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INVESTORS SERVICE

CREDIT OPINION
27 October 2022

New Issue

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Raiffeisen Bank d.d. Bosna i Hercegovina

New issuer

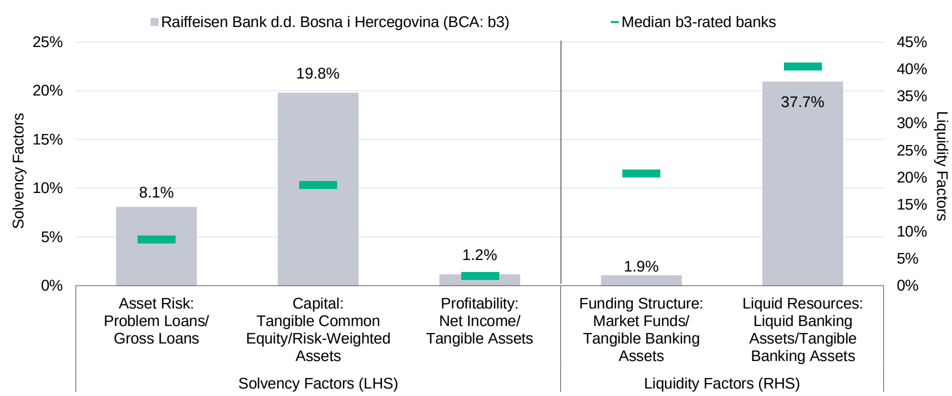
Summary

On 25 October 2022, we assigned first-time B1/NP local-currency and B3/NP foreign-currency deposit ratings to Raiffeisen Bank d.d. Bosna i Hercegovina (RBBiH), a b3 Baseline Credit Assessment (BCA) and a b1 Adjusted BCA.

RBBiH's B1 local-currency deposit rating reflects the bank's b3 BCA and two notches of rating uplift from our assessment of a high probability of affiliate support from Raiffeisen Bank International AG (RBI, A2/A2 stable, baa3[1]), resulting in a b1 Adjusted BCA. The B3 foreign-currency deposit rating is constrained by Bosnia and Herzegovina's (BiH, B3 stable) foreign-currency country ceiling,

RBBiH's b3 standalone BCA reflects its (1) robust capital, that affords it substantial capacity to absorb unexpected losses; and (2) a granular deposit-based funding structure and adequate liquidity. These strengths are balanced by (1) high asset risks from a challenging operating environment and indirect linkages with BiH sovereign credit risk, while problem loans are higher than similarly rated peers but are well provisioned; and (2) the lack of lender of last resort, which complicates liquidity management.

Exhibit 1
Rating Scorecard - Key financial ratios



These are our Banks Methodology scorecard ratios. Asset Risk and Profitability reflect the weaker of either the latest figure or the three-year and latest figure average. Capital is the latest reported figure. Funding Structure and Liquid Resources reflect the latest fiscal year-end figures.
Source: Moody's Investors Service

RATINGS

Raiffeisen Bank d.d. Bosna i Hercegovina

Domicile	Sarajevo, Bosnia and Herzegovina
Long Term CRR	B3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	(P)B3
Type	Senior Unsecured MTN - Fgn Curr
Outlook	Not Assigned
Long Term Deposit	B3 / B1
Type	LT Bank Deposits - Fgn Curr / Dom 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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Credit strengths

» Capital is robust and significantly above requirements

» A granular deposit-based funding structure and adequate liquidity

» Our assessment of a high probability of parental support in case of need

Credit challenges

» High asset risks driven by a challenging operating environment

» Indirect exposure to sovereign event risk at the B3 rating level, although direct exposure to government and public sector debt is low.

» Lack of a 'lender of last resort' complicates liquidity management

Outlook

The stable outlook on the bank's ratings reflects our expectation that it's financial performance will remain broadly stable and its capital significantly above regulatory requirements, despite operating environment pressures and some increase in problem loan formation. The outlook is also aligned with the stable outlook on the sovereign rating.

