

CREDIT OPINION

12 February 2024

Update

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RATINGS

SC Citadele Banka

Domicile	Rīga, Latvia
Long Term CRR	Baa1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Baa3
Type	Senior Unsecured - Dom Curr
Outlook	Positive
Long Term Deposit	Baa2
Type	LT Bank Deposits - Fgn Curr
Outlook	Positive

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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SC Citadele Banka

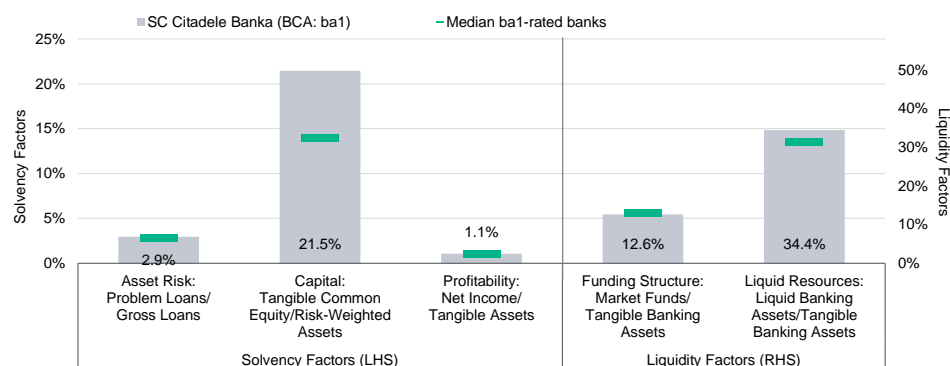
Update following rating action; outlook changed to positive

Summary

[SC Citadele Banka's](#) (Citadele) local-currency deposit ratings of Baa2/P-2 take into account the Baseline Credit Assessment (BCA) and Adjusted BCA of ba1, and a two-notch uplift based on our Loss Given Failure (LGF) analysis. We also assign a local-currency senior unsecured debt rating of Baa3. The outlooks on the long-term deposit and senior ratings are positive.

The ratings reflect the bank's improving asset quality and diversified lending to retail clients, including mortgages, consumer finance, and leasing as well as lending and leasing to small and medium-sized enterprise (SME) customers, in the Baltic countries. These improvements are partly offset by governance-related risks, with continued uncertainty regarding the strategy of the bank's largest shareholder, including the possibility of M&A, which could alter the financial fundamentals of the bank.

Exhibit 1
 Key financial ratios



These are our [Banks Methodology](#) scorecard ratios. The bank's problem loan and profitability ratios are the weaker out of the average of the latest three year-end and year-to-date ratios or the latest reported ratio. The capital ratio is the latest reported figure. The funding structure and liquid asset ratios are the latest year-end figures.

Source: Moody's Investors Service

Credit strengths

- » Sound funding and liquidity, underpinned by a domestic-based deposit funding model
- » Strong capital generation, underpinned by organic and non-organic growth
- » Improving asset quality with unwinding of problem loans.

Credit challenges

- » Governance risks, including uncertainty regarding the future strategy of the bank
- » Historic volatile profitability
- » High level of exposure to the SME sector in Latvia and Lithuania

Outlook

The positive outlooks on the long-term deposit and senior unsecured debt ratings reflect Moody's view that capital will continue to strengthen during the next 12 to 18 months, supported by higher sustained profitability and stable credit quality.

Factors that could lead to an upgrade

Factors that could lead to an upgrade include maintaining robust solvency of the bank over a sustained period, which would be reflected by a nonperforming loan (NPL) ratio below 3%, tangible common equity/risk-weighted assets (TCE/RWA) above 16% and a net income above 1% of tangible assets over a sustained period. An upgrade to ratings is not likely until the bank's strategic review has been completed.

Factors that could lead to a downgrade

Although a downgrade is not likely given the positive outlook, the ratings could return to stable if the bank's TCE/RWA falls below 16%, there is an increase in the proportion of NPLs to above 5% or there is an increase in the credit-related costs, for example, as a result of a significant deterioration in the Baltic economies or an increase in the bank's risk appetite.

The ratings could also be downgraded because of lower volumes of loss-absorbing liabilities protecting creditors and depositors in case of failure.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody.com> for the most updated credit rating action information and rating history.

