



Incentives for Ratings

Capital adequacy is a critical factor for the stability of the individual banks. Collectively, capital adequacy is important for the stability of the entire financial system. The regulators, at national and international level, have therefore paid a great deal of attention to regulating and monitoring the capital adequacy of banks. The Basel Committee on banking supervision issued a revised framework of capital measurement and capital standards for banks known as Basel-II. One of the objectives of this framework is to provide incentives to adopt more advanced risk sensitive approaches. The central banks are adopting this framework in their jurisdictions. The Central Bank of Bahrain (CBB) has also adopted Basel II framework.



Mr. Jamal Zaidi
IIRA's CEO

The banks are allowed to measure credit risk based upon credit ratings by an External Credit Assessment Institution (ECAI). As an incentive for using credit ratings, the risk-weights are determined in line with the credit rating category – the higher the rating category, the lower the risk-weight leading to lower capital requirements. The bank's capital requirement is thus reduced when its assets command higher credit ratings. It, therefore, implies that the banks will greatly benefit if they insist their counterparties produce a credit rating from a CBB approved ECAI.

Currently CBB has prescribed risk-weight on corporates ranging from 20% for AAA to AA- category to 150% for category below BB-. The risk-weight for unrated corporates is currently at 100% but it is subject to review by CBB. If a subsequent review enhances the risk-weight of unrated corporates, then, the banks will find themselves short of capital.

It is our experience and assessment that corporates that get a credit rating gradually improve their rating category through improvements brought about in the light of rating reports, which highlight strengths as well as weaknesses. This gradual shift to a higher category of rating is beneficial not only to individual corporates, as their cost of funding goes down but it is beneficial to banks as lenders as well, as their assets having a higher credit rating will require less capital allocation allowing the banks to enhance their business volume.

IIRA, as an approved ECAI by the CBB, has been actively promoting the credit rating culture and encouraging the corporates to get rated.

the presence of equity capital of YTL 550 mn, availability of funding lines and liquid assets (cash, placements with FIs and quoted investments) which remained 22% of the total liabilities. Shorter maturity gap also exhibited high funding needs and 1-3 month maturity GAP adjusted for stickiness in deposits amounted to -14.3%. Core earnings measured against average assets increased to 2.5% in 2007, up from 1.7% in 2006. By 2007 return on average asset (ROAA) and return on average equity (ROAE) improved to 2.0% and 19.9% from 1.5% and 16.0% in 2006. Increase in profitability is represented by growth in assets specifically retail assets, increase in fee based income and improvement in efficiency and productivity. The ratings are constrained by the relatively small size of the bank forcing it to assume a price taker status in the market. KTPB advances constitute 1.37% of the banking industry advances. The management is taking initiatives to increase the market share by focusing on branch expansion and market penetration. IIRA will continue to monitor progress on capital expansion, quality of asset growth, and indigenous growth in core profitability (ability of the bank to fund expansion through retained earnings) since these factors have substantial bearing on credit standing of the KTPB.

IIRA Announces its International and National Scale Ratings of Kuwait Turkish Participation Bank

IIRA has assigned its international scale ratings of BB+/A-3/ Stable for foreign currency long term and short term obligations and BBB-/A-3/ Stable for local currency long term and short term obligations of Kuwait Turkish Participation Bank. IIRA has also assigned its National scale ratings of A- (tr) (A minus) and A-2 (tr) (A two) to medium to long term and short term obligations of Kuwait Turkish Participation bank. The outlook for all the ratings is stable.

The above ratings indicate a strong parent, Kuwait Finance House as well as strong shareholders like the General Directorate of Foundations. When market conditions forced postponement of a planned IPO in February 2008, the shareholders added YTL 200 million in new equity to support growth. This was second capital increase from the shareholders after May 2007 increase in which shareholders added YTL 69 mn of equity capital. KTPB has strong management and improving asset quality. Though the historical data suggest asset quality problems with NPLs including loss reserves standing at 17% during 2004, improvements are reflected with 2007 problem assets almost approximating the industry average at 4.3% of gross loans. As a percentage of economic capital, problem assets remained 24.3% by 2007. Non performing assets net of loss reserves were YTL 39.7 million compared with core profits of YTL 85.6 million. Reserves coverage of the non-performing loans was adequate at 67.4% at year end. Separately reported, delinquent lease rental receivables totaled YTL 14.2 million. Exposure to market risk is minimal owing to nominal trading book exposure and largely matched currency positions. Capital is adequate to meet the current capital charge on current risk weighted assets with CAR at 14.7% in 2007 exceeding the regulatory requirement of 12%. However, management's plans for expansion in assets and branches warrant additional capitalization. The ratio is low when compared with peers like Albaraka and Bank Asya holding CAR of 21.7% and 17.2% in 2007.

