

CREDIT OPINION

31 May 2021

Update

✓ Rate this Research

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	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.

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Converse Bank CJSC

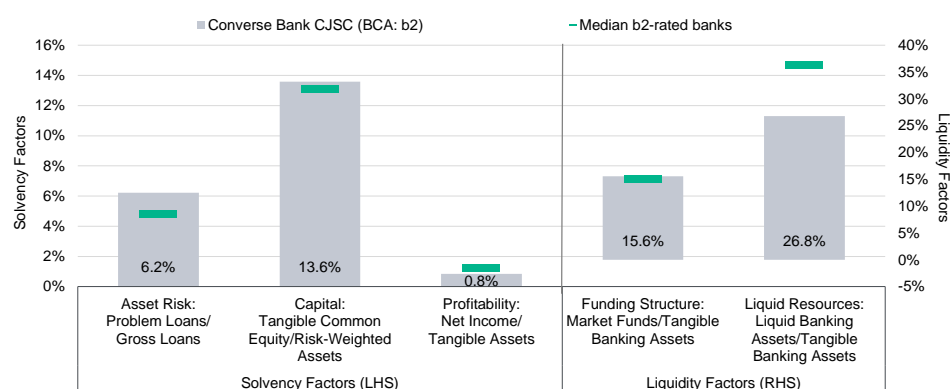
Update to credit analysis

Summary

The B1 deposit ratings of [Converse Bank CJSC](#) (Converse Bank) are based on the bank's Baseline Credit Assessment (BCA) of b2; and a moderate probability of support from the [Government of Armenia](#) (Ba3 stable), which benefits the bank's local-currency deposit rating. This results in one notch of rating uplift from its BCA of b2. Converse Bank's b2 BCA reflects its solid loss-absorption capacity, underpinned by its good capital buffer and profitability; stable funding profile and liquidity; high exposure to foreign-currency loans; and modest loan-loss reserve coverage of problem loans. At the same time, the bank's asset quality and profitability, similar to that of its local peers, is strained by deteriorated operating and economic conditions in 2020.

Exhibit 1

Rating Scorecard - Key financial ratios



Bank's IFRS data is as of 31 December 2020.
Source: Moody's Investors Service

Credit strengths

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

Credit challenges

- » Strained asset quality
- » Low coverage of problem loans
- » High exposure to foreign-currency loans, at around 60% of gross loans as of year-end 2020

Outlook

The stable outlook on Converse Bank's long-term deposit ratings is aligned with the stable outlook on the sovereign rating. The stable outlook also reflects our view that the elevated risks stemming from the deteriorated operating conditions will be counterbalanced by the bank's ample liquidity and robust capital position. Thus, any rating change is unlikely in the next 12-18 months.

Factors that could lead to an upgrade

Any upgrade of Converse Bank's BCA and its deposit ratings is unlikely in next 12-18 months because of the difficult operating conditions in the country. The bank's BCA could be upgraded if there is significant improvement in its asset quality and profitability.

Factors that could lead to a downgrade

Converse Bank's ratings could be downgraded if its financial fundamentals, primarily asset quality, capitalisation and profitability, were to deteriorate significantly.

Key indicators

Exhibit 2

Converse Bank CJSC (Consolidated Financials) [1]

