



Rating Action: Moody's downgrades BSTDB's ratings to Baa2, maintains negative outlook

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London, October 20, 2023 -- Moody's Investors Service (Moody's) has today downgraded Black Sea Trade and Development Bank (BSTDB)'s long-term issuer rating to Baa2 from Baa1. The rating outlook remains negative.

BSTDB's senior unsecured debt ratings have also been downgraded to Baa2 from Baa1, and its senior unsecured MTN program rating has been downgraded to (P)Baa2 from (P)Baa1. Concurrently, Moody's has downgraded the short-term issuer rating to P-3 from P-2.

The downgrade reflects signs of weakened shareholders' cohesiveness given the lack of an agreement on the envisaged capital increase, which risks undermining the bank's strategic relevance in the region over time. The downgrade is also informed by a weaker assessment of capital adequacy due to the deterioration of asset performance in the context of the Russia-Ukraine war.

The negative outlook reflects persisting risks to capital adequacy, reflecting potential pressures on asset quality and performance, as well as risks to liquidity due to the challenges related to the Russia-Ukraine war and challenging funding conditions, that are expected to continue in part given the lack of an agreement on the envisaged capital increase.

RATINGS RATIONALE

RATIONALE FOR DOWNGRADING THE RATINGS TO Baa2

INDICATIONS OF A WEAKENED SHAREHOLDERS' COHESIVENESS GIVEN THE LACK OF AGREEMENT ON THE PLANNED CAPITAL INCREASE

The rating downgrade reflects the lack of finalization of the capital increase which indicates a weakened shareholders' cohesiveness amid a difficult geopolitical environment. In March 2023, the shareholders approved the first step of a capital increase that was announced in October 2021. The envisaged capital increase allocated to the member states (except for Russia and Albania, the latter decided not to participate) the number of shares based on current shareholdings prior to the subscription offer. The final decision on allocation of shares, payment and transfer of voting rights, including potential Russia's participation, was expected to be made in a second step of the process.

However, at the special meeting of the Board of Governors held in September, no decision on the finalization of the capital increase process was made as the shareholders did not reach an agreement. Moody's assesses that the capital increase was not finalized due to the misalignment between the statutory provisions that protect the members' right to participate to a capital increase up to their current shares, and the still pending clearance from the regulatory authorities requested by BSTDB on Russia's participation. Given Russia's interest in participating, it remains unclear at this juncture if and when the capital increase will go ahead. Moody's expects ongoing discussions at member states level to remain protracted, with a decision on the capital increase unlikely to be reached until mid-2024.

In Moody's view, the successful implementation of the capital increase is important not only because of the additional paid-in capital provided (about EUR 200 million up to 2030, raising the overall paid-in capital to EUR 0.9 billion), but also because it would be a strong signal of endorsement for the strategic role of the institution in a difficult geopolitical environment and is expected to have a positive impact on investors' perception of the institution and thereby on the

quality and cost of funding.

DETERIORATION IN ASSET PERFORMANCE IN THE CONTEXT OF THE RUSSIA-UKRAINE WAR

The downgrade also reflects the deterioration in asset performance in the context of the Russia-Ukraine war that leads to a weaker assessment of capital adequacy. BSTDB has significant exposure to both Ukraine (Ca stable) and Russia, with both countries together accounting for almost 30% of development-related assets (DRAs) as of June 2023, although the outstanding exposure notably declined by 19% since end-2022.

While the asset performance deterioration has been manageable so far, the bank will continue to face credit pressure stemming from the uncertainty related to the Russia-Ukraine war. The exposure to Russia is experiencing issues of transactional nature due to the imposition of international sanctions and capital restrictions, which are slowing down the receipt of payments, while in the case of Ukraine, the weaker asset performance is mainly a reflection of pressures on the borrowers' credit profile. About 84% and 62% of the payments (including prepayments) scheduled in 2022 and up to September 2023 from Russia and Ukraine, respectively, have been received transparently and permissibly under EU exemption and derogation. Furthermore, in the case of the exposure to Russia, a further 13% of payments have been received, although currently held in restricted accounts.

Initially, all exposures to Ukraine and Russia were classified as stage 3, but based on the performance, a significant portion was reclassified as stage 2. As of end-2022, stage 3 loans represented 9.4% of DRAs, almost entirely from Ukraine's exposure, while non-performing assets (NPAs) under Moody's definition stood at 8.2%, from zero at the end of 2021. According to unaudited accounts, the NPAs ratio declined to 5.6% as of June 2023. However, these figures exclude the payment deferrals that have been agreed on about one third of the exposure to Ukraine, and might deteriorate. The performance of the rest of the portfolio has remained broadly stable.

