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Fitch Affirms EBRD at 'AAA'; Outlook Stable

Fitch Ratings - London - 14 Nov 2024: Fitch Ratings has affirmed European Bank for Reconstruction and Development Bank's (EBRD) Long-Term Issuer Default Rating (IDR) at 'AAA' with a Stable Outlook.

Key Rating Drivers

SCP Drives Rating: EBRD's Long-Term IDR reflects its Standalone Credit Profile (SCP) of 'aaa'. The SCP is based on the solvency assessment of 'aa+' and EBRD's 'low' risk business environment, which leads to a notching of '+1' over the lower of the solvency and liquidity assessments. The Stable Outlook reflects our expectation that EBRD's 'excellent' capital buffers will offset rising credit risks.

Excellent Capitalisation: The overall capitalisation assessment remains 'excellent' considering Fitch's usable capital to risk-weighted assets (FRA) ratio of 43% at end-1H24 (end-23: 44%) and an equity-to-assets ratio of 29% at end-1H24 (end-2023: 31%). Fitch expects EBRD's capitalisation to remain 'excellent' over the medium term. Our forecasts assume EBRD remains profitable in 2025 and 2026. The increase in the bank's paid-in capital due to the approved general capital increase (GCI) should further support capital ratios.

Credit Risks Constrain Solvency: EBRD's non-performing loan (NPL) ratio was over 6% in 2022, primarily due to the impact of the Russia-Ukraine war. The NPL ratio, as adjusted by Fitch (the agency excludes from the numerator of the ratio the Ukrainian exposures considered impaired by EBRD but that are still performing), improved to 4.5% in 1H24 from 5.6% at end-2023, mainly driven by repayments of Ukrainian exposures, the sale of a Russian exposure in 1Q24 and two Turkish exposures resuming payments in 2Q24. We expect the NPL ratio to rise above 6% again due to heightened risk from increasing exposure to Ukraine.

The average rating of loans and guarantees before preferred creditor status (PCS) was 'B+' at end-1H24, unchanged from the previous year. Overall, we expect the average rating of loans to remain at 'B+' over the forecast horizon.

Capital Increase Supportive: In December 2023, EBRD's shareholders approved a EUR4 billion GCI to further support Ukraine (RD). Paid-in capital payments will start in 2025 and will be paid annually via five equal instalments. The GCI and EBRD's role in providing support to Ukraine highlight the bank's high policy importance.

Increased Exposure to Ukraine: EBRD has committed EUR3 billion in new investments in Ukraine in 2022 and 2023, reflecting the strong commitment from shareholders to supporting the country. In recognition of the heightened level of risk in Ukraine, the EUR3 billion of new commitments benefit from either pari passu or first loss guarantees by some shareholders covering 50% on average.

Nevertheless, EBRD's exposure to the country, net of shareholders' guarantees, remains significant, at EUR3.1billion or 7.0% of the bank's total banking exposure at end-1H24. Ukrainian credit exposure is covered by a EUR0.9 billion loss provision. In 1H24, 46% of loans to Ukrainian counterparties were non-performing. A further marked increase in Ukrainian NPLs is a downside risk to EBRD's risk profile.

Prudent Provisioning Against Ukraine Exposures: In 1H24, EBRD reported a net profit of EUR1.3 billion (2023: EUR2.1 billion profit), supported by strong underlying operating income across all business segments. EBRD had reported a EUR1.1 billion loss (2021: EUR2.5 billion net profit) in 2022, mainly driven by EUR1.4 billion impairment losses, primarily on loans to entities in Ukraine, Russia and Belarus. The war also led to a significant fall in the value of the bank's legacy equity investments in Russia, resulting in overall equity losses of EUR1.1 billion in 2022. Fitch expects EBRD's prudent reserving and valuation approach to reduce the risk of significant further losses from the war.

Low Risk Business Environment: EBRD's business environment leads to a +1 notch uplift over the solvency assessment. The assessment of EBRD's business profile balances the high share of non-sovereign financing and an increased focus on less advanced economies, with the high quality of governance and importance of its public mandate. While the risk in EBRD's countries of operations has increased, this is offset by rising policy importance, given the bank's role in supporting Ukraine in line with the objectives of its shareholders.