Key indicators

Exhibit 2

SC Citadele Banka (Consolidated Financials) [1]

	09-23 ²	12-22 ²	12-21 ²	12-20 ²	12-19 ²	CAGR/Avg. ³
Total Assets (EUR Million)	4,831.2	5,404.3	5,054.6	4,597.3	3,742.8	7.0 ⁴
Total Assets (USD Million)	5,115.0	5,767.7	5,727.4	5,625.1	4,201.3	5.4 ⁴
Tangible Common Equity (EUR Million)	506.4	434.8	386.2	332.2	328.7	12.2 ⁴
Tangible Common Equity (USD Million)	536.2	464.1	437.6	406.5	369.0	10.5 ⁴
Problem Loans / Gross Loans (%)	2.4	2.7	3.3	3.5	4.8	3.3 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	21.5	17.0	14.6	18.7	17.3	17.8 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	11.5	15.3	19.4	14.2	20.3	16.1 ⁵
Net Interest Margin (%)	3.7	2.3	2.2	1.6	2.5	2.5 ⁵
PPI / Average RWA (%)	5.3	2.8	2.9	-0.2	2.3	2.6 ⁶
Net Income / Tangible Assets (%)	2.6	0.9	1.1	-0.3	1.0	1.1 ⁵
Cost / Income Ratio (%)	43.7	55.3	56.3	103.9	66.4	65.1 ⁵
Market Funds / Tangible Banking Assets (%)	5.2	12.6	13.6	10.0	0.1	8.3 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	29.1	34.4	37.7	57.6	47.2	41.2 ⁵
Gross Loans / Due to Customers (%)	77.6	77.7	73.7	44.0	50.0	64.6 ⁵

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; 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 III periods.

Sources: Moody's Investors Service and company filings

Profile

SC Citadele Banka (Citadele) is the fourth-largest bank domiciled in [Latvia](#) (A3 stable), with a market share of 17% in terms of assets (including Lithuanian and Estonian assets) as of June 2023 and reported total assets of €4.8 billion as of September 2023 (December 2022: €5.4 billion). The bank was created as a joint-stock company in 2010, taking over the assets and liabilities of the failed Parex Bank.

Citadele, the Latvian operating bank, is also the parent of a group that comprised 11 subsidiaries as of September 2023. The group primarily offers banking services and foreign-exchange transactions for retail and corporate clients, with a focus on individuals and SMEs. The group also offers leasing and insurance services, asset management, private banking, and facilitates local and international payments. As of September 2023, the group operated through 11 branches and client service centres in Latvia, one branch in Estonia and one branch with six customer service units in Lithuania, alongside a mobile application and an online platform.

The bank is 74.2% owned by a consortium of investors represented by the private equity firm Ripplewood Advisors LLC and 24.7% owned by [European Bank for Reconstruction & Development](#) (Aaa stable) and 1.1% owned by the management and employees. As of September 2023, around 46% of the group's assets were held in Latvia, 30% in Lithuania, 13% in Estonia, 8% in other EU countries and 4% in other countries.

Recent developments

On 6 December, the Latvian Parliament [adopted](#) amendments to the Law on the Protection of Consumer Rights, setting support for mortgage borrowers at 30% of their interest payments in 2024. On the same date, Parliament also amended the Corporate Income Tax Law, introducing a 20% advance income tax for banks and nonbank lenders. To fund the support for mortgage borrowers, financial institutions that provide mortgage lending in Latvia will need to pay a quarterly levy of 0.5% (2% annually) of their outstanding Latvian mortgage loan portfolio as of 31 October 2023. The levy payable to the tax authority to support mortgage borrowers will reduce banks' profitability and available profits for potential provisioning needs in the event of a deterioration in asset quality. We expect that Citadele will need to pay an annual levy of €9 million during 2024 on its Latvian mortgage portfolio.

On 17 July 2023 Citadele announced that it has initiated a review of strategic alternatives. Alternatives could include an initial public offering of its shares or other possible transactions, including mergers and acquisitions.

On March 31 2023 ECB published the outcome of the first asset quality review (AQR) of Citadele following the classification of the bank as a significant credit institution and commencing its direct supervision on 1 January 2021. As a consequence there was a 28 basis points adjustment to the bank's reported Common equity tier 1 (CET1) ratio from 16.31% to 16.03% (year end 2021).