	12-20 ²	12-19 ²	12-18 ²	12-17 ²	12-16 ²	CAGR/Avg. ³
Total Assets (AMD Million)	332,436.9	325,628.5	281,119.4	252,735.9	190,993.3	14.9 ⁴
Total Assets (USD Million)	636.1	678.8	581.1	522.1	394.7	12.7 ⁴
Tangible Common Equity (AMD Million)	44,952.9	39,626.7	34,028.6	30,396.7	27,319.8	13.3 ⁴
Tangible Common Equity (USD Million)	86.0	82.6	70.3	62.8	56.5	11.1 ⁴
Problem Loans / Gross Loans (%)	6.2	4.3	4.2	5.0	6.2	5.2 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	13.6	13.1	11.8	12.4	17.5	13.7 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	27.5	22.2	22.0	24.2	23.9	24.0 ⁵
Net Interest Margin (%)	4.4	4.5	4.4	4.3	4.2	4.4 ⁵
PPI / Average RWA (%)	3.0	2.8	2.8	2.8	2.3	2.8 ⁶
Net Income / Tangible Assets (%)	0.8	1.7	1.7	1.4	0.8	1.3 ⁵
Cost / Income Ratio (%)	50.6	55.0	55.5	58.4	68.3	57.5 ⁵
Market Funds / Tangible Banking Assets (%)	15.6	14.8	16.5	13.4	4.9	13.0 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	26.8	25.9	26.1	30.7	32.6	28.4 ⁵
Gross Loans / Due to Customers (%)	104.6	104.0	107.2	97.7	88.5	100.4 ⁵

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel I; IFRS. [3] May include rounding differences 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

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.moody's.com for the most updated credit rating action information and rating history.

Profile

Converse Bank CJSC (Converse Bank) is a universal commercial bank that ranked seventh among 17 Armenian banks by assets as of 31 March 2021. As of 31 March 2021, Converse Bank had a consolidated asset base of AMD356 billion (\$678 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

Asset quality will stabilise over the next 12-18 months

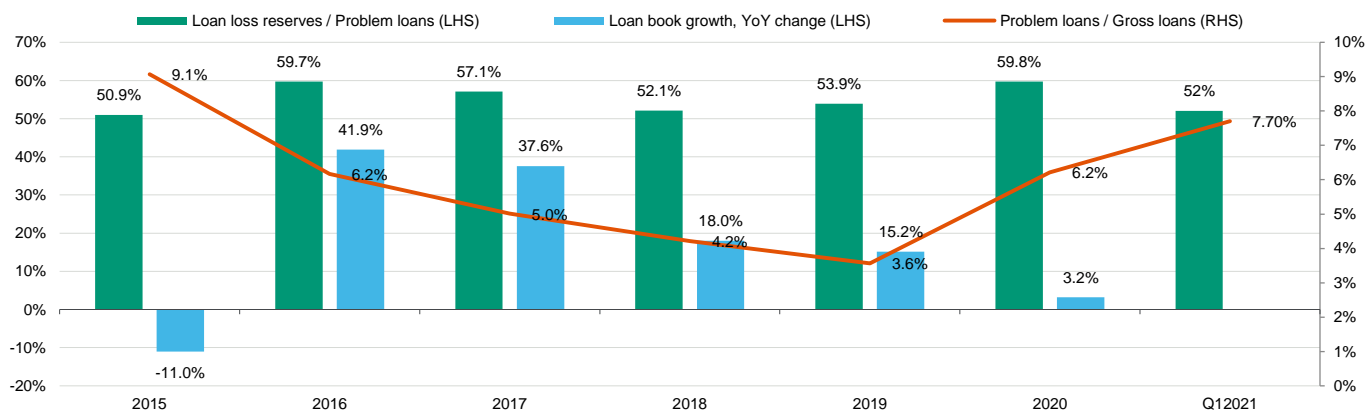
Converse Bank's problem loans (stage 3 loans) increased to 7.7% of gross loans as of 31 March 2021 from 6.2% as of year-end 2020 and 4.3% in 2019. We expect the bank's problem loans to stabilise at around 7% by year-end 2021, supported by stabilising economic and operating conditions for bank's borrowers.

In Q1 2021, problem loans increased by 22% in absolute terms because some restructured loans and stage 2 loans moved to stage 3. In 2020-Q1 2021, asset quality deteriorated across all sectors, including corporate, small and medium-sized enterprise (SME) and consumer loans. At the same time, the coverage of problem loans with loan-loss reserves was 50.7% compared with 47.5% as of year-end 2019.

