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Ratings

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Research Update:

Black Sea Trade and Development Bank 'BBB+' Ratings Remain On CreditWatch Negative

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Overview

- There has not yet been any resolution to Black Sea Trade and Development Bank's (BTSDB) capital replenishment program, but S&P Global Ratings understands it is still expected to proceed in the next few months.
- We believe challenges to the bank's funding profile could translate into a prolonged period of lending consolidation, which could raise concerns about the bank's medium-term policy relevance.
- At the same time the bank's solid capital, comprehensive liquidity buffers covering the upcoming Eurobond maturity, and limited new disbursements are helping it absorb increased provisioning on its Russian and Ukrainian loan books, and cope with strained access to global financing markets.
- We therefore affirmed our 'BBB+/A-2' ratings on (BSTDB).
- The ratings remain on CreditWatch with negative implications.

Rating Action

On Dec. 19, 2023, S&P Global Ratings affirmed its 'BBB+/A-2' credit ratings on BSTDB. The ratings remain on CreditWatch with negative implications.

CreditWatch

The CreditWatch placement reflects our view that we could lower our ratings on BSTDB, possibly by more than one notch if the bank's access to funding markets does not normalize well ahead of its Eurobond maturity in June 2024, or if we anticipate that the shareholders will not resolve obstacles related to the planned capital replenishment in the coming months.

Pressure on the rating could also arise over the medium term if BSTDB's shareholders reduced their support of the bank, prompting concerns about the bank's strategic role and shareholder backing.

We could remove the ratings from CreditWatch Negative if the bank secures new funding sources and if we have more visibility on how shareholders will find a resolution to the capitalization process.

Rationale

BSTDB's shareholders are yet to finalize the capital replenishment and make their capital contributions. We currently don't believe the delay indicates that the capital increase will be discarded entirely. The next scheduled Board of Governors meetings is the annual meeting, which would typically take place in July 2024. We view a solution prior to that as unlikely. BSTDB's shareholders demonstrated their willingness to support the bank by approving a capital replenishment in Sept. 2021 and subsequently subscribing to participate. Out of 11 shareholders, 10 subscribed at least according to their pro-rata ownership (including two that oversubscribed) when the capital subscription program closed on Jan. 31, 2023. So far, shares have been allocated to the shareholders that qualify without regulatory concerns, but the finalization still hinges on a decision about the allocation of the remaining shares. Shareholders will pay in the new capital only after that decision has been reached. We understand that there is no change to shareholders' willingness to participate, but there are conflicting views on how to treat the dissonance between regulatory risks and the bank's statutes in the case of an asymmetrical capital allocation. We understand that Russia has expressed its willingness to participate in the capital increase, but sanctions could prohibit it from doing so. In our view, the lack of a conclusion in the capital process indicates that shareholders are struggling with practical impediments to support the bank in the current geopolitical environment. We believe this creates uncertainty about BSTDB's medium-term funding and lending plans, and, potentially, its longer-term policy importance.

Failure to resolve outstanding issues related to the capital replenishment program could aggravate the banks already challenging funding conditions. We believe that in the absence of new funding, there is a risk of a prolonged period of lending consolidation that could raise concerns about the bank's medium-term policy relevance. The bank's medium-term strategy for 2023-2026, includes plans to reduce lending activity for the first two years to safeguard capital and liquidity during a period of stress. We consider this prudent in the current environment, but also see a risk of diminishing policy importance if it limits lending longer than initially planned. More specifically, the bank expects its portfolio to contract until June 2024 as a result of the focus on financial stability. Any new lending will likely be smaller in size, and focus on less wealthy shareholder countries, such as Ukraine. In Phase 2 (2025-2026) of the medium-term strategy, the bank will again target growth, albeit likely at a slower pace than before the war. In the absence of new funding sources, we see a risk that lending consolidation extends beyond 2024.

We continue to recognize the bank's strong liquidity levels and solid capital as cornerstones of its near-term repayment capacity. Liquidity sources are ample and new disbursements are limited, which reduces near-term liquidity pressures. We expect the bank's liquidity buffers can cope with near-term loan payment deferrals and strained access to global financing markets. As of June 2023, we estimated the 12-month liquidity ratio was 1.3x (including scheduled loan disbursements). We believe that the ratio still exceeded 1x by November, though it was likely somewhat lower as the bank used its own liquidity sources to pre-pay about €200 million in bilateral loans maturing in 2025 and beyond. We are monitoring BSTDB's liquidity coverage and market access closely ahead of its $420 million Eurobond maturity in June 2024. The initial amount outstanding of the Eurobond was $550 million, but the bank repurchased $130 million in

June 2023, which reduced the refinancing risk. We believe the bank has enough liquid assets to reimburse investors in full without turning to capital markets to refinance the maturing bond. However, not accessing funding markets will create more strains on the bank's liquidity position.