Detailed credit considerations

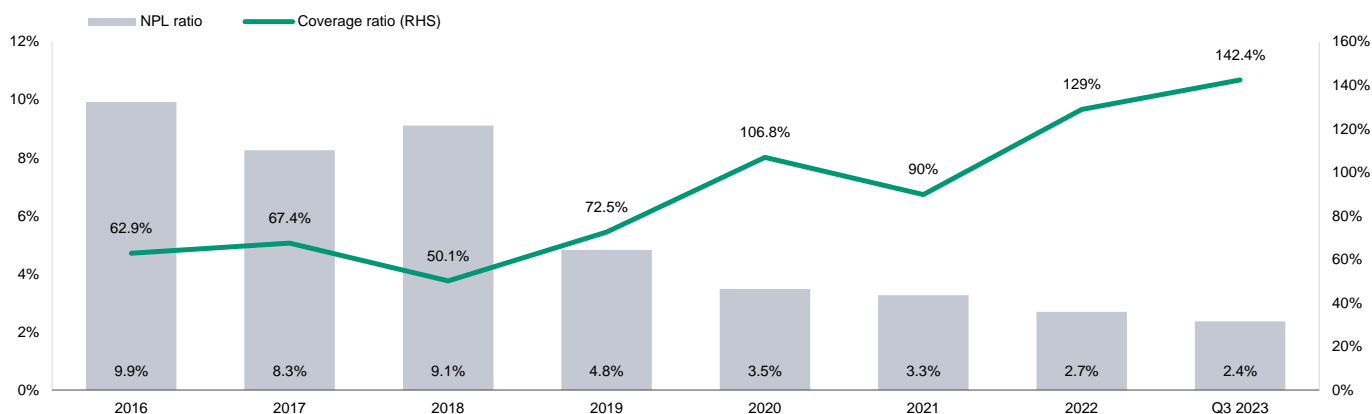
Asset risk under renewed pressure because of the economic slowdown

Citadele has brought down its problem loans¹ by unwinding some legacy assets. The bank's asset quality continued to improve in 2023 despite the economic environment, with pressures coming from high inflation, supply chain interruptions and elevated energy prices. In an effort to curb the historically high inflation in 2022, the ECB started to gradually raise the base interest rate, which translated into higher loan servicing costs for households and corporates and added some pressures on their finances.

During the first nine months of 2023, problem loans decreased by €13 million while gross loans decreased by €121 million. As a result, the problem loans ratio decreased to 2.4% as of September 2023, down from 2.7% as of 2022 (see Exhibit 3). Despite the recent strengthening in the problem loans ratio, we expect asset risk to remain elevated in 2024 because of uncertainty around the length and long-lasting effects of the current economic shock with additional pressure from the high interest rate environment.

Exhibit 3

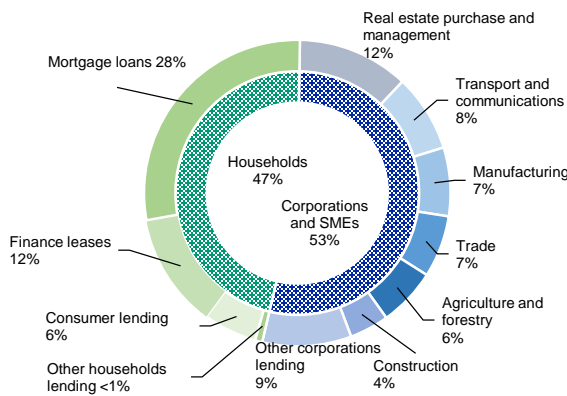
Improved asset-risk metrics because of the unwinding of legacy assets



Sources: Bank and Moody's Investors Service

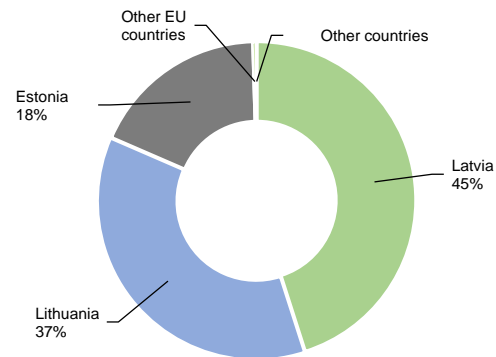
As of September 2023, 53% of the bank's exposure was to corporates and SMEs (see Exhibit 4), including corporate leasing. These segments are sensitive to fluctuations in the economy, and with the Baltic economies being relatively small and open, volatility has historically been high. The bank has a relatively large exposure to leasing, representing around 30% of total loans. It poses an asset risk to the bank in terms of residual values, which may trigger credit losses in case the operating environment deteriorates significantly.