In line with practices followed by other MDBs, BSTDB stopped new lending to Russia. Exposure to Russia declined by about 27% to EUR 293 million (equivalent to 16% of DRAs) in June 2023 from EUR 401 million (19.4%) in December 2022. Moody's expects that the exposure to Russia relative to BSTDB's portfolio of development assets will continue to decline over time, reducing risks to asset performance. Moody's estimates that the average residual maturity of the Russian portfolio is below 4 years.

RATIONALE FOR THE NEGATIVE OUTLOOK

The negative outlook reflects Moody's expectations that the challenges related to the Russia-Ukraine war will pose risks to BSTDB's capital adequacy and its liquidity position over the next 12 to 18 months.

While the deterioration in the bank's asset performance has been manageable so far, risks remain tilted to the downside due to the uncertain and difficult operating environment, in particular related to the exposure to Ukraine given the large amount of loans that has been granted payments extension. An increase in non-performing assets beyond what observed to date could result in a weaker assessment of capital adequacy.

Moody's expects BSTDB's liquid resources to remain adequate, supported by holdings of cash and highly rated securities (liquid assets under Moody's definition stood at about EUR 344 million as of end of September 2023). That said, the cost of market funding has increased significantly. As of September 2023, Moody's estimates that liquid assets covered 1.5X of projected net cash outflows over the next 18 months under a scenario of no market access. While liquidity buffers are sufficient to stem temporary payments deferrals and challenging market conditions, further payment delays on the Ukraine and Russia exposures (projected repayments from those two countries account for about a quarter of total repayments over the next 12 months) could weigh on the liquidity position.

In a strategic shift to ring-fence its balance-sheet in response to the Russia-Ukraine war, BSTDB is limiting new operations and plans to generate financial resources internally to service its financial obligations unless borrowing is available at more affordable terms. However, liquid resources risk being gradually eroded given the large upcoming international bond maturities next year (about EUR 390 million) in case the bank does not secure new financing.

Moody's expects BSTDB's funding base to remain constrained by the geopolitical conditions, despite the bank's effort to reduce its exposure to Russia. Furthermore, a prolonged period of restrained lending and extended absence from the international markets can call into questions the strategic role of the institution.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

BSTDB's credit impact score at CIS-2 reflects generally low exposure to environmental risks, low exposure to social risks, and a solid governance profile supported by a prudent framework.

The environmental issuer profile score is neutral-to-low (E-2). BSTDB's exposure to sectors affected by environmental considerations, such as the agriculture sector or sectors facing carbon transition risk, such as the oil and gas sector, is contained, with high portfolio diversification providing a mitigation.

BSTDB's neutral-to-low social issuer profile score (S-2) reflects good customer relations and, as demonstrated until the start of Russia-Ukraine war, solid demand from its member states which are also borrowers, policies in place to safeguard responsible production, and attention to societal trends.

The neutral-to-low governance issuer profile score (G-2) is underpinned by prudent policies and improvements in the bank's risk management framework over the past decade, which supported a robust track record of asset performance and is helping to contain asset quality risk in the current difficult operating environment in the Black Sea region. At the same time, a more fragmented shareholder base due to the geopolitical conditions can have implications for the strategic direction of the bank over time.

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

The negative outlook suggests that an upgrade is unlikely in the near term. The outlook could be changed to stable if BSTDB asset performance is preserved at current levels amid the current difficult operating environment. Signs of financial support from member states including the planned capital increase would also be supportive of a stabilization of the outlook.

BSTDB's ratings would likely be downgraded should Moody's conclude that a further deterioration in asset quality and/or performance materially affects its assessment of capital adequacy. Evidence of increased liquidity pressures and/or that access to funding sources at affordable costs has weakened on a permanent basis, could also exert downward pressure. Evidence that diminished cohesiveness or lack of cooperation between members is lastingly affecting the decision-making process of the bank, constraining its ability to meet its strategic objectives, would also be credit negative.

The principal methodology used in these ratings was Multilateral Development Banks and Other Supranational Entities Methodology published in October 2020 and available at <https://ratings.moody's.com/mc-documents/69182>. Alternatively, please see the Rating Methodologies page on <https://ratings.moody's.com> for a copy of this methodology.

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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 on <https://ratings.moody's.com/rating-definitions>.

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