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## IIRA Assigns Initial Ratings to International Islamic Bank

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**Manama, November 06, 2023** – Islamic International Rating Agency (“IIRA”) has assigned international scale, local and foreign currency ratings to International Islamic Bank (“IIB” or “the Bank”) at B- / B (Single B minus / Single B). The assigned international scale ratings take into consideration the sovereign risk profile of the Republic of Iraq (“Iraq” or “the Country”). IIRA has also assigned 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 the ratings is ‘Stable’.

After significant GDP growth in the past two years, economic activity is expected to slowdown relatively in 2023 with reduction in average oil prices, despite the recent rally. Expansionary fiscal stance in the current year may deplete the oil windfall, thereby putting pressure on public finances, however, economic activity may continue to be driven by fiscal stimulus and lead to opportunities for the banking sector. Meanwhile the Federal Reserve has placed a ban on the USD dealings of several Iraqi banks on account of transactions deemed to have violated US sanctions. Currently, of over 70 private banks in the Country, inclusive of the International Islamic Bank, just under a third are subject to restrictive sanctions. These restrictions will decrease business opportunities and adversely impact revenue generation, until resolved.

IIB's financing asset allocation is relatively higher and stands out compared to industry peers; it is set to grow further with business expansion. Investments portfolio is emblematic of both market and liquidity risk. Although credit risk indicators are muted at the moment, recent surge in financing and tighter economic conditions going forward, could lead to some deterioration in asset quality indicators, given also the recently increasing engagement with the risk-prone SME segment. However, the most significant risk to business prospects stems from regulatory restrictions placed on the bank vis-à-vis USD dealings.

Growth of current deposits has been consistent, making up a significant portion of non-shareholder funds, although deposit mix remains concentrated. Liquid reserves are comfortably high in relation to obligations, leaving significant room for business expansion.

The recent accelerated expansion of risk-weighted assets has impacted CAR. With growth likely to moderate, CAR would remain sufficient in the medium term. Management aims to meet the CBI's IQD 400bn new minimum capital requirement through a merger. Future shareholder support is considered uncertain, given a fragmented shareholding structure.

IIB's business model is less reliant on volatile revenue sources relative to domestic peers, with net margin income representing significant portion of total operating income. Stronger business volumes spurred a notable rise in income from financing and investments in 2022. Together with a significant surge in commission income, profits grew substantially even with increased provisioning charges. Net margins benefit from a high level of low-cost deposits. With restrictions to business, profitability trends are likely

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to be adversely affected in the near to medium term. However, potential erosion in earnings is expected to be contained given the relatively higher proportion of income from funded financing exposures.

IIRA has assessed IIB's fiduciary score in the '66 – 70' range, reflecting adequate fiduciary standards, wherein the rights of various stakeholders are considered to be adequately protected. The Bank adheres to CBI's governance standards, but there's room for better alignment with global standards, particularly in terms of independence at the position of Chairman. Upgrade to internal control environment is underway, with enhanced risk and AML tools being deployed. The Sharia governance practices are as per regulatory guidance and local norms, with a need to enhance disclosures. While banks in Iraq are lagging in terms of progress towards sustainable banking, this has not impacted assigned credit ratings in any way.

For further information on this rating announcement, please contact IIRA at [iira@iirating.com](mailto:iira@iirating.com).

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