CREDIT OPINION

13 December 2024

Update

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RATINGS

SC Citadele Banka

Domicile	Riga, Latvia
Long Term CRR	A3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Baa2
Type	Senior Unsecured - Dom Curr
Outlook	Stable
Long Term Deposit	Baa1
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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SC Citadele Banka

Update following upgrade of long-term deposit and senior unsecured debt ratings

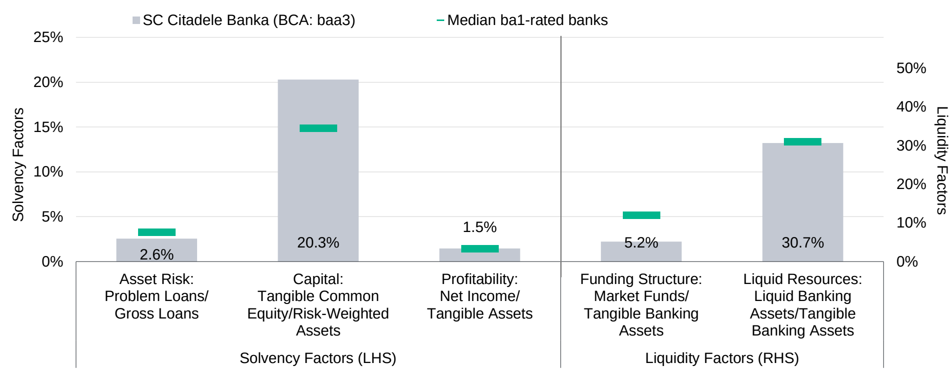
Summary

SC Citadele Banka's (Citadele) deposit ratings of Baa1/P-2 and senior unsecured debt rating of Baa2 take into account the bank's standalone creditworthiness, expressed in a Baseline Credit Assessment (BCA), and our assumption of very low and low loss-given-failure for junior depositors and senior bondholders respectively, which results in two notches of uplift for the long-term deposit rating and one notch of uplift for the senior unsecured debt rating. Our assumption of a low probability of support from the Government of Latvia (A3, stable) does not result in any further uplift to the ratings. The outlooks on the long-term deposit and senior unsecured ratings are stable.

The bank's BCA reflects its 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. It also reflects the bank's high capitalisation and strong deposit franchise in Latvia and Lithuania, albeit with risks stemming from a high share of more volatile SME deposits. This is also balanced against some 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 Ratings

Credit strengths

» Strong capitalisation underpinned by robust organic capital generation

» Sound funding and liquidity, underpinned by a domestic-based deposit funding model

» Improved and stabilised asset quality following the unwinding of problem loans

Credit challenges

» Governance risks, including uncertainty regarding the future strategy of the bank

» Historically volatile profitability, which is stabilising at robust levels

» Significant exposure to the SME sector in both lending and deposits heightens the potential volatility in asset quality and deposits

Outlook

The stable outlook on the long-term deposit and senior unsecured ratings reflects our expectation that despite a slight increase in asset risks, problem loans will remain at low levels. Capitalisation will remain strong even as the bank maintains robust lending growth. Furthermore, profitability will remain at healthy levels even as margins decline, and as the bank faces higher taxes in its operating markets.

Factors that could lead to an upgrade

Citadele Banka's ratings could be upgraded following a reduction of problem loans below 2%, alongside a tangible common equity/ risk-weighted assets (TCE/RWA) of above 18%, and a net income above 1.5% of tangible assets over a sustained period. The senior unsecured rating could also be upgraded if there is a material increase in the volume of junior securities.

Factors that could lead to a downgrade

Citadele Banka's ratings could be downgraded if the asset quality, capitalisation or profitability deteriorate, or if the bank is not able to access capital markets to refinance its outstanding debt. The ratings could also be downgraded if the volumes of loss absorbing liabilities decline significantly.

