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## **IIRA Reaffirms Fiduciary Ratings on Asia Aliraq Islamic Bank, Outlook on National Scale revised to 'Positive'**

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**Manama, November 03, 2022** – Islamic International Rating Agency (“IIRA”) has maintained the local and foreign currency ratings on Asia Aliraq Islamic Bank for Investment and Finance (“Asia” or “the Bank”) both at B/B (Single B / Single B) on the international scale, with a ‘Stable’ outlook. The international scale ratings take into consideration the sovereign risk assessment of the Republic of Iraq (“Iraq” or “the Country”). IIRA has also reaffirmed the national scale ratings of BBB (iq) / A3 (iq) (Triple B (iq) / Single A Three (iq)), which reflect the repayment capacity of the Bank in local currency terms in the national context. Outlook on the national scale ratings has been revised to ‘Positive’ from ‘Stable’ with expectations of continuing recent favorable trends in business generation and financial metrics.

Given the notable dependence on hydrocarbons, higher oil prices led to the recent improvement in Iraq’s economy as anticipated. Favorable short-term prognosis for oil may be expected to continue to support the Country’s macroeconomic trends over the coming periods. Nonetheless, downside risk stems from inherent volatility in hydrocarbon prices and weak long-term prospects, in the absence of economic diversification. Further, spill-over effect of ongoing Russia-Ukraine conflict may put some inflationary pressure. Domestic banking sector remains underdeveloped with low financial inclusion. Reinvigorated economic activity may support general business growth in the ongoing year, which along with the Central Bank of Iraq’s (“CBI”) credit support measures is expected to boost banking sector activity. Exclusion of Iraq from the list of non-compliant countries and grey list by the World Bank and EU, respectively, may also improve the local banking sector potential over the coming periods.

Asia posted faster growth in 2021 also outpacing the industry, thereafter, moderating over the interim periods of the ongoing year. This is attributable to both capital reinforcement and improved non-shareholder funds mobilization during the periods. Liquidity risks are low with significant excess liquidity on books. Moreover, the Bank depicts low leverage with assets predominantly funded by equity. Asia is now compliant with the CBI’s minimum capital requirement. While there is no clear majority sponsor for reliable external support in future, if required, overall capital position of the Bank likely remain sufficient for growth over the medium-term, despite rapid utilization as expected.

Asset allocation is gradually improving, with increasing investment in core banking business. Albeit still low scale of financings in relation to assets and equity, the Bank’s growing exposures towards relatively vulnerable segment and sectors may pose credit risk. Despite increase in non-performing financings, asset risk remains moderate due to improvement in risk buffers. Investments indicate a fair degree of market risk, though balanced by relatively liquid negotiable, financial instruments in the portfolio. Asia has exceeded regulatory threshold for financings in relation to deposits and also continues to hold majority-stake in non-banking investments, which may both indicate regulatory risk.

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Asia's profitability metrics depict weakening in 2021 due to lower ancillary income and extraordinary asset impairment charges, leading to a net loss. Nonetheless, with improved pace of banking operations and auction window business, the Bank more than recovered the prior full year loss in H1'22. Assuming continued steady growth, the Bank's core profit potential appears intact further supported by expectations for lower provisions. However, any hiccups in the trade flow business may present downside risks to profitability in the near-term.

IIRA has assessed Asia's fiduciary score in the '61 – 65' range, reflecting adequate fiduciary standards, wherein the rights of various stakeholders are considered to be adequately protected. IIRA has noted broad improvement in asset management quality and corporate governance scores. The Bank remains compliant with CBI's regulations on corporate governance; yet there remains scope for alignment with global best practices in terms of independent chairmanship.. Internal control infrastructure is being enhanced through various risk and AML tools. The Bank's Shari'a governance is aligned with regulatory requirements, and supported by well-versed members at the Shari'a Board; however, instituting a dedicated internal Shari'a control departments and improved disclosures may help to ensure adequate focus on related controls.

Given the CBI's push towards renewable energy financings allocation, IIRA expects a focused approach towards incorporating ESG related objectives in the Bank's operations. The Bank participated in domestic industry wide ESG scorecard evaluation circulated by CBI. Furthermore, the Bank has documented its commitment and objectives towards sustainability; however, the report is publicly unavailable. While the report is viewed as favorable, an external validation of the Bank's policies, target and achievements may add further value to its sustainability commitments. In addition, 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, in line with Principles of Responsible Banking. Notwithstanding, 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](mailto:iira@iirating.com).