

Commentary

Research Update:

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

Primary Credit Analyst:

Elie Heriard Dubreuil, London (44) 207-176-7302; elie.heriard.dubreuil@standardandpoors.com

Secondary Contact:

Benjamin J Young, London (44) 20-7176-3574; benjamin.young@standardandpoors.com

Research Contributor:

Marina Stefani, London; marina.stefani@standardandpoors.com

Analytical Group Contact:

SovereignEurope; SovereignEurope@standardandpoors.com

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Research Update:

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

Overview

- Black Sea Trade and Development Bank (BSTDB) improved its market presence through its maiden Swiss franc issue in 2012.
- 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 will endure.

Rating Action

On Sept. 17, 2013, 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 give any ratings uplift for extraordinary shareholder support, as we rate all of BSTDB's sovereign shareholders lower than the bank itself.

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) the Russian Federation, Turkey, Greece, Romania, Ukraine, Bulgaria, Azerbaijan, Albania, Armenia, Georgia, and Moldova.

We assess BSTDB's business profile as "moderate." The bank is relatively small compared to other MLIs. Although it registered an 18% increase in its total assets in 2012, to €984 million, the bank actually reduced the amount of new approved and signed operations, as it prioritized projects already in the

disbursement phase. We expect the economic recession in some of the BSTDB's member countries to lead it to revise downward its growth targets for the outstanding portfolio in 2013-2014.

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. The first payment deadline of Dec. 31, 2010, was extended to June 30, 2011 to accommodate some members. Three members still did not meet the extended deadline: Ukraine, Albania, and Moldova. In addition, neither Ukraine nor Albania made the 2011 payment, but both have cleared part of their capital contribution arrears: the Ukraine in June 2012 and March 2013, and Albania in May 2013. Though they had not completely eliminated them by end-2012, they have provided the bank with a payment schedule for the next five years, which the bank's board approved in 2013. We expect to see Ukraine and Albania adhere to this revised schedule and complete payment of their capital contributions commitments by 2018.

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 Georgia's allocation of new shares of 0.5%. 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 changed the bank's unit of account to euros and all authorized capital was then redenominated in euros.

As a young institution, the bank has no experience with preferred creditor treatment (PCT) on its sovereign exposure, or preferential treatment on the remainder of its loan portfolio.

BSTDB focuses on lending to private-sector borrowers, a large proportion of which is then on-lent to smaller companies in member states using local financial institutions as intermediaries (known as second-floor lending).

The bank's emphasis on project and trade financing is strong. Its loan portfolio has historically performed well, with impaired loans staying below 10% of total outstanding loans. At year-end 2012, five loans were impaired, with a total exposure of €69 million, representing 9% of the outstanding loan

portfolio. An amount of €33 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 section).

BSTDB's capitalization is the cornerstone of its "very strong" financial profile. Its baseline risk-adjusted capital (RAC) ratio was an estimated 33% on Dec. 31, 2012. Due partly to capping of the risk weight to high risk exposures as per our MLI criteria, the RAC ratio after MLI adjustments is higher, at an estimated 38%.

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, bi-lateral loans, a U.S. dollar bond issued in 2009, and a second BSTDB long-term issuance--a Swiss franc 200 million bond--made in the third quarter of 2012. The bank also issues U.S. dollar commercial paper in the European market. Outstanding euro commercial paper totaled US\$51 million at year-end 2012.

The bank has ample liquidity; although disbursements have increased in 2012, the bank's liquidity has remained comfortable and its liquidity ratios have been reinforced (in part due to the decline in approved but undisbursed loans). 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 year-end 2012.

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 delays from its members on its GCI. We could also lower the ratings if, contrary to our expectations, we see marked deterioration in the bank's loan underwriting standards or performance.

Related Criteria And Research

- Principles Of Credit Ratings, Feb. 16, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Nov. 26, 2012
- Banking Industry Country Risk Assessment Update: September 2013, Sept. 6, 2013
- How An Erosion Of Preferred Creditor Treatment Could Lead To Lower

Ratings On Multilateral Lending Institutions, Aug. 26, 2013

- Banking Industry Country Risk Assessment: Ukraine, July 19, 2013
- Banking Industry Country Risk Assessment: Turkey, July 10, 2013
- Banking Industry Country Risk Assessment: Russia, May 15, 2013
- Supranationals Special Edition 2012, May, 2013
- Banking Industry Country Risk Assessment: Greece, April 22, 2013
- Banking Industry Country Risk Assessment: Azerbaijan, Sept. 3, 2012
- Banking Industry Country Risk Assessment: Bulgaria, July 20, 2012
- Banking Industry Country Risk Assessment: Georgia, July 19, 2012
- Banking Industry Country Risk Assessment On Republic of Romania Raised To Group 7, Aug. 4, 2008

Ratings List

Ratings Affirmed

Black Sea Trade and Development Bank

Issuer Credit Rating

Foreign Currency

A-/Stable/A-2

Senior Unsecured

A-

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