Key indicators

Exhibit 2

SC Citadele Banka (Consolidated Financials) [1]

	09-24[2]	12-23[2]	12-22[2]	12-21[2]	12-20[2]	CAGR/Avg.[3]
Total Assets (EUR Million)	5,004.7	4,863.3	5,404.9	5,054.6	4,597.3	2.3[4]
Total Assets (USD Million)	5,585.4	5,372.3	5,768.4	5,727.4	5,625.1	(0.2)[4]
Tangible Common Equity (EUR Million)	536.8	516.3	428.9	386.2	332.2	13.7[4]
Tangible Common Equity (USD Million)	599.1	570.3	457.8	437.6	406.5	10.9[4]
Problem Loans / Gross Loans (%)	2.0	2.3	2.7	3.3	3.5	2.8[5]
Tangible Common Equity / Risk Weighted Assets (%)	20.3	20.9	16.8	14.6	18.7	18.3[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	10.5	11.0	15.4	19.4	14.2	14.1[5]
Net Interest Margin (%)	4.1	3.8	2.4	2.2	1.6	2.8[5]
PPI / Average RWA (%)	4.6	5.2	2.6	2.9	-0.2	3.0[6]
Net Income / Tangible Assets (%)	1.9	2.1	0.8	1.1	-0.3	1.1[5]
Cost / Income Ratio (%)	50.6	45.2	57.2	56.3	103.9	62.6[5]
Market Funds / Tangible Banking Assets (%)	4.4	5.2	12.6	13.6	10.0	9.1[5]
Liquid Banking Assets / Tangible Banking Assets (%)	27.5	30.7	34.4	37.7	57.6	37.6[5]
Gross Loans / Due to Customers (%)	82.5	77.7	76.8	73.7	44.0	71.0[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 Ratings and company filings

Profile

SC Citadele Banka (Citadele) is the fourth-largest bank domiciled in Latvia (A3 stable), with a market share of 16% in terms of assets (including Lithuanian and Estonian assets) as of June 2024 and reported total assets of €5.0 billion as of September 2024 (December 2023: €4.9 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 2024. The group primarily offers banking services 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 2024, the group operated through 11 branches and client service centers 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 2024, around 46% of the group's assets were held in Latvia, 31% in Lithuania, 14% in Estonia, 6% in other EU countries and 4% in other countries.

Recent developments

In December 2024, the Latvian government enacted the Solidarity Contributions Law, which will take effect in 2025. This law mandates that credit institutions pay an additional tax on net interest income exceeding 50% of the average from 2018-2022. Developed by the Ministry of Finance, it is projected to generate €96 million in 2025, €61 million in 2026, and €66 million in 2027.

Detailed credit considerations

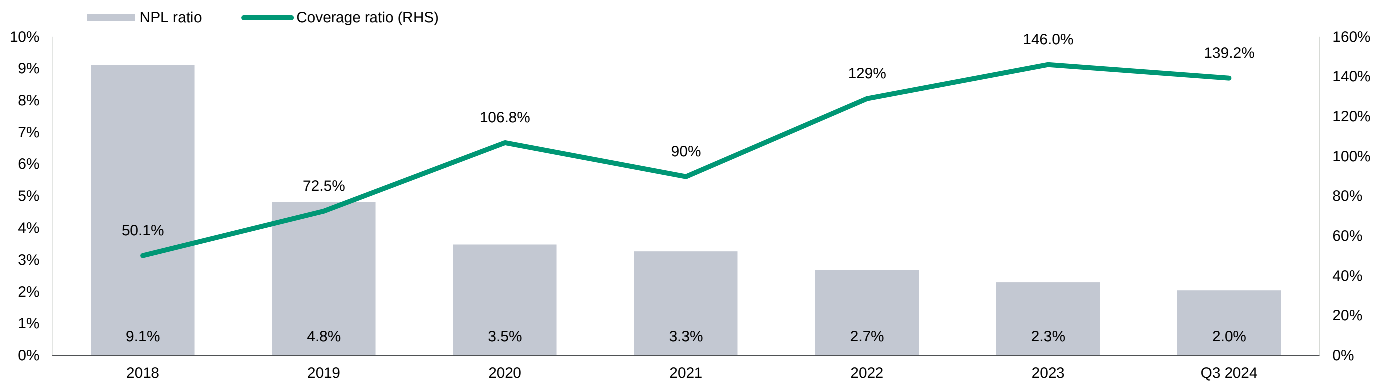
Improved and stabilised asset quality following the unwinding of problem loans

The bank's credit quality is supported by a lending portfolio well-diversified by both geography and sector, which has remained resilient despite the economic impacts of high inflation and elevated interest rates. It's non-performing loans ratio[1] stabilized at 2.0% in September 2024 and follows a long-term reduction from 2018 as the bank resolved a number of legacy problem loans. We expect the problem loans ratio will increase slightly due to still weak economic growth in the Baltic economies, although this will be partly offset by declining interest rates easing pressure on borrowers.

