S&P Global
Ratings

RatingsDirect®

Research Update:

Black Sea Trade and Development Bank 'A-/A-2' Ratings Affirmed; Outlook Remains Negative

July 27, 2022

PRIMARY CREDIT ANALYST

Johanna Melinder
Stockholm
+ 46 84 40 5926
johanna.melinder
@spglobal.com

SECONDARY CONTACT

Gabriel Forss
Stockholm
+ 46 84 40 5933
gabriel.forss
@spglobal.com

Overview

- We believe that Black Sea Trade and Development Bank's (BSTDB's) solid capital and comprehensive liquidity buffers and limited new disbursements in 2022 will help the bank weather the near-term fallout from increased provisioning and payment delays within its Russian and Ukrainian loan books.
- We see risks that medium-term liquidity pressures could arise if the protracted payment delays from its Russian portfolio compound or if the bank proves unable to receive desirable funding volumes well ahead of its sizable 2024 bond redemptions.
- We consider implementation of the ongoing capital subscription program key to demonstrating ongoing shareholder support of BSTDB's policy role.
- We continue to see risks to BSTBD's capital position if a protracted conflict in Ukraine erodes the credit quality of the bank's loan book, materially increases nonperforming loans (NPLs), and leads to significant write-offs.
- We have affirmed our 'A-/A-2' long- and short-term foreign currency issuer credit ratings on BSTDB.
- The negative outlook indicates that we could lower our rating within the next 18 months if funding access was restricted, the credit quality of its loan portfolio weakened, or shareholder support were to wane.

Rating Action

On July 27, 2022, S&P Global Ratings affirmed its 'A-/A-2' long- and short-term issuer credit ratings on Greece-headquartered Black Sea Trade and Development Bank (BSTDB). The outlook remains negative.

Outlook

The negative outlook reflects the near-term risk that economic and financial stress from the Russia-Ukraine conflict, and restricted access to funding, could erode BSTDB's financial buffers faster than we currently expect. It also reflects the medium-term risk that a persisting conflict between Russia and Ukraine, two of BSTDB's large shareholders, would have wider repercussions for the bank's shareholder base, ultimately reducing shareholder support and altering the bank's policy role.

Downside scenario

We could lower our rating, possibly by more than one notch, if:

- BSTDB's access to funding markets does not normalize well ahead of its June 2024 Eurobond maturity, resulting in a depletion of liquidity reserves and an extended inability to disburse under its policy mandate. This could also happen due to, for example, extended delays of loan payments or heightened demand for collateral postings on its derivatives positions.
- The bank suffered payment delays and write-offs beyond what we currently expect, so that its capital positioned weakened and our risk-adjusted capital (RAC) ratio fell below 15%.
- BSTDB's shareholders lessened their supportive stance toward the bank, for example by not following through on the ongoing capital replenishment program, prompting concerns about the bank's strategic role and shareholder backing.

Upside scenario

We could revise the outlook to stable if the pressure on the bank's financial risk profile subsided and it became clear that the ongoing conflict in Ukraine would leave only limited scars on the bank's capital and liquidity positions.

Rationale

We believe that BTSDB's capital position has proven more resilient than feared at the start of the military incursion, but a prolonged conflict could pressure the bank's asset quality and liquidity flows beyond what we currently expect, given that 30% of its loans are to borrowers in Russia and Ukraine.

In our view, BSTDB's lending exposures in Ukraine, which represent 12% of total loans as of May 31, 2022, face the most acute risk of credit deterioration. Nevertheless, we understand that so far the vast majority of its clients are current on their obligations and are operating without material disruptions. About 20% of the portfolio has received approval for payment deferrals, but the remaining 80% paid all amounts due before June 30. One operation, a wind power plant near Crimea (corresponding to about 8% of the Ukraine portfolio and less than 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 Ukraine portfolio in case the conflict is prolonged, and we anticipate the bank will face a sizable uptick in provisions by year end-2022. Importantly, the bank is coming from a strong position with no NPLs (loans older than 90 days) as of June 30, 2022, and BSTDB's ratio of impaired loans to total loans improved to 3.2% in 2021 from 3.8% in 2020 and is similar to that of other private-sector-focused peers.

With regard to BSTDB's overall lending exposures in Russia, we note that significant portions are to public-sector-related companies, which we believe indicates resilience of their financial standing. Also, we understand that they have the financial ability to pay BSTDB but are hindered by the lengthy processes to gain specific approval from Russian authorities, required for all borrowers paying from Russia, to make transfers to the EU. We consider Russian borrowers' technical ability to service loans to be the key short-term risk for BSTDB, rather than an imminent drop in their credit standing.

BSTDB is a multilateral lending institution (MLI). The commitments that shareholders subscribe to in the articles of agreement mean that the bank would be less likely to be subject to imposed restrictions, for example capital controls. We consider this important, also considering that parts of BSTDB's lending in Russia is conducted in hard currency. We understand that the Russian government has explicitly re-iterated its intention to respect BSTDB's MLI status.

Even so, payment flows from Russian counterparties experience delays. This is because Russian borrowers need to be granted a specific license from Russian authorities to make cross-border payments, but also because the intermediating commercial banks, domiciled in the EU, U.S., and the U.K., are required to seek regulatory approval to execute the transactions. About 80% of BSTDB's Russian borrowers are currently under the sanction regimes introduced by the U.S., EU, and the U.K., which further complicates the transaction process. We understand this process could be streamlined in the coming months so that payment flows can feed into BSTDB's accounts. If the Russian payment flows do not resume, it would raise concerns for BSTDB's statutory MLI status and accentuate liquidity risks.

