

Rating Action: Moody's affirms the A2 ratings of Black Sea Trade & Development Bank; maintains stable outlook

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Frankfurt am Main, October 02, 2020 -- Moody's Investors Service ("Moody's") has today affirmed Black Sea Trade & Development Bank (BSTDB)'s long-term and short-term A2/P-1 issuer ratings. BSTDB's senior unsecured debt ratings have also been affirmed at A2, and its senior unsecured MTN program rating has been affirmed at (P)A2. The rating outlook remains stable.

The key drivers for today's rating action are:

- (1) BSTDB's sound level of paid-in capital and strong asset performance balance the increase in leverage over the past years and the weak borrower credit quality;
- (2) Diversified funding mix compensates for low levels of highly rated liquid assets compared to peers;
- (3) High willingness of the bank's shareholders to provide support balanced by their moderate ability to provide such support if it ever was needed.

The stable outlook reflects Moody's view that the increasing leverage and some risk to asset performance will likely be balanced by a lower risk profile of the bank's lending.

RATINGS RATIONALE

RATIONALE FOR THE AFFIRMATION OF THE A2 RATINGS

FIRST DRIVER: SOUND LEVEL OF PAID-IN CAPITAL AND STRONG ASSET PERFORMANCE BALANCE INCREASING LEVERAGE AND WEAK BORROWER CREDIT QUALITY

At the end of 2019, BSTDB has 30% of its total subscribed capital in the form of paid-in capital, which is among the higher shares among Moody's rated MDB universe. A general capital increase, which was completed in April 2019 -- together with retained earnings and higher general reserves -- more than doubled the stock of total equity to €830 million at end-2019 compared to €373 million at the end of 2008.

Another credit strength is BSTDB's very strong asset performance, as measured by the ratio of nonperforming assets relative to development assets (NPA ratio). Between 2017 and 2019, BSTDB reported an average NPA ratio of only 0.8%, well below the median of A-rated MDBs at 4.2% and significantly lower than BSTDB's peak NPA ratio of 8.0% in 2012, following the global financial crisis. In Moody's view, the improved asset performance reflects the bank's prudent risk management framework, co-financing with highly rated MDBs such as the European Bank for Reconstruction and Development (Aaa stable, EBRD) and the Islamic Development Bank (Aaa stable, IsDB) and a good diversification of the loan portfolio, by country and sector, as well as by the size of individual projects. Non-performing loans have not shown a systemic trend over more than 20 years, which underscores BSTDB's prudent risk management approach.

These strengths are counter-balanced by a rapid increase in leverage and relatively weak borrower credit quality. Despite the 2010-2019 paid-in capital increase leverage (development assets/useable equity) has increased significantly over the past several years, as BSTDB's loan portfolio has risen at an even faster pace than the capital contributions. At end-2019, the bank's leverage ratio stood at 244%, compared to 123% in 2013 and 187% back in 2008, when shareholders agreed on the capital increase. Compared to most similarly rated MDBs, BSTDB's leverage ratio is high. Moody's expects that the ratio will increase to above 300% in 2021 and will remain above that level during the following years based on the bank's lending plans.

The relatively weak borrower credit quality of BSTDB is a reflection of the difficult operating environment in the bank's countries of operations as highlighted by severe recessions over the past decade in member countries such as Greece (B1 stable), Ukraine (B3 stable), Russia (Baa3 stable) and more recently Turkey (B2 negative). BSTDB is one of the most exposed MDBs to Turkey, on account of both its large loan exposure (26% of all loans as of July 2020) and Turkey's position as one of the bank's largest shareholders, with a share

of 16.5% in BSTDB's subscribed capital. Important mitigating factors are the large share of lending to the Turkish public rather than the higher-risk private sector, as well as a high share of co-financing with highly-rated MDBs, which give some comfort that BSTDB would be treated as a preferred creditor in the unlikely event of Turkey experiencing severe stress. Public-sector lending accounts for 68% of all active projects in Turkey as of July 2020, compared to 31% for the loan portfolio as a whole.

SECOND DRIVER: DIVERSIFIED FUNDING MIX COMPENSATES FOR RELATIVELY LOW LEVEL OF HIGH-QUALITY LIQUID ASSETS

BSTDB has a reasonably diversified pool of funding sources at its disposal, including bond issuances, a commercial paper programme for cash management purposes as well as bilateral loans from other development institutions such as Germany's Kreditanstalt fuer Wiederaufbau (KfW, Aaa stable), the Nordic Investment Bank (NIB, Aaa stable), French development entity Proparco and the Development Bank of Austria. Against the background of the bank's plans to increase lending in the coming years, it also plans to increase its borrowing with a target of €2.0 billion at end-2022 from €1.5 billion at end-2019, which Moody's believes should easily be feasible.