Factors that could lead to an upgrade

» RBBiH's b3 BCA is at the same level as the sovereign rating, and it's local-currency ratings are at the level of the local-currency country ceiling, an upgrade is therefore unlikely in the absence of an upgrade of the sovereign rating and a raising of the local-currency country ceiling.

» Given that the bank's foreign-currency ratings are constrained by the relevant country ceiling, the ratings could be upgraded if the foreign-currency country ceiling is raised.

Factors that could lead to a downgrade

» RBBiH's ratings could be downgraded if its BCA is downgraded, the sovereign rating is downgraded, or any of the country's ceilings are lowered.

» The bank's BCA could be downgraded if core capital buffers decline more than we expect, if problem loans increase significantly and provisioning coverage declines, or if its profitability is sustainably impaired. A significant deterioration in the bank's funding or liquidity can also put pressure on the BCA.

» Significantly reduced willingness by RBI to provide support to RBBiH, in case of need could also result in a ratings downgrade.

Key Indicators

Exhibit 2

Raiffeisen Bank d.d. Bosna i Hercegovina (Unconsolidated Financials) [1]

	12-21[2]	12-20[2]	12-19[2]	12-18[2]	12-17[2]	CAGR/Avg.[3]
Total Assets (EUR Million)	2,496.4	2,501.3	2,418.0	2,247.7	2,115.0	4.2[4]
Total Assets (USD Million)	2,828.6	3,060.5	2,714.2	2,569.5	2,539.7	2.7[4]
Tangible Common Equity (EUR Million)	280.6	284.2	278.9	283.2	273.6	0.6[4]
Tangible Common Equity (USD Million)	318.0	347.7	313.1	323.8	328.5	(0.8)[4]
Problem Loans / Gross Loans (%)	8.1	8.0	7.4	7.2	8.9	7.9[5]
Tangible Common Equity / Risk Weighted Assets (%)	19.8	20.6	18.9	19.7	17.1	19.2[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	28.0	27.5	26.8	25.2	29.1	27.3[5]
Net Interest Margin (%)	2.5	2.8	3.1	3.3	3.3	3.0[5]
PPI / Average RWA (%)	3.7	3.4	3.6	3.4	3.2	3.5[6]
Net Income / Tangible Assets (%)	1.4	0.9	1.2	1.9	1.8	1.4[5]
Cost / Income Ratio (%)	53.7	55.0	53.0	52.6	52.0	53.3[5]
Market Funds / Tangible Banking Assets (%)	1.9	3.1	7.2	4.0	3.5	4.0[5]
Liquid Banking Assets / Tangible Banking Assets (%)	37.7	37.1	34.0	29.5	29.8	33.6[5]
Gross Loans / Due to Customers (%)	63.1	65.1	72.9	73.7	73.0	69.5[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

RBBiH is a universal commercial bank operating in BiH and headquartered in Sarajevo. As of June 2022, RBBiH was the second-largest bank in the country with a 13% market share in terms of assets. The bank's total assets were BAM4.8 billion (€2.4 billion) as of the same date, according to information from the Federation of BiH Banking Agency (FBA).

RBBiH is a 100%-owned subsidiary of RBI, through Raiffeisen SEE Region Holding GmbH. The bank has been operating in BiH since 1992 as Market banka d.d. Sarajevo. Market banka was acquired in 2000 by the Raiffeisen Group and was renamed RBBiH.

