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Introduction To Supranationals Special Edition 2024

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Key Takeaways

- Multilateral lending institutions' (MLIs) focus on capital optimization continues as the sector works to address recommendations from the G20 following its review of MLIs' capital adequacy frameworks.
- The sector's capital optimization transactions, which vary in terms of types of instruments and as a share of the overall balance sheet, underpin a nascent broader shift toward an originate-to-share business model.
- Blended finance will continue to be an important financing mechanism that will support private-sector mobilization efforts, although we believe concessional blended sources are required to unlock additional financing in difficult markets.
- MLI capital assessments remain robust as the sector continues to carefully manage its capital ratios.

S&P Global Ratings is publishing its yearly report on multilateral lending institutions (MLIs) and other nonbank supranational institutions, a publication that first started in 1986.

Spotlight Remains On The G20 Capital Adequacy Initiative

Over the past few years, the MLI sector has been working to address recommendations from the G20 following its review of MLIs' capital adequacy frameworks. Some MLIs are more advanced--with meaningful implications for balance sheets--than others.

The 2022 G20 report on capital adequacy frameworks calls upon improving capital resources to support additional lending capacity from the multilateral sector. We have closely followed the sector's developments as it relates to the five recommendations laid out in the capital adequacy frameworks report (see "A Closer Look At The G-20 Expert Panel Review Of MLIs' Capital Adequacy Frameworks," Oct. 11, 2022, and "Abridged Supranationals Interim Edition 2024: Multilateral Lending Institutions Sector Updates," July 12, 2024).

Recommendation 1: Redefine the approach to risk appetite in capital adequacy frameworks

Some MLIs have calibrated limits and adjusted internal models on the margins, such as the International Bank for Reconstruction and Development (IBRD) adjusting its minimum equity-to-loans ratio, which has unlocked some additional lending capacity in the sector. However, the sector overall maintains a conservative risk tolerance, and we do not expect there to be any fundamental changes that affect our assessment of capital and risk management.

Recommendation 2: Incorporate uplift from callable capital into multilateral development banks' capital adequacy frameworks

While we have not seen MLIs begin to rely more extensively on callable capital, the sector has engaged with shareholders and broader stakeholders to clarify callable capital processes and usage (see "Will Callable Capital Be A Game Changer For The MLI Asset Class?," July 22, 2024). The IBRD just recently announced that it will introduce a new enhanced callable capital instrument that can be called on earlier if the rating on the bank is under pressure, and it can be leveraged like equity.

Recommendation 3: Implement innovations to strengthen multilateral development banks' capital adequacy and lending headroom

Here, the sector has taken meaningful strides and introduced or scaled various balance sheet transactions, and we expect this to intensify (see table 1).

Recommendation 4: Assess CRA methodologies and engagement

We are constantly evaluating the needs, and we update our methodologies to capture changes in the sector. For example, in 2022, we updated our hybrid criteria to include MLIs. While the MLI landscape has evolved, we believe that we are able to capture innovations around capital optimization in our capital measure. That said, we engage frequently with constituencies on our approach.

Recommendation 5: Improve the enabling environment for capital adequacy governance

Increasing data transparency has been a focus for the sector, and the emphasis has been on its aggregated credit risk database (Global Emerging Markets Risk Database or GEMS). Releases on recoveries and prior default statistics have pointed to strong performance on an aggregate level for the sector globally. However, in our view, the data in the report is insufficient to allow for the type of in-depth analysis that forms part of our credit rating process (see "GEMs' Enhanced Recovery Statistics Are Yet To Provide Sufficient Transparency And Quality For Detailed Analysis," June 4, 2024). We are currently looking into the additional release of data that occurred on Oct. 15.

