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## IIRA Maintains Fiduciary Ratings of Al Baraka Turk

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**Manama, June 29, 2020**– Islamic International Rating Agency (“IIRA”) has reaffirmed the foreign currency ratings of Albaraka Türk Katılım Bankası A.Ş. (“Albaraka Turk” or “the Bank”) at ‘BB+/A3’ (Double B Plus / A Three) and local currency ratings at ‘BBB-/A3’ (Triple B Minus / A Three), respectively on the international scale. Outlook on the assigned ratings remains ‘Negative’.

Albaraka Turk is a pioneer in participation banking and is one of the six participation banks in the Republic of Turkey. The Bank has held a 1.1% market share in terms of assets within the Turkish Banking Sector and an 18.1% share in the Participation Banking segment at end 2019. Foreign shareholders maintain 62% of the Bank’s shareholding, whereby Al Baraka Banking Group (“ABG”) and Dallah Group collectively hold a majority stake, with Islamic Development Bank also being a prominent shareholder. Albaraka Turk operated with 230 branches spread through Turkey at the end of 2019.

With the unfolding of the Covid-19 pandemic, IIRA expects 1% contraction in the Turkish economy in 2020, as the operating environment remains adversely affected. Severe negative implications on economic activity globally, will continue to affect emerging market inflows, maintaining pressure on the local currency.

The Central Bank took measures to improve the liquidity of the banking sector and enhanced credit facilities for exporters. Banking Supervisory authority also relaxed capital and provisioning requirements, which are aimed at maintaining stability via sustained confidence, while making sufficient liquidity available. On the other hand, the introduction of the regulatory asset ratio encourages banks to extend financing during the present stressed operating environment, which may impact quality parameters of new underwriting in the sector, with expectations of a surge in non-performance on an industry-wide basis. Overall, the banking sector indicators point to adequate buffers. However, notable depreciation of the currency, as already witnessed year to date, will have adverse effects, given the high levels of FCY debts in non-financial private firms. The negative outlook on the ratings, reflect these concerns.

During most of the year 2019, the Al Baraka Turk booked limited growth in financings, as the macroeconomic conditions and high benchmark rates remained non-conducive to growth, and resulted in depressed financing offtake. However, in the last quarter of the year, risk appetite improved following the successive and sharp benchmark rate cuts and improved economic activity.

The Bank’s gross impairment ratio increased moderately over the previous year as the sector recognized significant increase in asset impairment, with the Bank’s asset quality indicators beginning to converge to sector average in 2019, after posting trends that are slightly more adverse , during 2018. Further, notable decline was observed in stage 2 financings. On a positive note, the Bank has much lower exposure to more vulnerable sectors in the post-COVID 19 environment, such as tourism and

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transportation. While the portfolio remains well collateralized, having posted further slight increase in collateral cover over the year 2019, generally lower provision coverage, as well as noteworthy exposure to the real estate segment, which is susceptible to weakness in the present circumstances, positions the Bank at the riskier end of the Turkish Banking spectrum, from the asset quality perspective.

Capitalization metrics improved as the Bank completed TL450mn cash capital increase. At current levels, the bank's CAR and tier-1 ratio remains well above regulatory minimum levels. Cognizant of the Bank's plans to issue USD50mn tier 1 Sukuk in the second half of the year, IIRA believes that capital buffers would suffice for the ongoing year. However, internal capital generation trends may not be commensurate with an accelerated pace of business as expected, partly stemming from efforts to comply with regulatory asset ratio, and as such pose risk to the capital profile of the bank.

Net earnings fell further in 2019, as notable decline in net profit share income, lower trading income and high growth in personnel costs outweighed the positive impacts of increasing fee income generation and decline in other cost items. In the ongoing year, the accelerating volume growth and better cost of funding should support operating profitability which may offset increase in provision buffers expected during the year; as such overall profitability levels may not be materially lower than prior year although upside potential remains limited.

IIRA maintained the Bank's overall fiduciary score of '71-75', while noting improvements on the participation banking governance front. In addition, the CSR efforts of the Bank are well noted. The fiduciary scores implies adequate fiduciary standards, wherein the rights of various stakeholders are considered to be adequately protected. Supplemental monitoring exercised through ABG's oversight further uplifts the fiduciary governance framework.

In September 2019, Banking Regulatory and Supervisory Authority (BRSA) published the regulations concerning the PB Governance Framework of the sector and allowed six months to achieve compliance with the requirements, aimed at achieving convergence in practices of the Turkish PB sector to global best practices in the area. Albaraka Turk has complied with these wide ranging regulations by reconstituting its Consultancy Committee in terms of its charter and members, separating PB Audit and Compliance Departments among others. We recommend improvement in the PB related disclosures of the Bank.

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