Research Update:

Black Sea Trade and Development Bank Downgraded To 'BBB' On Reduced Policy Importance; Outlook Stable; Off Watch Neg

July 5, 2024

PRIMARY CREDIT ANALYST

Gabriel Forss
Stockholm
+ 46 84 40 5933
gabriel.forss
@spglobal.com

SECONDARY CONTACT

Christian Esters, CFA
Frankfurt
+ 49 693 399 9262
christian.esters
@spglobal.com

RESEARCH CONTRIBUTOR

Yatish V Udywar
CRISIL Global Analytical Center, an S&P affiliate, Mumbai

Overview

- We think Black Sea Trade and Development Bank's (BSTDB's) public policy mandate across its region of operations has structurally decreased following its substantial balance sheet reduction over the past two years.
- While we understand BSTDB's consolidation has been agreed upon with shareholders and it is producing near-term support to its capitalization, we think it has come at the expense of diminishing policy importance, a relevance we believe will take time to restore as the bank's resumed lending activity remains subject to challenges from the war between Russia and Ukraine, two of the bank's main shareholders.
- Positively, the bank's shareholder community have agreed to the terms and process for its capital replenishment, in our view a necessary signal of commitment to the institution's viability.
- In addition, following BSTDB's $412 million June 2024 Eurobond redemption, we project liquidity to remain solid over 2024-2025.
- We lowered our long-term issuer credit rating on BSTDB to 'BBB' from 'BBB+' and removed it from CreditWatch with negative implications. We also affirmed our 'A-2' short-term rating on the bank.
- The stable outlook reflects our expectation that shareholders will follow through on their commitments under the capital replenishment program while the broader risks from the war in Ukraine on the bank's asset quality and financial positions will remain manageable.

Rating Action

On July 5, 2024, S&P Global Ratings lowered its long-term issuer credit rating on the Black Sea Trade and Development Bank to 'BBB' from 'BBB+' and affirmed its 'A-2' short-term rating on the bank. The outlook is stable. We removed the ratings from CreditWatch, where we placed them with negative implications on July 26, 2023.

Outlook

The stable outlook reflects our expectation that shareholders will follow through on their commitments under the recently agreed-to capital replenishment program. The outlook also assumes that the broader risks from the war in Ukraine on the bank's asset quality and financial positions remain manageable, and the bank will contract bilateral credit facilities to secure sufficient financing for its medium-term commitments, allowing for a gradual increase in lending volumes in 2025 onward.

Downside scenario

We could consider lowering our ratings on the BSTDB within the next 24 months if:

- BSTDB's shareholders did not follow through on their commitments under the capital replenishment program or otherwise lessened their support to the institution;
- The bank suffered loan write-offs from its war-affected lending portfolios that lead to a substantial reduction in its risk-adjusted capital (RAC) position; or
- Its liquidity position deteriorated, possibly from an extended inability to contract financing, in combination with the lack of asset-side inflows.

Upside scenario

We could consider an upgrade if BSTDB navigated the numerous direct and indirect consequences--on the institution and on the region--from the war in Ukraine. We would assume this scenario to entail a fully supportive shareholder community, a normalized access to funding markets, alongside evidence that the bank is able to resume solid business growth, replenishing the policy relevance lost since the start of the war in Ukraine.

Rationale

The downgrade reflects our view that BSTDB's public policy role has structurally weakened following its substantial balance-sheet reduction over the past two years. This erased the positive momentum the bank enjoyed in 2018-2021. We consider the unwinding of activity to have come at the expense of a diminishing policy importance, which we believe will take time to restore. Therefore, we now assess BSTDB's enterprise risk profile as weak, reflecting its reduced developmental impact and our assessment that the bank's restart in 2025-2026 remains challenged by the ongoing war in its region of operations and impaired access to deep funding markets. The bank's extremely strong capitalization, and our expectation that its liquidity position will remain solid over 2024-2025, support the ratings.

