

Research Update:

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

November 2, 2022

Overview

- We don't regard the Black Sea Trade and Development Bank (BSTDB)'s extension of the deadline for pledges on its capital subscription program to Jan. 31, 2023, from Sept. 30, 2022, at the request of shareholders, as a signal of an imminent reduction of shareholder support.
- Successful implementation of the subscription process will be vital in demonstrating ongoing shareholder support for the BSTDB's policy role and restoring market confidence.
- The BSTDB's solid capital, comprehensive liquidity buffers, and limited new disbursements are helping it absorb increased provisioning on its Russian and Ukrainian loan books.
- 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 ratings within the next 12 months if the bank's funding access is restricted for a long period, the credit quality of its loan portfolio weakened sharply, or shareholder support reduced.

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Rating Action

On Nov. 2, 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 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. Moreover, we see a risk that the conflict between Russia and Ukraine, 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 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. 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

The BSTDB has extended the response period for pledges to its capital subscription program to Jan. 31, 2023, postponing it four months from the initial Sept. 30, 2022, deadline. We understand that the delay predominantly relates to technical and administrative holdups within the relevant decision-making bodies at some shareholder governments. We do not consider the delay to represent a negative shift in shareholders' perception of the bank's policy relevance. We believe that a prolonged conflict between Russia and Ukraine poses risks to shareholders' commitment but understand that, so far, they have continued to express steady support of the bank's financial viability and policy function.

Moreover, even though the capital subscription pledges are submitted via a sealed envelope process, we understand that the larger shareholders have reiterated their intention to participate. Aside from the extension to the response period, we understand that all other aspects of the capital subscription process, as unanimously decided by the shareholders in September 2021, remains intact, with the first tranches of capital to be paid in by the end of 2023. Despite Russia's willingness to participate in the capital replenishment program, we expect the sanctions imposed on it will prohibit it from taking part. This will dilute Russia's ownership stake in the BSTDB to 12.8% from 16.5%, assuming that all other shareholders subscribe according to their respective ownership stakes.

The successful completion of the capital subscription program represents, in our view, a cornerstone in confirming the BSTDB's policy relevance. We believe it will stand as a key indicator of the supportive stance and long-term commitment of the shareholders. In the near term, the confirmation of shareholder commitment will be crucial for the bank to restore capital market confidence and regain functional access to funding markets.

In line with International Financial Reporting Standard No. 9, BSTDB recorded a sizeable uptick in provisions as of midyear 2022. About one-third of its loans to borrowers in Russia (18% of total)

and Ukraine (12% of total) were recognized as Stage 3 loans. The provisions for impaired loans amounted to €53 million, doubling the amount already on the balance sheet. This was partly absorbed by continued positive income before impairment of €20 million (stable on the equivalent period in 2021), leading to a total drain on capital of €33 million. Even though impairments have materially increased, in line with our expectations, we take note that very few loan exposures have turned nonperforming. In particular, the lending exposures in Ukraine continue to exhibit performing credit characteristics, with the exception of a wind power plant near Crimea (corresponding to about 8% of the Ukrainian loan portfolio and less than 1% of the total loan book), which has been forced to cease operations because of damage.

We understand that the Russian entities have the financial ability to pay the BSTDB but are hindered by the lengthy processes to gain approval from the Russian authorities to make transfers to the EU. We consider Russian borrowers' technical ability to service loans to be a key short-term risk for BSTDB's Russian portfolio. About 80% of BSTDB's Russian borrowers are currently under sanctions introduced by the U.S., EU, and U.K. We understand the payment process could be streamlined in the coming months. Aside from the provisions made on the BSTDB's Ukrainian and Russian loans, at this stage, we are not aware of meaningful credit deterioration in its wider loan portfolio, despite mounting macroeconomic risks in that region.

The BSTDB's capital position has proven more resilient than we anticipated at the start of the Russia-Ukraine conflict. We estimate the bank's RAC ratio at 18.1% using balance-sheet exposures as of June 30, 2022. We also take into account that credit impaired loans classified as Stage 3 have a higher risk of becoming non-performing, and therefore apply a higher risk weight to these assets. The ratio is down from 19.1% on Dec. 31, 2021, primarily because of the drop in its total adjusted capital due to increased provisions, but also due to the higher risk weights applied to Stage 3 loans. At the same time, the bank's decreasing asset base is moderating the impact on capital. Total assets reduced by 8.5% over the first half of 2022 to €2.9 billion and we expect it to reduce a further 7% to about €2.7 billion by year end as a consequence of loan amortizations and the bank's strategy to curtail new lending.

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 of the conflict on areas and sectors where the BSTDB operates. We estimate that in a stress scenario with a significant write-down of the BSTDB's exposures in Russia and Ukraine, the RAC ratio could fall below 15%, signalling erosion of the bank's capital to a level not commensurate with the current rating.

The BSTDB is currently experiencing restricted access to funding markets, with any potential issuance likely carrying a high premium. At the same time, it has limited need to raise additional funding in the next six to 12 months since liquidity sources are ample. Consequently, we expect new lending to be marginal during that period. As such, we expect the bank's liquidity buffers to be more than sufficient to cope with near-term loan payment deferrals and strained access to global financing markets. We estimate that the BSTDB has €570 million in liquidity, about 90% of which comprises cash or short-dated securities. In addition, we understand the bank has €130 million in undrawn, available committed facilities with fellow multilateral lending institutions, but since these are contingent on new disbursement, we do not consider those funds to be readily available in the current circumstances. BSTDB has €350 million of debt due in 2023. We are monitoring its liquidity coverage and market access closely ahead of its \$550 million Eurobond's maturity in June 2024.

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

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/sourceld/504352 Complete ratings

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