Rating Action: Mortgage and Land Bank of Latvia

Moody's downgrades ratings of six Baltic banks

MLBL's long-term rating confirmed; two banks remain on review for downgrade

London, 25 June 2009 -- Moody's Investors Service today downgraded the ratings of six Baltic banks. The affected entities are Baltic International Bank (Latvia), BIGBANK (Estonia), Norvik Banka (Latvia), Siauliu Bankas (Lithuania) and Trasta Komercbanka (Latvia), with the BFSR of Mortgage and Land Bank of Latvia (MLBL) also being downgraded, while its long-term foreign currency deposit rating was confirmed.

Today's downgrades conclude the review process for the six banks that was initiated on 8 June 2009, although Moody's notes that the long-term debt and deposit ratings of Parex Bank and Swedbank AS remain on review for possible downgrade. These reviews were initiated on 11 May 2009 and 27 April, respectively, and both are expected to be concluded in the next month following the release of further information on Parex Bank and the conclusion of the review on Swedbank AS's parent bank, Swedbank AB.

The full list of rating actions can be found below.

Today's rating actions are driven by the speed and depth of the deterioration of the Baltic economies (Estonia, Latvia and Lithuania) and its impact on the banks' standalone creditworthiness, as measured by their bank financial strength ratings (BFSRs). With the three economies in deep recession, corporate defaults are rising and Moody's expects this to lead to significantly increased losses on the banks' corporate loan portfolios. Moreover, the rating agency expects delinquencies in the banks' retail portfolios to rise, reflecting higher unemployment, lower income levels and a likely further decline in house prices.

Moody's expects these potential losses and substantial provisioning needs to weaken Baltic banks' profitability and capital positions over the next two years. The declining profitability trends were already seen in the banks' Q1 financials. Also, a significant deterioration in asset quality ratio indicators was visible in 2008 and has continued this year.

Moody's notes, however, that the banks' funding positions remain relatively comfortable with customer deposits being the major source of funding for most of the entities. However, the fierce competition for deposits will exert pressure on some of the banks' funding. In particular, the rating agency remains concerned about the future prospects of those banks that are reliant on non-resident deposits for funding. A business model that mainly relies on non-resident business could potentially be adversely affected in the ongoing financial crisis.

Moody's has incorporated expected losses on bank loan portfolios into its ratings for some time, but the weight that it attaches to certain rating considerations, particularly capital and future earnings prospects, has been increased to better reflect the present conditions. This approach is consistent with Moody's reports "Calibrating Bank Ratings in the Context of the Global Financial Crisis" and "Moody's Approach to Estimating Bank Credit Losses and their Impact on Bank Financial Strength Ratings", published in February and May, respectively, this year. Both are available on www.moodys.com.

Moody's notes that there has been speculation that the Bank of Latvia may be forced to devalue the lat and outlined its opinion on a devaluation scenario in a recently published Special Comment entitled, "Living on the edge: Latvian devaluation speculation and implications for the sovereign rating".

Although the probability of a devaluation has recently declined due to the Latvian parliament's approval of a fiscal package that was welcomed by the EU and IMF, Moody's stresses that a devaluation cannot be ruled out completely, as economic and social pressure in Latvia will continue to be high for some time.

Therefore, Moody's already incorporates a moderate risk of a devaluation into its estimates of expected bank credit losses. However, the ratings of some banks would likely be downgraded further if the risk of a devaluation were to increase. The rating agency notes that a devaluation would lead to a further deterioration in the banks' asset quality, given the significant amount of loans in foreign currency. On average, foreign-exchange loans account for around 90% of the Moody's rated banks' total customer loans.

The long-term deposit and debt ratings of all the rated Baltic banks carry negative outlooks, reflecting the negative outlook that Moody's has placed on all three banking systems.

TODAY'S RATING ACTIONS

Moody's took the following rating actions on the Baltic banks:

Baltic International Bank

Baltic International Bank's E+ BFSR was affirmed, but now maps to a BCA of B3 (from B2). Consequently, the bank's long-term local and foreign currency deposit ratings were downgraded to B3 from B2. The Not Prime short-term rating was affirmed. The E+ BFSR and the B3 long-term local and foreign currency deposit ratings carry a negative outlook.