Exhibit 4
Citadele's loan book is more focused on Corporate and SME segments...



Sources: Bank and Moody's Investors Service

Exhibit 5
... with the largest exposure to Latvia



Sources: Bank and Moody's Investors Service

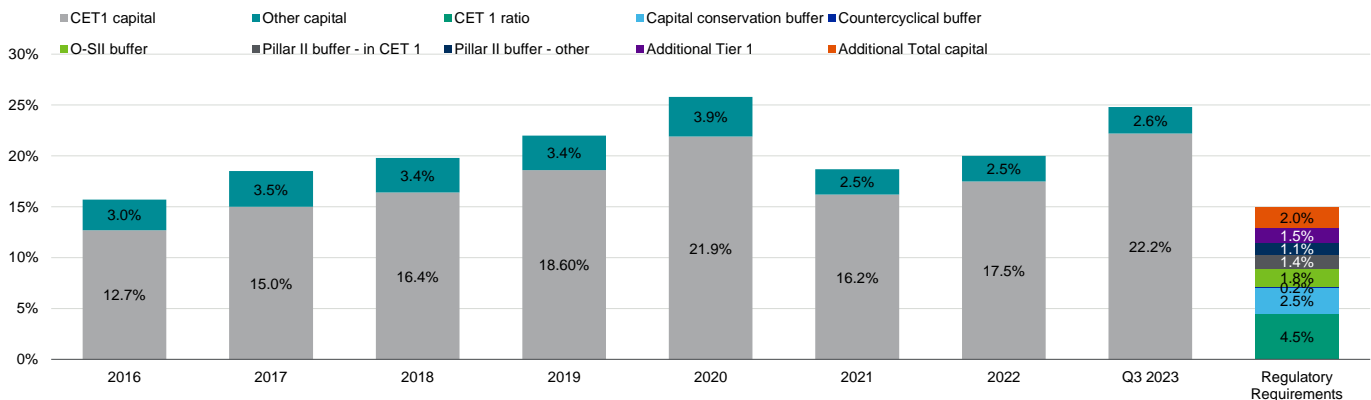
Because of the high uncertainty about the economic outlook, Citadele maintains respective portion of provisions and due to reduced amount of problem loans the coverage ratio has climbed to 142% as of September 2023, up from 129% as of December 2022. The high level of provisioning limits the risk of the bank having to take significant additional provisioning in 2024, even if the problem loan ratio increases.

Citadele's capital position has been volatile because of acquisitions and credit growth

The bank's TCE/RWA increased in 2023, reaching 21.5% as of September 2023, comparing to 17% as of December 2022 as higher retained earnings and slowdown in growth had a positive effect on the ratio.

Higher retained earnings were driven by an increase in net interest income resulting from the repricing of floating rate loans following interest rate hikes in 2023. We expect earnings to remain strong in 2024, supporting the bank's capital position. The assigned a2 score incorporates the strong capitalization and the bank's internal CET1 target of 16%.

Exhibit 6
Capitalisation has been volatile in recent years, but the bank has a comfortable capacity above the minimum requirements



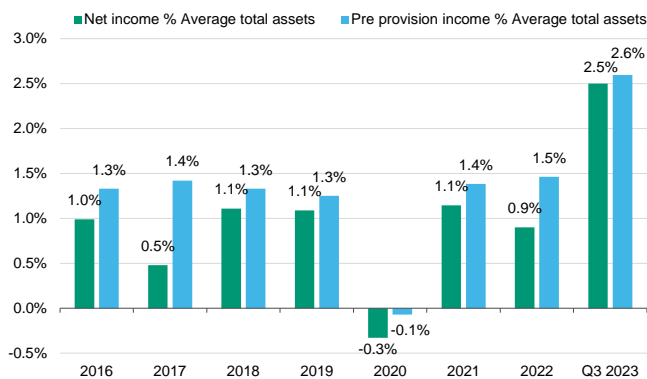
Sources: Bank and Moody's Investors Service

Pre-provision income is stable, driven by strong net interest margin

We expect Citadele's profitability to remain high over the next 12-18 months, supported by high net interest income resulting from increased interest rates, but fall from the 2023 level due to increased operating expenses, the temporary mortgage levy and higher taxes.

