

Bank of Bahrain and Kuwait B.S.C.

Key Rating Drivers

Standalone Profile Drives IDRs: Bank of Bahrain and Kuwait's (BBK) Issuer Default Ratings (IDRs) are driven by its standalone creditworthiness, as expressed by its Viability Rating (VR). BBK is an important retail bank in Bahrain with significant exposure to the sovereign and to the domestic operating environment, and its VR is capped by the Bahraini operating environment and by the sovereign rating.

The VR considers BBK's concentration of operations in the challenging operating environment in Bahrain, the weakening of the bank's asset quality, a strong domestic franchise, moderate profitability, as well as adequate capital, liquidity and funding.

Strong Domestic Franchise: BBK has a well-entrenched domestic retail and corporate banking franchise and is defined as a systematically important bank by the Central Bank of Bahrain.

Asset Quality to Weaken: BBK's impaired loans ratio increased slightly to 6.0% at end-9M20 from 5.9% at end-2019, mainly due to a 5% contraction in the loan book. Regulators in Bahrain mandated banks to defer loan payments for six months until September 2020 due to the impact of the pandemic. When payment holidays expire, we expect BBK's asset quality metrics to deteriorate as impairments rise, similar to peers.

Limited Exposure to Directly Impacted Sectors: BBK has limited exposure to sectors directly affected by the pandemic such as tourism and hotels. The bank has some concentration in its loan book and is exposed to a certain amount of large-scale project finance lending. BBK has limited exposure to mortgage loans but a high share of consumer loans that are mainly extended to payroll customers, which mitigates risks.

Adequate Capitalisation: Fitch Ratings deems BBK's capital ratios adequate for the weakening operating environment and potential asset quality problems. Its reported common equity Tier 1 (CET1) ratio was 18.8% at end-9M20, slightly down on end-2019. The bank's capital ratios were hit by marked-to-market securities losses in 9M20 (BHD53 million loss or about minus 200bp of CET1 ratio), and as a result the equity/assets ratio fell to 12.4% at end-9M20 from 14.1% at end-2019.

Decline in Profitability: BBK's profitability metrics weakened in 9M20 due to contracting margins in a lower interest-rate environment. Profitability could weaken further as the bank increases provisions for inflated risks after the end of payment holidays, similar to peers.

Comfortable Funding and Liquidity: The bank has comfortable funding and liquidity metrics. It is largely funded by customer deposits and its loans to deposit ratio was only 81% at end-9M20 but the deposit base is concentrated. The bank's main wholesale funding consists of deposit from banks, repo facilities and bond issuance. Our base-case expectation is that the currency peg remains intact and large deposits remain stable.

Rating Sensitivities

Downside Potential: BBK's Long-Term IDR would be downgraded if the bank's VR is downgraded. This would most likely result from a sovereign downgrade. Downside risk to BBK's VR may also arise from the impact of the pandemic on asset quality, earnings and capitalisation.

Upside Potential: An upgrade of the VR and IDR would require an upgrade of the sovereign rating.

Ratings

Foreign Currency	
Long-Term IDR	B+
Short-Term IDR	B

Viability Rating b+

Support Rating	4
Support Rating Floor	B

Sovereign Risk

Long-Term Foreign-Currency IDR	B+
Long-Term Local-Currency IDR	B+
Country Ceiling	

Outlooks

Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

[Bank Rating Criteria \(February 2020\)](#)

Related Research

[Global Economic Outlook \(December 2020\)](#)

[Fitch Downgrades Bank of Bahrain and Kuwait to 'B+'; Outlook Stable \(September 2020\)](#)

[Fitch Downgrades Bahrain to 'B+'; Outlook Stable \(August 2020\)](#)

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Ratings Navigator

Bank of Bahrain and Kuwait B.S.C.



Ratings

	Peer Ratings	Operating Environment	Company Profile	Management & Strategy	Risk Appetite	Asset Quality	Earnings & Profitability	Capitalisation & Leverage	Funding & Liquidity	Viability Rating	Support Rating Floor
aaa										aaa	AAA
aa+										aa+	AA+
aa										aa	AA
aa-										aa-	AA-
a+										a+	A+
a										a	A
a-										a-	A-
bbb+										bbb+	BBB+
bbb										bbb	BBB
bbb-										bbb-	BBB-
bb+										bb+	BB+
bb										bb	BB
bb-										bb-	BB-
b+										b+	B+
b										b	B
b-										b-	B-
ccc+										ccc+	CCC+
ccc										ccc	CCC
ccc-										ccc-	CCC-
cc										cc	CC
c										c	C
f										f	NF

Sovereign Support Assessment

Limited Probability of Sovereign Support; Willingness Remains High

Fitch believes the Bahraini authorities' willingness to support domestic commercial banks remains high in order to maintain market confidence in a market where contagion risk is high, and because these banks support economic growth. However, weak reserves and increasing indebtedness reduce the sovereign's financial flexibility to provide support, notably in foreign currency. This leads to a Support Rating Floor (SRF) of 'B' for domestic systemically important banks (D-SIB) in Bahrain, one notch below the typical D-SIB SRF for a 'B+' sovereign rating.

