

## CREDIT OPINION

25 March 2020

Update

✓ Rate this Research

### RATINGS

#### Converse Bank CJSC

Domicile	Yerevan, Armenia
Long Term CRR	Ba3
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	Stable

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.

### Contacts

Lev Dorf +7.495.228.6056  
AVP-Analyst  
lev.dorf@moodys.com

Yaroslav Sovgyra, +7.495.228.6076  
CFA  
Associate Managing Director  
yaroslav.sovgyra@moodys.com

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## Converse Bank CJSC

### Update to credit analysis

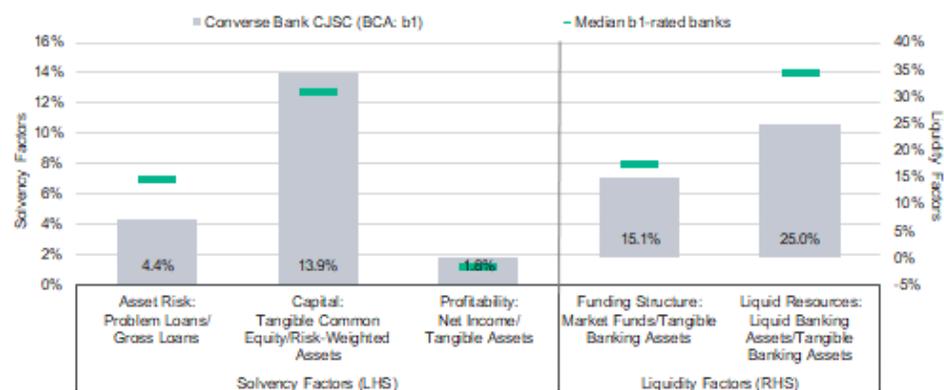
#### Summary

We assign long-term global local- and foreign-currency deposit ratings of B1 to the Armeniabased [Converse Bank CJSC](#) (Converse Bank). The ratings are at the same level as the bank's Baseline Credit Assessment (BCA) of b1 because the moderate probability of support from the [Government of Armenia](#) (Ba3 stable) does not result in a rating uplift.

Converse Bank's b1 BCA reflects its (1) solid loss-absorption capacity, underpinned by its good capital buffer and profitability; and (2) stable funding profile and liquidity. These strengths can, however, reverse if the current economic shock because of the global spread of coronavirus broadens and lengthens relative to our base case scenario. At the same time, Converse Bank's b1 BCA remains constrained by its high exposure to foreign-currency loans and low loan-loss reserve coverage of problem loans.

Exhibit 1

#### Rating Scorecard - Key financial ratios



Converse Bank's data is as of 30 June 2019.

Source: Moody's Investors Service

## Credit strengths

- » Solid loss-absorption capacity, underpinned by the bank's good capital buffer and profitability
- » Stable liquidity and moderate reliance on market funds
- » Moderate probability of government support in case of need, given the bank's solid 6% market share

## Credit challenges

- » High exposure to foreign-currency loans (61% of gross loans as of year-end 2019)
- » Low loan-loss reserve coverage of problem loans
- » Lasting effect of the coronavirus outbreak will exert pressure on the bank's asset quality and profitability

## Outlook

The stable outlook on Converse Bank's long-term deposit ratings is aligned with the stable outlook on the sovereign rating

## Factors that could lead to an upgrade

- » Converse Bank's BCA, and its deposit ratings will not likely be upgraded in next 12-18 months due to increased challenges related to coronavirus outbreak

## Factors that could lead to a downgrade

- » Converse Bank's ratings could be downgraded if operating environment in Armenia deteriorates, increasing pressures on the bank's asset quality, profitability and capital adequacy
- » Converse Bank's deposit ratings could be downgraded following a downgrade of Armenia's sovereign rating

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moodys.com](http://www.moodys.com) for the most updated credit rating action information and rating history.

