

Research Update:

Arab Bank for Economic Development in Africa Assigned 'AA/A-1+' Ratings; Outlook Stable

October 4, 2022

Overview

- Arab Bank For Economic Development in Africa (BADEA), a financial institution owned by 18 members of the League of Arab States, provides concessional financing and technical support within Africa to improve economic, financial, and technical cooperation between Arab and Sub-Saharan African (SSA) countries.
- We consider BADEA's enterprise risk profile (ERP) as adequate, underpinned by strong shareholder support and its important policy role, but limited by a small purpose-related lending portfolio and less frequent capital injections by shareholders compared with similar peers.
- We assess the bank's financial risk profile as extremely strong based on a very high risk-adjusted capital (RAC) ratio of 86.1% and very strong liquidity coverage on a six- and 12-month basis.
- We assigned BADEA our 'AA/A-1+' long- and short-term issuer credit ratings.
- The stable outlook is based on our expectation that BADEA will maintain its high RAC and liquidity coverage ratios, and that shareholder support will remain forthcoming.

PRIMARY CREDIT ANALYST

Leon Bezuidenhout
Johannesburg
837975142
leon.bezuidenhout
@spglobal.com

SECONDARY CONTACT

Alexander Ekblom
Stockholm
+ 46 84 40 5911
alexander.ekblom
@spglobal.com

ADDITIONAL CONTACT

Sovereign and IPF EMEA
SOVIPF
@spglobal.com

Rating Action

On Oct. 4, 2022, S&P Global Ratings assigned its 'AA' long-term and 'A-1+' short-term issuer credit ratings to Arab Bank For Economic Development in Africa (BADEA). The outlook is stable.

Outlook

The stable outlook reflects our expectation that BADEA will maintain sound capitalization, as demonstrated in its high risk-adjusted capital (RAC) ratio, and solid liquidity through conservative lending and very low reliance on debt. We expect the bank will continue to fill its policy role as a leading Arab-based institution mandated to support cooperation with Sub-Saharan African (SSA) countries through providing development finance and technical assistance to SSA countries. The

stable outlook also balances our expectation that BADEA's asset quality will remain supported by highly diversified exposures across SSA, against the bank's exposures to relatively low-rated sovereigns in the region.

Downside scenario

We could lower the rating in the next 24 months if we observe signs of a weakening role and public policy mandate, for instance if there is a sustained slowdown in lending.

We could also lower the ratings if asset quality or liquidity ratios deteriorate. This could stem from greater financial risk in less-creditworthy sovereigns to which BADEA is exposed, indicating a weakening in the bank's preferred creditor treatment (PCT).

Upside scenario

We believe there is a low likelihood of an upgrade over the next two years. However, ratings upside could arise from an improvement in BADEA's public policy importance, together with strengthening risk management and governance, for instance through a substantial increase in lending to SSA countries accompanied by resilience in capital and liquidity buffers.

Rationale

BADEA was established in 1974 by treaty and is owned by 18 members of the League of Arab States (LAS). The institution enjoys privileges given to multilateral lending institutions (MLIs), such as exemptions from taxes, appropriations, moratoriums, and foreign exchange controls. The bank's objective is to provide concessional financing and technical assistance to SSA countries to foster economic development and to enhance relations between the LAS and SSA.

Our ratings on BADEA reflect our assessment of its enterprise risk profile as adequate and its financial risk profile as extremely strong. The bank's balance sheet is split, with 60% of its assets held in liquid Organisation for Economic Co-operation and Development (OECD) securities (majority fixed income and to a lesser extent in listed equity). The remaining 40% comprises purpose-related loans into SSA. BADEA is almost solely focused on lending to SSA sovereigns, government-related entities, and multilateral development banks, and it has minimal private sector exposure. Furthermore, BADEA provides finance through trade facilities.

BADEA plays an important role as the leading Arab institution focused on African lending and engagement. There is significant coordination between BADEA, Arab states, and Arab funds, with BADEA taking the leading role as a financier into Africa. While BADEA's lending activities into Africa have been small (\$4.4 billion in cumulative disbursements over 48 years), there is significant co-financing with Arab states and funds, as well as other MLIs (including the African Development Bank and World Bank Group). Therefore, BADEA has a larger overall impact in terms of lending into Africa, and the institution plans to increase its purpose-related lending portfolio to 50% of assets, although this will be a gradual and incremental process. Nevertheless, BADEA's lending activities are small compared with the funding needs in Africa, and BADEA maintains a conservative approach to lending.

