FitchRatings

15 May 2019 | Affirmation

Fitch Affirms BOAD's IDR at 'BBB'; Outlook Stable

Fitch Ratings-Paris/London-15 May 2019: Fitch Ratings has affirmed Banque Ouest Africaine de Developpement (BOAD)'s Long-Term Issuer Default Rating (IDR) at 'BBB' with a Stable Outlook.

A full list of rating actions is at the end of this Rating Action Commentary.

KEY RATING DRIVERS

BOAD's ratings are driven by extraordinary support from its shareholders, assessed at 'bbb'. Fitch assesses shareholders' capacity to support at 'bbb-' taking into account the support of the bank's key shareholders: the regional central bank (Banque Centrale des Etats de l'Afrique de l'Ouest, BCEAO, 47% of capital) and Cote d'Ivoire ('B+', 6% of capital). The ability of the BCEAO to tap the fiscal resources that it manages on behalf of the regional member states (RMS) to secure payments of capital translates into an 'exceptional' propensity of shareholders to support and a one-notch uplift over the capacity to support to 'bbb', for the overall support assessment.

The bank's intrinsic assessment is 'bb+', based on its solvency assessment of 'bbb+' and a three-notch negative adjustment resulting from the 'high-risk' business environment in which the bank operates. The bank's solvency assessment of 'bbb+' is unchanged from the previous review. However, this is now derived from the combination of a 'strong' capitalisation assessment and a 'moderate' risk profile, both of which have changed from the previous review, when capitalisation was deemed 'excellent' and the risk profile was assessed as 'high'.

The revision of the overall capitalisation assessment to 'strong' from 'excellent' primarily reflects Fitch's more conservative forecast for internal capital generation as the introduction of IFRS 9 accounting standards, based on expected loss, will lead to higher provisions, thereby weakening capital generation. This also factors in a temporary deterioration in the equity/assets ratio below 25% in 2020 as the bank is set to issue a new Eurobond to comply with its liquidity policy after the repayment of the 2021 Eurobond (USD750 million). A plan to accelerate paid-in capital payments in 2020 has been agreed by the Council of Ministers. However, as the modalities of capital payments still need to be defined, Fitch does not factor this acceleration into its forecast. Fitch assumes regular paid-in capital payments from RMS and annual loan growth of 8% in its forecasts. This is consistent with an equity/assets ratio recovering to slightly above 25% by 2021 after the projected dip in 2020.

The improvement in the overall risk assessment to 'moderate' from 'high' reflects the upgrade in the bank's risk reporting framework as a result of the new provisioning approach and the strengthening of the bank's internal ratings framework.

Fitch assesses credit risk as 'moderate', an improvement from the 'high' assessment at the previous review. The improvement reflects an upgrade by one notch in Fitch's assessment of the average rating of loans and guarantees of the bank to 'B' from 'B-'. This follows the strengthening of the bank's internal risk ratings framework that the agency uses as an input for assessing non-sovereign credit risk. The bank's Preferred Creditor Status is considered 'strong', leading to a two-notch uplift to the average rating of loans, to 'BB-'.

Following the adoption of IFRS 9 accounting standards in 2018, loan loss reserves are now computed based on expected credit loss (as opposed to incurred loss before IFRS 9 adoption). Total loan loss reserves were XOF53.6 billion at end-2018, up from XOF28.1 billion at end-2017 (an increase of 91%). Non-performing loans (NPLs) were 2.2% of total gross loans at end-2018 and all concentrated in the private sector (NPLs were 6.7% of private sector loans). The bank's record of NPLs has been consistent and we expect NPLs to remain slightly above 2% of total loans by 2021.

The risk management framework is 'moderately' conservative. BOAD's outstanding debt is limited to 3x its equity (241% at end 2018). The liquidity management framework foresees that liquid assets must cover between 9 and 12 months of net cash outflows. At least 25% of treasury assets must be invested at the central bank. The bank does not hold highly rated (AAA-AA) treasury assets. Ongoing work on a risk appetite framework and the computation of economic capital could support further strengthening of the risk management function.