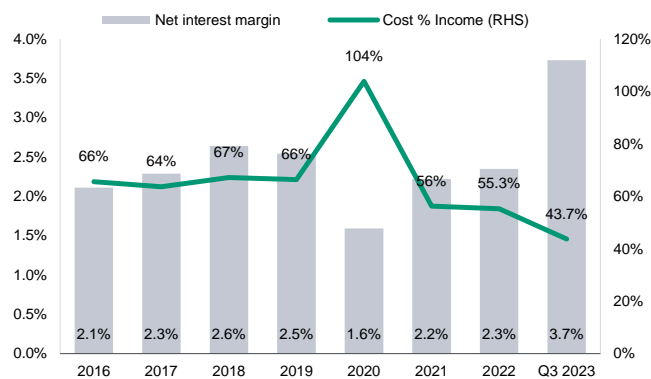
Net income/tangible assets rose to 2.6% in September 2023 from 0.9% in 2022. The higher interest rate environment had a positive effect on the bank's net interest margin as well as reduced inflation. We expect interest rate margins to decline during 2024, but still remain relatively high with net income to total assets well above 1%.

Exhibit 7
Reduced loan loss provisions and strong net interest margin helped to improve profitability in 2023



Sources: Bank and Moody's Investors Service

Exhibit 8
The interest rate hikes benefitted the bank's net interest margin



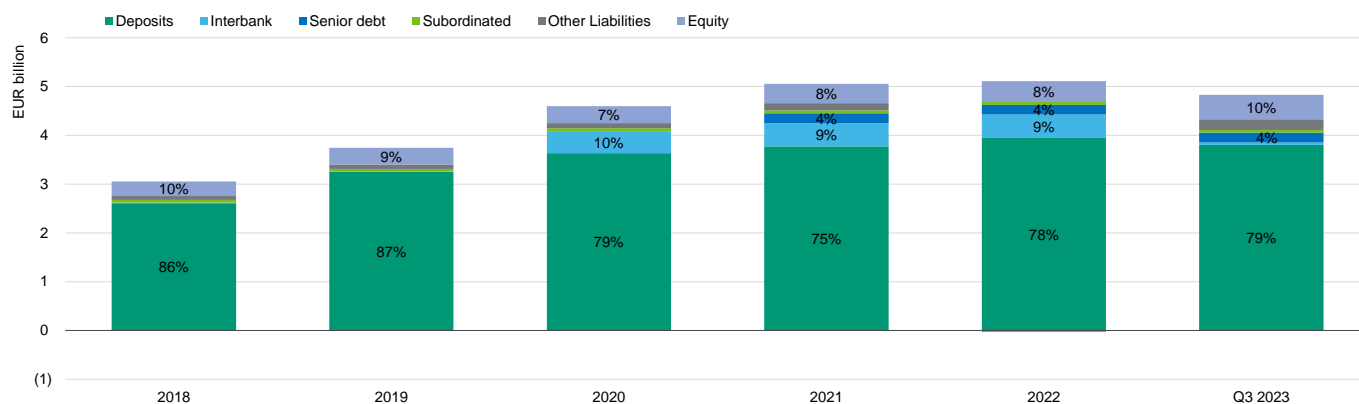
Sources: Bank and Moody's Investors Service

Citadele's large share of SME deposits increase risks of funding volatility

Citadele is mostly funded by domestic deposits, representing around 79% of the bank's total funding sources as of September 2023 (see Exhibit 9), with approximately half of which stemming from SME's and larger corporations.

Deposits from Corporates and SMEs, which we view as more volatile than retail deposits, represent around 48% of the total deposit base. With a large portion of deposits viewed as volatile, the lack of alternative sources of funding is a constraint. Our assigned market funding score reflects the bank's lack of a track record of accessing wholesale funding; the high proportion of corporate deposits, representing 48% of total deposits; and the non-domestic deposits, representing 1.9% of total deposits.