## Key indicators

Exhibit 2

### Converse Bank CJSC (Consolidated Financials) [1]

	09-19 <sup>2</sup>	12-18 <sup>2</sup>	12-17 <sup>2</sup>	12-16 <sup>2</sup>	12-15 <sup>2</sup>	CAGR/Avg. <sup>3</sup>
Total Assets (AMD Million)	302,182.7	281,119.4	252,735.9	190,993.3	158,903.2	18.7 <sup>4</sup>
Total Assets (USD Million)	634.9	581.1	522.1	394.7	328.5	19.2 <sup>4</sup>
Tangible Common Equity (AMD Million)	38,219.1	34,028.6	30,396.7	27,319.8	16,860.5	24.4 <sup>4</sup>
Tangible Common Equity (USD Million)	80.3	70.3	62.8	56.5	34.9	24.9 <sup>4</sup>
Problem Loans / Gross Loans (%)	4.7	4.2	5.0	6.2	9.1	5.8 <sup>5</sup>
Tangible Common Equity / Risk Weighted Assets (%)	13.6	11.8	12.4	17.5	14.4	13.9 <sup>6</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	23.9	22.0	24.2	23.9	37.8	26.4 <sup>5</sup>
Net Interest Margin (%)	4.5	4.4	4.3	4.2	4.4	4.4 <sup>5</sup>
PPI / Average RWA (%)	2.8	2.8	2.8	2.3	2.4	2.6 <sup>6</sup>
Net Income / Tangible Assets (%)	1.7	1.7	1.4	0.8	-0.4	1.1 <sup>5</sup>
Cost / Income Ratio (%)	54.0	55.5	58.4	68.3	67.1	60.6 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	14.1	16.5	13.4	4.9	10.9	11.9 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	25.8	26.1	30.7	32.6	41.4	31.3 <sup>5</sup>
Gross Loans / Due to Customers (%)	104.1	107.2	97.7	88.5	78.0	95.1 <sup>5</sup>

[1]All figures and ratios are adjusted using Moody's standard adjustments. [2]Basel I; IFRS. [3]May include rounding differences due to scale of reported amounts. [4]Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5]Simple average of periods presented for the latest accounting regime. [6]Simple average of Basel I periods presented.

Source: Moody's Investors Service; Company Filings

## Profile

Converse Bank CJSC (Converse Bank) is a universal commercial bank that ranked seventh among 17 Armenian banks by assets as of 30 June 2019. The bank has been actively developing its retail (48% of gross loans as of year-end 2019) and small and medium-sized enterprise banking segments (21% as of year-end 2019). In 2019, Converse Bank held the third-largest mortgage portfolio among local banks and was among the top five banks by retail loans.

As of 31 December 2019, Converse Bank had a consolidated asset base of AMD326.6 billion (\$0.7 billion). 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 conglomeration of different companies that are active in the administration and operation of airports in Latin America and Europe, as well as in the agriculture, energy and infrastructure sectors. Corporacion America Airports S.A. is listed on the New York Stock Exchange since 2018.

## Recent developments

On 18 March 2020, the Armenian government announced that it will allocate AMD150 billion (\$310 million) to help the economy weather the widening effects of the coronavirus pandemic.

The Central Bank of Armenia (CBA) has recently clarified the situation on loan repayments amid the risk of the spread of coronavirus and encouraged commercial banks to apply an individual approach to the loan obligations of borrowers, especially those borrowers who have businesses in the hotel, restaurant, transport and entertainment sectors.

Starting from 16 March 2020, Converse Bank (like other local banks) announced supporting measures to individuals, sole proprietors and small businesses. According to the bank, borrowers are granted a two-month grace period on principal and interest payments. It also offered an option to reschedule their liabilities to address the imminent risks associated with the slowdown in these sectors.

## Detailed credit considerations

### Lasting effect of the coronavirus outbreak will exert pressure on the bank's asset quality

Converse Bank's problem loans (stage 3 loans) slightly increased to 4.4% of gross loans as of 31 December 2019 from 4.2% as of year-end 2018. The absolute amount of stage 3 loans increased by 19% driven by its corporate and unsecured retail portfolios. At the same