The assets are mostly concentrated in customer loans. While it is good for profitability, the bank should consider the liquidity implications of the same. By the year end 2007, loans to deposits ratio was 101.7% suggesting excess utilization. High loan to deposit is partially mitigated with

IIRA Assigns First-Time Credit Ratings to the Republic of Turkey

IIRA has assigned following credit ratings to the financial obligations of the Republic of Turkey :

• Global Scale

| | |
|------|---|
| BBB- | for long-term local currency obligations |
| BB+ | for long-term foreign currency obligations |
| A-3 | for short-term local currency obligations |
| A-3 | for short-term foreign currency obligations |

• National Scale

| | |
|---------|----------------------------|
| AAA ns | for long-term obligations |
| A-1+ ns | for short-term obligations |
| Outlook | Stable |

Turkey has achieved extraordinary progress in the last seven years largely as a result of sound economic and financial management leading to very significant lowering of the debt burden relative to GDP, shifting much of the government's external debt to a domestic basis, gaining control of inflation, and broadening the export base.

Improving economic fundamentals reflect a strong and diversifying economy which achieved average real GDP growth of 6.6% over the past three years coupled with control over inflation which remained under 10% during the last 4 years. (2007 8.4% and 2006 9.6%). Due to the volatilities in the external environment, the growth has slowed down to 4.5% in 2007 and going forward with inflation expectation of 11% in 2008, IIRA expects real GDP growth to be 3.5%.

Total government debt declined to YTL 333.5 billion in 2007, equal to 38.9% of GDP. Equivalent figures for 2006 were YTL345 billion, equal to 45.5% of GDP. Of these totals, the government's external debt was reduced from an amount equivalent to 12.3% of GDP to 9.1%. Consistent with the recent trends, the total government debt to GDP ratio is expected to decline further in 2008, ultimately reaching the target of 30% in a few years time. Despite the relatively low debt to GDP burden, because of the high interest rate

environment, government debt servicing relative to the government revenues remain comparatively high, calculated at 25.7% in 2007 (2006 26.5%) .

As a result of the increased burden of transfer payments, the Government's primary fiscal balance (before interest) declined from 5.4% in 2006 to 4.1% during 2007. The overall fiscal deficit in the country's high interest rate environment increased to 1.6% of GDP in 2007 up from 0.6% the prior year. Due to continuing fiscal discipline IIRA expects fiscal deficit to come down to approximately 1% of GDP in 2008.

Increasing imports resulting from the effect of higher oil prices, rising capital equipment imports and consumption have contributed to a current account deficit of USD37.5 billion in 2007, up from USD 31.9 billion the prior year. The deficit is 5.7% of GDP stated in dollars, In recent years, the deficit has been funded by foreign direct investment and investment the government classifies as "Other." This is principally interbank funding and corporate borrowing for expansion. Turkey has accumulated USD 108.2 billion of foreign exchange and gold reserves, up from USD90.7bn in 2006. Current import cover is 7.34 months of imports.

Turkey is a candidate country to join the European Union and many of its strategies have been geared to further this objective. According to the Central bank's publications, the country is sensitive to the global environment and increasingly volatile external environment caused by the sub-prime mortgage crisis and rising food and energy prices. Going forward IIRA will continue to monitor the potential impact of these factors on the country since this could have substantial bearing on the credit standing.

These ratings were carried out on IIRA's initiative. For further information on this rating announcement, please contact J. M. McMullen (Senior Vice President- Ratings) or Mr. Umer Zuberi (Assistant Vice President) at +973-1721 1606 or fax no +973 1721 1605

Announcing IIRA as a Sponsor of the 15th Annual WIBC Rating Workshop

As a continuation of its strategy to disseminate the knowledge of analysis, and to generate awareness about ratings and its importance in the Islamic capital markets, IIRA has sponsored a rating workshop on the sideline of WIBC. The workshop will be held on the pre-conference day, Sunday 23rd November 2008, and will start at 2:00pm. The workshop will be led by senior members of IIRA's rating team representing collectively nearly a century of experience in financial markets.

It is one of the most valuable, professional and unique learning opportunities as well as networking opportunities where directors, CEOs, senior managers and other professionals from different financial and corporate institutions are invited.

The full agenda of the workshop is as following:

14:00 – 14:15 Registration

14:15 – 14:20 Introduction to Ratings, their Functions and History

14:20 – 14:50 Session 1: Ratings in MENA Market

- Regulators
- Issuers Behavior

14:50 – 15:20 Session 2: Key Analytical Approaches to Different Types of Issuers:

- Sovereigns
- Financial Institutions

- Commercial Enterprises / Industrial Companies
- Real Estate Ratings

15:20 – 15:50 Refreshment & Networking Break

15:50 – 16:20 Session 3: Other Types of Ratings:

- Corporate Governance Ratings
- Shari'a Quality Rating

16:20 – 16:45 Session 4: Islamic International Rating Agency (IIRA) and its Rating Process

16:45 Q&A and Close of the workshop

Islamic International Rating Agency, Al-Zamil Tower, 7th Floor, Govt. Avenue, Manama - 305, Kingdom of Bahrain
P.O. Box 20582, Ph: +973 17211606, Fax: +973 17211605
Website: www.iirating.com