BADEA has a strong relationship with its shareholders, and it is viewed as a critical institution in advancing SSA developmental finance and as a vehicle to further improve international relations. Shareholders have been supportive, most recently in April 2022 when they increased BADEA's capital base to \$5 billion paid in capital from \$91 million in 1975. Also in April 2022, callable

capital worth \$5 billion was added. That said, we do not consider this as eligible callable capital, as per our rating approach, because all shareholders are rated below our 'aa' assessment of BADEA's stand-alone credit profile. No shareholders have withdrawn from BADEA since its inception.

We assess the bank's PCT as strong, underpinned by an arrears ratio of 2.68%. Although BADEA participated in the World Bank's Debt Initiative for Highly Indebted Poor Countries (HIPC), it did not allow any reprofiling or debt service suspension under the G20's Debt Service Suspension Initiative or the G20's Common Framework for restructuring. Although BADEA has improved arrears management since 2016 and its nonperforming loan ratio currently stands at 0.7%, significant exposure to low-rated SSA sovereigns exposes the bank to potential deterioration in its arrears ratio. Since the bank's inception, however, no credit losses or loans have been written off. Occasional technical arrears occur due to administrative challenges in SSA sovereigns. But, since the implementation of stricter arrears management policies in 2016, all such arrears are generally resolved before becoming material or above 180 days.

We assess BADEA's governance and management as adequate. The bank has a relatively diverse shareholding structure, with no controlling majority by any individual sovereign. Shareholders are not beneficiaries of lending from BADEA, and there is no private shareholding. Additionally, shareholders allow all earnings to be retained. Governance standards are strong, given well-established management practices that ensure stability in shareholding as well as in BADEA's operations. The bank is susceptible to operational risk, due to Khartoum, Sudan being its main site of operations. These risks are somewhat mitigated by business continuity plans, secondary offices in Egypt, and plans to digitalize key operations.

The bank employs financial and risk management policies that are in line with global practices. However, the bank has a relatively short track record utilizing its risk management frameworks since significant improvements were made in 2016 only. Prior to those improvements, arrears occurred more frequently. Nevertheless, BADEA could effectively withstand loss of key personnel, and there is a long track record of stable and conservative management within the organization.

BADEA's financial risk profile is extremely strong, driven by one of the highest RAC ratios among all MLIs rated by S&P Global Ratings. The RAC ratio after adjustments was 86.1% using data from end-2021 and parameters as of Aug. 1, 2022. The ratio benefits from a sizable securities portfolio of \$3.4 billion, comprising \$1.8 billion in fixed income securities, \$700 million in listed equities, \$400 million in cash, and \$400 million in other instruments (such as sukuk). The ratio is also supported by geographic diversification and preferential treatment from sovereigns. We believe the RAC ratio will remain high over the next 24 months.

The bank's funding profile is entirely dependent on its shareholders' equity. The bank does not borrow from the capital markets currently, although it is looking to do so in the future. We understand that BADEA is unlikely to materially change its funding profile in favor of debt financing and that borrowing will likely be done on a small scale and incrementally.

Our calculations for liquidity ratios as of end-2021 show very strong coverage ratios of 4.7x for the six-month and 2.9x for the 12-month periods. These are above the coverage ratios of similarly rated peers and allows BADEA to potentially accelerate disbursements. This reflects BADEA's sizable and highly liquid asset portfolio.

Ratings Score Snapshot

Issuer Credit Rating

AA/Stable/A-1+

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| | |
|----------------------------|------------------|
| Stand-alone credit profile | aa |
| Enterprise risk profile | Adequate |
| Policy importance | Adequate |
| Governance and management | Adequate |
| Financial risk profile | Extremely strong |
| Capital adequacy | Extremely strong |
| Funding and liquidity | Strong |
| Extraordinary support | 0 |
| Callable capital | 0 |
| Group support | 0 |
| Holistic approach | 0 |

Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Jan. 31, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Abridged Supranationals Interim Edition 2022: Comparative Data For Multilateral Lending, May 27, 2022
- How The Russia-Ukraine Conflict May Affect Multilateral Lenders, June 16, 2022
- Introduction To Supranationals Special Edition 2021, Oct. 27, 2021
- ESG Industry Report Card: Supranationals, Feb. 11, 2020

Ratings List

New Rating

Arab Bank for Economic Development in Africa

Issuer Credit Rating

Foreign Currency AA/Stable/A-1+

Regulatory Disclosures

- Primary credit analyst: Leon Bezuidenhout, Associate Director
- Rating committee chairperson: Alexis Smith-Juvelis
- Date initial rating assigned: Oct. 4, 2022
- Date of previous review: N/A

Disclaimers

This rating has been determined by a rating committee based solely on the committee's independent evaluation of the credit risks and merits of the issuer or issue being rated in accordance with S&P Global Ratings published criteria and no part of this rating was influenced by any other business activities of S&P Global Ratings.