Converse Bank has a rather diversified loan-book structure, with retail loans (consumer loans and mortgages) accounting for 46% of total loans as of 31 March 2021 and corporate loans (including SME loans) accounting for the rest.

Exhibit 3

Asset-quality indicators



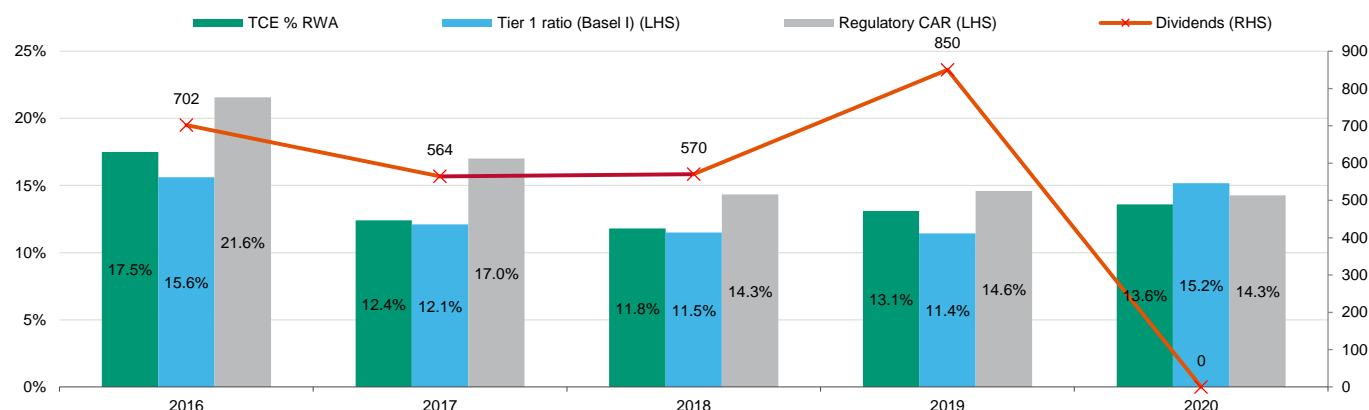
Source: Bank's IFRS reports

The bank's net related-party exposure is not significant because most loans are collateralised by cash deposits from the shareholder. In addition, Converse Bank's exposure to foreign-currency-denominated loans accounted for a high 60% of total loans, 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 caa1 to Converse Bank, which is one notch lower than the historical score. The negative adjustment reflects (1) the bank's high exposure to foreign-currency-denominated loans, and (2) its currently low level of loan-loss reserve coverage.

Capital position will remain broadly stable in the next 12-18 months

Converse Bank's capital position will remain robust and broadly stable in the next 12-18 months, supported by its profit and moderate lending growth. We expect Converse Bank's tangible common equity/risk-weighted assets will be around 14% in 2021, compared with 13.6% in 2020. In 2020, the bank's shareholders injected AMD2.4 billion. During 2020, no dividends were declared and paid.

Exhibit 4

Converse Bank's capital ratios

Sources: Bank's IFRS reports and management data

Our assigned ba3 Capital score reflects recent developments and the expected trend.