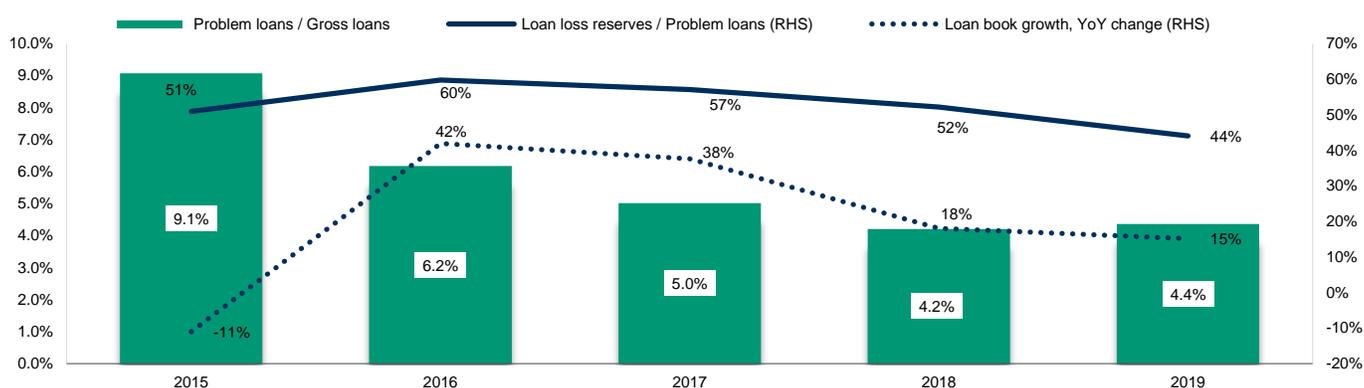
time, the coverage of problem loans with loan-loss reserves reduced in 2019 to just 44% from 52% as of year-end 2018 (see Exhibit 3). We expect that the coronavirus outbreak will have a direct impact on Armenian banks' asset quality and the level of problem loans will increase in the next 12-18 months. We could reassess our current assessment of this factor depending on the breath and severity of the shock and the broad deterioration in credit quality that it will trigger.

We see additional downside risks stemming from the bank's exposure to sectors such as hotels, restaurants and non-food retail, which are most vulnerable to the coronavirus outbreak. We estimate that these sectors accounted for around 10% of the bank's loan book or around 50% of shareholders' equity at the end 2019.

Converse Bank has a rather diversified loan-book structure, with retail loans (consumer loans and mortgages) accounting for 48% of total loans as of 30 June 2019 and corporate loans (including SME) accounting for the rest. However, In case of a lasting impact from the coronavirus outbreak, banks will be more willing to restructure loans to accommodate client needs and retail sector will be affected as well because SME sector accounts for a substantial share of employment in Armenia.

Net related-party exposure is not significant, because most loans are collateralised by cash deposits from the shareholder.

Exhibit 3

**Converse Bank's asset quality indicators**

Sources: Bank's IFRS reports and Moody's Investors Service

In addition, Converse Bank's exposure to foreign currency-denominated loans accounted for a high 61% of total loans as of year-end 2019, a level that, although typical for many Armenian banks, renders the bank's asset quality vulnerable to potential foreign-exchange volatility.

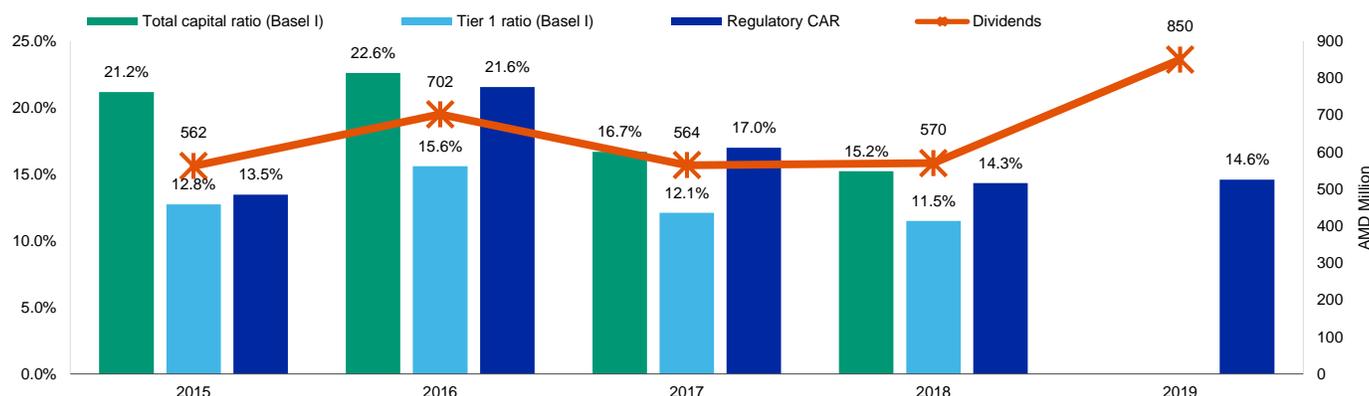
We assign an Asset Risk score of b3 to Converse Bank, which is two notches lower than the historical score. The negative adjustment reflects (1) our expectation that the problem loan ratio will exceed 5% in the next 12 -18 months, (2) the bank's high exposure to foreign-currency-denominated loans, and (3) its currently low level of loan-loss reserve coverage.