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Materials Used In The Credit Rating Process: Sufficient information in general consists of both (i) financial statements that describe the Issuer's financial condition, results of operations and cash-flows, and (ii) a description of the activities and obligations of the entity including of its governance and legal structure.

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Glossary

- Adjusted assets: Total assets less nonservicing intangibles.
- Adjusted common equity: Common shareholders' equity plus minority interest, minus dividends (not yet distributed), minus revaluation reserves, minus nonservicing intangibles, minus interest only strips, minus tax-loss carry forwards, minus postretirement benefit adjustments.

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- Asset-liability mismatch: Occurs when financial terms of an institution's assets and liabilities do not correspond.
- Asset quality: A key measure of the quality and performance of the assets of an MLI.
- Arrears: Exposures (typically a loan or a claim for insurance or sovereign guarantees provided to an MLI) in which either interest or principal is overdue beyond 180 days. Cross-default is assumed, meaning that the full amount of outstanding exposure is considered overdue and not only the payable share.
- Callable capital: The portion of an MLI's capital subscriptions that is not "paid-in" but that each shareholder has committed to provide in certain circumstances (generally, only to prevent a default on an MLI's debt).
- Capital and earnings: A measure of an MLI's ability to absorb losses.
- Cost of funds: Interest expense as a percentage of average interest-bearing liabilities.
- Credit losses: Losses arising from credit risk.
- Credit risk: Risk that a borrower will default on its payment obligations.
- Date initial rating assigned: The date S&P Global Ratings assigned the long-term foreign currency issuer credit rating on the entity.
- Date of previous review: The date S&P Global Ratings last reviewed the credit rating on the entity.
- Enterprise risk profile: The strength of an MLI's business operations in relation to the rest of the MLI sector globally. This assessment is informed by S&P Global Ratings' view of an MLI's policy importance and governance and management expertise.
- Extraordinary support: The likelihood that an MLI would receive extraordinary shareholder support to service its debt obligations if needed, typically in the form of an injection of callable capital, and less often in the form of guarantees or other types of support.
- Financial risk profile: This includes S&P Global Ratings' assessment of the MLI's capital adequacy and its funding and liquidity.
- Funding and liquidity: A combined assessment of the strength and stability of an MLI's funding mix and its ability to manage its liquidity needs in adverse market and economic conditions over an extended period.
- Governance and management expertise: A qualitative assessment of an MLI's bylaws, internal governance rules, strategy, and risk management policies. An MLI's governance and strategy is assessed in the context of its public mission, which is typically to foster economic development and integration.
- Group support: An assessment of whether an MLI is a subsidiary of a group.
- High risk exposure cap (HREC): Adjustment to S&P Global Ratings' RAC framework by capping the risk weight so that the capital allocated to such exposures (for example, private equity) does not exceed the exposed amount.
- Holistic analysis: Recognizes S&P Global Ratings' forward-looking view of sustained, predictable operating and financial underperformance or outperformance and helps capture a more comprehensive analysis of creditworthiness.
- Issuer credit rating: A forward-looking opinion about an obligor's overall creditworthiness.
- MLI adjustments: Include several amendments to the risk capital framework used for financial

institutions, such as concentration, preferred creditor treatment, and sector and geographic profile.

- Preferred creditor treatment: A discretionary status that borrowing member countries afford to an MLI, under which MLIs are generally given priority for repayment of debt in the event of financial distress. Factored into various places under both enterprise risk profile and financial risk profile.
- Policy importance: Our view of the importance of an MLI's mandate and of its public policy role for the institution's shareholders and members.
- Purpose related loan: Loans which fall under an MLI's mandate and policy objectives.
- Risk position: S&P Global Ratings' view of the specific risk characteristics of a particular MLI.
- Risk-adjusted capital (RAC) ratio before diversification: This is calculated according to S&P Global Ratings' methodology as total adjusted capital over risk-adjusted assets.
- Role and public policy mandate: The extent to which an MLI's role can be, or is performed by other institutions and its track record of implementing its public policy mandate throughout the credit cycle.
- Single-name concentration. S&P Global Ratings applies a single-name concentration charge (for sovereigns) in its risk-adjusted capital calculation as MLIs are significantly more concentrated than commercial banks in terms of number and size of exposures.
- Stand-alone credit profile (SACP): An interim step in assessing an MLI's overall creditworthiness. It includes the enterprise risk profile and the financial risk profile together with a cap if liquidity is assessed at weak or very weak.
- Total adjusted capital (TAC): Adjusted common equity plus admissible preferred instruments and hybrids.

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