IIRA Reaffirms Fiduciary Ratings on Al Mustashar Islamic Bank For Investment and Finance P.S.C., Iraq

Manama, December 6, 2022 – Islamic International Rating Agency ("IIRA") has reaffirmed the local and foreign currency ratings on 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. The assigned international scale ratings take into consideration the sovereign risk profile of the Republic of Iraq ("Iraq" or "the Country"). IIRA has also maintained the national scale ratings of BBB (iq) / A3 (iq) (Triple B (iq) / Single A Three (iq)) that reflect the repayment capacity of the Bank in local currency terms in the national context. Outlook on both ratings is 'Stable'. Established in 2018, Al Mustashar is a Shari'a compliant bank licensed by the Central Bank of Iraq ("CBI").

Given the Country's notable dependence on hydrocarbons, current oil prices are likely to support favorable macroeconomic trends as noted in 2021, in addition to planned fiscal reforms. Domestic banking sector remains underdeveloped with low financial inclusion. While spill-over effect of ongoing Russia-Ukraine conflict may be felt in rising inflation and costs, reinvigorated economic activity may support general business growth in the ongoing year, which along with CBI's credit support measures is expected to boost banking sector activity. Recent election of the President and Prime Minister has resulted in normalization of government function, however, political instability leaves room for disruptions. Exclusion of Iraq from the list of non-compliant countries and grey list of the World Bank and EU, is expected to boost integration of the Iraqi banking sector with the international financial system.

Growth continued in Al Mustashar, albeit having slowed in 2021 and later reviving over the interim periods of the ongoing year. Rebound over the recent quarters is led by reinforced capital and rapid non-shareholder funds mobilization. While there is intense competition in the local deposits market, Al Mustashar has been able to access fresh deposits, in addition to mobilizing borrowings from CBI. However, the Bank's funding base is still to evolve given its as yet limited presence. While wholesale funds grew faster and remain sizable, the Bank's funding mix is favorable in terms of cost effective and non-remunerative accounts. Liquidity risks are low with surplus liquidity at hand.

Banking book is yet to develop. While there are no delinquencies yet, increase in credit risk is noted with increase in stage 2 financings and exposures to relatively vulnerable sectors like construction. Financial investment options remain limited in the domestic economy. While the Bank has restructured most of its major non-banking strategic holdings, overall investment levels were consistent with new investment in additional real estate investments, which represent a high degree of market risk, albeit contained due to a limited portfolio size. Reflective of sector trends, the Bank's financings exceed the regulatory threshold in relation to deposits in addition to holding majority-stake in non-banking investments, which indicate regulatory risk.

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Al Mustashar's profitability in 2021 was suppressed due to lower core earnings; which however, later recovered in 9M'22. This improvement was primarily led by ancillary income, while net margin income still remained relatively low vis-à-vis corresponding prior year period. Upward trend in expenses may be expected to continue with business growth. However, with normalized asset impairment charge-offs in 2021 and expectations of lower provisions this year, overall profitability is expected to recover in the current year.

Through additional capital injection in Q1'22, the Bank has complied with regulatory minimum requirement. Al Mustashar depicts very low leverage with assets being predominantly funded by equity. Shareholding structure remains wide and fragmented with no clear majority sponsor; overall capital position is deemed sufficient for growth over the medium-term despite ongoing utilization, albeit at a measured pace.

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 adequately protected. Minor improvement has been noted in all components of fiduciary scores. Having onboarded new Board members, the Bank has complied with regulatory minimum members requirement; yet there remains scope for alignment with global best corporate governance practices in terms of independent Chairmanship and Board committees' composition. Organizational structure and internal control infrastructure are being enhanced through additional functions and resources. There is no change in the Bank's Shari'a governance infrastructure, which is aligned with regulatory requirements; however, instituting a dedicated internal Shari'a control department and improved disclosures may help ensure adequate focus on related controls.

With CBI's push towards renewable energy financings allocation, IIRA expects a focused approach towards incorporating environmental, social, and governance ("ESG") related objectives in the Bank's operations. The Bank has documented its commitment to ESG elements in the form of a published report outlining its policy, initiatives and achievements. While the sustainability report is favorable, an external validation of the Bank's policies, targets, and achievements may add further value to its sustainability commitments. Furthermore, the Bank may form a Board-level committee to devise and integrate sustainable objectives and a dedicated function for supervising and managing its sustainable initiatives and achievements with adequate public disclosures periodically. IIRA believes that current practices do not constitute a risk to the Bank's creditworthiness, at present

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

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