Exhibit 3

Improved asset-risk metrics because of the unwinding of legacy assets and better underwriting

Non-performing loans and coverage ratios

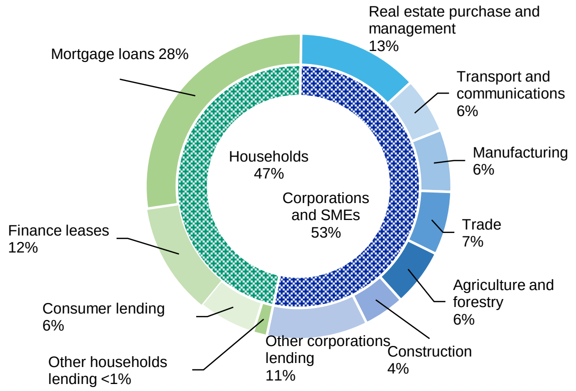


Sources: Bank and Moody's Ratings

As of September 2024, 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. While the bank has increased its share of lending in Lithuania and Estonia to 37% and 19% in 2024, from 32% and 10% in 2020, its primary market remains Latvia (44% of total loans), which has historically been weaker than its Baltic neighbors. 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.

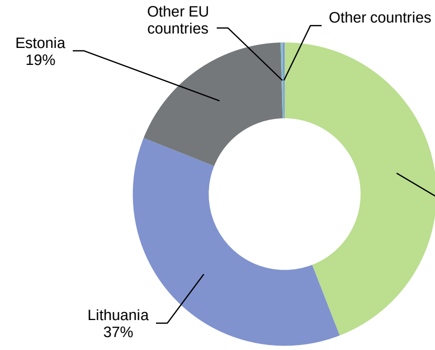
The assigned ba2 Asset Risk score is five notches below the macro adjusted score, reflecting the bank's exposure to higher risk corporate lending segments and historically volatile operating environment, balanced against a reduction in problem loans and recent resilient performance.

Exhibit 4
Citadele's loan book is more focused on Corporate and SME segments...
Loan portfolio by lending segment and industry



Sources: Bank and Moody's Ratings

Exhibit 5
... with the largest exposure to Latvia
Loan portfolio by geography



Sources: Bank and Moody's Ratings

Strong capitalisation underpinned by robust organic capital generation

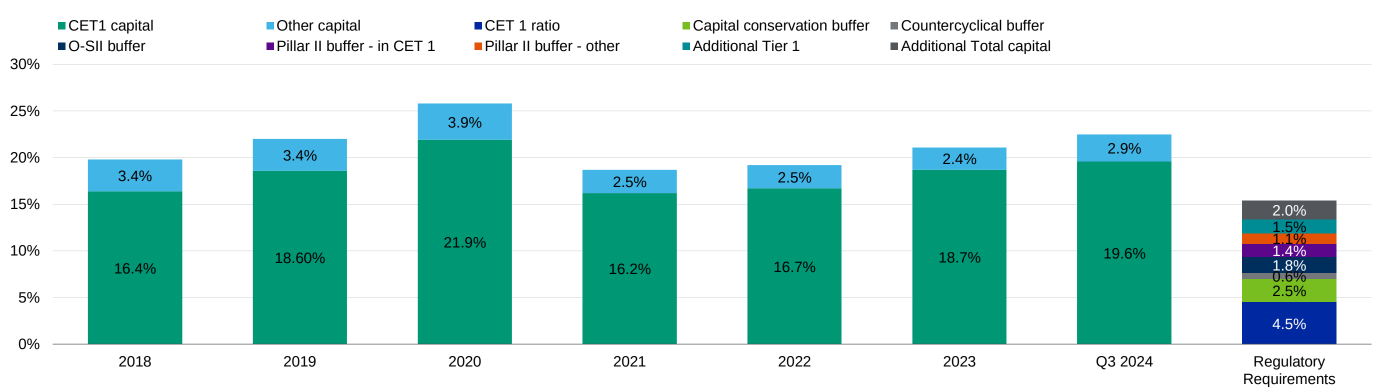
The bank's TCE/RWA ratio decreased slightly in 2024 to 20.3% as of September 2024, compared to 20.9% in December 2023, however remains at very strong levels. This decline was due to a slight moderation in profitability and the resumption of positive lending growth. Looking ahead, we expect the bank's core capitalization to remain strong, supported by high, albeit moderating, profitability, balanced against a modest growth agenda that has historically included inorganic growth.