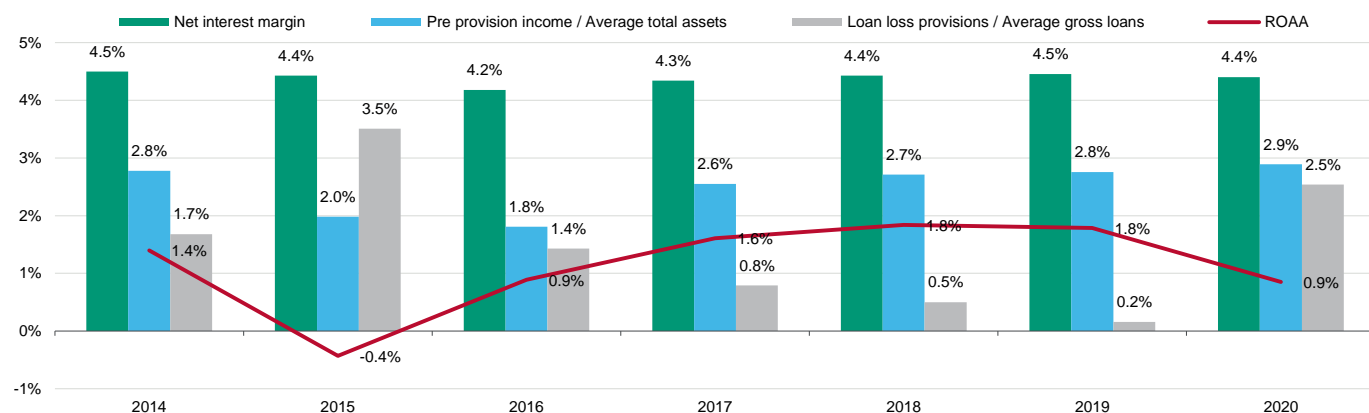
Profitability will gradually recover, supported by stabilising operating conditions

Converse Bank's profitability will marginally improve in 2021, with net income-to-tangible assets ratio of around 1%, up from 0.8% in 2020, supported by gradual stabilisation of the operating environment and economic conditions in Armenia. Provisioning charges will gradually decline. Recovering business activity, strengthening credit demand and increasing transaction volumes will drive up income from interest and fees and commissions.

For 2020, Converse Bank reported net profit of AMD2.8 billion, a 49% decrease from the AMD5.5 billion reported for 2019, which translated into a return on tangible assets of 0.8% compared with 1.7% in 2019. The bottom-line results were weakened by the increase in loan loss provisions, which increased cost of risk to 2.5% in 2020 from 0.7% in 2019. In 2020, the bottom-line results were supported by trading gain and gain from currency translation.

Converse Bank has consistently reported sound profitability, underpinned by its resilient net interest margin (NIM) of around 4.4% in 2016-2020, supported by the growing share of high-yielding consumer loans in the bank's portfolio. We expect the bank's robust pre-provision income (PPI, around 3.0% of average assets in 2020) will provide a good buffer to absorb the expected credit losses. At the same time, profitability will remain strained by low coverage of problem loans by loan loss reserves of around 50%.

Exhibit 5

Converse Bank's profitability

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

Our assigned Profitability score of b1 reflects recent developments and expected trends.

Ample liquidity and limited reliance on market funding

Converse Bank's liquidity and funding profile will remain stable over the next 12-18 months, supported by the bank's good funding diversification; its healthy buffer of liquid assets; and its access to alternative liquidity sources, such as funding from international financial institutions (IFIs). Converse Bank's reliance on market funding was moderate at around 15%-16% of tangible assets as of year-end 2020, with issued bonds and funds from both domestic and international development institutions. Nevertheless, we view the bank's funding profile as stable, with moderate deposit concentration and a moderate reliance on market funding.

As of 31 March 2021, customer funds accounted for around 80% 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 around 28% of its tangible assets in Q1 2021.

Our Combined Liquidity score of b1 reflects recent developments and expected trends.

ESG considerations

In line with our general view for the banking sector, Converse Bank has a 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 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 of 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 raise 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 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 as 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. 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 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 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 results in one notch of rating uplift from Converse Bank's BCA of b2.

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 take into account only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default, and 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 B1(cr)/NP(cr)

The CR Assessment is positioned one notch above the BCA of b2 and, therefore, in line with 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 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 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 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 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	6.2%	b3	↔	caa1	Collateral and provisioning coverage	Market risk	
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel I)	13.6%	ba3	↔	ba3	Expected trend		
Profitability							
Net Income / Tangible Assets	0.8%	b1	↔	b1	Expected trend		
Combined Solvency Score		b1		b2			
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets	15.6%	ba3	↔	b1	Deposit quality		
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets	26.8%	ba3	↔	ba3	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	Stable
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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