'Medium Risk' Operating Environment: We assess the operating environment as 'medium risk', reflecting the moderate average credit quality and political risk in most countries of operations and strong operational support from member states.

Excellent Liquidity and Market Access: We assess EBRD's liquidity at 'aaa'. The bank's coverage of short-term debt by liquid assets was 2.6x at end-1H24. EBRD operates with a higher level of treasury assets (43% of total assets at end-1H24) than comparable peers and this weighs positively on our assessment of liquidity. The quality of treasury assets is 'strong', with the share of treasury assets rated 'AAA' to 'AA' at 63% as of end-1H24. Fitch expects the liquidity ratio to remain above the 1.5x 'excellent' threshold. In Fitch's view, EBRD has 'excellent' access to capital markets.

No Support Uplift: Fitch assesses shareholders' support at 'aa-', which is based on the weighted average rating of key shareholders as its coverage of net debt by callable capital is at a lower level (full coverage from shareholders rated at least 'BBB' at end-1H24). Fitch views shareholders' propensity to support the bank as' strong'.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/ downgrade:

Solvency (Capitalisation): A decline in capitalisation metrics with an FRA ratio below 35% on a sustained basis or an equity-to-assets and guarantees ratio below 15%. This would affect our 'excellent' capitalisation assessment. This could be driven by significant losses, faster-than expected growth, and/ or a significant increase in risk-weighted assets.

Solvency (Risk): A revision of our assessment of the bank's credit risk to 'high', which could be driven by a decline in the average rating of loans and guarantees below 'B+' and/or an increase of the NPL ratio markedly above the 6% threshold for 'high' risk over the medium term. This would, for example, be the case if EBRD's entire exposure to Ukraine (including to the sovereign) went into default.

Business Environment (Operating Environment Risk): Rapid expansion into 'high' risk countries in sub-Saharan Africa or a larger number of sovereign downgrades of EBRD's countries of operations that affect our assessment of the bank's operating environment.

Solvency (Capitalisation) / Business Profile: In the unlikely event that a major shareholder withdrew from EBRD in a way that significantly affects its capitalisation and/or business profile.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The rating is at the highest level on Fitch's scale and cannot be upgraded.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

EBRD has an ESG Relevance Score of '4' for 'Exposure to Social Impacts'. In order to provide temporary liquidity support, the bank has allowed payment deferral for some of its borrowers affected by the coronavirus crisis but that had not experienced payment delays before the deferral was granted. 'Exposure to Social Impacts' has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

EBRD has an ESG Relevance Score of '4' for 'Rule of Law, Institutional and Regulatory Quality'. All supranationals attract a score of '4' as they are neither subject to bank regulation nor supervised by an external authority. Instead, supranationals comply with their own set of prudential limits. Fitch pays particular attention to these internal prudential policies, including the bank's compliance with them. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

Fitch Ratings Analysts

Khamro Ruziev, CFA
Director

Primary Rating Analyst
+44 20 3530 1813
Fitch Ratings Ltd 30 North Colonnade, Canary Wharf London E14 5GN

Ralf Ehrhardt
Director
Secondary Rating Analyst
+49 69 768076 163

Paul Gamble
Senior Director
Committee Chairperson
+44 20 3530 1623

Media Contacts

Peter Fitzpatrick
London
+44 20 3530 1103
peter.fitzpatrick@thefitchgroup.com

Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
European Bank for Reconstruction and Development	LT IDR	AAA	Affirmed		AAA
	ST IDR	F1+	Affirmed		F1+
• senior unsecured	LT	AAA	Affirmed		AAA
• senior unsecured	ST	F1+	Affirmed		F1+

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	◉	◆
STABLE	◯	

Applicable Criteria

Supranationals Rating Criteria (pub.03 Oct 2024) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

European Bank for Reconstruction and Development	UK Issued, EU Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch’s website.

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