Fitch views BBK as a D-SIB and therefore its SRF is in line with the Bahraini D-SIB SRF. In addition, the Bahraini government has a 33% stake in BBK via its social insurance organisation, which adds to Fitch's view on the sovereign's propensity to provide support to BBK.

Bar Chart Legend

Vertical bars - VR range of Rating Factor
 Bar Colors - Influence on final VR
 ■ Higher influence
 ■ Moderate influence
 ■ Lower influence

Bar Arrows - Rating Factor Outlook
 ↑ Positive ↓ Negative
 ⇕ Evolving □ Stable

Support Rating Floor		Value		
Typical D-SIB SRF for sovereign's rating level (assuming high propensity)		B+		
Actual country D-SIB SRF		B		
Support Rating Floor:		B		
Support Factors	Positive	Neutral	Negative	
Sovereign ability to support system				
Size of banking system relative to economy			✓	
Size of potential problem			✓	
Structure of banking system		✓		
Liability structure of banking system			✓	
Sovereign financial flexibility (for rating level)			✓	
Sovereign propensity to support system				
Resolution legislation with senior debt bail-in			✓	
Track record of banking sector support		✓		
Government statements of support	✓			
Sovereign propensity to support bank				
Systemic importance		✓		
Liability structure of bank		✓		
Ownership	✓			
Specifics of bank failure		✓		
Policy banks				
Policy role				
Funding guarantees and legal status				
Government ownership				

Significant Changes

Deterioration in the Operating Environment Following the Sovereign Downgrade

Fitch downgraded the operating environment for banks to 'b+' from 'bb-' with Stable Outlook in September 2020, reflecting our expectation of a deterioration in operating conditions due to the pandemic following the downgrade of Bahrain's IDR to 'B+' from 'BB-'. The downgrade reflects the combined impact of lower oil prices and the coronavirus pandemic on Bahrain, which is causing marked increases in the budget deficit and government debt, pressure on already low FX reserves and sharp GDP contraction.

Fitch forecasts real GDP to contract 5.8% in 2020 and recovery of 4.7% in 2021. The main concern with a contraction in GDP is low reserves and increasing debt, which should be viewed in the context of low oil prices and a high break-even oil price.

The performance of the Bahraini banks has deteriorated, although the impact of the pandemic on financial metrics is still not clear due to forbearance measures. As a result of the pandemic the Central Bank of Bahrain supported the banks through repo facilities when volatility was high, mainly in March and April. During the pandemic, there was no full lockdown in Bahrain: the banks continued their operations and branches mainly remained open.

Navigator Peer Comparison

Peer Group Summary

Bahraini Domestic Banks	Operating Environment		Company Profile		Management & Strategy		Risk Appetite		Asset Quality		Earnings & Profitability		Capitalisation & Leverage		Funding & Liquidity		Viability Rating
Bank of Bahrain and Kuwait B.S.C.	b+	■	b+	■	bb-	■	b+	■	b+	▼	b+	■	b+	■	b+	■	b+
National Bank of Bahrain BSC	b+	■	b+	■	bb-	■	b+	■	b+	▼	b+	■	b+	■	b+	■	b+

Source: Fitch Ratings

Company Summary and Key Qualitative Assessment Factors

One of the Leading Retail Banks, Domestic Focus

BBK is listed on the Bahrain stock exchange and 52% of the bank's shares are owned by arms of the Bahraini and Kuwaiti governments. Bahrain's Social Insurance Organization (a longstanding shareholder in the bank) holds a 33% stake and the Kuwait Investment Authority holds a 19% stake.

BBK has a good franchise in Bahrain and had a market share of about 11% total retail banks' assets at end-9M20. However, it is reliant on a small and competitive domestic operating environment. BBK has a well-entrenched domestic retail and corporate banking franchise.

BBK offers retail and corporate services, project finance, investment products and treasury services but the business model is more focused on corporates. Corporate and commercial loans comprise about 65% of the loan book and the remaining (i.e. retail lending) mainly consists of consumer loans (24% of the loan book at end-1H20).