Like many of its rated Baltic peers, Citadele maintains capital well in excess of its prudential requirements. As of September 2024, the bank's common equity tier 1 (CET1) capital ratio and total capital ratio stood at 20.1% and 23.0%, respectively, compared to prudential requirements of 12.35% and 16.94% (including Pillar 2 Guidance). Additionally, the bank maintains strong nominal leverage, with a tangible common equity to total assets ratio of 10.7% as of September 2024.

The assigned a2 capital score reflects the strong capitalization. The assigned score incorporates a two-notch negative adjustment to reflect the bank's high growth agenda and its limited access to capital as a non-listed bank.

Additionally, the one-notch corporate behavior adjustment from the baa2 Financial Profile reflects potential changes in the bank's risk profile due to inorganic growth and its ongoing strategic review.

Exhibit 6
Capitalisation has been volatile in recent years, but the bank has a comfortable capacity above the minimum requirements
Capital ratios and prudential capital requirements



Sources: Bank and Moody's Ratings

Historically volatile profitability, which is stabilising at robust levels

Citadele's profitability has significantly improved over the past two years, following historically volatile performance, particularly in 2020 due to a sizable financial loss. The sharp increase in profitability has been largely driven by rising net interest margins from higher interest rates, despite rising taxes in its key Baltic markets. Additionally, the bank has benefited from increased efficiency through streamlined operations and IT investments. This resulted in a return on tangible assets of 2.1% in 2023 and 2.0% in the nine months to September 2024, up from 1.1% in 2021 and 0.8% in 2022.

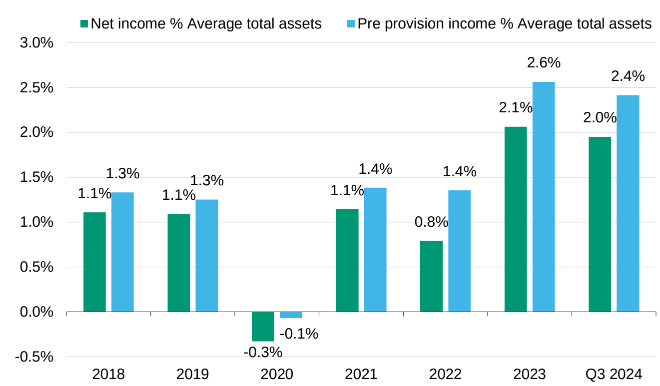
Looking ahead, we anticipate profitability to moderate over the next 12-18 months as interest rates decline and higher taxes impact earnings. However, we expect the bank's net income to tangible assets ratio to remain above 1.25%, supported by a higher expected terminal policy rate.

The assigned profitability score of baa1, which incorporates a one-notch negative adjustment, reflects our view of moderating profitability as well as historically volatile earnings.