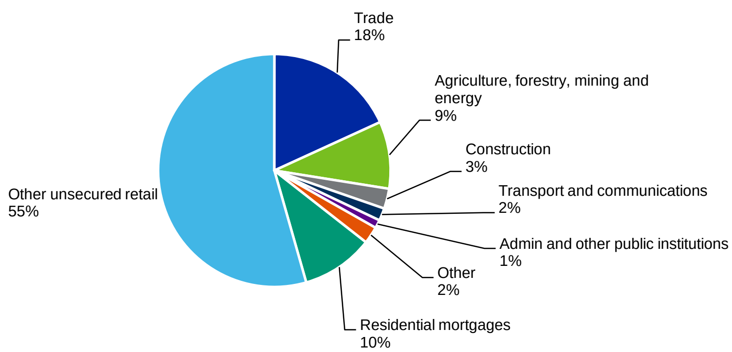
Detailed credit considerations

High asset risk driven by a challenging operating environment

RBBiH's asset risk is high, mainly driven by a challenging operating environment. The macro profile we assign to BiH is 'Very Weak'. While RBBiH's exposure to domestic government securities and public sector entities is low, the bank operates exclusively within BiH and is exposed to sovereign event risk at the B3-rating level given that generally sovereign crises can transmit shocks across the economy and the banking system. Reported problem loans are higher compared to similarly-rated global peers, however these are well provisioned. Additionally, underwriting standards are broadly conservative and borrower concentration levels are moderate.

Loans accounted for 49% of the bank's assets at the end of 2021 and loan growth was broadly flat in past 3 years. Loans to individuals made up 64% of total gross loans (see Exhibit 3), of which 84% were unsecured loans and 16% housing loans. Higher credit risk for unsecured retail loans, mainly general purpose consumer loans, is mitigated by salary-assignment, while local requirements cap the maturity and the total amount of the loan, and provide for a maximum loan repayment per income bracket. Currency risk for borrowers, 55% of the bank's loans have a euro currency clause, is mitigated by the long-standing currency board arrangement that pegs the convertible mark to the euro.

Exhibit 3
Retail loans to individuals dominate RBBiH's loan book
Loan breakdown by sector as of the end of 2021

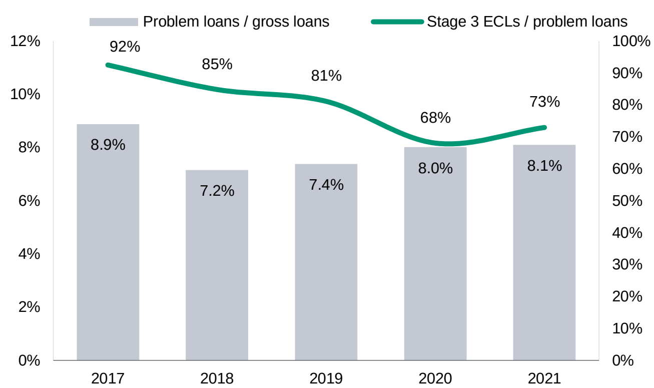


Sources: Bank's financial statements, Moody's Investors Service

Problem loans (defined as IFRS 9 Stage 3 loans and purchased or originated credit impaired loans that are in Stage 3) were 8.1% of gross loans as of the end of 2021 (end-2020: 8.0%). However, coverage of problem loans by Stage 3 expected credit losses (ECLs) was adequate at 73% (see Exhibit 4). Stage 2 loans (loans with a significant increase in credit risk) made up a further 11.1% of total loans at end-2021 and coverage with Stage 2 ECLs was also relatively high at 8.0%. Conservative provisioning is supported by a domestic regulatory framework that mandates minimum ECLs by IFRS 9 stage.[2]

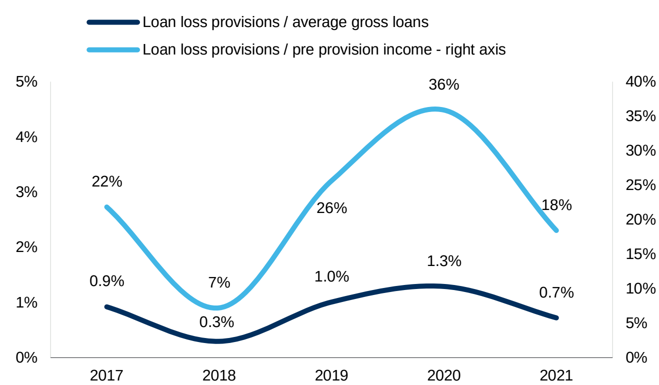
Cost of risk (loan loss provisions to average gross loss) averaged 0.8% during 2017 to 2021 (see Exhibit 5) and was generally well covered by pre-provision income. Provisions increased during 2020 in light of the pandemic-driven economic downturn, consuming a higher 36% of pre-provision income, but then declined again in 2021.

