IIRA Assigns Fiduciary Ratings to Libyan Islamic Bank, as the first bank to be rated in Libya

Manama, January 01, 2024 – Islamic International Rating Agency ("IIRA") has assigned foreign currency and local currency ratings on the international scale as 'B/B' (Single B / Single B) to Libyan Islamic Bank ('LIB' or 'the Bank') and takes into account the sovereign risk profile of Libya. National scale ratings of the Bank have been assessed to be in investment grade at 'BBB (lb) /A3 (lb)' (Triple B (lb) / Single A Three (lb). Outlook on the ratings is 'Stable'.

The Libyan Islamic Bank ('the Bank') is an Islamic financial institution established in 2017 with a capital of 250 million Libyan dinars ('LYD'). The Bank carries out Islamic banking activities on a country-wide basis in Libya ("Libya" or "the country"), in accordance with the provisions of Islamic Shari'a. While Shari'a compliant banking has been legislated for in Libya, the Bank is among the few which have instituted a governance structure conducive to adherence with principles of Shari'a. The network comprised 15 branches at YE2022 with the addition of 5 new branches set up early in the year. In H2'23, and the year 2024, the Bank aims to expand by a further 7 physical and 3 digital branches. Despite a short history of operations, the bank has laid down a modernized strategy for growth and has potential to innovate and lead Islamic banking in the country driven by its financial strength, as the first Islamic bank in Libya.

Broadly in line with sector trends, the balance sheet structure of LIB is dominated by cash holdings, with the share of earning assets, including financings and investment limited to 9.5%, and even lower than 16.6% for the sector as of December 2022. The dominance of cash and cash equivalents is attributed to both the absence of suitable financing opportunities in the country as well as the Bank's short operating history. Total assets retreated by 1.6% YoY to LYD3.1bn in 2022, with decline in deposit funds, followed by recovery post year-end, and with the market share remaining largely range-bound between 2% -2.5%. Non-performing exposures stem mostly from risks built up during the Covid-19 period as per management representation. Netting for provisions held, net non-performing exposures stood at 1.2% of total assets as of June 2023, further down from 1.7% in December 2022.

Libya Islamic Bank's funding base comprises current account deposits and cash margin accounts. While the investment deposit product has not been launched yet, it is expected to be introduced towards the end of the year, with the Bank having been the first to apply for regulatory approval. The deposit base has depicted volatility with decline registered during 2021 and 2022, followed by recovery in H1' 2023, and symptomatic of the Bank's market access being at an early stage of development. On the liquidity front, indicators point to excess buffers reflective of a highly liquid balance sheet.

The paid-up capital of the Bank increased to LYD250mn from LYD100mn in 2022. Meanwhile, the Bank is in the process of further increasing its paid-up capital to LYD500mn in two phases, to be completed by

Q2'24. The total capital adequacy ratio for the Bank stood at 99.6% as of June 2023 marking sizable premium over regulatory thresholds. Current capitalization profile derives strength from the Bank's balance sheet, given the large quantum of liquid assets, and limited deployment in risk assets. However, growth over time may rapidly erode excess buffers. Increased capital requirements and consequent recapitalization in the near-term, may however delay such erosion. A fragmented shareholding structure renders the possibility of external capital support if needed, to be largely uncertain. As such, the bank's progress towards meeting enhanced capital requirements will be monitored.

With relatively low allocation to financings, the Bank's asset allocation translates into low and trending still lower momentum of Islamic financing revenues, with fee & commissions revenues contributing more significantly to operating income. Partly reflecting the sharp depreciation of Libyan Dinar in 2021, fee from international trade operations and forex trading profits supported profitability in the last 2 years. After surging by 186.5% in 2021, net profit declined by 4.2% in 2022, with a particularly sharp decline in H2'2022, to post full year RoAA of 0.8%. In H1'2023, net earnings declined YoY, mainly on account of a significant decline in FCY trading profits, and despite further increase in the net fee & commissions income, yet remaining range bound around full year 2022 RoAA. For the remainder of the year, similar trends in profitability are expected to be observed vis-à-vis H1'23, with moderate increase in the cost base due to new branch openings to be mitigated by modestly higher fee & commission income, allowing for maintained net returns.

IIRA has assessed Libya Islamic Bank's fiduciary score in the range of '61-65' as the first bank to be assessed in Libya, reflecting adequate fiduciary standards, wherein the rights of various stakeholders are sufficiently protected. Libya Islamic Bank's corporate governance practices derive strength from high level of independent representation at the Board level which also reflects onto Board committees and independence of control functions. However, transparency and disclosures are deemed to be limited. Latest initiatives on the social responsibility front included the bank's participation in social and health related causes, and organization of events promoting social connectivity. On the environmental front, the Bank has launched a Murabaha facility to finance installation of solar panels. As yet, there is limited traction on evaluating climate risk posed by customers being financed; however, this has not translated onto the assigned credit ratings in any way. LIB plans to conduct a credit assessment to detect climate change risks. On the Shari'a governance front, the existence of the Central Authority of Shari'a Supervision at Central Bank of Libya and recent regulation for Islamic Banks provide standards for Shari'a compliant operations. Unrestricted investment account deposits have not been launched in the Country yet but are expected to be introduced towards the end of the year and will allow the bank to play a participatory role in a more holistic manner.

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