

Research Update:

# Black Sea Trade and Development Bank Downgraded To 'A-/A-2' On Asset Quality Risks; Outlook Negative

March 30, 2022

## Overview

- We believe the implications of Russia's military actions in Ukraine will erode the quality of Black Sea Trade and Development Bank's (BSTDB) loan book and weigh on its capital adequacy position, since 30% of loans are to borrowers in Russia and Ukraine.
- Although we believe BSTDB's solid capital standing and liquidity buffers will help cushion the near-term financial impact, we consider that its lending exposures in Ukraine face imminent risk of payment disruption, likely resulting in a material rise in nonperforming loans over 2022.
- Furthermore, we believe a long-term Russia-Ukraine conflict has the potential to disrupt BSTDB's shareholder base, prompting concerns about the bank's strategic direction and future shareholder support, which includes an ongoing capital subscription process.
- We therefore lowered our long- and short-term foreign currency issuer credit ratings on BSTDB to 'A-/A-2' from 'A/A-1'.
- The negative outlook indicates that we could lower our ratings during the next 24 months if extended payment delays, loan write-offs, alongside weakening liquidity and shareholder support, threaten the sustainability of BSTDB's capital.

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## Rating Action

On March 30, 2022, S&P Global Ratings lowered its long- and short-term issuer credit ratings on the Black Sea Trade and Development Bank to 'A-/A-2' from 'A/A-1'. The outlook is negative.

## Outlook

The negative outlook reflects the near-term risk that economic and financial stress from the Russia-Ukraine conflict will erode BSTDB's financial buffers faster than we currently expect. It also reflects the medium-term risk that a persisting conflict between two of BSTDB's large shareholders could 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 ratings in the next 24 months if BSTDB suffered extended payment delays and write-offs that weakened its capital, resulting in our risk-adjusted capital (RAC) ratio falling below 15%. We could also downgrade the bank if its liquidity position worsened due to extended inability to access market financing in combination with a lack of loan payment inflows.

In a scenario where the bank's capital and liquidity both deteriorate significantly, a multi-notch downgrade could result. If BSTDB's shareholders lessened their supportive stance to the institution, downside pressure will also build.

## 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

The downgrade reflects our assessment that BSTDB will experience asset-quality pressures, given the concentration of lending in Russia and Ukraine, which together account for about 30% of the loan book as of Dec. 31, 2021. 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. Even though the ultimate impact on its capital position will become clearer as the duration and severity of the conflict in Ukraine evolves, we consider the risks material.

We estimate BSTDB's RAC ratio at 19.5% using balance-sheet exposures as of June 30, 2021, but parameters such as sovereign ratings and Banking Industry And Country Risk Assessments as of March 23, 2022. We believe this capital position, while allowing some room to absorb loan write-offs, could weaken further given the potential magnitude of the economic impact on BSTDB's areas and sectors of operations from the conflict. In our stress scenario, where we factor in a 50% write-down of BSTDB's exposures in Russia and Ukraine, our RAC ratios fall below 15%, signaling erosion of the bank's capital to levels that would not be commensurate with the current rating, other factors being equal.

We believe BSTDB's lending exposures in Ukraine, which represent 12% of total loans as of Dec. 31, 2021, face the most acute risk of credit deterioration. Over the short term, we anticipate the bank will face a sizeable uptick in provisions and a meaningful increase of nonperforming loans.

With regards 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. Even so, we believe the financial strain on Russia-based counterparts will build as the macroeconomic situation worsens, likely prompting a need for restructuring of loan agreements and increased provisioning. We consider Russian borrowers' technical ability to service loans to be the key short-term risk for BSTDB, rather than an imminent drop in credit standing.

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. That said, given BSTDB's status as a multilateral lending institution, and the commitments that shareholders subscribe to in the articles of agreement, the bank should in theory be exempt from imposed restrictions, for example capital controls. We are not aware of any

payment interruption on debt-service flows from the bank's Russian counterparts.

Aside from BSTDB's direct exposures to Russia and Ukraine, we consider that asset quality concerns could build in its wider portfolio. Aside from the direct impact of BSTDB's lending in Russia and Ukraine, the conflict is having a material near-term macroeconomic impact on the Black Sea region. 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 23% 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 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 €680 million in liquidity, of which 90% is in cash or short-dated securities. On top of these, we understand the bank has €130 million in undrawn, available committed facilities with fellow multilateral development banks, and a regional bond portfolio of €120 million outside Russia and Ukraine. For 2022, we understand that BSTDB has €365 million of debt liabilities coming due, mostly Euro commercial paper but also domestic bonds issued in Romanian lei and Georgian lari.

The buildup of external risks erases the positive momentum that BSTDB enjoyed over the past two years. 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.

We believe ongoing conflict between two of BSTDB's large shareholders--Russia and Ukraine--poses risks to shareholders' commitment. In previous years, the bank has been able to manage periods of tensions between shareholders. However, we have concerns that a prolonged conflict would destabilize the shareholder base and potentially derail the ongoing capital replenishment program. We believe shareholders' commitment to the bank's strategic direction and setup will become clearer as the Russia-Ukraine conflict evolves.

Environmental, social, and governance (ESG) credit factors for this change in credit rating/outlook and/or CreditWatch status:

- Other governance factors

## **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

## Ratings List

### Downgraded; Outlook Action

	To	From
<b>Black Sea Trade and Development Bank</b>		
Sovereign Credit Rating		
Foreign Currency	A-/Negative/A-2	A/Stable/A-1
Senior Unsecured	A-	A

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