

Research Update:

Black Sea Trade and Development Bank Upgraded To 'A/A-1' On Shareholder Support; Outlook Stable

November 25, 2021

Overview

- The Black Sea Trade and Development Bank (BSTDB) has continued to expand during the pandemic-related economic downturn in most shareholder countries, with its asset quality only mildly affected.
- In our view, the recently approved capital increase illustrates shareholders' support of the bank's mandate and confirms its policy relevance.
- We raised our ratings on BSTDB to 'A/A-1'.
- The stable outlook reflects our expectation that BSTDB will effectively manage its expected moderate expansion without hampering its risk position.

Rating Action

On Nov. 25, 2021, S&P Global Ratings raised its long- and short-term issuer credit ratings on the Black Sea Trade and Development Bank (BSTDB) to 'A/A-1' from 'A-/A-2'. The outlook is stable.

Rationale

The upgrade reflects the institution's confirmed policy relevance, illustrated by solid loan book growth over the past three years and a recent decision from shareholders to inject capital. BSTDB benefits from a resilient and very strong financial risk profile, and it has weathered the financial repercussions of the pandemic with only a mild impact on asset quality.

The bank has implemented a largely front-loaded expansion agenda over the past three years with a growth-focused medium-term business plan for 2019-2022. Its ratio of impaired loans to total loans has remained low at about 3.9% on June 30, 2021, which is stable compared with year-end 2020 and only marginally up from 2.8% in 2019. This is a level similar to private-sector-focused peers. The institution makes use of several risk-sharing mechanisms, such as public-sector guarantees and lending via intermediating financial institutions, through which it conducts all its lending to small and midsize enterprises. These mechanisms, along with the increasing share of

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public-sector loans, provide some cushion to prevent abrupt deterioration in asset quality.

We consider shareholders' decision to increase the bank's subscribed capital as illustrating their recognition of its mandate fulfilment and confirming their commitment to its activities. Although we consider the approval of this capital injection an important demonstration of shareholder intent, we believe its size of €245 million paid-in, and likely protracted installment period, will leave short-term lending capacity largely unchanged. That said, we consider these additional resources key for promoting BSTDB's medium-term business expansion, including purpose-based lending and other related activities, and they further its position as a financing counterpart in the region.

Following the decision from its governors, BSTDB's subscribed capital is set to increase to €3.10 billion from €2.29 billion. The paid-in portion of the newly subscribed capital will be 30%, with 70% callable--in line with the bank's current capital structure. As a result of the new subscription, the bank will receive additional paid-in capital of €245 million, raising book capital to €932 million. Although smaller than the previous replenishment in 2008, we consider the approval for a capital increase--endorsed during the currently strained COVID-19-related fiscal context--as a key signal of appreciation from shareholders of the bank's policy function. The capital subscription period opened on Oct. 15, 2021, and will go until Sept. 30, 2022, whereby the shareholders will return with their formal subscriptions. We expect these to remain in line with their current ownership stakes. The timing on capital payments will be decided in 2022 with installments likely to start in 2023. We note that the previous capital increase was over a period of eight-to-nine years and we expect a similar cycle this time.

The growth in BSTDB's loan book over the past three years entailed a strategic shift toward infrastructure financing, and the bank's public-sector exposure has increased to almost 30% of loans. The bank has explored various business avenues and entertained several strategic shifts in attempts to balance various shareholders' interests. Its recently adopted long-term business strategy proposes off-balance-sheet activities to further its policy relevance. In this vein, BSTDB aims to complement its direct lending activities by enhancing its position as a knowledge center to attract private-sector investment into the region through identifying, managing, and co-financing investments projects that span the private and public sectors. Although the intention of mobilizing financing using its existing resources could complement BSTDB's development mandate, the buildup of this business line comes with execution risks. In particular, we believe the introduction of new business niches can take time to gear up since the bank will need to build operational capabilities.

We believe the inflow of shareholder capital over the medium term could focus on direct financing and enhance the predictability of the bank's strategic direction, as well as shareholders' intent. We expect these steps to be formalized in the 2023-2026 business plan due to be decided in autumn 2022, by which time the capital subscription of the shareholders and instalment calendar will be known. We believe future loan growth in core operating areas would need to be sustained at strong levels, through the cycle, to demonstrate a marked strengthening of BSTDB's policy importance.

We estimate BSTDB's risk-adjusted capital (RAC) ratio at a very strong 22.2% at June 30, 2021. The RAC position has remained stable since year-end 2020 despite a meaningful 22% increase in exposures, primarily due to the improved risk profiles of regional banking sectors and a 4% improvement in total-adjusted capital. We believe the upcoming capital injection, with paid-in capital anticipated at €245 million, will support the bank's medium-term lending capacity.

We consider BSTDB to have a strong funding and liquidity profile on the back of its liquidity management, under which prefinancing of upcoming disbursements or redemptions of existing debt are made well in advance. BSTDB has broadened its funding channels over the past three

years by enlarging its market, tenure, and currency penetration. Even though BSTDB enlarged its euro commercial paper issuance in 2021 to about €400 million compared with about €100 million two years ago, the lengthening of the funding curve, including euro benchmarks with up to 15-year maturities, has allowed the average maturity of its liabilities to stay above that of assets. In addition, the bank has issued three environmental, social, and governance (ESG)-themed bonds over the past two years and we anticipate this funding channel will be increasingly explored as the bank implements its ESG lending policy over 2022-2023. Furthermore, the bank continues to foster strong relationships among multilateral lending institutions, and the multilateral development bank community in general, which have allowed comprehensive liquidity lines to be contracted.

The ratings on BSTDB do not include potential extraordinary support from shareholders, since we rate all its sovereign shareholders lower than the bank. In addition, our view of the bank's moderate policy importance precludes the notion of extraordinary callable capital support.

Outlook

The stable outlook reflects our expectation that the capital increase from shareholders will progress according to plan and allow BSTDB to pursue solid medium-term expansion. We further expect that the bank will effectively manage the anticipated loan book growth without hampering its risk position such that its financial risk profile remains very strong.

Upside scenario

We could raise the ratings if BSTDB's lending footprint materially extends beyond our base-case expectation. In such a scenario, we would expect further shareholder recognition to be evident, as the disbursement levels amplify BSTDB's support of funding for economic development; strong execution along the bank's multiple expansion avenues; and a maintained very strong financial risk profile with upheld asset quality.

Downside scenario

We would lower the rating if the execution of BSTDB's capital injection underwhelms; evidenced, for example, by material and lengthy arrears on capital commitments, suggesting shareholder engagement has strengthened less than we currently believe. Furthermore, if BSTDB's strategic business plan leads to the various business lines failing to complement each other, and does not contribute to its core public policy mandate, downside momentum to the ratings would build.

Ratings Score Snapshot

Issuer credit rating: A/Stable/A-1

Stand-alone credit profile: a

Enterprise risk profile: Moderate

- Policy importance: Moderate
- Governance and management expertise: Adequate

Financial risk profile: Very strong

- Capital adequacy: Very strong
- Funding and liquidity: Strong

Extraordinary support: 0

Callable capital: 0

Group support: 0

Holistic approach: 0

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- 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

Upgraded

| | To | From |
|---|----|------|
| Black Sea Trade and Development Bank | | |
| Senior Unsecured | A | A- |

Upgraded /Outlook Action

| | To | From |
|---|--------------|-----------------|
| Black Sea Trade and Development Bank | | |
| Sovereign Credit Rating | | |
| Foreign Currency | A/Stable/A-1 | A-/Positive/A-2 |

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