Capital Optimization Snapshot

Table 1

MLIs' capital optimization transactions*

Type of instrument	MLI adoption	RAC treatment
Exposure exchange agreements	Asian Development Bank (AsDB): $3.5 billion representing 2.3% of outstanding loans as of December 2023. African Development Bank (AfDB): UA4.2 billion, representing 18% of loans outstanding as of December 2023. Inter-American Development Bank (IADB): $7.4 billion representing 6.4% of outstanding loans as of December 2023. IBRD: $3.6 billion (including with MIGA) representing 1.4% of loans outstanding as of June 2024. The OPEC Fund: Exposure exchange agreements approved with IADB in April 2024 for $210 million.	Exposure exchange agreements represent synthetic risk transfers of sovereign exposure with the purpose of introducing more diversification and reducing concentration on MLI balance sheets. The magnitude of improvement in the risk-adjusted capital (RAC) ratio, with a reduction in total risk-weighted assets, depends on the overall concentration of the MLI and the sovereigns that are included in each transaction.
Hybrid capital instruments	AfDB: Approved and issued a $750 million commercial hybrid instrument in 2024, with a 'AA-' long-term issue rating. IBRD: Approved a shareholder hybrid (not rated), although the full amount subscribed by shareholders is ongoing.	Hybrid instruments are incorporated within total adjusted capital depending on whether they receive equity content. The full amount is incorporated until certain thresholds related to overall hybrid volumes to equity are reached, then they will be adjusted depending on the equity value of the instruments outstanding. Like capital, they create a possibility to extend more loans for development.
Guarantees from highly rated shareholders or development partners for specific countries and programs	AfDB: Received insurance cover from African Trade Insurance Agency for non-sovereign loans (UA27.6 million as of June 2024); Private Sector Enhancement Facility (AfDB trust fund), created mainly from donor grants to absorb risk on select non-sovereign loans (UA216.5 million as of June 2024). European Investment Bank (EIB): $3.5 billion in EU comprehensive guarantees and EU political risk guarantees on Ukraine, Belarus, Israel, and Palestine exposures as of December 2023. European Bank for Reconstruction and Development (EBRD): Shareholders have provided €1.75 billion, until May 2024, for lending to Ukraine. About 70% of these resources are guarantees and 30% are outright grants. IBRD: $10.9 billion guarantees received by shareholders and other MLIs, of which $8.1 billion is for Ukraine as of June 2024. IADB: $320 million in guarantees from the Swedish International Development Cooperation Agency, allocated mainly to Brazil as of December 2023.	If the guarantees meet the conditions laid out in our "Guarantee Criteria," we apply credit substitution for the amount, which is reflected in the RAC. Typically, the sovereign exposure is reduced and replaced by the sovereign or development partner providing the guarantee. The benefit to the RAC stems from a reduction in risk-weighted assets given an improved risk charge to the highly rated shareholder or development partner.
Credit risk mitigation purchased from insurance companies	AfDB: Credit insurance on Egypt for UA53.2 million and on Cote d'Ivoire for UA157.9 million as of June 2024. International Finance Corp. (IFC): $5.274 billion as of June 2024 ($4.466 billion as of June 2023 and $2.998 billion as of June 2022). IADB: 14 insurers combined have provided $300 million in protection to Brazil as of December 2023. IDB Invest: $1.23 billion as of June 2024.	Assuming insurance contracts are structured similar to a financial guarantee and meet the conditions in our "Guarantee Criteria," we would assume credit-risk substitution in our RAC and assign the counterparty exposure as a corporate. The overall benefit in the RAC depends on the insurer and its jurisdiction, which determines the economic risk score and corresponding risk weight vis-à-vis the exposure that receives the credit enhancement.

Table 1

MLIs' capital optimization transactions* (cont.)