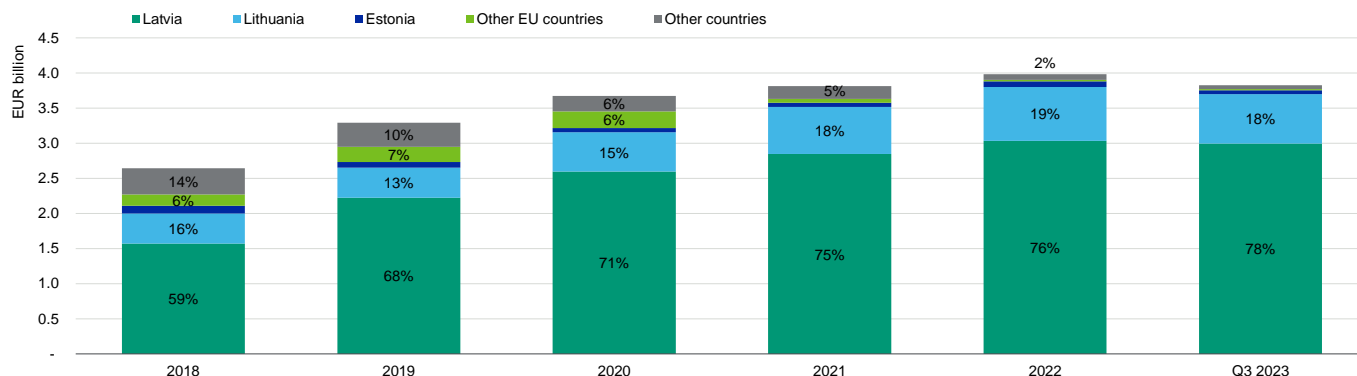
Exhibit 9
Citadele's funding profile



The percentages displayed correspond to the percentages in terms of liabilities and equity.
 Sources: Bank and Moody's Investors Service

Citadele's deposits are primarily sourced from Baltic countries. Deposits from outside the bank's core Baltic markets have declined considerably from 20% as of year-end 2018 (see Exhibit 10) to 1.9% as of September 2023, of which 1.4% are from non-EU countries. In particular, Citadele has significantly moved away from nonresident businesses initiated from the Commonwealth of Independent States (CIS) in recent years.

Exhibit 10
Geographical breakdown of Citadele's customer deposits through the years



Figures also include deposits from financial corporations.
 Sources: Bank and Moody's Investors Service

Interbank funding represents 1% of the bank's total funding sources and consists of ECB's targeted longer-term refinancing operations (TLTRO III) with a maturity in 2024 (EUR441 million of the TLTRO-III borrowing due 28 June 2023 was repaid before maturity). The bank issued its first senior debt in 2021, which represents 4% of total funding sources. The increase in other liabilities in 2021, 2022 and 2023 was caused by Kaleido Privatbank AG, which, since 2021, is presented as discontinued operations.

Citadele is currently fully compliant with its MREL targets of 23.70% + CBR of 4.9% of TREA or 5.91% of LRE, whichever is higher, applicable from 1 January 2024. We expect the targets to be manageable through high core capital and additional issuance of eligible liabilities, as needed.

Stock of liquid assets remains high, a mitigant to volatile deposits

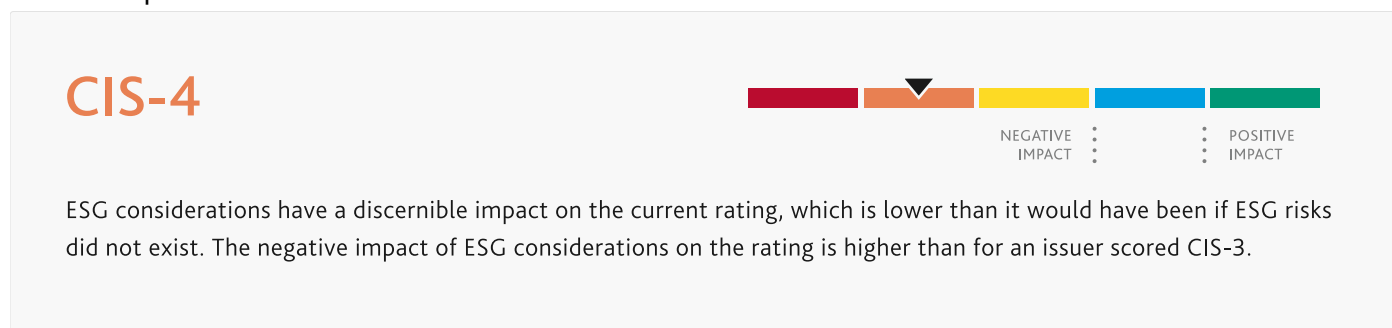
As of the end of September 2023, liquid assets included 35% in cash, 60% in government securities and 5% in other securities. Around 82% of government securities in the liquidity portfolio are held at amortized cost, which poses a risk of relatively high unrealized losses in the case of an urgent need for liquidity when the assets are sold (30% of CET1 ratio as of December 2022). Nevertheless, through the ECB repo facilities Citadele can access liquidity without having to sell assets and currently operates with high capital buffers. As of September 2023, the CET1 capital level is high enough to absorb potential losses and remain above the regulatory minimum.

