FitchRatings

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Fitch Affirms EBRD at 'AAA'; Outlook Stable

Fitch Ratings - London - 21 Nov 2023: 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, which Fitch has revised to 'aa+' from 'aaa' because of heightened credit risk. Fitch has also revised EBRD's business environment to 'low' risk from 'medium' risk, which leads to a notching of '+1' (from '0' previously) over the lower of the solvency and liquidity assessments, to reflect the bank's increased policy importance. The Stable Outlook reflects our expectation that EBRD's 'excellent' capital buffers will offset rising credit risks.

Credit Risks Constrain Solvency: The revision of the solvency assessment to 'aa+' from 'aaa' reflects our expectation that EBRD's non-performing loan (NPL) ratio will remain above 6% in the medium term. EBRD's NPL ratio, as adjusted by Fitch, increased to 6.6% in 1H22 from 4.9% in 2021, primarily due to the impact of the Russia-Ukraine war, and has remained in excess of 6%, at 6.3% as of end-1H23 (end-2022: 7.2%). The average rating of loans and guarantees before preferred creditor status (PCS) was 'B+' at end-1H23, unchanged from the previous year. Overall, we expect the average rating of loans to weaken but to remain at 'B+' over the forecast horizon.

Planned Capital Increase Supportive: In November 2023, EBRD's board of directors formally recommended a EUR4 billion general capital increase (GCI) to further support Ukraine (CC). The GCI is expected to be approved by end-2023 and paid-in capital payments to start in 2025. The GCI and EBRD's role in providing support to Ukraine highlight the bank's increased policy importance and support our revised assessment of its business profile.

Increased Exposure to Ukraine: EBRD has committed an envelope of up to EUR3 billion 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 envelope of new investments benefits from either pari passu or first loss guarantees by shareholders covering 50% on average. Nevertheless, EBRD's exposure to the country, net of shareholders' guarantees, remains significant, at EUR2.5 billion or 6.3% of the bank's total banking exposure at end-1H23.

The Ukrainian credit exposure is covered by a EUR1.1 billion loss provision. In 1H23, 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.

Excellent Capitalisation: The overall capitalisation assessment remains 'excellent' considering Fitch's usable capital to risk-weighted assets (FRA) ratio of 45% at end-1H23 (end-22: 44%) and an equity-to-assets (E/A) ratio of 30% at end-1H23 (end-2022: 29%). Fitch expects the two ratios to remain above its 'excellent' thresholds of 35% and 25%, respectively, over the medium term. Our forecasts assume EBRD remains profitable in 2024 and 2025 and prudent management of the bank's leverage. The expected increase in the bank's capital should further support capital ratios.

Prudent Provisioning Against Ukraine Crisis: EBRD returned to profitability in 1H23, achieving net income of EUR1.2 billion after it reported a EUR1.1 billion loss in 2022 (2021: EUR2.5 billion net profit) mainly driven by EUR1.4 billion impairment losses, primarily on loans based in Ukraine, Russia and Belarus. The war in Ukraine 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 arising from the war in Ukraine.

Low Risk Business Environment: EBRD's business environment now leads to a +1 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 the 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.

We also 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: EBRD's liquidity is assessed at 'aaa'. The bank's coverage of short-term debt by liquid assets was 3x at end-1H23. EBRD operates with a higher level of treasury assets (42% of total assets at end-1H23) 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'-'AA' at 62% as of end-1H23.

Fitch expects the liquidity ratio to remain above the 1.5x 'excellent' threshold but to weaken to around 2.5x reflecting slower projected growth of treasury assets than of the bank's loan portfolio. 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 'A+' at end-1H23). 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 equity-to-assets and guarantees ratio sustained below 25% or a FRA ratio below 35%. This would affect our 'excellent' capitalisation assessment. This could be driven by further 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.

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 respond to the policy priorities of its shareholders, the bank is extending significant support to Ukraine, including at its own risk. '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.

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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.11 Apr 2023) (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. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

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