We believe that BTSDB's capital position has proven more resilient than expected at the start of the military incursion. We estimate BSTDB's risk-adjusted capital (RAC) ratio is 23.9%, based on balance-sheet exposures as of June 31, 2023, sovereign ratings, and Banking Industry Country Risk Assessments (BICRA) as of Dec. 11, 2023. This is up from 20.6% as of Dec. 2022, reflecting a 17% decrease in total exposure and a 5% increase total-adjusted-capital due to €42.6 million in profit recorded for the first six months of 2023. We expect our RAC ratio to remain at these higher levels in the coming year as risk-weighted exposure is declining on the back of loan book consolidation and divestments of the Russian portfolio. This partly compensates for potential pressure stemming from further asset quality deterioration in the Russian and Ukrainian book due to a prolonged conflict. We considered a worst-case scenario where all remaining Russian and Ukrainian exposure would be written off and expect the capital position to be resilient enough to sustain our current assessment, all else being equal.

If lending growth resumes, we believe overall exposures will increase and normalize the capitalization level.

Even though provisions and impairments have markedly increased, we note that very few loan exposures have become nonperforming. About 51% of BTSDB's loans to borrowers in Ukraine, and 27% of Russian exposures, were recognized as Stage 3 loans in June 2023. The provisions for impaired loans reduced by €12 million for the first six months of the year, mainly attributable to loan repayments over the period, but remain twice as high as before the war. As of June 30, 2023, three operations were classified as nonperforming loans (NPLs) by the bank. This corresponded to about 5.6% of total lending, up from no exposure overdue for more than 90 days as of June 30, 2022. One of those NPL has was sold in the second half of 2023. The two operations that remain, one in Russia and one in Ukraine, correspond to about 4% of total exposure per November 2023.

BSTDB's lending exposures in Ukraine faces the most acute risk of further credit deterioration, in our view. As of June 31, 2023, loans to Ukraine represented about 13.5% of total lending. Nevertheless, we understand that the majority of clients are current on their obligations and are operating without material disruptions. Up to Nov. 2023, the bank received about 77% of scheduled payments due from Ukrainian exposures since the start of 2022. One operation, a wind power plant near Crimea (corresponding to about 10% of the Ukrainian portfolio and about 1% of the total portfolio) has been forced to cease operations fully because of severe damage to its operations. That said, we still see a risk of further deterioration and NPLs in the Ukrainian portfolio if the conflict is prolonged.

We consider Russian borrowers' technical ability to service loans to be the key short-term liquidity risk for BSTDB, rather than an imminent drop in the borrowers' credit standing. We note that significant portions of BSTDB's overall lending exposures in Russia are to, or are closely linked to, the public-sector and related companies, which we believe is an indication of resilient finances. Also, we understand that these borrowers have the financial ability to pay BSTDB but are hindered by the lengthy processes to gain specific approval from Russian authorities. These approvals are required for all Russia-based borrowers making transfers to the EU. This resulted in three of the Russian exposures being classified as NPLs in 2023, although only one remains as an NPL as the other two have been divested at discounted price levels. No further provisioning was required because of these transactions. We note that the bank has actively divested the Russian loan portfolio. For example, the banks swapped the majority of its exposure in sanctioned Sovcombank for non—Russian assets and transferred its participation in a Uralkali syndication loan to a co-lender. Overall, the portfolio has shrunk by about 50% as of November 2023, compared to before the conflict, as a result of repayments and divestments. We believe this supports asset quality and has helped reduce risks related to payment delays.

BSTDB's private-sector-focus precludes it from being treated as a preferred creditor. Direct sovereign exposure is typically below 25%. We therefore do not incorporate preferred creditor treatment in our assessment of the bank's enterprise risk profile.

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

Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Jan. 31, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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

Related Research

- Supranationals Special Edition, Oct. 12, 2023
- Black Sea Trade and Development Bank Placed On CreditWatch Negative On Challenges To Funding Profile, Sep. 21, 2023
- Black Sea Trade and Development Bank Placed On CreditWatch Negative On Challenges To Funding Profile, July 26, 2023

Ratings List

Ratings Affirmed	
Black Sea Trade and Development Bank	
Sovereign Credit Rating	
Foreign Currency	BBB+/Watch Neg/A-2
Black Sea Trade and Development Bank	
Senior Unsecured	BBB+/Watch Neg

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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