

Research Update

Research Update:

Black Sea Trade and Development Bank Ratings Affirmed At 'A-/A-2'; Outlook Stable

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Overview

- We are affirming our long- and short-term issuer credit ratings on BSTDB at 'A-/A-2'.
- The stand-alone credit profile for BSTDB is 'a-', reflecting our assessment of its very strong financial profile and moderate business profile, as our criteria define these terms.
- The stable outlook reflects our view that the credit strengths of the bank, in particular the BSTDB's extremely strong levels of capital adequacy, will endure.

Rating Action

On Aug. 22, 2014, Standard & Poor's Ratings Services affirmed its 'A-' long-term and 'A-2' short-term foreign currency issuer credit ratings on Black Sea Trade and Development Bank (BSTDB). The outlook is stable.

Rationale

The ratings on BSTDB reflect our assessment of its moderate business profile and its very strong financial profile, as our criteria define these terms. The combination of a moderate business profile and a very strong financial profile results in an 'a-' stand-alone credit profile (SACP) under our criteria for multilateral lending institutions (MLIs).

We do not factor in any ratings uplift for extraordinary shareholder support, as we rate all of BSTDB's sovereign shareholders lower than the bank itself. Further downward pressure on the ratings on key sovereign shareholders could nevertheless ultimately affect BSTDB's SACP, should such pressure reflect a deterioration of macroeconomic performance. This could weaken BSTDB's asset quality over time.

BSTDB's mandate is to accelerate economic development in, and promote economic cooperation among, its 11 member countries, which are contiguous to or near the Black Sea. Headquartered in Thessaloniki, Greece, the bank was established in 1994 and commenced operations in 1999. BSTDB's member countries comprise (in order of size of capital contribution) Greece, the Russian Federation, and Turkey; Romania; Bulgaria and Ukraine; Azerbaijan; Albania; Armenia; and Georgia and Moldova.

We assess BSTDB's business profile as moderate. The bank is relatively small

compared to other MLIs. During 2013, total assets in euro terms declined by nearly 5% on the back of a weaker dollar, and a step-up in early repayments. Newly approved and signed operations declined for the second consecutive year, reflecting weaker demand for credit across the region. Due to the economic slowdown in key member countries, the BSTDB has revised its medium-term loan growth target to 7.5%, from 13.5%, in line with its historical average.

Shareholders demonstrated their support in 2007 by a general capital increase (GCI) in the bank's authorized capital to Special Drawing Rights (SDR) 3 billion (€3.5 billion) from SDR1 billion. Of the voted SDR2 billion increase, SDR1 billion was offered to and subscribed by members, thereby increasing the subscribed capital to SDR2 billion. Of this, SDR300 million was to be paid in nine instalments: SDR100 million in 2010 and the remainder in eight equal annual instalments of SDR25 million between 2011 and 2018. As of end-2013, all member states were current with their capital contributions with the exception of Albania (which became current on its revised payment schedule as of Feb. 4, 2014, within the 60-day grace period) and Ukraine.

BSTDB's larger shareholders appear to be committed to maintaining their shares of subscribed capital. However, support from small shareholders is less certain. In 2004, three of the smaller shareholders--Armenia, Georgia, and Moldova--requested that their portion of subscribed capital be halved, from 2% to 1% of the initial authorized capital. The BSTDB board approved this request and the resulting 3% of authorized capital remained unallocated until 2008. Following the 2007 GCI, Azerbaijan subscribed to the 3% unallocated capital, while Romania subscribed to 0.5% of the new shares originally intended for Georgia. In 2011, the board of governors approved Moldova's request to reduce its portion of subscribed capital by half, to 0.5%.

Following an amendment to the bank's Establishing Agreement that became effective in June 2013, the board of governors changed the bank's unit of account to euros and all authorized capital was then redenominated in euros. Because 40% of the BSTDB's total assets are denominated in U.S. dollars, foreign exchange effects can have a material effect on balance sheet amounts from year to year.

As a young institution, the bank has limited experience with preferred creditor treatment (PCT) on its sovereign exposure, or preferential treatment on the remainder of its loan portfolio.

BTSDB focuses on loans to private-sector borrowers, a large proportion of which are then on-lent to smaller companies in member states using local financial institutions as intermediaries (known as second-floor lending). Second-floor lending accounts for an estimated 45% of BSTDB's current loan book.

The bank's emphasis on project and trade financing is strong; compared to most MLIs, however, impaired loans are high at an estimated 9.5% of total outstanding loans. At 16.4%, end-2013 nonperforming loan levels on the BSTDB's direct loan portfolio (that is, excluding loans to financial institutions) are

even higher. As of mid-June 2014, six loans were impaired, with a total exposure of €72.8 million. Against these, €38 million was set aside for provisioning. BSTDB's second-floor lending makes it more exposed to financial-sector systemic risk than idiosyncratic corporate credit risk (see Banking Industry Country Risk Assessments, in Related Criteria and Research).

BSTDB's capitalization is the cornerstone of its very strong financial profile. Its baseline risk-adjusted capital (RAC) ratio before adjustments was an estimated 35% on Dec. 31, 2013. Due partly to capping of the risk weight to high risk exposures (primarily equity participation) as per our MLI criteria, the RAC ratio after MLI adjustments is higher, at an estimated 42%.

Given BSTDB's relatively small size and its strong capitalization, it rarely issues in the bond markets. Therefore, shareholders' capital has represented an important portion of funds for operations and, additionally, the bank has relied on a combination of syndicated loans, bilateral loans, and a Swiss franc 200 million bond--issued in the third quarter of 2012--that comes due in October 2016. The bank also has the capacity to issue commercial paper in multiple currencies on the European market, though as of end-August 2014 there is none outstanding.

Net loan disbursements slightly decreased in 2013, reinforcing the bank's already comfortable liquidity ratio. Unlike many other MLIs, the bank does not benefit from unilateral credit support annexes on its derivatives contracts, and therefore would have to post collateral against positions with a negative mark-to-market value above set thresholds. There was no such posted collateral as of mid-2014.

Outlook

The stable outlook indicates our view that risks to our ratings on BSTDB are evenly balanced.

We could raise the ratings if we see substantial improvements to the bank's institutional arrangements or its financial profile.

We could lower the ratings if BSTDB experiences significant additional GCI-related delays from its members. We could also lower the ratings if, contrary to our expectations, we see marked deterioration in the bank's loan underwriting standards or performance. The ratings might also come under downward pressure were the BSTDB to continue to reduce its lending operations, leading us to question the strength of its public policy mandate, as well as its willingness and capacity to lend against the credit cycle.

Related Criteria And Research

Related Criteria

- Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Nov. 26, 2012
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Related Research

- Banking Industry Country Risk Assessment Update: August 2014, Aug. 5, 2014
- Banking Industry Country Risk Assessment: Greece, June 26, 2014
- Banking Industry Country Risk Assessment: Russia, June 17, 2014
- Banking Industry Country Risk Assessment: Turkey, June 4, 2014
- Banking Industry Country Risk Assessment: Georgia, Jan. 24, 2014
- Banking Industry Country Risk Assessment: Azerbaijan, Feb. 13, 2014
- Banking Industry Country Risk Assessment: Bulgaria, Jan. 8, 2014
- Banking Industry Country Risk Assessment: Ukraine, July 19, 2013

Ratings List

Ratings Affirmed

Black Sea Trade and Development Bank

Issuer Credit Rating

Foreign Currency	A-/Stable/A-2
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Senior Unsecured	A-
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