

Credit Rating Strategies: A Study of GCC Banks

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Abstract

Purpose

It is difficult to predict when the next financial crisis will happen. Identifying financial strategies, which help a bank to survive a crisis, is the main purpose of the paper. This paper examines the financial strategies of those banks, which managed to retain good credit ratings both before and after the global financial crisis, so as to throw light on the characteristics of banks which managed to remain steady and stable.

Design

This paper analyses Fitch credit ratings of 51 banks Islamic and commercial banks operating in GCC, divided into pre global financial crisis (2002 to 2007) and post global financial crisis (2008 to 2013) periods. Trend and behavior of average ratios of top rated banks in both the periods is first attempted before moving to “Ordered Choice Logit” regression method to further analyze the data.

Findings

Size and cost management are very important factors in ratings, both before and after the financial crisis. As long as asset quality is under control, liquidity is the focal point in achieving good ratings. Top rated Islamic banks seem to be following a strategy of allowing capital ratios to trend down during a crisis as long as capital is well above the regulatory requirements.

Originality and Value

The paper is the first of its kind which examines credit rating strategies of Islamic banks as well as commercial banks. The findings of the paper are extremely important for banks as they throw light on appropriate strategies to be adopted by banks during crises.

Table 1: GCC – Gulf Cooperation Council Countries

Bahrain	Kingdom of Bahrain
Kuwait	State of Kuwait
Oman	Sultanate of Oman
Qatar	State of Qatar
Saudi Arabia	Kingdom of Saudi Arabia
United Arab Emirates	United Arab Emirates

Table 2: Key ratios related to bank financial management practices

Total Capital Ratio (CAP)

Net Interest Margin (NIM)

Return on Assets (ROA)

Return on Equity (ROE)

Cost to Income Ratio (COST)

Non Performing Assets Ratio – Loan Loss Reserves to Gross Loans (LLGL)

Liquid Assets to Demand Deposits (LIQ)

Total Assets (TA)

Table 3: Fitch ratings and dependent variable values

Fitch Rating	Dependent Variable Value	Fitch Rating	Dependent Variable Value
AAA	14	BBB+	7
AA+	13	BBB	6
AA	12	BBB-	5
AA-	11	BB+	4
A+	10	BB	3
A	9	BB-	2
A-	8	CCC	1

Table 4 : Average Ratios of Top Rated Banks

Ratio	Average of Banks in Top Quartile	Average of Banks in Top Quartile	Average of the Banks which remained in Top Quartile	Average of the Banks which remained in Top Quartile
	Post GFC	Pre GFC	Post GFC	Pre GFC
Capital Adequacy Ratio -Total Capital Ratio (CAP)	18.74	19.49	18.22	24.5
Net Interest Margin (NIM)	3.84	3.65	3.76	3.775
Return on Assets (ROA)	2.35	3.09	2.2	3.89
Return on Equity (ROE)	16.07	43.94	13.56	54.77
Cost to Income Ratio (COST)	34.28	32.75	35.4	27.64
Loan Loss Reserves / Gross Loans (LLGL)	3.35	2.81	4.78	4.37
Liquid Assets / Customer & ST Funding (LIQ)	23.56	326.56	20.35	155
Total Assets US\$ (TA)	16,753	9,234	30,290	18,340

Table 5: Ratios of All Locally Incorporated Banks in GCC

Ratio	First Quartile	First Quartile	Second Quartile Median	Second Quartile Median	Third Quartile	Third Quartile
	Post GFC	Pre GFC	Post GFC	Pre GFC	Post GFC	Pre GFC
Capital Adequacy Ratio - Total Capital Ratio (CAP)	15.07	15.27	17.37	17.66	19.08	20.93
Net Interest Margin (NIM)	2.60	2.75	2.89	3.31	3.55	4.03
Return on Assets (ROA)	1.04	2.48	1.67	3.18	2.22	4.09
Return on Equity (ROE)	9.09	18.14	12.61	22.8	16.73	27.58
Cost to Income Ratio (COST)	27.65	21.36	32.67	30.07	37.85	36.48
Loan Loss Reserves / Gross Loans (LLGL)	2.21	1.72	3.05	2.86	4.87	3.99
Liquid Assets / Customer & ST Funding (LIQ)	17.32	22.12	23.36	32.72	33.39	42.54
Total Assets US\$ (TA)	7882	5093	15762	12480	33823	21249

Table 6 Descriptive Statistics	Table 6 Descriptive Statistics	Table 6 Descriptive Statistics	Table 6 Descriptive Statistics
	Post GFC (2008 to 2013)	Post GFC (2008 to 2013)	Post GFC (2008 to 2013)
	Mean	Std. Dev.	Obs
RATING	8.65	1.40	223
CAP	18.12	4.10	223
NIM	3.07	1.04	223
ROA	1.73	1.10	223
ROE	12.25	12.31	223
COST	35.91	10.82	223
LLGL	3.76	2.12	223
LIQ	22.98	10.01	223
TA	26487582	23456006	223

