



Rating Action: Moody's Ratings changes outlook on BSTDB to stable from negative; affirms Baa2 ratings

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London, July 05, 2024 -- Moody's Ratings (Moody's) has today changed the outlook on Black Sea Trade and Development Bank (BSTDB) to stable from negative and affirmed the Baa2 long-term issuer and senior unsecured debt ratings and the (P)Baa2 senior unsecured MTN programme rating. Concurrently, we have also affirmed the short-term issuer rating at P-3.

The change in outlook to stable reflects the resilience of BSTDB's capital position amid a challenging operating environment in the context of the Russia-Ukraine war. The capital position has been supported by BSTDB's declining leverage, resilient asset quality and asset performance. The stabilization of the outlook is also driven by the recently approved capital increase, which highlights the members' commitment to the institution despite geopolitical tensions. The capital increase supports the strategic role of the bank in the region over the longer term. Overall, the bank has been successful in responding to the challenges that the war conditions in Ukraine (Ca stable) and the international sanctions on Russia have posed to the institution.

Our affirmation of the Baa2 ratings reflects BSTDB's solid capital position, and expectation that the leverage and asset quality will remain broadly stable in the medium term amid a persistently difficult operating environment. The rating also reflects adequate liquid resources, which are sufficient to meet debt repayments due over the next 12 months even when assuming no access to external funding. While we expect funding conditions to gradually improve, BSTDB is likely to continue to generate financial resources internally and relying on new bilateral financing to service its financial obligations and finance its operations unless borrowing becomes available on more affordable terms.

RATINGS RATIONALE

RATIONALE FOR CHANGING THE OUTLOOK TO STABLE

RESILIENT CAPITAL ADEQUACY AMID CHALLENGING OPERATING ENVIRONMENT

The first driver for stabilizing the outlook is the resilience of BSTDB's capital adequacy amid the current difficult operating environment. The resilience reflects declining leverage, stable asset quality, and improving asset performance despite the challenges posed by the Russia-Ukraine war. Since the start of the war in February 2022, BSTDB has focused on consolidating its balance sheet, limiting new operations and focusing on preserving its financial strength and portfolio quality. As a result, after contracting by 12.8% in 2022, the bank's development-related assets (DRAs) declined again by 23.3% in 2023. BSTDB's leverage ratio stood at 189% at end-2023, down from 256% in 2022 and a peak of 282% in 2021.

At the onset of the conflict, BSTDB had significant exposure to both Ukraine and Russia, with both countries together accounting for over 30% of DRAs as of December 2022. BSTDB stopped lending to Russia after the start of the war and the exposure notably declined by about 60% to EUR 162 million (equivalent to 10% of DRAs) at end-2023 from EUR 401 million (19.5% of DRAs) in December 2022. The outstanding exposure to Ukraine has declined as well although remaining broadly stable as a share of the portfolio (about 12% of DRAs).

The stabilization of the outlook reflects the resilience of the asset performance in the context of the Russia-Ukraine war. The exposure to Russia has experienced issues of transactional nature due to the imposition of international sanctions, which have affected the timely receipt of payments. In the case of Ukraine, the weaker asset performance is mainly a reflection of challenges posed by the war conditions to the borrowers' credit profile. About 89% and 74% of the payments (including prepayments and sold exposure) scheduled in 2022 and up to May 2024 from Russia and Ukraine, respectively, have been received by the bank. Nevertheless, in the case of Russia, about 10% of the due payments were received but are currently held in restricted accounts.

As of end-2023, stage 3 loans - mostly from Ukraine's exposure - were about 20% lower compared with 2022 but remained broadly stable as a share of DRAs at 9.6% of DRAs. Non-performing assets (NPAs) under Moody's definition stood at 6.8% at end-2023, down from 8.2% at end-2022. According to unaudited accounts, the non-performing loans (NPLs) ratio reached 5.7% as of May 2024. While these figures exclude the payment deferrals that have been agreed on about 16% of the exposure to Ukraine, our expectation is that any deterioration in asset quality would be

contained. The performance of the rest of the portfolio has remained broadly stable.

