppress deposit growth this year, and thus negate any funding benefits that are likely to come from slower loan growth due to lower economic activity. However, Converse Bank's reliance on market funding will likely remain moderate (it was around 18% of tangible assets as of June 2021), and will mainly constitute bonds and borrowed funds from both domestic and international development institutions.

The bank's moderate deposit concentrations will also mitigate the impact of expected deposit volatility. As of 30 September 2021, customer funds accounted for around 80% of the bank's liabilities, and almost half of the customer deposits were retail, including funds of high-net-worth individuals from the Armenian diaspora, thus reducing concentration risk. Converse Bank's stock of liquid assets to tangible assets was 34% as of June 2021, which is in line with the 35% median for banks with a BCA of b2. We expect the bank to build up its liquidity buffer amid uncertainty that has been triggered by the on-going Russia-Ukraine crisis.

ESG considerations

In line with our general view of the banking sector, Converse Bank has low exposure to environmental risks (see our [environmental risk heat map](#) for further information).

We regard the escalating military conflict in Armenia as high social risk under our environmental, social and governance (ESG) framework because of the substantial implications for public health and safety. Banks in the Commonwealth of Independent States (CIS) face social risks from four key factors, three of which stem from demographic and societal trends that pose greater risks for CIS banks than the global average. Firstly, a potential escalation of domestic and regional conflicts can trigger economic disruptions and a deterioration in asset quality and funding. Secondly, shrinking and ageing populations in some CIS countries (Russia, Ukraine and Belarus) are a long-term threat to banks' revenue generation and profitability. Thirdly, state-owned banks actively involved in social policies play a large role in several CIS banking systems, and their policy-driven lending decisions often lead to asset risks. The fourth key factor is customer relations, which pose very high risks for CIS banks as they do for their peers globally. See [Banks – Commonwealth of Independent States: Civil unrest and demographic changes pose substantial social risks](#), published in April 2021, for further information.

We also regard the coronavirus pandemic as a social risk under our ESG framework because of the substantial implications for public health and safety.

Governance is highly relevant for Converse Bank, as it is to all competitors in the banking industry. Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. For banks operating

in CIS countries, key-person and related-party risks are key governance risks. These risks are manifested in, but not limited to, heavy related-party loan concentrations and banks' heavy dependence on single individuals for business, which often give rise to weak corporate governance and lax underwriting standards.

Governance risks are largely internal rather than externally driven. For Converse Bank, we do not have any particular governance concern, and we do not apply any corporate behaviour adjustment to the bank's scores. Converse Bank has not shown any significant governance shortfall in recent years, and its risk management framework is commensurate with its risk appetite. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Government support considerations

We incorporate a moderate probability of support from the Armenian government, reflecting the proven sustainability of the bank's recently regained market share of around 6% in total assets, loans and retail deposits. This support assumption results in one notch of rating uplift from Converse Bank's BCA of b2.

Counterparty Risk (CR) Assessment

Converse Bank's CR Assessment is B1(cr)/NP(cr)

The CR Assessment is positioned one notch above the BCA of b2 and, therefore, in line with the deposit ratings. This reflects our view that its probability of default is lower than that of senior unsecured debt and deposits in the absence of government support. Senior obligations represented by the CR Assessment will more likely be preserved to limit contagion, minimise losses and avoid the disruption of critical functions.

Counterparty Risk Ratings (CRRs)

Converse Bank's CRRs are B1/NP

Converse Bank's global CRRs are positioned at B1/Not-Prime, one notch above the bank's Adjusted BCA. This reflects our view that CRR liabilities are not likely to default at the same time as the bank fails and will more likely be preserved to minimise banking system contagion, minimise losses and avoid the disruption of critical functions.

Methodology and scorecard

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement is expressed. As a result, the output of our scorecard may significantly differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 6

Converse Bank CJSC

Macro Factors							
Weighted Macro Profile		Weak	100%				
Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2	
Solvency							
Asset Risk							
Problem Loans / Gross Loans	7.7%	b3	↔	caa1	Collateral and provisioning coverage	Market risk	
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel I)	13.7%	ba3	↓	ba3	Expected trend		
Profitability							
Net Income / Tangible Assets	0.6%	b2	↓	b2	Expected trend		
Combined Solvency Score		b2		b2			
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets	15.6%	ba3	↔	b1	Market funding quality		
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets	26.8%	ba3	↓	b1	Expected trend		
Combined Liquidity Score		ba3		b1			
Financial Profile				b2			
Qualitative Adjustments				Adjustment			
Business Diversification				0			
Opacity and Complexity				0			
Corporate Behavior				0			
Total Qualitative Adjustments				0			
Sovereign or Affiliate constraint				-			
BCA Scorecard-indicated Outcome - Range				b1 - b3			
Assigned BCA				b2			
Affiliate Support notching				0			
Adjusted BCA				b2			
Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating	
Counterparty Risk Rating	1	0	b1	0	B1	B1	
Counterparty Risk Assessment	1	0	b1 (cr)	0	B1(cr)		
Deposits	0	0	b2	1	B1	B1	

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Investors Service

Ratings

Exhibit 7

Category	Moody's Rating
CONVERSE BANK CJSC	
Outlook	Negative
Counterparty Risk Rating	B1/NP
Bank Deposits	B1/NP
Baseline Credit Assessment	b2
Adjusted Baseline Credit Assessment	b2
Counterparty Risk Assessment	B1(cr)/NP(cr)

Source: Moody's Investors Service

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