Table 7: Commercial Banks

Ordered Choice Logit Regression Results

Method: Maximum Likelihood (BHHH) with Robust (Huber / White heteroscedasticity consistent) standard errors

Post GFC Regression Commercial Banks Ordered Choice Dependent Variable : Fitch Rating (2008 to 2013)	Post GFC R
Variables	Coeff.
COST	-0.049*
Log (TA)	2.283*
CAP	-0.047
LIQ	0.026**
LLGL	0.071
NIM	0.025
Pseudo R-squared	0.258
AIC	2.57
LR Statistic	190.17*
Jarque – Bera	3.62 (p: 0.16
N	223

* p< 0.01 (significant at 1% level); ** p< 0.05 (significant at 5% level)

Table 8: Islamic Banks

Ordered Choice Logit Regression Results

Method: Maximum Likelihood (BHHH) with Robust (Huber / White heteroscedasticity consistent) standard errors

Post GFC Regression Islamic Banks Ordered Choice Dependent Variable : Fitch Rating (2008 to 2013)	Post GFC Regression Islamic Banks Ordered Choice Dependent Variable : Fitch Rating (2008 to 2013)	Post GFC Regression Islamic Banks Ordered Choice Dependent Variable : Fitch Rating (2008 to 2013)	Descriptive Statistics: Islamic Banks	Descriptive Statistics: Islamic Banks	Descriptive Statistics: Islamic Banks	Descriptive Statistics: Islamic Banks
Variables	Coeff.	Std. Error	Mean	Std. Dev.	Obs	
COST	0.096	0.053	RATING	8.77	1.61	44
Log (TA)	2.582*	0.852	COST	38.57	10.84	44
CAP	-0.222*	0.082	EQTA	17.15	5.24	44
LIQ	0.056	0.058	CAP	19.90	5.66	44
LLGL	0.080	0.023	LIQ	24.22	10.24	44
ROE	0.024	0.135	LLGL	3.46	2.09	44
Pseudo R-squared	0.487		ROA	1.90	1.35	44
AIC	1.97		ROE	11.22	7.27	44
LR Statistic	61.79*		TA	23387196	20022155	44
Jarque – Bera	0.79 (p: 0.67)					
N	44					

* $p < 0.01$ (significant at 1% level); ** $p < 0.05$ (significant at 5% level)

Annexure A

Classification of banks into commercial banks and Islamic banks is as given by Bankscope database (now renamed as Orbis Bank Focus). Al Rajhi Bank and Tamweel PJSC are classified as commercial banks by Bankscope in the Pre-GFC period and as Islamic banks in the Post-GFC period. Also Tamweel PJSC is classified as a bank by BankScope.

List of commercial banks included in the study

1. National Bank of Abu Dhabi
2. National Bank of Kuwait S.A.K.
3. Abu Dhabi Commercial Bank
4. Al Rajhi Bank
5. Commercial Bank of Kuwait SAK (The)
6. Emirates NBD PJSC
7. First Gulf Bank
8. Gulf Bank KSC (The)
9. HSBC Bank Oman
10. National Commercial Bank (The)
11. Qatar National Bank
12. Riyadh Bank
13. Samba Financial Group
14. Union National Bank
15. Arab National Bank
16. Banque Saudi Fransi
17. Commercial Bank of Qatar (The) QSC
18. Doha Bank
19. Gulf International Bank BSC
20. Mashreqbank PSC
21. Saudi British Bank (The)
22. Ahli Bank QSC
23. Ahli United Bank KSC
24. Al Ahli Bank of Kuwait (KSC)
25. Al Khaliq Commercial Bank
26. Bank Al-Jazira
27. Bank Muscat SAOG
28. Commercial Bank of Dubai P.S.C.
29. Saudi Hollandi Bank
30. Saudi Investment Bank (The)
31. Ahli United Bank BSC
32. Bank Dhofar SAOG
33. Bank of Sharjah
34. Bank Sohar SAOG
35. National Bank of Oman (SAOG)
36. National Bank of Ras Al-Khaimah (P.S.C.) (The)-RAKBANK
37. Tamweel PJSC
38. National Bank of Bahrain
39. BBK B.S.C.
40. Arab Banking Corporation BSC

List of Islamic bank included in the study

1. Abu Dhabi Islamic Bank
2. Al Hilal Bank PJSC
3. Al Rajhi Bank
4. Alinma Bank
5. Dubai Islamic Bank PJSC
6. Kuwait Finance House
7. Kuwait International Bank
8. Qatar International Islamic Bank
9. Qatar Islamic Bank SAQ
10. Sharjah Islamic Bank
11. Tamweel PJSC

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