BSTDB's shareholders agreed on its capital replenishment program in May 2024, with capital contributions set to commence in 2027. We view this constructive solution as alleviating the immediate risks that shareholders' near-term commitment to the institution might waiver. We understand that the general capital increase will allow shareholders to be allocated shares in accordance with their existing ownership stake. Of 11 shareholders, we understand that 10 have communicated firm intentions to take part in the capital replenishment. Following the conclusion, Albania's share will be reduced to 1.48% (from 2.01%) due to its non-participation in the capital increase, Romania and Ukraine will increase their shareholding to 14.08% (from 14.07% and 13.57%, respectively) due to their oversubscriptions. All other shareholders will retain their ownership shares. This includes Russia, which will be allocated shares according to its pro rata ownership, thereby retaining its 16.58% stake in the bank. In addition to finding internal shareholder agreement on the capital program, we understand that BSTDB has solicited legal advice to ensure full regulatory, sanctioned-relevant compliance for receiving capital payments from sanctioned shareholders would be met.

BSTDB's consolidation agenda has come at the expense of a materially reduced lending footprint and a lowered policy relevance. The bank has adhered to its initial phase of its medium-term strategy for 2023-2026, which included a plan to reduce lending activity for the first two years to safeguard capital and liquidity during a period of stress. We observe a notable reduction in activity over 2022-2023, when the bank's balance sheet decreased 33%. BSTDB reduced its exposure to Russia 65% and to Ukraine 35% in this time, following the strategy of de-risking its loan book. Even so, we consider the breadth of the bank's consolidation as illustrating its inability to pivot resources to other geographical areas to a degree relevant in fulfilling its overall policy function through distressed cycles. Specifically, outside BSTDB's Russia and Ukraine books, we observe that loans to key markets have also decreased substantially in the past two years: There was a 15% reduction in the bank's Turkey book, a decrease of 16% and 22.5%% in the bank's Bulgarian and Romanian exposures, respectively, and reductions in the loan books of several smaller recipient countries. We expect new lending in second-half 2024 will likely be lower than in the pre-war period and focus on less wealthy shareholder countries such as Ukraine. In phase 2 (2025-2026) of the medium-term strategy, the bank will again target growth, albeit likely slower than before the war.

BSTDB's very solid capitalization levels, combined with modest business expectations over 2025-2026, have allowed the bank to delay the start of payments from the capital increase to January 2027. We consider the postponed deadline will also allow time for possibly normalized relationships between shareholders, a less heated geopolitical environment, and a more easily navigated regulatory context. At the same time, we recognize the complex relationships among some of BSTDB's shareholders, and believe the extended time frame until payments from the capital increase start could make the process vulnerable to re-emerging uncertainties. Moreover, we think the 2025-2026 startup period will be crucial in solidifying shareholder commitment to the bank's policy function. Our base-case scenario assumes that all shareholders that have signaled their intention to take part in the capital replenishment will stand by their promises come January 2027.

We expect BSTDB's liquidity buffers to remain stable after the redemption of its Eurobond on June 25, 2024. The bank has buffered its own funds over the past 1.5 years to cater for the redemption of the $412.5 million Eurobond. We calculate our one-year liquidity ratio at 1.38x as of Dec. 31, 2023, when only taking account of the committed loan disbursements, a reflection of the strong liquidity position heading into 2024. While BSTDB's liquidity holdings have fallen nominally following the bond redemption, we expect the bank will retain a strong liquidity position. In particular, BSTDB has very minor commercial debt liabilities coming due over the next two years, which, together with low levels of committed lending and our expectation of maintained bank profitability, support the liquidity parameters.

We consider BSTDB's access to commercial funding markets to have structurally weakened, giving rise to a notable uptick in funding costs on the capital markets. Since the war's start, the yield levels on the bank's debt securities outstanding stand above the coupons at issuance, making capital market financing a commercially nonviable option. However, we view positively BSTDB's ability to strike bilateral financial arrangement with fellow multilateral development banks, which we assess will be sufficient to secure financing for its medium-term financial commitments. On a broader level, we expect the bank's funding market profile will require re-establishing and likely developing in tandem with the success BSTDB has in expanding its lending activities and building funding volumes over 2025-2027. Before then, we expect the bank to be an infrequent issuer and only execute wholesale market trades sporadically, awaiting a full normalization of its funding market profile.