BBK's operations are concentrated mainly in Bahrain (81% of total loans), with the remaining split mainly between Dubai (2%), Kuwait (4%), India (6%), Turkey (4%) and CrediMax (3%). Fitch does not believe international activities will become a major contributor to BBK's balance sheet.

BBK has two fully-owned subsidiaries that are consolidated, CrediMax B.S.C., which does credit card operations, and Invita Company, which provides business process outsourcing services.

Good Management with Cautious Growth Strategy

Fitch believes BBK has a good management team that is adequate for its risk profile, and has a good knowledge of the domestic market. A new Group Chief Executive was appointed in 2020, having previously held the position of deputy Chief Executive. There was also some restructuring of some executive management roles, some divisions and some reporting hierarchy in 1H20.

BBK remains focused on the domestic market and its main objective is to solidify its position and market shares in Bahrain. BBK is investing continuously in upgrading and digitalising its distribution channels. BBK's ultimate aim is to strengthen its core activities and adapt new Fintech innovations. The main strategic directions of the new strategy are to revitalise international operations, improve digital banking, expand the retail products offerings and grow the corporate banking business cautiously.

Exposures to Cyclical Sector

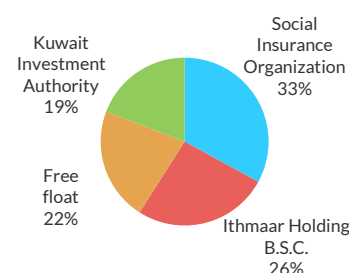
BBK is a cautious lender/investor and has relatively conservative underwriting standards. Risk management practices are adequate and commensurate with the bank's risk profile. Credit risk is the largest source of risk, constituting about 88% of the bank's total RWAs. Exposure to the real estate and construction sector was 11% of the loan book at end-1H20. Loans to the construction sector are typically to local contractors with links to infrastructure projects, often government-related and the bank has limited exposure to commercial real estate.

BBK's exposures to sectors directly affected by the pandemic such as tourism and hotels are small. The bank has some concentration in its loan book and is exposed to some large project-finance lending. BBK has limited exposure to mortgage loans but a high share of consumer loans; the latter are mainly extended to payroll customers, which mitigates risks. The bank's 10 largest performing loan exposures amounted to 64% of total equity at end-1H20, or 16% of total loans.

BBK has a sizeable investment portfolio (34% of total assets or 3x equity) and exposures to non-investment grade fixed-income securities (excluding Bahrain and mainly to sovereign or quasi sovereign) equal about 40% of equity, which we consider a potential vulnerability.

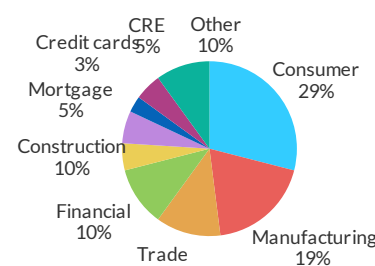
BBK's exposure to market risk is mainly interest rate; due to volatility in the market, the bank recorded BHD75 million change in fair value of investments in 1H20. Foreign currency net exposures, arising from the bank's long position in USD, represents a high 21% of total regulatory capital, but it is mitigated by the long-standing BHD/USD peg. Exposures to other single currencies are trivial.