Type of instrument	MLI adoption	RAC treatment
First-loss and portfolio guarantees (MLI receiving)	AfDB: UA1.5 billion in credit protection on 11 sovereign exposures with first-loss in form of insurance policy and second-loss portion as a guarantee from the UK FCDO (R2R III). AsDB: Launched an Innovative Finance Facility for Climate (IF-CAP) funded through sovereign guarantees and grant partners to provide first-loss guarantees on its sovereign exposure. EIB: Benefits from several first-loss guarantees issued under the EFSI, Invest EU, and ELM mandates. European Investment Fund (EIF): A large part of its operations is carried out under EU mandates benefiting from guarantees, often with a first -loss structure from the member states. International Finance Facility for Education (IFFED): While no guarantee has been issued, it's expected to provide portfolio support to IADB, AsDB, IBRD, and AfDB.	Depending on the portfolio/MLI balance sheet that receives a first-loss portfolio-wide guarantee, we apply analytical judgement to best capture the risk reduction. This can be, for instance, through a weak-link approach or a portfolio pro-rata approach, depending on the characteristics of the underlying assets and the details of the structure, among other factors.
Synthetic securitization and other ad hoc structures	AfDB: Incorporated a synthetic securitization in 2018 for $1 billion of the private-sector portfolio, which was subsequently terminated in June 2024 (R2R I).	We estimate the likely total losses emanating from the underlying pool of assets based on our RAC framework or CDO evaluator. We subsequently infer a ratings estimate for tranche that would, in turn, determine the risk weights applied. The overall size of the benefit depends on the underlying assets, the tranche detachment points, and the funded or unfunded nature and credit quality of the counterparties.

*This is a non-exhaustive list.

Capital optimization transactions as a share of the overall balance sheet varies widely across the sector. The European Investment Bank (EIB) and European Investment Fund (EIF) stand out, with over half of their portfolios containing some form of credit enhancement given their engagement with the EU comprehensive guarantee and EU political risk guarantee programs, among other measures. The use of guarantees and credit risk insurance has increased markedly this year, and we expect that many MLIs will implement some form of first-loss portfolio-wide guarantees over the next 12 months.

These optimization structures underpin an initial broader shift in the sector toward an originate-to-share business model. While this model largely represents what private sector-focused MLIs have done for decades through their A/B loan and syndicate structures, it is extending to a broader share of stakeholders and investors while offloading or reducing risk from their balance sheets.

Generally, we believe that the originate-to-share model is well suited for the private sector. We don't think, at these volumes, that it will affect sovereign lending and, specifically, the relationship with borrowers and the preferred creditor treatment afforded to MLIs.

Furthermore, as more transactions are introduced, we will monitor the interaction of these capital optimizations, particularly through the possible overlap of portfolio guarantees and specific guarantees and other credit enhancements.

Mobilization: Guarantees And Blended Finance Are The Way Forward

For years, private-sector capital mobilization has been encouraged to support development efforts in the sector. But mobilized capital in low- and middle-income countries still stagnates, especially compared with high-income countries (see "Shareholders Are Calling On Multilateral Lending Institutions To Increase Private-Sector Capital Mobilization For Climate And Development," May 28, 2024).

Blended finance will continue to be an important financing mechanism that will support mobilization efforts (see "Factors To Consider In The Growing Blended Finance Market," Aug. 15, 2024). The traditional instruments that MLIs offer--and that we expect they will scale--include guarantees, partial credit guarantees, and liquidity facilities that encourage private-sector actors into projects.

