IIRA Maintains Fiduciary Ratings of Al Baraka Banking Group B.S.C.

Manama, February 10, 2022 - Islamic International Rating Agency ("IIRA") has reaffirmed the international scale ratings assigned to Al Baraka Banking Group B.S.C. at BBB+ / A3 (Triple B Plus / A Three). The national scale ratings have also been maintained at A+ (bh) / A2 (bh) (Single A Plus / A Two). Outlook on the assigned ratings is 'Stable'.

Al Baraka Banking Group B.S.C. ("ABG" or "the Group") is an Islamic wholesale bank licensed by the Central Bank of Bahrain ("CBB"). Following IIRA's last review, the shareholders of the Group resolved and proposed license conversion into a 'category 1 – investment business firm', which is pending final regulatory approval. IIRA deems the proposed conversion to be credit neutral based on our understanding of minimal impact on ABG and subsidiary operations, although we remain cognizant of the eased capital requirement under the proposed entity status.

The assigned ratings on ABG weigh in the country risk metrics and political landscape of host jurisdictions. Slower than anticipated pace of global recovery may pose continuing challenges from resurgence of Coronavirus variants. Risks persist in the form of macroeconomic headwinds in operating jurisdictions, in addition to unfavorable prognosis on host currencies, which may compound the stress of narrower banking sector margins with the expected reversal of heretofore-accommodative monetary policy stance. Business strategy of the Group is inclined towards optimization of risk adjusted returns and harnessing prudent organic growth amidst continued uncertainty. A strong franchise in the local retail deposit markets continues to provide stable and relatively cost effective funding to larger Units.

Reflective of customer repayment challenges posed by the pandemic, ABG posted an increase in non-performing financings over the last 21 months. While this may have also precipitated due to lifting of regulatory forbearance measures in host jurisdictions over the course of last year, much of the increase in the Group's credit risk metrics was mitigated with higher loss allowances. Amidst the tough industry conditions, the Group subsidiaries have adopted a de-risking approach and allocating relatively capital light exposures, which is viewed favorably.

The Group posted higher net earnings in 9M'21 vis-à-vis 9M'20 due to reversal of provision charge-offs in some Units and despite relatively lower core earnings. While tighter policy rate environment may put pressure on profit share margins over the coming periods; expected improvement in ancillary income, cost efficiencies and lower expected provisioning cost will support the bottom line. Furthermore, long-term earnings expectations remain healthy as business activities normalize in later periods.

ABG's consolidated capitalization is noted to have improved in Q3'21 led by a favorable risk assets position. Outlook on the international scale ratings has been revised to 'Stable' from 'Negative' as the units' capital position largely indicated adequate buffers for growth and loss absorption at 2020 end, in addition to which further reinforcement is also on the anvil for some subsidiaries. Sharp and adverse currency movements in some Units' host jurisdictions, more specifically in Turkey as noted recently, may be expected to reduce equity buffer. However, overall capital adequacy is likely to remain largely in line with the last 5-years average of 16.5% (2016-2020) and sufficiently above requirement. Downside risk to capital may stem from slower than anticipated internal capital generation, deterioration in asset quality or further significant currency fluctuations, which are unlikely in the short-term.

IIRA's assessment of ABG's fiduciary scores remains in the range of '81-85', reflecting strong fiduciary standards, wherein the rights of various stakeholders are well defined and protected. Since our last review, Board and Board committee composition transition have been noted in addition to changes in some senior management functions at ABG. While Units continue to operate autonomously, ABG has maintained secondary oversight in addition to the Units' own internal framework. Furthermore, enhanced Group direct intervention is aimed at through organizational structure and reporting changes over the coming periods. Greater involvement of ABG in Units' decision-making is due to be ensured through implementation of revised organizational reporting framework. Any impact of this and its effectiveness may be considered once the strategy is implemented across the Units. IIRA takes cognizance of appropriate risk management and strategy measures undertaken across ABG and its Units. The Group also remains committed towards achieving the sustainable development goals.

The Group benefits from a robust local Shari'a regulatory environment and internal framework. ABG remains compliant with Shari'a rules and principles as ratified by the Unified Shari'a Supervisory Board. Close coordination with Units' Shari'a Boards for harmonization of policies and practices in addition to adequate disclosures compliment the Group's Shari'a governance framework.

For further information on this rating announcement, please contact IIRA at iira@iirating.com.