The 'moderate' risk assessment also takes into account the 'moderate' concentration risk, with the bank's top five largest exposures accounting for 44% of total exposures in 2018. All the bank's assets are denominated in CFA francs and the bank hedges its USD/XOF exchange rate risk (arising from its two US dollar Eurobond issuances) with cross-currency swaps. Equity participation increased to 4.7% of total banking exposure (TBE) in 2018 from 4.5% in 2017, largely as a result of fair value gains. Fitch expects it will remain limited and close to 5% of TBE by 2021.

Fitch assesses the bank's liquidity at 'a'. The assessment takes into account the 'strong' coverage of short-term debt by liquid assets, expected to remain between 100% and 150% over the forecast horizon. To compute the liquidity ratio, Fitch only considers as liquid the deposits held at the central bank (27% of treasury assets at end-2018) and regional sovereign debt securities (42% of treasury assets) to which it applies a 10% discount reflecting the hair-cut that the central bank would apply to refinance these assets. The remaining treasury assets (30%) are placements in non-rated regional banks that Fitch does not consider as liquid assets.

The liquidity assessment also takes into account BOAD's access to the regional central bank's refinancing window. The bank is a benchmark issuer in the regional capital market. It had access to international capital markets in 2016 (USD750 million) and 2017 (USD850 million) and is expecting further Eurobond issues in the coming years. It is also considering a programme to access the short-term money market in France.

At end-2020, short-term liabilities will increase significantly due to the USD750 million Eurobond maturing in 2021. The bank expects to issue a Eurobond in 2020 to refinance the 2021 maturity. It has also started to build an internal sinking fund, although its size is modest (with payments of XOF15 billion, or USD26 million, per year from 2018).

BOAD's 'high risk' business environment primarily reflects the low income and high political risks in the countries in which the bank operates, including Togo where the bank's headquarters is located. The assessment also takes into account the exposure to non-sovereign risk (40% of TBE at end-2018), high lending growth targets, the relatively small size of the bank and the importance of its public mandate as one of the main providers of funds to entities in the region.

The Short-Term rating of 'F2' is the higher option at the 'BBB' cusp point on Fitch's long-term rating correspondence table. The choice of the higher option results from the bank's liquidity assessment of 'a', which is higher than the level equivalent to the minimum long-term rating (BBB+) at which the higher Short-Term rating (F2) would always apply.

RATING SENSITIVITIES
The main factor that could trigger a positive rating action is:
- An improvement in BOAD's 'bbb' support rating, which would stem from an improvement in the credit quality of BOAD's key shareholders.

The main factors that could, individually or collectively, trigger a negative rating action are:

-Weakening in the support assessment, which would stem from deterioration in the credit quality of BOAD's main shareholders;

- A marked deterioration in BOAD's solvency assessment, potentially stemming from higher-than-expected lending growth, which would affect the bank's capitalisation, a deterioration in the bank's credit risk profile or a softening of its prudential rules, which could lead to a deterioration in the intrinsic assessment by two notches or more;

- A material deterioration in Fitch's liquidity assessment, which could result from a weakening in the coverage of short-term debt by liquid assets over the medium term, which in turn would lead to a weakening of the intrinsic assessment.

KEY ASSUMPTIONS

Fitch assumes that the monetary arrangement between France and the franc zone will remain in place and that the French treasury would honour its commitment to provide euro liquidity to the central bank, if needed. The agency further assumes that the exchange rate between the euro and the CFA franc will remain unchanged, at EUR1/XOF656.

The full list of rating actions is as follows:

Long-Term IDR affirmed at 'BBB'; Outlook Stable
Short-Term IDR affirmed at 'F2'
Issue ratings on long-term senior unsecured bonds affirmed at 'BBB'

Contact:

Primary Analyst
Arnaud Louis
Senior Director
+33 1 44 29 91 42
Fitch France S.A.S.
60 rue de Monceau
75008 Paris

Secondary Analyst
Khamro Ruziev
Associate Director
+44 20 3530 1813

Committee Chairperson
Tony Stringer
Managing Director
+44 20 3530 1219

Media Relations: Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email: peter.fitzpatrick@thefitchgroup.com

Additional information is available on www.fitchratings.com

Applicable Criteria

Short-Term Ratings Criteria (pub. 02 May 2019)

Supranationals Rating Criteria (pub. 24 May 2018)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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