The lowering of the bank's BCA reflects its relatively low capital level with a capital adequacy ratio of 10.4% at end-March 2009, which raises its vulnerability to prolonged stress. While acknowledging the bank's relatively small loan portfolio when compared with that of its Baltic peers (25% of total assets), there was a significant increase in problem loans last year. In addition to weakening asset quality, further concerns relate to the bank's loan portfolio concentrations to the real estate sector. The downgrade also reflects Moody's concerns about how the ongoing recession could affect the bank's business model, which is primarily focused on private banking and non-resident business.

BIGBANK

Moody's downgraded BIGBANK's BFSR to E (mapping to the BCA of Caa1) with stable outlook from E+ (mapping to the BCA of B1). The bank's long-term deposit rating was downgraded to Caa1 with a negative outlook from B1 following the downgrade of the BFSR. The Not Prime short-term deposit rating was affirmed.

The magnitude of the downgrade and the negative outlook reflects Moody's view that BIGBANK's capital position will come under significant pressure in the short term because of its 100% exposure to higher-risk consumer finance. Although the bank's total capital adequacy ratio was 19.2% at the end of March 2009, Moody's expects that future credit costs in its consumer loan book will lead to a significant risk of the bank becoming undercapitalised. Moody's notes that the bank reported an exceptionally high problem loan ratio of 43% at the end of March 2009, a rapid increase from 18% at the beginning of 2008. The rating agency adds that the downgrade reflects its expectation that the bank's capital cushion under financial covenants will narrow as it limits deterioration in the capital adequacy ratio to 15%.

Mortgage and Land Bank of Latvia (MLBL)

Moody's confirmed MLBL's long-term foreign currency deposit rating at Baa3 and downgraded its BFSR to E+ with a stable outlook (mapping to a BCA of B1) from D- (mapping to a BCA of Ba3). MLBL's long-term foreign currency deposit rating is at the same level as the Latvian sovereign bond rating of Baa3. The outlook on the Baa3 long-term deposit rating is negative, in line with the negative outlook on the Latvian sovereign rating. The Prime-3 short-term rating was confirmed.

The downgrade of the BFSR reflects the bank's weakened profitability and asset quality. It also reflects Moody's expectation of potential losses associated with the bank's significant exposure to the property sector and SMEs. In particular, this is in light of the bank's low loan loss reserves, which provided a low 16% coverage of problem loans at the end of 2008. Furthermore, the bank has reported a rapid increase in problem loans, which accounted for 8.6% of gross loans at the end of 2008 compared with 2.7% at the end of 2007.

Commenting on keeping MLBL's long-term foreign currency deposit rating at the same level as the government bond rating, Moody's notes the government's very high commitment to support the bank. This commitment is demonstrated by: (i) capital injections in the past, most recently in January 2009 amounting to LVL29 million (US$59 million), and the planned LVL43 million (US$87 million) in July 2009; (ii) the fact that the bank is wholly owned by the Latvian government (the Ministry of Finance, specifically); and (iii) the bank's important role as the sole development bank in Latvia and its role as a contributor of state funds to the SME sector. Also, supporting this view, Moody's understands that the bank is in the process of being transformed into a pure development bank. Accordingly, the rating agency continues to assess the probability of government support as very high and consequently expects that state support would be forthcoming if necessary.

Norvik Banka

Moody's downgraded Norvik Banka's BFSR to E+ with negative outlook (mapping to a BCA of B1) from D- (mapping to a BCA of Ba3). The bank's local and foreign currency deposit ratings were downgraded to B1 from Ba3, due to the downgrade of the BFSR, also with a negative outlook. The Not Prime short-term rating was affirmed.

