

### **Rating-Agentur Expert RA GmbH confirmed the credit rating of Bank Saderat Tashkent at 'B' according to the international scale. The rating outlook is stable.**

Rating-Agentur Expert RA GmbH confirmed the credit rating of Bank Saderat Tashkent at 'B' (Moderately low level of creditworthiness) according to the international scale. The rating outlook is stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

#### **BANKING SYSTEM RISK ASSESSMENT:**

The bank's operations are concentrated 100% in Uzbekistan, and the bank's funding base is concentrated 100% in Iran. The banking system risk (BSR) of Uzbekistan and Iran is high. Therefore, the overall systemic risk of Bank Saderat Tashkent was assessed as high.

#### **MAJOR FACTORS THAT INFLUENCED THE RATING:**

##### **Positive factors:**

- Capitalization of the bank remains quite favorable as the Tier 1 capital adequacy ratio stood at 86,2% and the capital adequacy ratio at 86,6% as of June 2018, well above the 13% minimum requirement for capital adequacy of the Central Bank of Uzbekistan (CBU). Moreover, both capitalization indicators have remained substantially stable and we expect them to remain in the same trend going forward;
- Given the low amount of loans to customers, we consider that the exposure of the capital to credit risks is negligible. In case a counterparty would default on a loan, the impact on financial statements would be insignificant;
- Very strong liquidity metrics as the instant liquidity ratio stood at 1094% and the current liquidity ratio (current assets divided by liabilities of up to 30 days) at 3228%;
- The bank has limited exposure to interest rate risk as most of the funding is equity-based and interest income is mostly from deposits at fixed rates with Bank Saderat Iran (BSI). However, these deposits with fixed rates are also short-term (mostly less than three months) and represent around 91% of the overall income, i.e. there is a risk of a reduction in earnings in case there is an adverse effect in the interest rates due to the short-term nature of the deposits;
- Reduced risk on the term and structure of assets. As of June 2018, 97% of the bank's assets were deposits in BSI. These deposits are mainly FX-denominated and short-term (with a maturity of one year or less);
- High level of transparency of the ownership structure. There are no intermediate companies between Bank Saderat Tashkent and BSI and information about the largest beneficial owners has been disclosed.

##### **Restricting factors:**

- The risk assessment of the bank's interbank deposits located in BSI, despite being moderately favorable, is restricted due to the lack of an internationally recognized credit rating of the Iranian bank. Even though BSI is systematically important for Iran, it has a track record of adequate performance, it benefits from the Iranian government support and has a global branch network, the assessment of the counterparty risk is subdued by the absence of a recognized credit rating;

- The level of profitability remains moderately low as compared to the Uzbek banking sector. Even though profitability ratios improved, the hike was mainly driven by UZS devaluation against USD since most of the bank's assets are denominated in USD. As of the end of 2017, ROE was at 5%, around 3p.p higher than in 2016 while ROE of the local banking sector was at 17,1% as of the same date. ROA, on the other hand, was at 4,5%, almost similar to ROE showing the extremely low amount of liabilities in the bank;
- The diversification of the funding base remains very low as the bank is mostly funded by equity accounting for 90% of the assets as of June 2018. Additionally, on the liabilities side, 100% of the funds due to other banks are from BSI and 98% of the customer accounts of legal entities belong to the Embassy of the Republic of Iran. Despite the high concentration, we believe the funding base will remain stable as there exists a long-lasting relationship between Saderat Tashkent and BSI;
- The bank is exposed to currency risks both transactional and translational as the financial position and the amount of capital can change in case there is an adverse exchange rate fluctuation (around 60% of the income came from FX operations due to devaluation of the UZS). This would not only hurt the financial position but the competitive position of the bank in Uzbekistan. Even though we do not expect this to negatively affect the bank in the short-term, potential volatility in the UZS/USD exchange rate could create mismatches in the income and balance sheet structure;
- Even though the strategic plan of the bank is consistent with the objective of a bank dedicated to transactional banking, previous strategy objectives, such as increasing the relationship with banks from countries other than Iran have not been met. This reflects different market conditions compared to what was previously expected by the bank. We will keep closely monitoring the realization of the new strategy.