### Capital position will remain broadly stable in the next 12-18 months if the coronavirus outbreak remains largely contained

If the outbreak remains largely contained, local currency does not materially depreciate and disruption is short-lived, Converse Bank's capital position will remain broadly stable in the next 12-18 months, supported by its profit and slowing lending growth. We estimate that Converse Bank's tangible common equity/risk-weighted assets increased to 13.6% in 9M 2019 from 11.8% in 2018.

The bank's regulatory capital adequacy ratio amounted to 14.6% as of 31 December 2019, well above the minimum required level of 12%. Its Basel I total capital adequacy ratio would be higher than the regulatory one, which is typical of all Armenian banks because of stricter requirements of the CBA in terms of provisioning and assigning risk weights to banks' assets. We also expect CBA to apply forbearance measures, which would help to avoid deterioration of regulatory capital.

Exhibit 4

**Converse Bank's capital ratios**

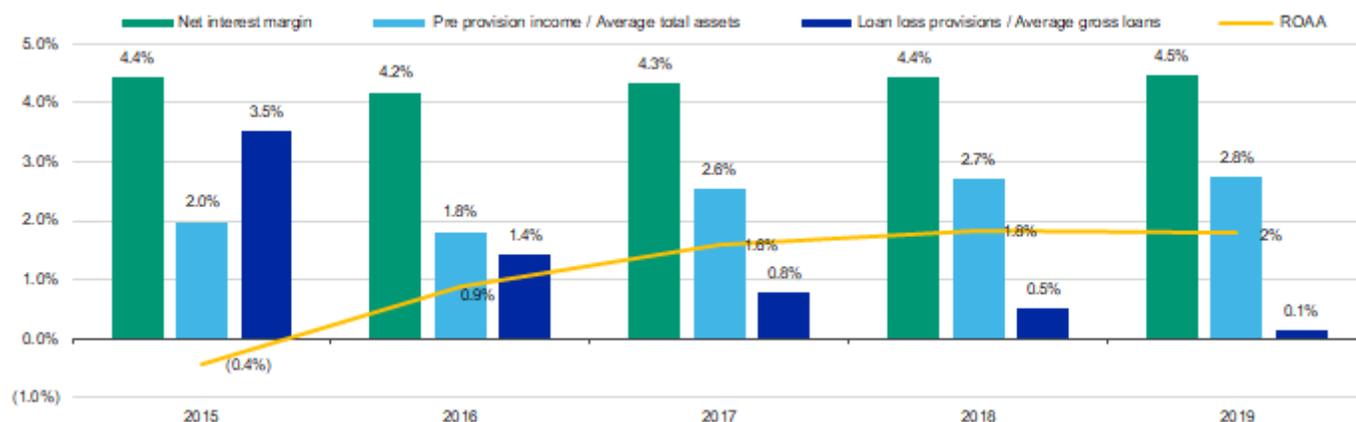
Sources: Bank's IFRS reports and management data

Our assigned ba2 Capital score reflects recent developments and the expected trend.

**Currently sound profitability will likely to decline in 2020**

We expect profitability in 2020 will be pressured constrained by slowing business activity and pressured by additional provisioning needs in case of a lasting impact of the coronavirus outbreak because banks will be more willing to restructure loans to accommodate client needs. From 16 March 2020, Converse Bank (like other local banks) announced supporting measures to individuals, sole proprietors and small businesses that can delay payments of their loan for two months. Converse Bank has consistently reported sound profitability, underpinned by a healthy net interest margin of around 4.5%, which has recently been supported by the growing share of high-yielding consumer loans in the bank's portfolio. Fees and commissions, generating 24%-26% of the bank's pre-provision income, will likely to decline because of slowing business activity in 2020.