RECENTLY AGREED CAPITAL INCREASE INDICATES SHAREHOLDER SUPPORT FOR BANK'S STRATEGIC ROLE

After protracted discussions among the member states, the subscription process for the capital increase was completed in May 2024. BSTDB's subscribed capital will rise to EUR 3.1 billion from EUR 2.3 billion, as originally announced in 2021, with a paid-in portion of the newly subscribed capital of 30% (the remaining 70% is callable), in line with the bank's current capital structure. The transfer of shares will occur on 1 January 2027, and the subscribed capital payments will be made in eight instalments over 2027 to 2034.

According to the agreement reached in May 2024, and given a special exemption for International Financial Institutions provided by the EU, Russia will participate in the capital increase, but will be required to pay by cash upfront in 2027. There had been a misalignment between internal rules due to Russia's interest in participating in the capital increase, which is protected by the bank's statute, and the sanctions risk deriving from its participation, which led BSTDB to seek clearance from regulatory authorities in the EU. The share of Romania (Baa3 stable) and Ukraine will increase slightly given their oversubscription versus Albania (B1 positive) which does not participate.

Even though the capital increase will only materialize over the coming years, we consider it a clear sign of the commitment of the shareholders for the strategic role of the institution in a difficult geopolitical environment, and consequently improve our assessment of members' willingness to support BSTDB. This results in an improvement of the overall strength of member support, which also captures a large amount of callable capital to total debt, balanced against the low credit quality of most of the bank's shareholders.

RATIONALE FOR AFFIRMING THE Baa2 RATINGS

The affirmation of BSTDB's ratings at Baa2 reflects our expectation that BSTDB's capital adequacy will remain broadly stable at the current level as the bank will continue to pursue a prudent strategy given the persisting challenges posed by the Russia-Ukraine war.

While the bank will likely continue to experience asset performance pressures on its exposure to Ukraine stemming from the uncertainty related to the war, we expect NPAs to remain on an improving trend over the medium term, with any potential deterioration temporary and contained. The exposure to Russia relative to BSTDB's overall portfolio has declined materially, and we expect that this trend will continue over time, given an

average residual maturity of the portfolio is about 3.5 years, reducing risks to asset performance.

Liquid resources are likely to decline over the next 12 months if no additional funding is secured, but we expect them to remain clearly sufficient to cover BSTDB's upcoming repayment obligations. While we expect funding conditions to gradually improve, BSTDB is likely to continue to generate financial resources internally and rely on new bilateral financing rather than tapping international capital markets, at least until borrowing becomes available on more affordable terms and the bank returns to growth.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

BSTDB's credit impact score at CIS-2 reflects generally low exposure to environmental risks, low exposure to social risks, and a solid governance profile supported by a prudent framework.

The environmental issuer profile score is E-2. BSTDB's exposure to sectors affected by environmental considerations, such as the agriculture sector or sectors facing carbon transition risk, such as the oil and gas sector, is contained, with high portfolio diversification providing a mitigation.

BSTDB's social issuer profile score at S-2 reflects good customer relations and, as demonstrated until the start of Russia-Ukraine war, solid demand from its member states which are also borrowers, policies in place to safeguard responsible production, and attention to societal trends.

The governance issuer profile score at G-2 is underpinned by prudent policies and improvements in the bank's risk management framework over the past decade, which supported a robust track record of asset performance and is helping to contain asset quality risk in the current difficult operating environment in the Black Sea region. At the same time, a more fragmented shareholder base due to the geopolitical conditions can have implications for the strategic direction of the bank over time.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Upward pressure on the rating could emerge if BSTDB's development asset credit quality materially improves and the bank manages to maintain its track record of moderate NPAs even in a continuing difficult operating environment. A significant improvement in the operating environment and in the creditworthiness of the bank's major shareholders would also be positive for the rating.

BSTDB's ratings would likely be downgraded should we conclude that a deterioration in asset quality and/or performance materially affects our

assessment of capital adequacy. Evidence of liquidity pressures and/or that access to funding sources at affordable costs has weakened on a permanent basis adversely affecting the business model, could also exert downward pressure. Any evidence that diminished cooperation between members is lastingly affecting the decision-making process of the bank, constraining its ability to meet its strategic objectives, would also be credit negative.

The principal methodology used in these ratings was Multilateral Development Banks and Other Supranational Entities published in February 2024 and available at <https://ratings.moodys.com/rmc-documents/414557>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

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Daniela Re Fraschini
Vice President - Senior Analyst
Sovereign Risk Group
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London, E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Dietmar Hornung
Associate Managing Director
Sovereign Risk Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London, E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

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