Exhibit 7

Strong net interest margin and improving efficiency has outstripped the impact of higher taxes

Post-tax and pre-provision income

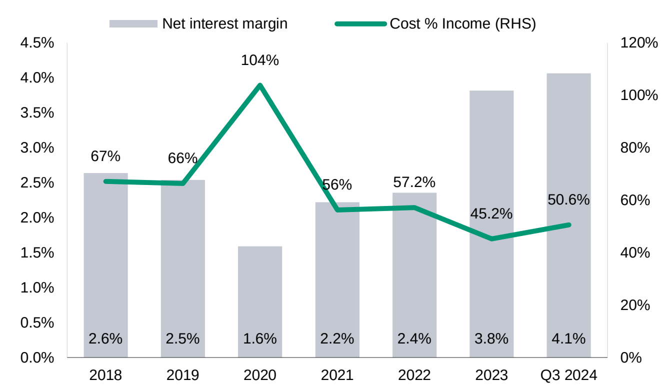


Sources: Bank and Moody's Ratings

Exhibit 8

Citadele's net interest margin has benefitted from higher interest rates

Net interest margin and cost-to-income ratio



Sources: Bank and Moody's Ratings

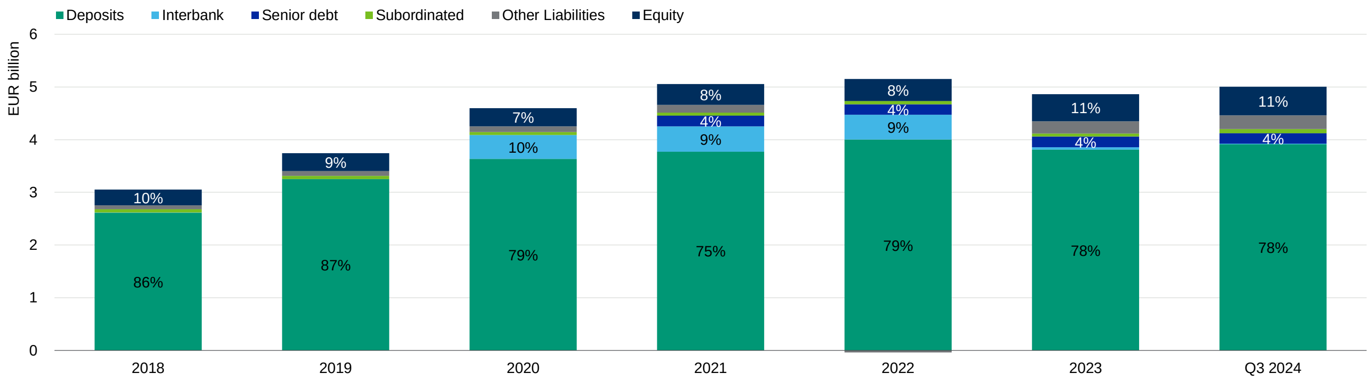
Sound funding profile with a domestic deposit model, though it includes a high proportion of volatile SME deposits

Citadele is mostly funded by domestic deposits, representing around 78% of the bank's total funding sources as of September 2024 (see Exhibit 9). Approximately half of which stem from SME's and corporates, which we view as less stable than retail deposits. The bank's deposit concentrations pose a risk, as outflows could lead to more volatile changes in its balance sheet.

Exhibit 9

Citadele's funding profile

Liability breakdown



The percentages displayed correspond to the percentages in terms of liabilities and equity.