The downgrade reflects the potential losses stemming from the bank's relatively concentrated corporate portfolio and reduced level of profitability compared with previous years. While acknowledging the bank's higher-than-average capital ratio of 14.2% at the end of March 2009, Moody's notes that its loan book exhibits concentrations to shipping and consumer finance, which have the potential to generate large losses in the current environment. Also of concern is the swift growth of problem loans, which accounted for 12.5% of gross loans at the end of 2008, up from 1.5% at the beginning of the same year.

Siauliu Bankas

Moody's downgraded Siauliu Bankas's BFSR to D- (mapping to a BCA of Ba3) with negative outlook from D (mapping to a BCA of Ba2). The local and foreign currency deposit ratings were also downgraded to Ba3 with negative outlook from Ba2 following the downgrade of the BFSR. The Not Prime short-term rating was affirmed.

The downgrade and negative outlook reflect Moody's view that the bank's profitability and asset quality is expected to be severely impacted by the ongoing economic downturn due its sizeable exposure to SMEs and the real estate sector, which are being adversely affected by the recession. However, Moody's notes that the bank's customer loan portfolio is not exposed to foreign-exchange risk to the same extent as its Latvian peers. Also, standing at 15.9% at the end of March 2009, the bank reports one of the highest capital adequacy ratios in the Baltic region.

Trasta Komerbanka

Trasta Komercbanka's E+ BFSR was affirmed, but now maps to a BCA of B3, down from B2. Consequently, the bank's long-term local and foreign currency deposit ratings were downgraded to B3 from B2. The Not Prime short-term rating was affirmed. All the ratings carry a negative outlook.

The lowering of the bank's BCA incorporates its relatively weak capital level, which raises its vulnerability to prolonged stress, as well as its rapid asset growth over the past few years. Although the bank's loan portfolio accounted for a relatively low 44% of total assets at the end of 2008, potential losses associated with its significant exposure to the property sector are a cause for concern. Furthermore, the downgrade also reflects Moody's concerns about how the ongoing recession will affect the bank's business model, which is primarily focused on non-resident business.

PREVIOUS RATING ACTIONS AND METHODOLOGIES

Moody's last rating action on Baltic International Bank was on 8 June 2009 when Moody's placed its long-term local and foreign currency deposit ratings on review for possible downgrade.

Moody's last rating action on BIGBANK was on 8 June 2009 when Moody's placed its ratings on review for possible downgrade.

Moody's last rating action on Mortgage and Land Bank of Latvia was on 8 June 2009 when Moody's placed its ratings on review for possible downgrade.

Moody's last rating action on Norvik Banka was on 8 June 2009 when Moody's placed its ratings on review for possible downgrade.

Moody's last rating action on Siauliu Bankas was on 8 June 2009 when Moody's placed its ratings on review for possible downgrade.

Moody's last rating action on Trasta Komercbanka was on 8 June 2009 when Moody's placed its long-term local and foreign currency deposit ratings on review for possible downgrade.

The principal methodologies used in rating the banks were "Bank Financial Strength Ratings: Global Methodology" (February 2007) and "Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology" (March 2007), which can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies sub-directory. Other methodologies and factors that may have been considered in the process of rating these issuers can also be found in the Credit Policy & Methodologies directory.

Baltic International Bank is headquartered in Riga, Latvia, and reported consolidated total assets of LVL0.167 billion (EUR0.24 billion) at the end of December 2008.

BIGBANK is headquartered in Tallinn, Estonia, and reported consolidated total assets of EEK2.9 billion (EUR0.18 billion) at the end of December 2008.

Mortgage and Land Bank of Latvia is headquartered in Riga, Latvia, and reported total assets of LVL969 million (EUR1.4 billion) at the end of December 2008.

Norvik Banka is headquartered in Riga, Latvia, and reported total assets of LVL506 million (EUR0.7 billion) at the end of December 2008.

Siauliu Bankas is headquartered in Siauliu, Lithuania, and reported total assets of LTL2.1 billion (EUR0.6 billion) at the end of December 2008.

Trasta Komercbanka is headquartered in Riga, Latvia, and reported consolidated total assets of LVL0.28 billion (EUR0.4 billion) at the end of December 2008.

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