At the same time, Moody's considers BSTDB's available liquidity to be weaker than that of many other MDBs. According to BSTDB's liquidity policy, the bank needs to have liquid assets of at least 50% of net cash requirements for the next 12 months, which is significantly lower than the minimum coverage of 100% or more that many other MDBs require. In a recent global stress test exercise Moody's identified BSTDB as one of the few MDBs that would be vulnerable in a severe liquidity stress scenario. However, BSTDB has significant amounts of lower rated treasury assets available, which are not included in Moody's key liquidity metric but could still be used in a situation of stress.

THIRD DRIVER: SHAREHOLDERS HAVE HIGH WILLINGNESS TO PROVIDE SUPPORT BUT ONLY MODERATE ABILITY

Moody's bases its assessment of shareholders' ability to provide support on the weighted average shareholder rating, which in BSTDB's case is comparatively low at Ba3. The largest shareholders are Greece, Russia and Turkey with a share of 16.5% each, followed by Romania (Baa3 negative, 14.0%). Bulgaria (Baa2 positive) and Ukraine (B3 stable) each hold 13.5%.

Moody's view of shareholders' strong willingness to support the institution compensates for the relatively weak ability to support. Shareholders have provided significant amounts of callable capital to BSTDB, which cover 108% of the entity's total gross debt as of end-2019. In Moody's view callable capital -- an explicit, irrevocable and unconditional obligation for each shareholder to provide additional capital if needed -- is an important source of contractual support. Moreover, BSTDB has some protection against the unexpected withdrawal of a member state; according to Article 39 of BSTDB's establishment agreement, a member country is liable for its obligations until the shares are bought by the bank at book value, up to five years after the cessation of membership.

Moody's also takes into account the shareholders' track record of capital injections, such as the 2008 general capital increase which doubled the subscribed capital and allowed the bank to significantly raise its profile in its member states. Despite some arrears in the original payment schedule, which resulted in an extended payment timeline in some cases, the capital increase was completed in April 2019. Last year's strong loan growth of 37% was driven by lending to the public sector, which Moody's believes raises the bank's profile and relevance to its shareholders. The share of public sector funding increased to 27% of the total portfolio at-end 2019 from 13.5% at end-2018. The bank's support for the post-COVID-19 recovery in its member states should further support the bank's relevance to its shareholders, with lending focused on support for SMEs and critical infrastructure in 2020.

RATIONALE FOR STABLE OUTLOOK

The stable outlook on BSTDB's A2 rating reflects Moody's view that the increasing leverage and some risks to asset performance due to the COVID-19 shock and the large Turkish exposure will likely be balanced by a lower risk profile of the bank's lending as it continues to shift towards less risky public-sector and infrastructure lending.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

Environmental considerations are not material for Moody's assessment of BSTDB's credit profile. This is because the majority of BSTDB's borrowers are not subject to environmental risks. BSTDB's exposure to

sectors affected by environmental considerations, such as the agriculture sector in Moldova and Ukraine, or sectors facing carbon transition risk such as the oil sector in Azerbaijan, was a moderate 11% of its total lending portfolio at end-June 2020.

Moody's regards the coronavirus outbreak as a social risk under its ESG framework, given the substantial implications for public health and safety. For BSTDB, the coronavirus outbreak poses risks to the bank's operating environment through the negative impact the pandemic has on the economies of the Black Sea region, but Moody's expects the impact on overall asset quality to be limited.

Governance considerations are material. Moody's does not apply a positive qualitative adjustment, but Moody's views positively improvements in the bank's risk management framework over the past decade, which supported the downward trend in NPAs despite a challenging operating environment in the Black Sea region.

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

Upward pressure on the rating could emerge if BSTDB's asset quality materially improved and the bank also managed to maintain its strong track record of very low NPAs. A significant improvement in the creditworthiness of the bank's major shareholders would also be positive for the rating.

The rating would come under downward pressure if asset performance and borrower credit quality were to deteriorate beyond the rating agency's baseline expectation of an only limited deterioration. Such a deterioration could result from the current adverse economic developments in the bank's member countries caused by COVID-19, the difficult situation in Turkey or a borrower specific shock. The rating would also come under downward pressure if the bank's envisaged increase in development-related assets to above €2.6 billion by 2022 as per the bank's medium-term plan was not accompanied by another capital increase. Moreover, a material deterioration of the bank's major shareholders' creditworthiness would be credit negative.

The principal methodology used in these ratings was Multilateral Development Banks and Other Supranational Entities published in June 2019 and available at https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1147813. Alternatively, please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Heiko Peters
Asst Vice President - Analyst
Sovereign Risk Group
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Yves Lemay
MD - Sovereign Risk
Sovereign Risk Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main 60322
Germany
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

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