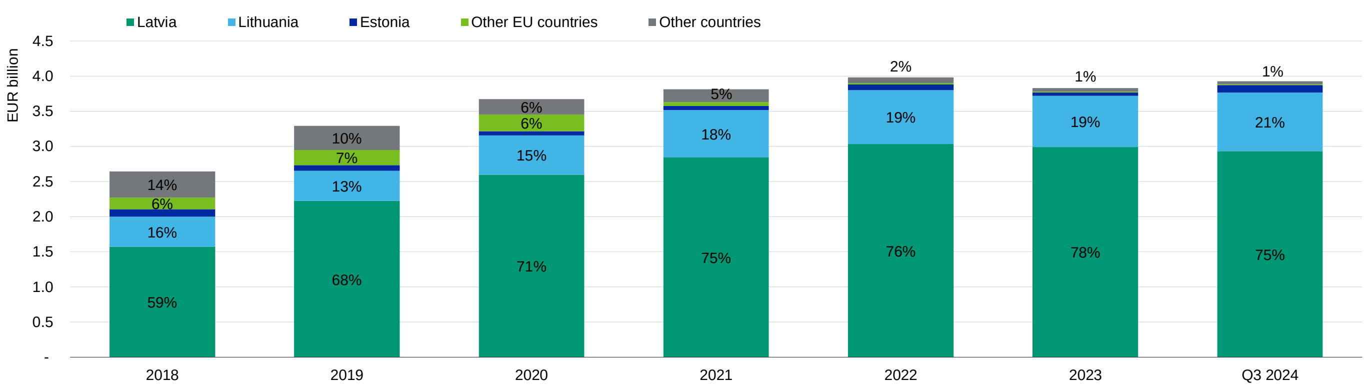
Sources: Bank and Moody's Ratings

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 1.5% as of September 2024, of which 1.1% 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. We view the reduction in non-resident deposits positively, as we perceive these deposits to be more stable and carry lower money-laundering and terrorism financing risks.

Exhibit 10

Declining share of non-resident deposits is positive

Deposit book by geography



Figures also include deposits from financial corporations.

Sources: Bank and Moody's Ratings

The bank has increased its share of wholesale funding to meet its MREL requirements, however its track record of accessing wholesale funding remains limited and the bank has €235 million of senior preferred funding maturing in 2026 which presents a refinancing risk. Citadele is currently fully compliant with its MREL targets of 24.13% + 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.

Our assigned Funding Structure score is baa2, three notches below the macro adjusted score to reflect a higher share of more volatile corporate deposits and the refinancing risk associated with sizable maturity towers and limited market access.

Solid stock of liquid assets, a mitigant to volatile deposits

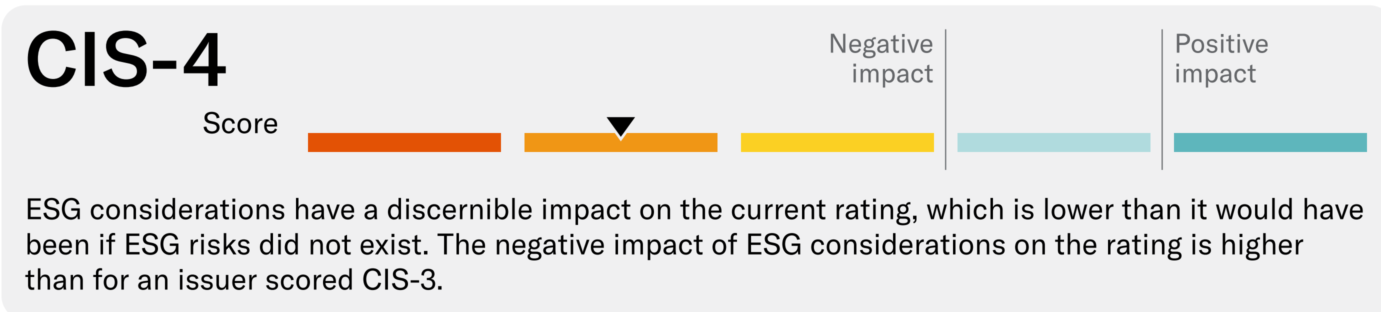
As of the end of September 2024, liquid assets included 31% in cash, 66% in government securities and 3% in other securities. Around 75% of government securities in the liquidity portfolio are held at amortized cost, which poses a risk of unrealized losses in the case of an urgent need for liquidity when the assets are sold (fair value of these securities are 94% the carrying value as of September 2024). Nevertheless, through the ECB repo facilities Citadele can access liquidity without having to sell assets and currently operates with high capital buffers.

We assign a baa2 Liquid Resources score, two notches below the macro adjusted score to incorporate our expectation that the bank's liquidity will marginally decrease.

