

**Moody's downgrades Parex Bank to Ba1/NP/E+ from Baa3/P-3/D+**

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Latvia's Mortgage Bank acquires 51% stake in Parex Bank

Moody's Investors Service has today downgraded the bank financial strength rating (BFSR) of Parex Bank to E+ from D+, the local and foreign currency long-term bank deposit and debt ratings to Ba1 from Baa3 and the short-term rating to Not Prime from Prime-3. The outlook on the deposit and debt ratings is developing while the BFSR has a stable outlook. At the same time, Moody's has affirmed the ratings of Mortgage and Land Bank of Latvia (Mortgage Bank) at A3/P-2/D- with negative outlook.

Today's rating action follows the announcement on 8 November 2008 that the Latvian government will acquire a 51% stake in Parex Bank via its fully owned bank, Mortgage Bank. The government intervention was in response to Parex Bank's short-term liquidity difficulties in light of adverse market conditions. The government is to be viewed as a temporary shareholder only as it plans to find a strategic investor for the bank. Moody's notes that the transaction is subject to regulatory approval by the EU Competition Council and by Latvia's Financial and Capital Market Commission (FCMC).

The downgrade of the BFSR to E+ from D+ reflects Parex Bank's weakened profitability, stretched capitalisation levels and Moody's concerns with regard to the bank's asset quality development, especially in light of the weakening economic environment in Latvia. In particular, Moody's views Parex Bank as facing increasing challenges due to its high exposure to the real estate sector (both commercial and residential), which could be adversely affected by the current economic slowdown. The rating agency also notes the bank's weakened liquidity position, although this has been now restored following the government intervention.

Parex Bank's profitability weakened in the first half of 2008: its pre-tax, pre-provision income decreased 27% year on year, primarily due to weaker financial income and higher operating expenses. In addition, the combination of weaker internal capital generation and rapid historic growth has put pressure on the bank's capital adequacy. The Tier 1 ratio at end-June 2008 was 7.6%, down from 8.8% at year-end 2007, and the total capital adequacy ratio was 9.1%, down from 9.6% at year-end 2007. In Moody's view, the weakened capitalisation levels have significantly reduced the bank's loan loss absorption capacity.

Parex Bank's asset quality indicators have also weakened in 2008. The ratio of problem loans (i.e. individually impaired and over 90 days past due but not impaired loans) accounted for 3.8% of total loans at end-June 2008, up from 2.4% at end-2007. Moody's expects that the economic downturn -- which is likely to be worse than previously anticipated -- could have a negative impact on the bank's asset quality. At the same time the bank's credit risk concentrations remain high. The bank's real estate management sector exposure accounted for a high 18% of the total loan portfolio (or 175% of Tier 1 capital) at end-June 2008, whilst residential mortgage loans accounted for 17%. Moody's also notes that non-residential clients have historically been a key customer group for the bank on both the asset and liability sides.

The downgrade of Parex Bank's deposit and debt ratings to Ba1 is primarily a result of the downgrade of the BFSR, which has resulted in the bank's baseline credit assessment falling to B1 from Ba1 under Moody's rating methodology. However, following the government's intervention, Moody's now assesses the probability of systemic support for the bank in the event of a stress situation as high. Consequently, the bank's deposit and debt ratings receives a three-notch uplift from its B1 baseline credit assessment.

According to **Moody's**, the developing outlook on **Parex** Bank's deposit and debt ratings reflects the uncertainties surrounding the bank's future ownership, given that the government has stated its intention to be only a temporary shareholder in the bank. Upward rating pressure could emerge if a higher-rated entity were to make an acquisition proposal. Conversely, downward rating pressure could emerge if attempts to find a strategic investor were unsuccessful or if the bank's franchise were to be further adversely affected by recent events.

The affirmation of Mortgage Bank's ratings reflects **Moody's** recognition that it will not be a permanent shareholder in **Parex** Bank and will be kept as a fully separate entity; therefore, the acquisition of the stake has no implications for the bank's BFSR and long-term ratings. **Moody's** notes that it downgraded Mortgage Bank's deposit ratings on 7 November and changed the outlook on all ratings to negative (see separate press release for more details).

Headquartered in Riga, Latvia, **Parex** Bank reported total assets of LVL3.3 billion (EUR4.6 billion) at the end of June 2008.

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