Additionally, Citadele has repaid €441 million of its TLTRO III before its maturity using assets in the liquidity portfolio. Since the scorecard liquidity score does not reflect this repayment yet, we add an additional negative adjustment to our assigned liquidity score to reflect this expected decline in liquid assets.

ESG considerations

SC Citadele Banka's ESG credit impact score is CIS-4

Exhibit 11
ESG credit impact score



Source: Moody's Investors Service

CIS-4 indicates the credit rating is lower than it would have been if ESG risk exposures did not exist, incorporated in the one-notch negative adjustment of the rating for corporate behaviour. The bank has shown an acquisitive strategy during the years, which implies potential volatility in the fundamentals of the bank. However, the bank has improved its risk management in recent years with higher capital buffers in place, which allows additional flexibility.

Exhibit 12

ESG issuer profile scores



Source: Moody's Investors Service

Environmental

Citadele faces moderate environmental risks primarily because of its portfolio exposure to carbon transition risk as a diversified bank. In line with its peers, the bank is facing mounting business risks and stakeholder pressure to meet broader carbon transition goals. In response, Citadele is developing its climate risk and portfolio management capabilities.

Social

Citadele faces high industry-wide social risks related to regulatory and litigation risks, requiring high compliance standards. These risks are mitigated by the bank's developed policies and procedures. High cyber and personal data risks are mitigated by the bank's strong IT framework.

Governance

Citadele's governance risks are high with the bank's governance being weaker than peers. The bank has an acquisitive strategy, which can imply significant strategic shifts. This can lead to large shifts in the fundamentals of the bank, with for example lower capitalization or additional costs. Due to the historical AML issues in the Baltic countries, financial crime is a high risk, but the bank has significantly reduced its exposures to non-resident clients which reduces the current risk for Citadele.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moody's.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Support and structural considerations

Loss Given Failure (LGF) analysis

We apply our LGF analysis to Citadele because it is subject to an operational resolution regime, the EU Bank Resolution and Recovery Directive, whereby creditors and investors will bear losses in case of a failure. For this analysis, we assume that the bank's equity and losses will be 3% and 8% of tangible banking assets, respectively, in a failure scenario. We also assume a 25% runoff of junior wholesale deposits and a 5% runoff of preferred deposits. Moreover, we assign a 25% probability to junior deposits being preferred to senior unsecured debt. Junior deposits are assumed to account for 26% of total deposits. These assumptions are in line with our standard assumptions.

Citadele's deposits are likely to face very low losses given failure because of the bank's high volume of junior deposits, which means that any losses would be shared over a large base. As a result, our Preliminary Rating Assessment includes a two-notch uplift from the bank's Adjusted BCA of ba1.

For the bank's senior unsecured debt ratings, the Advanced LGF analysis indicates a low loss given failure, leading to a position one notch above the bank's Adjusted BCA. The lower rating compared with deposits reflects the probability of junior deposits being preferred to senior unsecured debt in case of failure.

Government support considerations

We assess that although the bank has increased in systemic importance and is the third-largest deposit-taker registered in Latvia in 2021, the probability of government support remains low, resulting in no further uplift. A significant share of deposits is sourced from outside Latvia, and excluding non-Latvian deposits, the bank ranks number three in terms of market share. Furthermore, there is evidence in the past years that the Latvian government will let systemically important banks that are likely to fail be liquidated, or resolved, most significantly ABLV Bank in 2018.