Exhibit 4
Problem loans were relatively high, but are well-provisioned



Source: Moody's Investors Service

Exhibit 5
Cost of risk peaked in 2020 but subsided in 2021



Source: Moody's Investors Service

Higher interest rates, high inflation and an economic slowdown will challenge borrower's capacity to service loans. A significant proportion of loans are at variable rates and predominantly linked to Euribor. We therefore expect new problem loan formation. We also expect higher cost of risk as the bank books additional provisions driven by measures from the authorities to mitigate the impact on credit risk from rapidly rising interest rates.[3]

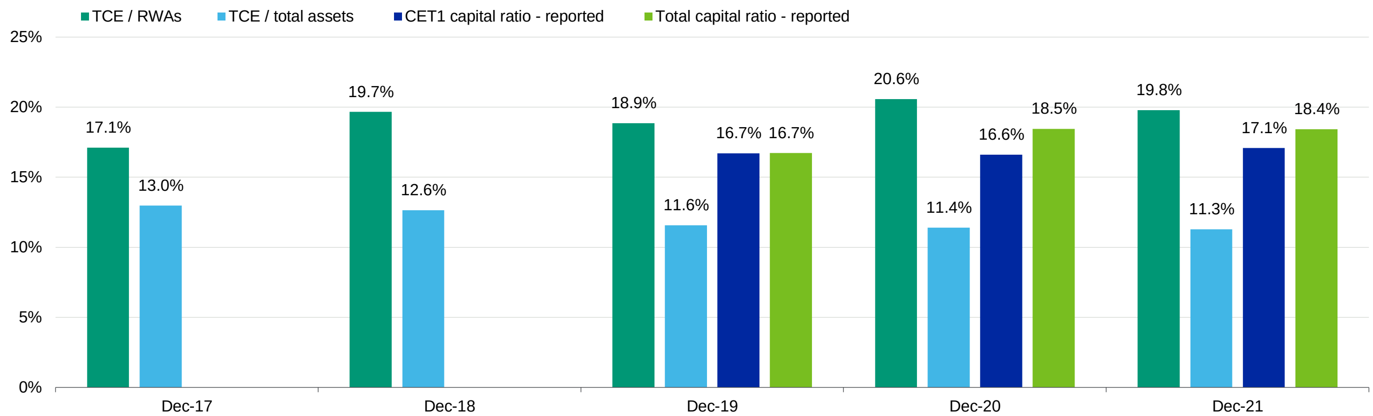
Capital is robust and significantly above requirements

RBBiH's capital levels are robust, which we consider a credit strength, affording it capacity to absorb sizeable unexpected losses also taking into account its adequate problem loan coverage. We expect the bank's core capitalisation to decline somewhat as it upstreams dividends and grows its loan book, but to remain sufficiently above regulatory requirements and to be compatible with the current rating level.

RBBiH's adjusted tangible common equity (TCE)-to-risk-weighted assets (RWAs) ratio, where we risk-weight government exposures according to BiH's sovereign rating and that includes all current period profits, was 19.8% and its TCE-to-total assets ratio was 11.3% as of the end of 2021 (see Exhibit 6).

Exhibit 6

Capital is robust and well above requirements



In 2019, the bank transitioned calculating capital under Basel III from Basel II
Source: Moody's Investors Service

RBBiH reported a regulatory Common Equity Tier 1 (CET1) capital ratio and total capital ratio of 17.1% and 18.4% respectively as of the end of 2021. Both metrics were substantially above the bank's requirements for that period. These were 9.25% for the CET1 ratio 14.5% for the total capital ratio, which include the 2.5% capital conservation buffer but not the undisclosed pillar 2 capital charge that is specific to RBBiH. The bank also reported a Basel leverage ratio of 9.2%, which also incorporates off-balance sheet exposures, that is also well above the 6% requirement.