#### Negative factors:

- The systemic risk for Saderat Tashkent remains high according to our assessment of the Banking Sector Risk (BSR). The bank operates in Uzbekistan, its capital comes from Iran and most of their assets are also located in Iran. Both countries are characterized by reduced transparency and highly underdeveloped financial markets. Despite Uzbekistan having recently liberalized the exchange rate, we still consider that the macro environment of the country is rather subdued;
- The captivity of the bank remains quite high as the bank's operations remain heavily related to BSI. As of June 2018, around 97% of the bank's assets (loans and deposits in other banks) were assigned to related parties staying practically unchanged from a year ago. Moreover, around 93% of the income in 2017 was attributable to related parties (interest income and profit from FX operations from deposits in BSI);
- Bank Saderat Tashkent continues to have an unfavorable competitive position and limited geographic reach. The bank operates in Uzbekistan with a single office in Tashkent. Moreover, as of June 2018, Saderat Tashkent's assets accounted for as low as 0,2% of the Uzbek banking system and its loans to a merely 0,001% of the sector. Currently, the main source of income for the bank consists of having deposits in BSI, which continues to limit the potential of the bank to penetrate the Uzbek market.

#### External support factors:

- Support from the owners. The bank has received financial support from BSI in the form of additional capital during periods of non-financial distress and based on recommendation of the CBU. This demonstrates the shareholder's ability and willingness to support the bank if required (weak support factor).

#### SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Significant improvement in the economic and financial conditions of Uzbekistan and Iran according to our internal BSR assessment;
- Diversification of the funding base, loan portfolio and banking activities;
- Increase in the bank's competitive position as a result of a stronger penetration in the Uzbek market and lower dependence on funding from BSI.

The following developments could lead to a downgrade:

- Significant deterioration of the bank's capital, liquidity and income as a result of UZS appreciation and/or changes in the yield curve combined with the continued use of short-term deposits as their main source of income;
- Deterioration of the financial conditions of Bank Saderat Iran, the bank's main source of funding.

#### JUSTIFICATION OF THE RATING:

The Agency confirmed the rating of Bank Saderat Tashkent at 'B' mainly due to the fact that we did not observe in the current and mid-term perspective any material or potential changes in the underlying factors. On the positive side, the rating remains supported by outstanding capitalization, low exposure to credit and interest rate risks and very strong liquidity metrics. Nonetheless, the creditworthiness of the entity remains constrained by the negative macro profile, low competitive position and high captivity levels. Moreover, profitability figures are below the Uzbek market average and the exposure to foreign exchange risk, albeit currently being mitigated, could potentially harm the stance of the bank in case there is UZS appreciation.

The bank has capital adequacy and liquidity figures well above the requirements of the CBU and we expect them to remain this way going forward. Both positive figures are the reflection of the almost non-existing liabilities in the bank; as of June 2018 the ratio of liabilities to assets was as low as 9,9%. Moreover, the low amount of loans to customers reduces the potential impact of a counterparty default in the capital metrics of the bank. Also, despite the low interest rate risk, the fact that most of the income generating assets are short-term (mostly three months) could potentially hurt profitability in case there is a significant movement in the yield curve.

Our BSR score shows once again a high systemic risk for the bank since it is exposed to the Uzbek and Iranian financial systems, both of which we assessed to have high market risks mainly due to the underdevelopments of the systems, subdued transparency and low depth of their respective banking sectors. In addition, the competitive position of Saderat Tashkent remains negative and its geographical diversification minimal. As of as of June 2018, Saderat Tashkent's assets accounted for as low as 0,2% of the Uzbek banking system and its loans to a merely 0,001% of the sector. It is also ranked 25<sup>th</sup> out of 28 banks in terms of assets. These figures show a low level of participation in the Uzbek market which, alongside a state-owned-bank-dominated sector, would make it more difficult for the bank to penetrate the market.

Additionally, the bank showed significant signs of captivity since 97% of the bank's assets and 93% of the income as of June 2018 were assigned to Bank Saderat Iran (BSI). Moreover, the funding base remains very low as the bank is mostly funded by equity accounting for 90% of the equity and liabilities as of June 2018. Furthermore, on the liabilities side, 100% of the funds due to other banks are from BSI and 98% of the customer accounts of legal entities belong to the Embassy of the Republic of Iran. The combination of the concentration of assets and equity on BSI augments the risk of the sustainability of the bank's capitalization and profitability in case a distress situation were to occur in BSI.