Counterparty Risk Ratings (CRRs)

Citadele's CRRs are Baa1/Prime-2

The CRRs are Baa1, three notches above the bank's Adjusted BCA of ba1, based on the buffer of subordinated obligations providing counterparties with protection against default.

Counterparty Risk (CR) Assessment

Citadele's CR Assessment is positioned at Baa1(cr)/Prime-2(cr)

The CR Assessment is Baa1(cr), three notches above the bank's Adjusted BCA of ba1, based on the buffer of subordinated obligations providing counterparties with protection against default. The main difference with our Advanced LGF approach used to determine instrument ratings is that the CR Assessment captures the probability of default on certain senior obligations rather than the expected loss. Therefore, we focus purely on subordination and take no account of the volume of the instrument class.

Sources of facts and figures cited in this report

Unless noted otherwise, we have sourced data relating to systemwide trends and market shares from the Association of Latvian Banks and the central banks. Bank-specific figures originate from banks' reports and Moody's Banking Financial Metrics. All figures are based on our own chart of account and may be adjusted for analytical purposes. Please refer to [Financial Statement Adjustments in the Analysis of Financial Institutions](#), published on 9 August 2018.

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 13

SC Citadele Banka

Macro Factors							
Weighted Macro Profile		Strong -		100%			
Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2	
Solvency							
Asset Risk							
Problem Loans / Gross Loans	2.9%	a3	↔	ba3	Quality of assets	Sector concentration	
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - fully loaded)	21.5%	aa3	↓↓	a2	Capital retention		
Profitability							
Net Income / Tangible Assets	1.1%	baa2	↑↑	baa2	Expected trend	Earnings quality	
Combined Solvency Score		a2		baa2			
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets	12.6%	a3	↑↑	baa3	Deposit quality		

Liquid Resources

Liquid Banking Assets / Tangible Banking Assets	34.4%	a3	↓	baa2	Expected trend	Quality of liquid assets
Combined Liquidity Score		a3		baa3		
Financial Profile				baa2		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				-1		
Total Qualitative Adjustments				-1		
Sovereign or Affiliate constraint				A3		
BCA Scorecard-indicated Outcome - Range				baa2 - ba1		
Assigned BCA				ba1		
Affiliate Support notching				0		
Adjusted BCA				ba1		

Balance Sheet

	in-scope (EUR Million)	% in-scope	at-failure (EUR Million)	% at-failure
Other liabilities	589	12.3%	977	20.4%
Deposits	3 804	79.3%	3 416	71.2%
Preferred deposits	2 815	58.7%	2 674	55.7%
Junior deposits	989	20.6%	742	15.5%
Senior unsecured bank debt	200	4.2%	200	4.2%
Dated subordinated bank debt	60	1.3%	60	1.3%
Equity	144	3.0%	144	3.0%
Total Tangible Banking Assets	4 797	100.0%	4 797	100.0%

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional Notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	23.9%	23.9%	23.9%	23.9%	3	3	3	3	0	baa1
Counterparty Risk Assessment	23.9%	23.9%	23.9%	23.9%	3	3	3	3	0	baa1 (cr)
Deposits	23.9%	4.3%	23.9%	8.4%	2	3	2	2	0	baa2
Senior unsecured bank debt	23.9%	4.3%	8.4%	4.3%	2	0	1	1	0	baa3

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	3	0	baa1 (cr)	0	Baa1(cr)	
Deposits	2	0	baa2	0	Baa2	Baa2
Senior unsecured bank debt	1	0	baa3	0	Baa3	

[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 14

Category	Moody's Rating
SC CITADELE BANKA	
Outlook	Positive
Counterparty Risk Rating	Baa1/P-2
Bank Deposits	Baa2/P-2
Baseline Credit Assessment	ba1
Adjusted Baseline Credit Assessment	ba1
Counterparty Risk Assessment	Baa1(cr)/P-2(cr)
Senior Unsecured -Dom Curr	Baa3

Source: Moody's Investors Service

Endnotes

1 Problem loans correspond to Stage 3 loans and purchased or originated credit-impaired (POCI) exposures, according to the IFRS 9 accounting standard.

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