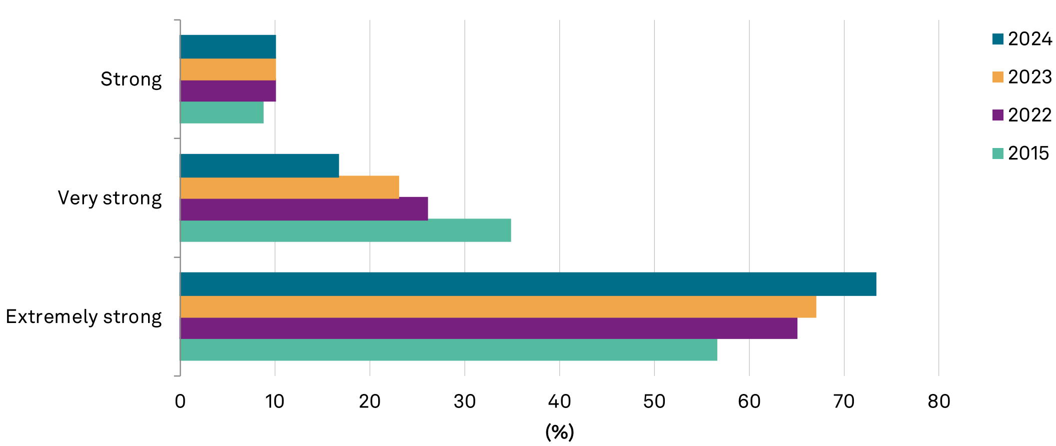
A few MLIs are also exploring concessional blended structures that we believe will be crucial to supporting projects in low-income countries. These structures combine financing from donors or third parties, alongside MLIs' own account lending to notably reduce the risk of projects. We believe that scaling concessional sources and blending these into projects will allow MLIs to augment the loss-absorbing qualities that are required to unlock additional financing in difficult markets.

Capital Positions Are Robust, Lending Is Picking Up

MLI capital assessments remain stable year over year as the sector continues to carefully manage its capital ratios. Around 73% of multilaterals that we rate have the highest capital adequacy assessments, up from 67% last year. The increase was due to the incorporation of International Finance Facility for Education (IFFEd) that is in a start-up phase and Black Sea Trade and Development Bank (BSTDB) as it improved its capital position following its divestments in key markets as a result of the Russia-Ukraine war.

Chart 1

Capital improvements across the MLI sector
Distribution of capital adequacy assessments



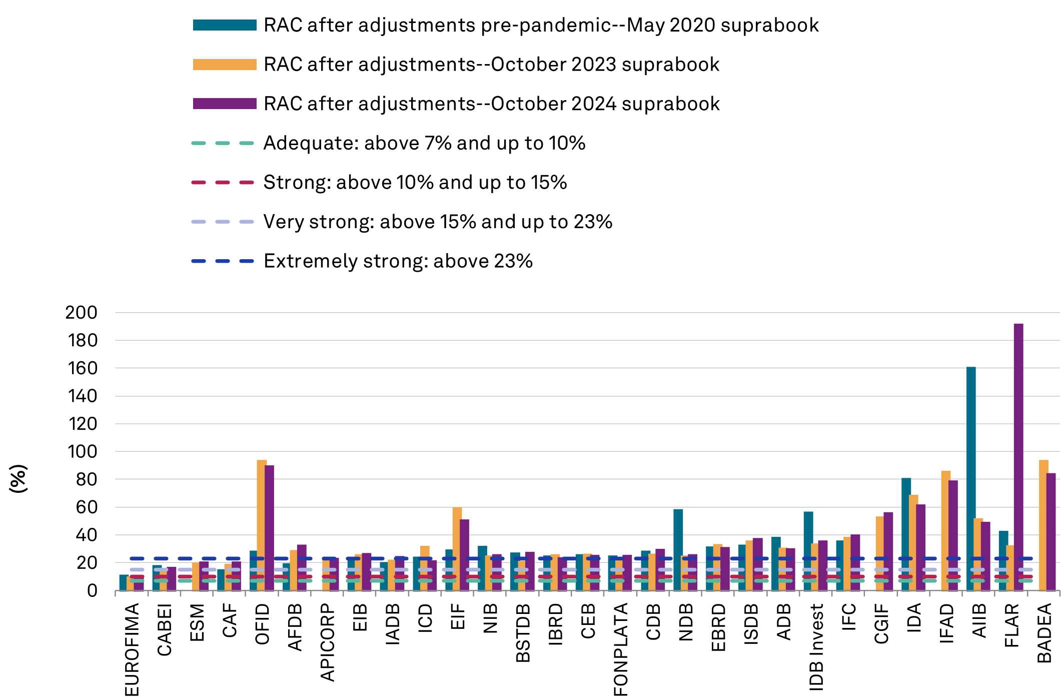
Source: S&P Global Ratings.

