



IIRA Maintains Ratings of Bank Al Jazira, Kingdom of Saudi Arabia, Outlook and Fiduciary Scores Raised

Manama, August 07, 2022 – Islamic International Rating Agency (“IIRA”) has reaffirmed the ratings of Bank AlJazira (“BAJ” or “the Bank”), based in the Kingdom of Saudi Arabia (“KSA” or “the Country”) at A-/A2 (Single A minus / A Two) on the international scale and A+(sa)/A1 (sa) (Single A Plus / A One) on the national scale. Outlook on the assigned ratings is ‘Positive’ revised from ‘Stable’, reflecting IIRA’s expectations of sustained improvement in the Bank’s profitability and financial strength in the ongoing year. Ratings may be revisited for an upward assessment as recent positive trends in earnings, capitalization and asset quality indicators continue, and the macroeconomic indicators remain favorable.

As anticipated, KSA economy rebounded in 2021 following the pandemic-induced deceleration in the prior year. Prognosis of sustained improvement in oil prices that have ranged around plus US\$100/barrel until now in the ongoing year may continue to support positive momentum in macroeconomic trends in KSA, over the near-term, with positive implications for the banking sector. Downside risk stems from continued constrained trade and global stagflation.

Banking sector performance has remained resilient, and ongoing measures from government and regulatory authorities are likely to continue to provide growth opportunities. So far, the local economy appears insulated from the ongoing Russia-Ukraine conflict.

BAJ is a full-fledged Islamic Bank, licensed by Saudi Arabian Monetary Authority (“SAMA”) and predominantly operates domestically. The Bank has shareholding in various non-banking entities, of which its flagship subsidiary is a brokerage company. BAJ continued its growth trajectory, having outpaced the industry over the years and gradually gaining local deposits market share. Asset allocation has improved on a timeline, yet portfolio quality indicators have leaned towards relative weakness over the last five years, reflective of overall sector drift. While asset risk is largely contained given increasing exposures to government and quasi-government entities, emerging trends in asset quality may need to be monitored, particularly with regards to micro, small and medium enterprises (“MSME”) segment with the lifting of SAMA’s deferred payment program (“DPP”) program by end-Q1’22. Nonetheless, risk is deemed limited given that the Bank has set aside substantial allowances for potential losses.

Steady core profits and notably lower asset impairment charges shored up net earnings in 2021. Expectations of further acceleration in business generation in line with improved economic activity may continue to support earnings aggregation in the near-term. Margins are likely to be constrained amidst a tighter policy rate scenario; however, favorable funding profile with sizable non-profit bearing non-shareholder funds will mitigate the effects of expected decline in yield. Despite low internal capital generation due to high dividend distributions, BAJ’s capital adequacy has remained strong, also reinforced

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by supplementary capital from time to time with the issuance of Tier 1 perpetual Sukuk last year in addition to replacement of the matured Tier 2 subordinated Sukuk. Annual capital generation is slightly below growth in risk assets, alleviating any potential concern of capital shortfall over the medium term. While short-term maturity mismatch risk has widened due to longer-term core assets vis-a-vis short-term deposits, liquidity reserves are adequate, exemplified also regulatory ratios maintained above guidelines.

IIRA has assessed the Bank's overall fiduciary score in the "76 - 80" range, uplifted to the higher band vis-à-vis prior year, and reflecting strong fiduciary standards, wherein the rights of various stakeholders are protected. Broad improvement in all three components of fiduciary score have been noted. Regulatory environment in KSA support strong governance practices and adequate disclosures. IIRA views BAJ's control framework as sound, with effective functional segregation and well-defined reporting lines. The Bank's risk framework remains comprehensive in scope and organization and has deployed tools that are at par with international banking standards and also continually upgraded.

With SAMA recently having initiated a preliminary assessment of climate-related risks to the banking system and the ESG disclosure guidelines issued by Saudi Exchange for listed companies, IIRA expects a focused approach towards incorporating ESG related objectives in the Bank's operations. It may be pertinent to note that BAJ has incorporated both corporate social responsibility and ESG in its strategic objectives, and remains committed to community development initiatives. While the Bank is still in the nascent stages of embedding ESG related objectives within its financing strategy or at organizational level, IIRA believes that current practices do not constitute a risk to its creditworthiness, at present.

BAJ has updated its Shari'a governance framework in line with the latest regulatory amendments issued by SAMA. Role of Shari'a is expected to be further entrenched in the risk functions. Including more participatory forms of investing, financing and funding is needed, to add depth to product profile.

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