Research Update:

Black Sea Trade and Development Bank 'A-' Ratings Affirmed; Outlook Positive

July 9, 2020

Overview
- We expect the COVID-19 pandemic to temporarily interrupt Black Sea Trade and Development Bank's (BSTDB's) strategic shift toward public-sector lending and prompt a gradual weakening of its capital position as continued solid lending levels consume capital ratios amid rising asset quality concerns.
- That said, we forecast BSTDB's financial risk profile will remain very strong and it will enjoy solid shareholder recognition for its expanding portfolio, while its underlying buildup of public-sector infrastructure lending has the potential to improve its contribution to economic development and regional cooperation.
- We are affirming our 'A-/A-2' ratings on BSTDB and maintaining our positive outlook.

Rating Action

Rationale
The ratings are based on our assessments of BSTDB's very strong financial risk and moderate enterprise risk profiles. The bank's financial strength continues to underpin the ratings. Even though the resilience of BSRDB's dynamic expansion agenda will be tested amid the COVID-19 pandemic, we view its enlarged lending footprint, sustained disbursement levels, and agility to adapt to shareholder requests for heightened private-sector focus in 2020 to be a credit positive. These developments have the potential to gradually diminish our concerns related to the bank's relatively small balance sheet and limited possibilities to act as a countercyclical lender. The bank recorded impressive lending growth of 30% in 2019 and we view the strengthening of its relevance and policy role in 2020-2022 as plausible once it restarts its public-sector expansion following the pandemic. In turn, we expect shareholders will remain committed to the institution and support its
expansion agenda over 2021-2022.

We have revised downward our assessment of BSTDB's financial risk profile due to our expectation of a decline in its capital position. We believe BSTDB's risk-adjusted capital (RAC) ratio is likely to gradually transition to below 23% due to heightened medium-term disbursement levels and short-term deterioration in asset quality linked to the COVID-19 pandemic. Although we have not observed any noticeable uptick in nonperforming loans (NPLs) to date, we believe pressures will build as the stressed macroeconomic situation could linger.

In 2019, BSTDB's board of governors approved a 2019-2022 business plan to extend its funding contribution and expand disbursement levels through heightened direct funding of the real economy via sovereign-sponsored infrastructure projects. The bank gained immediate traction following this important inflexion point, having closed 2019 with an almost 30% pickup in outstanding lending and only marginal consumption of capital due to the public sector nature of the loans added to its books. We believe that the pandemic will temporarily interrupt BSTDB's strategic policy shift as shareholder demands prompt it to return to private-sector lending, particularly to the small and midsize enterprise (SME) sector where support is needed, and public-sector infrastructure projects take a backseat. However, we assume that BSTDB's recently broadened lending focus will continue and that it will increasingly engage in public-sector infrastructure project financing over the medium term.

Although BSTDB's underlying expansion into infrastructure projects has the potential to strengthen its policy role, we consider several key execution risks. Specifically, overall profitability in a highly competitive market, with other multilateral lending institutions (MLIs) and national development banks present. Furthermore, if not successfully executed and BSTDB proved unable to meaningfully increase funding for the public sector while deemphasizing the private sector, this could suggest its policy importance and overall lending footprint would stay only moderate, in our view.

We expect stressed macroeconomic conditions in BSTDB's countries of operations as the COVID-19 pandemic sweeps the region and global economy into recession. We forecast that asset-quality risks will increase, particularly in pockets of BSTDB's private-sector exposures, with the impact likely felt with a lag amid a potential protracted economic recovery as fiscal support measures are phased out. However, so far we understand payment behavior has been unaffected and we are not aware of any significant requests for loan moratoria or restructuring of terms from BSTDB's existing borrowers. We do not exclude that pressure could intensify in the short-to-medium term and repercussions felt with a time lag. Reassuringly, BSTDB makes use of several risk-sharing mechanisms, such as public-sector guarantees and lending via intermediating financial institutions through which the bank conducts the entirety of its SME lending. These, along with the increasing public-sector focus in its loan book, provide some cushion to prevent a material decline in the bank's capital position.

We assess BSTDB's RAC ratio at 25.1% at year-end 2019. Solid earnings and an increasing proportion of disbursements to public-sector guaranteed entities allowed the bank's capital position to absorb a 30% increase in balance sheet assets over 2019. We believe BSTDB's RAC ratio will be pressured over the coming two years and expect the bank's management to allow for a gradual reduction to below 23% as its expansion agenda continues. Although we expect BSTDB's provisions and stock of impaired loans to increase over 2020, we forecast it will be able to sustain its very strong capitalization.

We consider BSTDB to hold a strong funding and liquidity profile on the back of its competent liquidity management, under which pre-financing of upcoming disbursements or redemptions of existing debt are made well in advance. In addition, the institution is fostering strong relationships across the MLI and multilateral development bank community, which have allowed
comprehensive liquidity lines to be contracted. We incorporate these in our liquidity analysis.

The ratings on BSTDB do not include 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 extraordinary callable capital support.

**Outlook**

The positive outlook reflects our view that BSTDB's role as a regional supranational could strengthen over the coming two years, thanks to its expansion strategy. In addition, we believe that BSTDB's very strong financial profile and competent risk management will allow it to navigate the challenges presented by the COVID-19 pandemic, including likely deteriorating borrower credit quality and a temporary deviation from its medium-term strategic lending focus.

**Upside scenario**

We could raise the ratings over the next 12 months if BSTDB continues to build its track record of strong disbursement increases under its new mandate, confirming its broader public-policy role, while maintaining its very strong financial risk profile. In such a scenario, we would expect asset quality to be maintained and shareholder recognition to be evident as the higher disbursement levels amplify BSTDB's support of funding for economic development across its footprint.

**Downside scenario**

We would revise the outlook to stable if BSTDB's financial risk profile deteriorated. This could, for example, be due to a material deterioration in loan portfolio credit quality amid the economic effects of the COVID-19 pandemic, resulting in an accumulation of NPLs and credit-impaired loans. We could take a similar action if we observed that the bank was unable to cement its public-policy role over the coming 12 months, with disbursement levels returning to lackluster levels, or shareholder engagement was lacking.

**Ratings Score Snapshot**

Issuer credit rating: A-/Positive/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

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- Group support: 0

Holistic approach: 0

Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018


- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017

- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

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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 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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.
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