RBBiH applies the standardised approach to calculate credit-related risk-weighted assets and therefore the bank's capital metrics are less sensitive to potential amendments in regulatory methods to calculating risk-weighted assets, including floor requirements, or to macroeconomic shocks that could increase risk-weights of more risk-sensitive models.

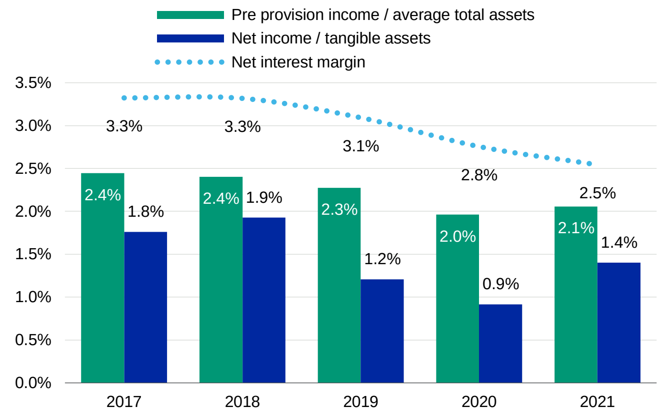
Moderate profitability has been challenged by the low interest rate environment and fierce competition

The bank's profitability has been moderate, challenged by narrowing net interest margins in light of declining lending yields and high liquidity in a low interest rate environment. However, as mentioned earlier pre-provision profits sufficiently cover cost of risk and bottom-line profitability generates adequate internal capital. Return on equity was 12% in 2021. Looking ahead, we expect profitability to improve as interest rates rise, although cost of risk will also increase and price inflation will increase operating costs, particularly staff expenses.

Net income rose to 1.4% of tangible assets in 2021, from 0.9% in 2020 when pandemic-driven provisions consumed a higher portion of pre-provision income (see Exhibit 7). However, profitability remains lower than the pre-pandemic levels and the net interest margin according to our definitions has gradually declined to 2.5% in 2021 from 3.3% in 2018. Intense competition and high liquidity eroded the banking sector's lending and asset yields. The bank partly mitigated this by expanding fee and commission and other income, which accounted for 48% of net revenue in 2021 up from 40% in 2018.

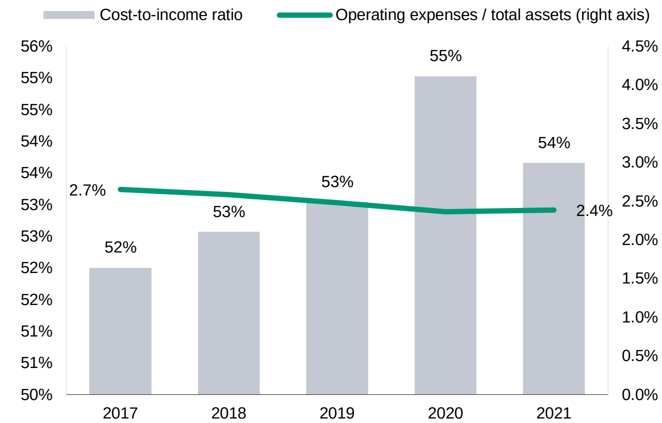
The bank benefits from an established franchise, as the second-largest bank in the country and some economies of scale. Therefore, pre-provision profitability has been broadly stable. Operating efficiency remains adequate with a cost-to-income ratio of 54% in 2021, while a focus on cost control has allowed the bank to reduce operating expenses to 2.4% of total assets in 2021 from 2.7% in 2017 (see Exhibit 8).

Exhibit 7
Profitability is moderate, challenged by declining margins



Source: Moody's Investors Service

Exhibit 8
Operating efficiency is adequate, benefiting from a focus on cost control



Source: Moody's Investors Service

Over the coming quarters we expect the net interest margin to widen given higher euro area rates, the bank's high proportion of variable rate loans and a lower cost on placements and reserves with the central bank.[4] Provisions will also rise somewhat, as will operating expenses but ongoing efforts to digitalise branches, to increase process automation and to move transaction to digital and alternative channels will support efficiency, despite high IT investments.