BSTDB's conservative strategy execution over 2022-2023 has secured near-term financial resilience and maintained its very strong financial risk profile in a challenging environment. In particular, we recognize that BSTDB's consolidating balance sheet has strengthened capitalization, providing a buffer to risks of near-term asset quality deterioration.

We consider the reduction and de-risking of the bank's loan book, most visibly by the 70% reduction in Russian lending exposure since the start of the war, to have strengthened its near-term capital resilience and now assess its capital position as extremely strong. We estimate BSTDB's RAC ratio at 27.1% based on balance-sheet exposure as of Dec. 31, 2023 (and with sovereign ratings and our and Banking Industry Country Risk Assessments as of June 19, 2024). This is up from 23.9% at June 2023 (and 20.6% as of December 2022), reflecting a 14% decrease in total exposures and a similar reduction in risk weights. We expect BSTDB's RAC ratio to remain above 23% over the next two years as the overall loan book will likely remain stagnant over 2024 and only gradually increase over 2025-2026; meanwhile, we forecast stable profitability. In addition, our base-case scenario assumes that share capital will begin to flow into the bank by 2027, providing support to BSTDB's capital position and its financial ability to underwrite new lending. Following a nearly 70% reduction over the past two years, the rest of the bank's lending exposures in Russia are, or are closely linked to, the public-sector and related companies, which we believe is an indication of resilient finances. Still, we understand that repayment continues to be hindered by the lengthy processes to gain specific approval from Russian authorities, which are required for all Russia-based borrowers making transfers to the EU. We expect BSTDB's Russia lending exposures to fall further over 2024-2025, which should support asset quality and help reduce risks related to payment delays. In addition, the bank will not engage in any new lending in Russia for as long as global sanction regimes are in place.

BSTDB's lending exposures in Ukraine faces the most acute risk of further credit deterioration, in our view. On Dec. 31, 2023, loans to Ukraine represented about 11.5% of total lending, down about one percentage point from a year prior. We understand that the majority of clients are current on their obligations and operating without material disruptions. Up to May 2024, the bank received about 75% of scheduled payments due from Ukrainian entities since the start of 2022. One operation, a wind power plant near Crimea (corresponding to about 10% of the Ukrainian portfolio and about 1% of the total portfolio), has been forced to cease operations because of severe damage. We still see risks of further deterioration and nonperforming loans in the Ukrainian portfolio if the conflict continues.

BSTDB's private-sector-focus precludes it from being treated as a preferred creditor. Direct sovereign exposure is typically below 25%. We therefore do not incorporate preferred creditor treatment in our assessment of the bank's enterprise risk profile.

The ratings on BSTDB do not reflect potential extraordinary support from shareholder. Our view of BSTDB's weak policy importance precludes the notion of callable capital support.

Ratings Score Snapshot

	To	From
Issuer credit rating	**BBB/Stable/A-2**	**BBB+/Watch Neg/A-2**
Stand-alone credit profile	bbb	a-
Enterprise risk profile	Weak	Moderate
Policy importance	Weak	Moderate
Governance and management expertise	Adequate	Adequate
Financial risk profile	Very strong	Very strong
Capital adequacy	Extremely strong	Very strong
Funding and liquidity	Adequate	Strong
Extraordinary support	0	0
Callable capital	0	0
Group support	0	0
Holistic approach	0	-1

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Jan. 31, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Downgraded; CreditWatch Action

	To	From
Black Sea Trade and Development Bank		
Senior Unsecured	BBB	BBB+/Watch Neg

Downgraded; CreditWatch/Outlook Action; Ratings Affirmed

	To	From
Black Sea Trade and Development Bank		
Sovereign Credit Rating		
Foreign Currency	BBB/Stable/A-2	BBB+/Watch Neg/A-2