Nevertheless, we consider BSI to be reliable as we assess it as a systematically important bank for Iran as it is the largest bank in the country, has a track record of adequate performance, maintains

the Iranian government support and has a global branch network. However, the lack of an internationally recognized credit rating restricts a fully positive counterparty risk assessment.

The bank is exposed to currency risks both transactional and translational as the financial position and the amount of capital can change in case there is an adverse exchange rate fluctuation. In 2017, the bank benefited from the devaluation of the UZS since around 60% of the income came from dealing with FX operations. In contrast, after the exchange rate was liberalized, the UZS has appreciated by 5% in the last five months, hurting the bank's income. Even though we do not expect this to negatively affect the bank in the short-term, potential volatility in the UZS/USD exchange rate could create imbalances for the bank.

Profitability remains subdued as the ROE figure posted by the bank in 2017 was 5% as compared to a market average of 17,1%. Moreover, most of the increase in profit in 2017 was due to the extreme devaluation of the UZS against the USD back in September 2017.

The stable outlook still reflects our view of the bank's stable structure and operations. We believe the link of the bank to the BSI serves a regular and certain source of income and funding which contributes to the stability of the bank.

#### COMPANY PROFILE:

Bank Saderat Tashkent was established in 1999 and is a subdivision and a fully-owned subsidiary of the Bank Saderat Iran which is located in Tehran (Iran). The bank carries out its main activities on the basis of the banking license for banking operations issued by the Central Bank of the Republic of Uzbekistan No. 2 – D dated from 25 September 2004. The principal activity of the Bank is commercial and retail bank operations on the territory of the Republic of Uzbekistan and beyond. These operations include operations with securities, foreign currency, attracting deposits and issuance of commercial loans in UZS, and in freely convertible currencies, rendering services to customers in realization of export and import operations. The Bank operates its principal activities in Tashkent city and does not have any branches in the Republic of Uzbekistan.

Responsible expert: Hector Alvarez, Rating Associate of Rating-Agentur Expert RA GmbH

Reviewer: Ilya Makunin, Rating Analyst of Rating-Agentur Expert RA GmbH

#### Related research:

- ◆ Research report on Uzbekistan – 16.03.2018

<https://raexpert.eu/reports/Research report Uzbekistan 16.03.2018.pdf>

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RATING HISTORY:

<b>Date</b>	<b>Review reason</b>	<b>Rating Score</b>	<b>Outlook</b>
01.08.2017	Initial assignment	B	stable

### **Minute's summary:**

The rating committee for Bank Saderat Iran was held on 25 July 2018. The quorum for the rating committee was present. After the responsible expert presented the factors which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Banks methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the rating class voting.

The rating was disclosed to the rated entity prior to the publication and was not changed during the process of coordination.

The following methodology was used for the rating assessment: Methodology for Assigning Credit Ratings to Banks – Short Public Version (from August 2017) can be found under the following link: [https://raexpert.eu/files/methodology/Methodology\\_Short\\_Banks\\_August2017.pdf](https://raexpert.eu/files/methodology/Methodology_Short_Banks_August2017.pdf). Descriptions and definitions of all rating categories can be found under the following link: <http://www.raexpert.eu/banks/> under the “Rating scale” section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

**This rating is solicited. The rated entity participated in the rating assignment process.**

**No other third party participated in the preparation of the rating.**

Main sources of information:

- Annual IFRS report from the bank
- Monthly reports of the bank to the CBU
- Questionnaire from the bank
- Saderat Bank Iran website

### **Limits of the Credit Rating**

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information as well as non-public information (obtained from the rated entity and/or other third parties) which was considered to be reliable, complete and non-biased. The responsible expert performed rating assessment of the bank with information considered as the most reliable and up to date in accordance to the overall position of the bank and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

### **Conflict of interest**

The responsible expert was neither influenced nor biased by third parties during the rating assessment. The experts involved in the rating assessment and revision of the rated entity showed no conflict of interests before initiation of the rating process.

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies from RAEX group.

### **Risk warning**

The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's press-release.

This press-release represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

### **Office responsible for preparing the rating**

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

Rating-Agentur Expert RA GmbH is a credit rating agency established in Germany and therefore shall comply with all applicable regulations currently in force in the European Union.

The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.