Granular deposit-based funding structure and adequate liquidity, but lack of a 'lender of last resort' complicates liquidity management in a crisis

RBBiH's reliance on potentially more confidence sensitive market funding has been very low at 2% of tangible banking assets as of year end 2021, because its funding structure is mainly driven by a granular deposit base. Going forward we expect some increase in market funding reliance because of issuances to meet a definite minimum requirement for own funds and eligible liabilities (MREL) starting from 2023, which will also increase funding costs. This is reflected in our assigned score for the bank.

Customer deposits made up 94% of total liabilities, excluding equity, as of the end of 2021. Additionally, the deposit base is relatively granular whereby 58% of deposits were from private individuals. The remaining 42% was from legal entities. Around 35% of deposits were denominated in foreign currency, mostly in euro. The rest of the liabilities were predominantly funds from developmental and international financial institutions that are generally less confidence sensitive.

Nevertheless, the lack of a lender of last resort because of the country's strict currency board arrangement complicates liquidity management in a crisis. Further exacerbating this constraint is a lack of developed domestic interbank and capital markets, or a secondary market for government securities.

Mitigating this concern, the bank has some access to funding from its parent, while it also maintains a sufficient level of liquid assets on its balance sheet. Liquid assets made up 38% of tangible banking assets at the end of 2021. The bulk of these liquid assets were cash and money market placements. RBBiH also reported a liquidity coverage ratio of 268% at end-2021 (379% for end-2020), significantly above the 100% requirement. The bank's net stable funding ratio was 178% as of the end of 2021, also well above 100%.

Source of facts and figures cited in this report

Unless noted otherwise, we have sourced data relating to systemwide trends and market shares from the central bank of BiH, the FBA and the Banking Agency of Republika Srpska. Bank-specific figures originate from the banks' reports and all figures are based on our own chart of account and may be adjusted for analytical purposes. Please refer to the document Financial Statement Adjustments in the Analysis of Financial Institutions published on 9 August 2018.

To date, RBBiH has only published unconsolidated accounts. We have used these unconsolidated accounts as a proxy for the bank's consolidated financial profile given that the contribution from its subsidiaries was relatively immaterial in terms of total assets, or profit and loss.

ESG considerations

In line with the banking sector, RBBiH has a low exposure to environmental risks because direct lending to the hydrocarbon sector is fairly limited. See our Environmental risk heat map for further information.

The most relevant social risks for banks arise from the way they interact with their customers. See our Social risk heat map for further information. Social risks are particularly high in the area of data security and customer privacy, which are mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage because of product mis-selling or other types of misconduct are further social risks. Societal trends are also relevant in a number of areas, such as shifting customer preferences towards digital banking services, increasing information technology cost, ageing population concerns in several countries, including BiH, affecting demand for financial services or socially driven policy agendas that may translate into regulation that affects banks' revenue base. We also regard the coronavirus pandemic as a social risk under our environmental, social and governance (ESG) framework because of the substantial implications for public health and safety. Overall, banks, including RBBiH face moderate social risks.

Governance is highly relevant for RBBiH, as it is to all participants in the banking industry. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit a bank's credit profile. Governance risks are largely internal rather than externally driven, and for RBBiH, we do not have any particular governance concerns. However, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Affiliate support

We assess that there is a high probability of support by RBI to RBBiH. Our assessment is based on RBI's 100% stake in RBBiH, the parent's ongoing operational support and oversight, and the subsidiary's use of the Raiffeisen logo and name. RBBiH is also a strategic fit to RBI's Western Balkans presence given its established and sustainable franchise as one of BiH's largest banks. Therefore, the risk of the parent disposing of its subsidiary is relatively low. This assessment results in two notches of rating uplift for RBBiH's Adjusted BCA to b1 from the bank's standalone BCA of b3.

Government support considerations

RBBiH's ratings do not benefit from government support uplift given that the bank's Adjusted BCA and therefore the preliminary rating assessments (PRAs) for its ratings are already above the sovereign rating of BiH.

