الوكالة الإسلامية الدولية للتصنيف
Islamic International Rating Agency

IIRA Upgrades Ratings on Bank Al Jazira, Kingdom of Saudi Arabia

Manama, June 18, 2023 – Islamic International Rating Agency ("IIRA") has raised the ratings of Kingdom of Saudi Arabia ("KSA" or "the Country")-based Bank AlJazira ("BAJ" or "the Bank") to A / A2 (Single A / A Two) from A- / A2 (Single A Minus / A Two) on the international scale. At the same time, IIRA has raised the national scale ratings assigned to the Bank to AA-(sa) / A1 (sa) (Double A Minus / A One) from A+(sa) / A1 (sa) (Single A Plus / A One). Outlook on the assigned ratings is 'Stable'. BAJ is a full-fledged Islamic Bank, licensed by Saudi Arabian Monetary Authority ("SAMA"). The Bank operates only in KSA and has shareholding in various non-banking entities, including its flagship subsidiary – AlJazira Capital Company, which operates as a brokerage firm in the Kingdom.

KSA economy continued recovery in 2022, also translating into improved external balance and public finances. Despite moderation, OPEC+ production cuts may continue to support oil prices that are further expected to fuel economic activity in the Country. Banking sector performance has remained resilient, and ongoing measures from government and regulatory authorities are likely to continue to provide growth opportunities. Ongoing government incentivized expansion also drives the favorable outlook for KSA over the near- to- medium term. However, since last year the banking sector has been facing liquidity pressure with deposits growth not being commensurate with rapid pace of financings. Constrained global trade flows, continued inflationary pressure and tighter than expected global financial conditions may continue to pose challenges.

Growth trajectory has been maintained, with the Bank also slowly and gradually gaining local deposits market share over the years. Business potential remains favorable given the positive economic prognosis. Non-performing financings were reported lower in 2022 vis-a-vis prior year, yet the portfolio quality indicators have leaned towards relative weakness over the last few years, reflective of overall sector drift. Nonetheless, overall asset risk is largely contained with substantial allowances having been set aside for potential losses.

Increase in remunerative time deposits was noted last year, while the Bank also utilized short-term borrowings as bridge funds. Short-term maturity mismatch risk remains wide due to longer-term core assets vis-a-vis short-term deposits; however, liquid reserves are sufficient. The Bank recorded largely consistent core profitability last year supported by higher income and offset by sharp increase in returns to non-shareholder funds and higher operating costs. Yields widened in 2022; however, lagged the pace of fund returns, thereby translating into relatively narrow spreads. Margins may stabilize in 2023 as pressure on funding cost is expected to gradually ease towards the latter half of this year. This along with continued acceleration in business generation and lower asset impairment charges, should allow momentum in profitability trends to be sustained. Internal capital generation improved relatively last year due to low dividend distributions and steady profitability; however, decline in equity was led by fair value adjustments. BAJ's capital adequacy is expected to remain sufficient providing room for medium-term growth even with implementation of Basel IV regime in the ongoing year.

IIRA has assessed the Bank's overall fiduciary score in the "76 - 80" range, reflecting strong fiduciary standards, wherein the rights of various stakeholders are protected. Regulatory environment in KSA remains strong and conducive to governance practices. BAJ's control framework remains sound, with effective functional segregation and well-defined reporting lines. The Bank's risk framework is comprehensive in scope and organization. Risk management tools deployed are at par with international banking standards and are continually upgraded.

The Bank has a dedicated Board-level committee to devise and integrate social objectives, the scope of which was extended last year to cover sustainability. The Bank is in the process of implementing ESG scorecard to benchmark climate transition risk and is equipped with an ESG risk scoring application, as part of the credit evaluation tools deployed. IIRA expects significant scale up in this regard, driven by regulatory developments, and believes that current practices do not constitute a risk to the Bank's creditworthiness at present.

Regulatory impetus to Shari'a governance standards in the financial sector has scaled up significantly in recent years, with new amendments continuing to influence organizational set up and emphasis on Shari'a related review and checks. The Bank has updated its Shari'a governance framework in line with the latest regulatory amendments issued by SAMA. The product suite remains concentrated in non-participative structures, although all products and contracts are in line with approvals granted by the Shari'a Committee.

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