ESG considerations

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

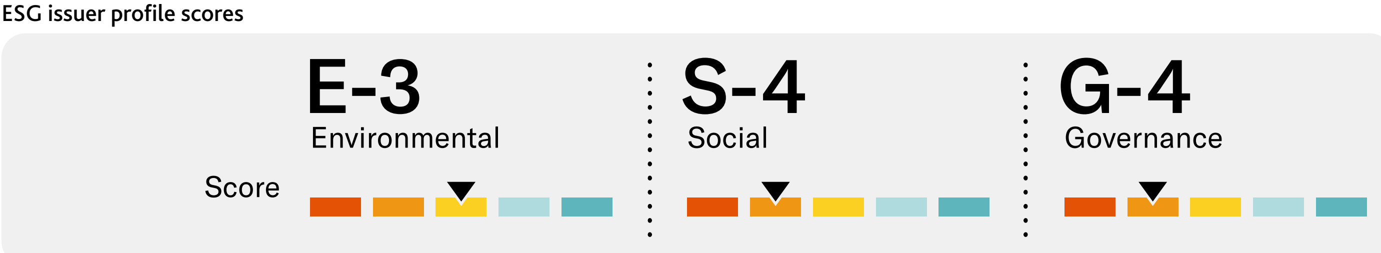
Exhibit 11
ESG credit impact score



Source: Moody's Ratings

Citadele's **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 Ratings

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 Moodys.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 Advanced LGF analysis to Citadele because the bank is based in Latvia, Lithuania and Estonia, which we consider operational resolution regimes. Our standard assumptions, which are applied to Citadele, assume a residual Tangible Commone Equity (TCE) at failure of 3% of tangible banking assets, post-failure losses of 8% of tangible banking assets, junior wholesale deposits of 26% of the bank's total deposit book, a 25% run-off in junior wholesale deposits, a 5% run-off in preferred deposits and a 25% probability of deposits being preferred to senior unsecured debt.

Citadele's depositors are likely to face very low losses given failure because of the loss absorption provided by bail-in-able debt and deposits, resulting in a two-notch uplift. Its senior bondholders are likely to face low loss given failure, resulting in a one-notch uplift.

Government support considerations

Despite the bank's increased systemic importance as the third-largest deposit-taker registered in Latvia in 2024, and its strong presence in Lithuania, we assess the probability government support as low, which results in no further uplift. Our assessment takes into account past instances where the Latvian government did not intervene when systemically important banks were at risk of failing, most notably in the case of ABLV in 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
Rating Factors

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		2.6%	a3	↔	ba2	Sector concentration	
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - fully loaded)		20.3%	aa3	↓	a2	Access to capital	
Profitability							
Net Income / Tangible Assets		1.5%	a3	↓	baa1	Expected trend	Earnings quality
Combined Solvency Score			a2		baa2		
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets		5.2%	a2	↔	baa2	Deposit quality	Lack of market access
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets		30.7%	a3	↓	baa2	Expected trend	

Combined Liquidity Score	a2	baa2
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		baa3
Affiliate Support notching		0
Adjusted BCA		baa3

Balance Sheet	**in-scope (EUR Million)**	**% in-scope**	**at-failure (EUR Million)**	**% at-failure**
Other liabilities	631	12.7%	1,030	20.7%
Deposits	3,911	78.7%	3,512	70.7%
Preferred deposits	2,894	58.2%	2,749	55.3%
Junior deposits	1,017	20.5%	763	15.3%
Senior unsecured bank debt	200	4.0%	200	4.0%
Dated subordinated bank debt	80	1.6%	80	1.6%
Equity	149	3.0%	149	3.0%
Total Tangible Banking Assets	4,970	100.0%	4,970	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	24.0%	24.0%	24.0%	24.0%	3	3	3	3	0	a3
Counterparty Risk Assessment	24.0%	24.0%	24.0%	24.0%	3	3	3	3	0	a3 (cr)
Deposits	24.0%	4.6%	24.0%	8.6%	2	3	2	2	0	baa1
Senior unsecured bank debt	24.0%	4.6%	8.6%	4.6%	2	0	1	1	0	baa2

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	a3	0	A3	A3
Counterparty Risk Assessment	3	0	a3 (cr)	0	A3(cr)	
Deposits	2	0	baa1	0	Baa1	Baa1
Senior unsecured bank debt	1	0	baa2	0	Baa2	

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

Ratings

Exhibit 14

Category	Moody's Rating
SC CITADELE BANKA	
Outlook	Stable
Counterparty Risk Rating	A3/P-2
Bank Deposits	Baa1/P-2
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Counterparty Risk Assessment	A3(cr)/P-2(cr)
Senior Unsecured -Dom Curr	Baa2

Source: Moody's Ratings

Endnotes

1 Non-performing 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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