Shareholder Structure



Source: Fitch Ratings, BBK

Exposures



Source: Fitch Ratings, BBK

Summary Financials and Key Ratios

	30 Jun 20		31 Dec 19	31 Dec 18
	6 months - interim	6 months - interim	Year end	Year end
	(USDm) Reviewed - unqualified	(BHDm) Reviewed - unqualified	(BHDm) Audited - unqualified	(BHDm) Audited - unqualified
Summary income statement				
Net interest and dividend income	114	42.9	111.2	116.1
Net fees and commissions	26	9.9	26.6	28.2
Other operating income	30	11.3	20.5	16.8
Total operating income	170	64.1	158.3	161.1
Operating costs	82	30.7	63.2	57.7
Pre-impairment operating profit	89	33.4	95.1	103.4
Loan and other impairment charges	11	4.3	18.9	35.3
Operating profit	77	29.1	76.2	68.1
Other non-operating items (net)	n.a.	n.a.	n.a.	n.a.
Tax	-1	-0.4	0.2	0.4
Net income	78	29.5	76.0	67.7
Other comprehensive income	-205	-77.0	33.9	-19.7
Fitch comprehensive income	-126	-47.5	109.9	48.0
Summary balance sheet				
Assets				
Gross loans	4,551	1,711.2	1,774.2	1,896.6
- Of which impaired	285	107.2	104.3	150.8
Loan loss allowances	288	108.4	103.3	124.1
Net loans	4,263	1,602.8	1,670.9	1,772.5
Interbank	1,195	449.3	278.3	239.2
Derivatives	4	1.5	1.3	11.3
Other securities and earning assets	3,830	1,440.1	1,430.0	1,273.5
Total earning assets	9,292	3,493.7	3,380.5	3,296.5
Cash and due from banks	1,134	426.4	376.4	191.1
Other assets	300	112.8	108.1	94.1
Total assets	10,726	4,032.9	3,865.0	3,581.7
Liabilities				
Customer deposits	6,321	2,376.7	2,169.5	2,374.5
Interbank and other short-term funding	2,241	842.5	676.5	457.7
Other long-term funding	501	188.5	333.0	144.5
Trading liabilities and derivatives	199	75.0	27.0	4.8
Total funding	9,263	3,482.7	3,206.0	2,981.5
Other liabilities	288	108.2	112.0	99.8
Preference shares and hybrid capital	n.a.	n.a.	n.a.	86.1
Total equity	1,176	442.0	547.0	414.3
Total liabilities and equity	10,726	4,032.9	3,865.0	3,581.7
Exchange rate		USD1 = BHD0.376	USD1 = BHD0.376	USD1 = BHD0.376

Source: Fitch Ratings, Fitch Solutions, BBK

Summary Financials and Key Ratios

	30 Jun 20	31 Dec 19	31 Dec 18
Ratios (annualised as appropriate)			
Profitability			
Operating profit/risk-weighted assets	2.3	2.9	2.6
Net interest income/average earning assets	2.5	3.4	3.6
Non-interest expense/gross revenue	49.8	41.7	36.8
Net income/average equity	12.0	16.1	16.8
Asset quality			
Impaired loans ratio	6.3	5.9	8.0
Growth in gross loans	-3.6	-6.5	2.4
Loan loss allowances/impaired loans	101.1	99.0	82.3
Loan impairment charges/average gross loans	0.6	0.9	1.8
Capitalisation			
Common equity Tier 1 ratio	17.5	20.6	15.2
Fully loaded common equity Tier 1 ratio	n.a.	n.a.	n.a.
Fitch Core Capital ratio	n.a.	n.a.	15.5
Tangible common equity/tangible assets	11.0	14.1	11.5
Basel leverage ratio	10.3	n.a.	n.a.
Net impaired loans/common equity Tier 1	-0.3	0.2	6.6
Net impaired loans/Fitch Core Capital	n.a.	n.a.	6.5
Funding and liquidity			
Loans/customer deposits	72.0	81.8	79.9
Liquidity coverage ratio	396.3	361.1	n.a.
Customer deposits/funding	69.7	68.2	77.5
Net stable funding ratio	130.8	128.7	n.a.

Source: Fitch Ratings, Fitch Solutions, BBK

Key Financial Metrics – Latest Developments

Expected Deterioration in Asset Quality Due to Pandemic

BBK's impaired loans ratio increased slightly to 6.0% at end-9M20 from 5.9% at end-2019, mainly due to a 5% contraction in the loan book. Regulators in Bahrain mandated banks to defer loan payments for six-months until September 2020 due to the impact of the pandemic. Total exposure value of BHD788.8 million (47% of gross loans) is deferred, in line with the regulatory forbearance measures. When payment holidays expire, we expect BBK's asset quality metrics to deteriorate as impairments rise, similar to peers.

Reported Stage 2 exposures were a high 16% of gross loans at end-9M20, suggesting the potential for an increase in non-performing loans (NPLs) given pressures on the operating environment. BBK has increased its total reserve coverage to an adequate 105% of impaired loans at end-9M20 (99% at end-2019). Coverage of Stage 3 and Stage 2 loans were 75% and 9% at-end-9M20, respectively.

The largest contributors to impaired loans are the trading and manufacturing sectors (47% of total impaired loans at end-9M20), as well as the construction and real estate sectors (16%).

Low Rate Environment Weakened Profitability

BBK's profitability metrics weakened in 9M20 due to declining margins in a lower interest-rate environment (NIM narrowed to 2.5% in 9M20 from 3.4% in 2019). The contribution from fee income also declined due to the impact of pandemic and new regulations on capping fees and charges. Profitability could weaken further as the bank increases provisions for inflated risks after the end of payment holidays, similar to peers.

Adequate Capitalisation

Fitch deems BBK's capital ratios adequate for the weakening operating environment and potential asset-quality problems. Its reported CET1 ratio was 18.8% at end-9M20, slightly down on end-2019. The bank's capital ratios were hit by marked-to-market securities losses in 9M20 (BHD53million loss or about minus 200bp of CET1 ratio), and as a result the equity/assets ratio fell to 12.4% at end-1H20 from 14.1% at end-2019. However, these losses have since been reversed.