Exhibit 5

**Converse Bank's profitability**

Source: Bank's IFRS reports and Moody's Investors Service

Accordingly, we expect Converse Bank's return on assets to remain above 1.0% in the next 12-18 months, with some strain from an increased cost of risk. These expectations are reflected in our assigned Profitability score of ba2.

**Sound liquidity and limited reliance on market funding**

Converse Bank's reliance on market funding was moderate at around 14%-15% of tangible assets at the end 2019, reflecting issued bonds and funds from both domestic and international development institutions. Nevertheless, we generally view the bank's funding profile as stable, with moderate deposit concentrations and a manageable degree of market funding reliance. As of year-end 2019, customer funds accounted for around 79% of the bank's liabilities, almost half of which are retail deposits, including funds of high-

net-worth individuals from the Armenian diaspora. Converse Bank's liquidity provides a sufficient buffer against potential outflow, amounting to 24% of its tangible assets as of 31 December 2019. Our combined liquidity score ba3 reflects recent developments and expected trends.

### Environmental, social and governance considerations

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

The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which are partly mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage because of product mis-selling or other types of misconduct is a further social risk. Societal trends are also relevant in a number of areas, such as shifting customer preferences toward digital banking services increasing information technology cost, aging population concerns in several countries impacting demand for financial services or socially driven policy agendas that may translate into regulations that affect banks' revenue base. Overall, we expect banks to face moderate social risks.

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 the Commonwealth of Independent States, we have identified key-person and related-party risks as the 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 gives rise to weak corporate governance and lax underwriting standards. Fraud and weak risk management have recently caused multiple bank closures and restructurings in Russia.

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 behavior adjustment to the bank. Converse Bank has not shown any material governance shortfall in recent years, and its risk management framework is commensurate with the bank's risk appetite. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

## Support and structural considerations

### Government support

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 does not currently result in any rating uplift, given the small gap between the sovereign rating of Ba3 and Converse Bank's BCA of b1.

### Counterparty Risk (CR) Assessment

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 both the likelihood of default and the expected financial loss suffered in the event of default, 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 (for example, swaps), letters of credit, guarantees and liquidity facilities.

#### **Converse Bank's CR Assessment is positioned at Ba3(cr)/NP(cr)**

The CR Assessment is positioned one notch above the BCA of b1 and, therefore, above senior unsecured and deposit ratings, reflecting our view that its probability of default is lower than that of senior unsecured debt and deposits. We believe senior obligations represented by the CR Assessment will be more likely preserved to limit contagion, minimise losses and avoid disruption of critical function.

### Counterparty Risk Ratings (CRRs)

CRRs are opinions of the ability of entities to honour the uncollateralised portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralised portion of payables arising from derivatives transactions and the uncollateralised portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

#### **Converse Bank's CRRs are positioned at Ba3/NP**

Converse Bank's global CRRs are positioned at Ba3 and Not-Prime, one notch above the bank's Adjusted BCA, reflecting our view that CRR liabilities are not likely to default at the same time as the bank fails and will more likely to be preserved to minimise banking system contagion, minimise losses and avoid 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 materially 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	5.0%	b1	↔	b3	Market risk	Collateral and provisioning coverage	
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel I)	13.6%	ba2	↔	ba2	Expected trend		
Profitability							
Net Income / Tangible Assets	1.4%	ba2	↓	ba2	Expected trend		
Combined Solvency Score		ba3		b1			
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets	16.5%	ba2	↔	ba3	Expected trend		
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets	26.1%	ba2	↓	ba3	Expected trend		
Combined Liquidity Score		ba2		ba3			
Financial Profile				b1			
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				ba3 - b2			
Assigned BCA				b1			
Affiliate Support notching				0			
Adjusted BCA				b1			

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	ba3	-	Ba3	Ba3
Counterparty Risk Assessment	1	0	ba3 (cr)	-	Ba3(cr)	
Deposits	0	0	b1	-	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
<b>CONVERSE BANK CJSC</b>	
Outlook	Stable
Counterparty Risk Rating	Ba3/NP
Bank Deposits	B1/NP
Baseline Credit Assessment	b1
Adjusted Baseline Credit Assessment	b1
Counterparty Risk Assessment	Ba3(cr)/NP(cr)

Source: Moody's Investors Service

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