Counterparty Risk Ratings (CRRs)

RBBiH's local-currency CRRs are B1/NP and its foreign-currency CRRs are B3/NP

In line with our methodology, for the CRRs, we constrain the PRA to two notches above the sovereign rating, reflecting our view that expected loss is likely to be higher under a sovereign default. The foreign-currency CRRs are constrained by the relevant ceiling at B3.

Counterparty Risk (CR) Assessment

RBBiH's CR Assessment is B1(cr)/NP(cr)

According to our methodology, the CR Assessment typically does not exceed the sovereign's rating by more than two notches where the Adjusted BCA is already above the sovereign rating.

Methodology and scorecard

Rating methodology

The principal methodology used is Banks Methodology, published in July 2021.

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 materially 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 9

Raiffeisen Bank d.d. Bosna i Hercegovina

Macro Factors							
Weighted Macro Profile	**Very Weak**	**100%**					

Factor	**Historic Ratio**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	8.1%	caa2	↔	caa1	Collateral and provisioning coverage	
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	19.8%	b1	↓	b2	Expected trend	Access to capital
Profitability						
Net Income / Tangible Assets	1.2%	caa1	↑	caa1	Expected trend	Loan loss charge coverage
Combined Solvency Score		b3		b3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	1.9%	ba3	↓↓	b3	Expected trend	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	37.7%	b3	↔	b3	Stock of liquid assets	
Combined Liquidity Score		b1		b3		
Financial Profile				b3		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				B3		
BCA Scorecard-indicated Outcome - Range				b2 - caa1		
Assigned BCA				b3		
Affiliate Support notching				2		
Adjusted BCA				b1		

Instrument Class	**Loss Given Failure notching**	**Additional notching**	**Preliminary Rating Assessment**	**Government Support notching**	**Local Currency Rating**	**Foreign Currency Rating**
Counterparty Risk Rating	1	0	b1	0	B1	B3
Counterparty Risk Assessment	1	0	b1 (cr)	0	B1(cr)	
Deposits	0	0	b1	0	B1	B3
Senior unsecured bank debt	0	0	b1	0	(P)B1	(P)B3

[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 10

Category	Moody's Rating
RAIFFEISEN BANK D.D. BOSNA I HERCEGOVINA	
Outlook	Stable
Counterparty Risk Rating -Fgn Curr	B3/NP
Counterparty Risk Rating -Dom Curr	B1/NP
Bank Deposits -Fgn Curr	B3/NP
Bank Deposits -Dom Curr	B1/NP
Baseline Credit Assessment	b3
Adjusted Baseline Credit Assessment	b1
Counterparty Risk Assessment	B1(cr)/NP(cr)
Senior Unsecured MTN -Fgn Curr	(P)B3
Senior Unsecured MTN -Dom Curr	(P)B1

Source: Moody's Investors Service

Endnotes

1 The ratings shown here are RBI's deposit rating, senior unsecured debt rating and Baseline Credit Assessment.

2 Under local rules, the minimum ECL for Stage 1 exposures is 0.1% for low risk exposures, such as to the country's central bank and state and entity governments, and 0.5% for all other exposures, 5% for Stage 2 exposures and minimum ECLs start at 15% for Stage 3 exposures, rising gradually to 100% depending on days past due and whether the exposure is secured or unsecured.

3 At the end of September 2022 the two banking agencies announced temporary measures to mitigate risk from rising interest rates. Banks are instructed to assess the impact of rising interest rates on their exposures before implementing the increase and to reflect the risk in expected credit losses (ECLs). For existing or new exposures with a significant increase in interest rates, defined as 200 basis points from the rate that would be applicable in June 2022, the minimum ECL for Stage 1 exposures is 2% and for Stage 2 exposures 12%. Banks should also determine whether the significant increase in interest rate represents also a significant increase in credit risk, and therefore assign those exposure to Stage 2

4 As of July 2022, the central bank of BiH will remunerate funds exceeding the required reserves at -0.25% up from -0.75% and required reserves in foreign currency at -0.10% from -0.60%. There is no remuneration for required reserves in local currency.

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CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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