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## IIRA Assigns Fiduciary Ratings to Al Mustashar Islamic Bank For Investment and Finance P.S.C., Iraq

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**Manama, October 06, 2021** – Islamic International Rating Agency (“IIRA”) has assigned local and foreign currency ratings to Al Mustashar Islamic Bank For Investment and Finance (“Al Mustashar” or “the Bank”) both at B/B (Single B / Single B) on the international scale, with a ‘Stable’ outlook. The assigned international scale ratings also take into consideration the sovereign risk profile of the Republic of Iraq (“Iraq” or “the Country”). Established in 2018, Al Mustashar is a Shari’a compliant bank licensed by the Central Bank of Iraq (“CBI”).

Sovereign risk assessment on Iraq takes into account the Country’s sizable natural resource reserves, still moderate external indebtedness in relation to GDP, vis-à-vis coverage provided by foreign currency reserves. On the other hand, significant infrastructure building requirements coupled with political and social strain caused also by unemployment among other factors, constrain the overall assessment. High hydrocarbon dependence and Covid-19 have resulted in significant contraction of the economy in 2020, accompanied by deficits on both, the fiscal and external account, marking a deviation from surpluses in prior years. This led the CBI to devalue the currency sharply in late 2020. With steady recovery in oil prices and with waning effects of global recession, Iraqi economy is expected to rebound in 2021, in addition to improvement in fiscal position and a reversal in the current account balance.

An already under-banked economy further faced adverse effects of the pandemic and public protest that translated into banking sector slowdown last year. This necessitated temporary forbearance measures by the CBI. Downside risks are evident given elevated credit segment concentration and high non-performance in the prevailing macroeconomic situation. On a positive note, ongoing reforms in the banking sector may strengthen the system-wide governance and control infrastructure, with significant room available for growth in an improving economic and investment climate.

IIRA has also assigned national scale ratings of BBB (iq) / A3 (iq) (Triple B (iq) / Single A Three (iq)) on the Bank, with a ‘Stable’ outlook. Since commencement of operations, the Bank has depicted rapid deposit growth at a CAGR of 75.4% (2018-H1’21) exceeding peer average, despite intense competition. As a fairly new Bank with limited operating history, the Bank’s non-shareholder funding mix is still evolving and depicts a gradually growing retail base with steady growth in the network; yet wholesale sources are still sizable. Foreign currency funding is also noted to have increased on a timeline. The Bank has a positive net open position that may provide opportunity for gains with depreciation pressures on the local currency. However, when viewed in relation to equity the mismatch is material at year-end 2020. So far, the funding profile is cost effective given largely non-remunerative deposit accounts.

The Bank’s financings also exhibited faster growth of CAGR 217% (2018-H1’21). Given a lack of Shari’a compliant investment avenues in the Country, the investment portfolio primarily comprises non-

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banking, unquoted, strategic holdings. As such, while still growing, the banking book is limited both in absolute terms and in relation to assets and equity of the Bank, leaving substantial excess liquidity. While there is no reported portfolio impairment until end-2020, IIRA may continue to monitor the emerging trends in asset quality, given an as yet unseasoned portfolio and a presently, challenging economic environment. Nonetheless, in our view the risk on the balance sheet is contained given relatively low share of financings in relation to assets.

In line with industry, Al Mustashar derives major earnings from ancillary sources and growth in unfunded business. While margin income is noted to have retreated in 2020, with gradual business growth and steady pace in banking operations, the Bank may further cultivate margin income stream over the coming years. Despite continuing increase in operating costs over the years, Al Mustashar has posted positive bottom-line since 2019. While cost of fresh provision were reported relatively lower in 2020 vis-à-vis prior year, downside risks to profitability in the form of continued charge-offs against potential asset losses may undermine the Bank's internal capital generation in the near-term; however, assuming continued steady growth and continuing cost efficiency trend, the Bank's core profit potential appears intact.

At present, the Bank has low leverage given that the assets are predominantly funded by equity that has been supported by phased capital increase to meet with CBI's minimum capital requirement. Further, final phase of capital reinforcement is on the anvil this year to comply with regulatory thresholds. Overall sound asset quality and excess risk buffers underline the currently low; although yet to evolve risk profile of the bank and as such support the investment grade rating assigned to the bank. Fragmented private individual ownership profile with no clear majority shareholder constrains potential for reliable sponsor support in the future if required.

IIRA has assessed Al Mustashar's fiduciary score in the '61 – 65' range, reflecting adequate fiduciary standards, wherein the rights of various stakeholders are considered to be adequately protected. Corporate governance standards in the sector have been guided by regulation, ensuring strong board supervision and an adequate control infrastructure, particularly with regards to compliance related practices. Nevertheless, there is scope for further enhancing the resources deployed, both human and technological, to further strengthen controls. While broadly in line with regulatory requirements, some changes are required on the front of both board and board committee composition for complete alignment with directives; these are understood to be on the anvil. The CBI has also issued specialized guidelines and regulatory framework for Islamic banks in the Country. The Bank's operations are well-supported by its Shari'a governance infrastructure.

For further information on this rating announcement, please contact IIRA at [iira@iirating.com](mailto:iira@iirating.com).