The bank's capital ratios benefit from a 0% risk weighting on sovereign securities and some government-related project-finance, similar to other banks in Bahrain. The total capital adequacy ratio (CAR) was 19.9% at end-9M20, comfortably above the 12.5% minimum regulatory requirement. Pre-impairment operating profit of 3.5% of average gross loans in 9M20 (annualised) still provides a good buffer against unexpected losses. BBK's capital buffers remain exposed to high event risk in a weakened operating environment.

Stable Funding and Liquidity

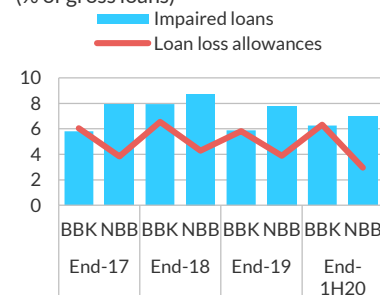
BBK is largely funded by customer deposits, which represented 67% of non-equity funding at end-9M20. The Fitch-calculated gross loans-to-deposits ratio remained flat at 81% at end-9M20. The bank's deposits contracted by a significant 13% in 3Q20 as the bank did not roll-over some high cost fixed rate deposits. The deposit base includes some large deposits. These are mainly from Kuwaiti and Bahraini government-related entities given the bank's ownership and are believed to be stable. Excluding shareholder deposits, the concentration ratio decreases to a more reasonable level.

At end-9M20, retail deposits formed around 41% of the customer deposit base and the remainder was split between corporates (33%), international banking (4%) and foreign operations. A majority (79%) of the bank's customer deposits are in Bahrain and the remainder is split between Kuwait (16%) and India (5%).

Overall the bank has comfortable liquidity - comprising cash, central bank placements and interbank placements - covering 23% of deposits. The bank's main wholesale funding consists of deposits from banks, repo facilities (USD1 billion evenly distributed by maturities) and bond issuance (USD500 million maturing in 2024). Our base-case expectation is that the currency peg will remain intact and large deposits stable.

Asset Quality

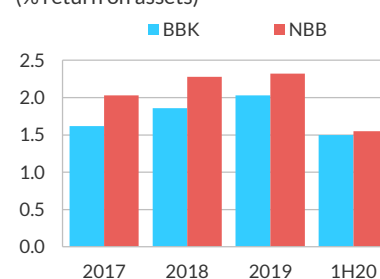
(% of gross loans)



Source: Fitch Ratings, banks

Profitability

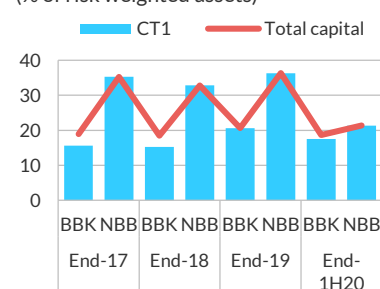
(% return on assets)



Source: Fitch Ratings, banks

Regulatory Capital

(% of risk weighted assets)



Source: Fitch Ratings, banks

Environmental, Social and Governance Considerations

FitchRatings Bank of Bahrain and Kuwait B.S.C.

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Bank of Bahrain and Kuwait B.S.C. has 5 ESG potential rating drivers

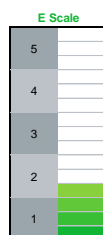
- Bank of Bahrain and Kuwait B.S.C. has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

Overall ESG Scale

key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
	4	issues	2
not a rating driver	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference
GHG Emissions & Air Quality	1	n.a.	n.a.
Energy Management	1	n.a.	n.a.
Water & Wastewater Management	1	n.a.	n.a.
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality



How to Read This Page

ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

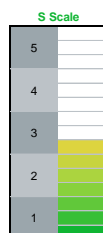
The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

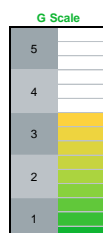
Social (S)

General Issues	S Score	Sector-Specific Issues	Reference
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities; SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy
Employee Wellbeing	1	n.a.	n.a.
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile



Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference
Management Strategy	3	Operational implementation of strategy	Management & Strategy
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal/compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy



CREDIT-RELEVANT ESG SCALE	
How relevant are E, S and G issues to the overall credit rating?	
5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

The highest level of ESG credit relevance is a score of 3. This means ESG issues are credit neutral or have only a minimal credit impact on BBK, either due to their nature or to the way in which they are being managed by the bank. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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