Aside from the direct impact of BSTDB's lending in Russia and Ukraine, the conflict is having a macroeconomic impact on the Black Sea region, which could lead to asset quality concerns in its wider portfolio. This exacerbates the risk for BSTDB from operating in this region, which already had pockets of economic distress. One example is Turkey, which is home to 21% of the bank's outstanding loans and where we assess economic policy developments will push inflation to about 50% in 2022, with a highly uncertain growth trajectory.

We believe the bank will lean on its liquidity and capital buffers to navigate the near-term fallout from any loan payment disruption and temporarily strained capital market access. BSTDB furthermore benefits from the solid monitoring processes of its lending counterparts, as illustrated during the pandemic, which only led to a mild impact on asset quality. We expect this to continue also in the current stressed environment. BSTDB makes use of several risk-sharing mechanisms, such as public-sector guarantees and lending via intermediating financial institutions, through which the bank conducts all its lending to small and midsize enterprises. These, along with the increasing share of public-sector loans, provide some cushion to prevent abrupt declines in capital.

We estimate BSTDB's RAC ratio at 19.1% using balance-sheet exposures as of Dec. 31, 2021, but also more recent parameters such as sovereign ratings and Banking Industry And Country Risk Assessments as of July 14, 2022. This ratio is down from 22.2% a year prior, primarily reflecting an increase in risk weights in the bank's exposure to Russia and Ukraine.

We believe this capital position, while allowing some room to absorb loan write-offs, could weaken further owing to the potential magnitude of the economic impact on BSTDB's areas and sectors of operations from the conflict. We estimate that in a stress scenario with a significant write-down of BSTDB's exposures in Russia and Ukraine, the RAC ratio could fall below 15%, signaling erosion of the bank's capital to a level not be commensurate with the current rating.

BSTDB is currently experiencing restricted access to funding markets, with any potential issuance likely carrying a high premium. At the same time, the bank has limited need to raise additional funding in next six to 12 months since liquidity sources are ample and we expect new lending to be marginal in the that time. As such, we expect the bank's liquidity buffers can cope with near-term loan payment deferrals and strained access to global financing markets. We estimate that it has €500 million in liquidity, of which more than 90% is in cash or short-dated securities. On top of this liquidity buffer, we understand the bank has €130 million in undrawn, available committed facilities with fellow MLI development banks, but since these are contingent on new disbursement, we do not consider those funds as readily available in the current circumstances. For the rest of 2022, BSTDB only has €30 million of debt liabilities coming due, and €350 million in 2023. Nonetheless, we are monitoring BSTBD's liquidity coverage and market access closely ahead of its $550 million Eurobond maturity in June 2024.

Prior to the conflict, BSTDB broadened its funding channels by enlarging its market, tenure, and currency penetration. Furthermore, the bank continues to foster strong relationships among MLI lending institutions, and the MLI development bank community in general, which have allowed it to contract comprehensive liquidity lines. This, together with competent and proactive liquidity management, supports our view of BSTDB's still strong funding and liquidity profile.

BSTDB's private-sector-focused mandate precludes it from being treated as a preferred creditor. We therefore do not incorporate preferred creditor treatment in our assessment of the bank's enterprise risk profile.

We believe that a prolonged conflict between Russia and Ukraine poses risk to shareholders' commitment. However, we understand that so far, shareholders have expressed steady support of the bank's financial viability and policy function. We believe that the finalization of the bank's capital subscription program on Sept. 30, 2022, will prove a key determinant to the supportive stance of the shareholders and act as an indication of shareholders longer-term commitment to the bank.

Though we understand that Russia has expressed its willingness to participate in the capital replenishment program, we expect that the sanctions will prohibit it from taking part. This will dilute the Russian Federation's ownership in the bank to 12.8% from 16.5%, under the assumption that all other shareholders subscribe according to their respective ownership stakes.

The buildup of external risks halted the expansion agenda and strong lending growth that BSTDB enjoyed over the past two years prior to the conflict. Over that period, its continued profitability and stronger mandate fulfillment led to its shareholders' unanimous agreement to start a capital replenishment program in October 2021.

BSTDB displayed strong loan book growth over 2019-2021 as part of its growth-focused business plan for 2019-2022. This growth entailed a strategic shift toward infrastructure financing, and the bank's public-sector exposure has increased to almost 30% of loans. However, we expect near-term growth to slow significantly because new disbursements are very limited, and we anticipate that new lending to Russia will be suspended until the conflict ends and international sanctions are relaxed.

The ratings on BSTDB do not reflect potential extraordinary support from shareholders, since 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.

Ratings Score Snapshot

Issuer credit rating	A-/Negative/A-2
Stand-alone credit profile	a-

Enterprise risk profile	Moderate
Policy importance	Moderate
Governance and management expertise	Adequate
Financial risk profile	Very strong
Capital adequacy	Very strong
Funding and liquidity	Strong
Extraordinary support	0
Callable capital	0
Group support	0
Holistic approach	0

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

- How The Russia-Ukraine Conflict May Affect Multilateral Lenders, June 16, 2022

Ratings List

Ratings Affirmed	
Black Sea Trade and Development Bank	
Sovereign Credit Rating	
Foreign Currency	A-/Negative/A-2
Black Sea Trade and Development Bank	
Senior Unsecured	A-

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.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914