While capital assessments remained stable, we saw mixed results in terms of changes in RAC ratios (see chart 2). Many institutions saw improved profitably that supported capital generation--driven by higher rates and an easing of risk in their lending books as ratings have stabilized. Other MLIs ran down their already signficant buffers, as expected, which supported larger lending volumes.

Capital optimization transactions continue to support capital ratios for many entities. Although, the overall benefit varies depending on when the transaction was implemented and the type and size of risk that was covered.

Chart 2

Supranationals' risk-adjusted capital (RAC) ratios



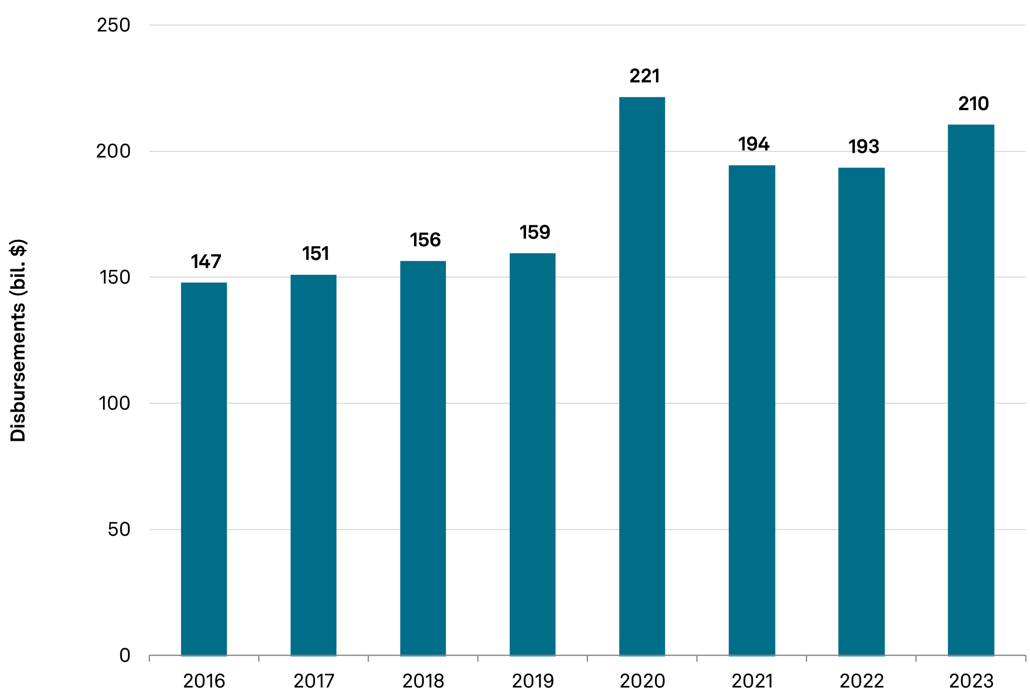
Source: S&P Global Ratings.

Lending grew meaningfully in 2023 compared with the past two years but remains below the 2020 peak. In terms of new loans disbursed, MLIs paid out $210 billion in 2023, up from $193 billion in 2022 and significantly higher than before the pandemic (see chart 3). Notably, International Development Assn. (IDA) disbursements hit a record $27.7 billion, compared with $21.2 billion the year prior, and the International Finance Corp. (IFC) disbursements grew to 18.7 billion from $13.2 billion, driving the increase in disbursements in the sector as a whole.

Lending across regions remains relatively stable. Although, the share of lending from EIB decreased slightly to 26% of all new disbursements in 2023, from 28% in 2022, and the share of lending from the World Bank Group increased to 34% of all new disbursements, from 32% the year prior. Disbursements by region in 2023 were Europe (35%), Asia-Pacific (30%), Latin America and the Caribbean (18%), and Africa (17%).

Chart 3

Aggregate disbursements across MLIs



Source: S&P Global Ratings.

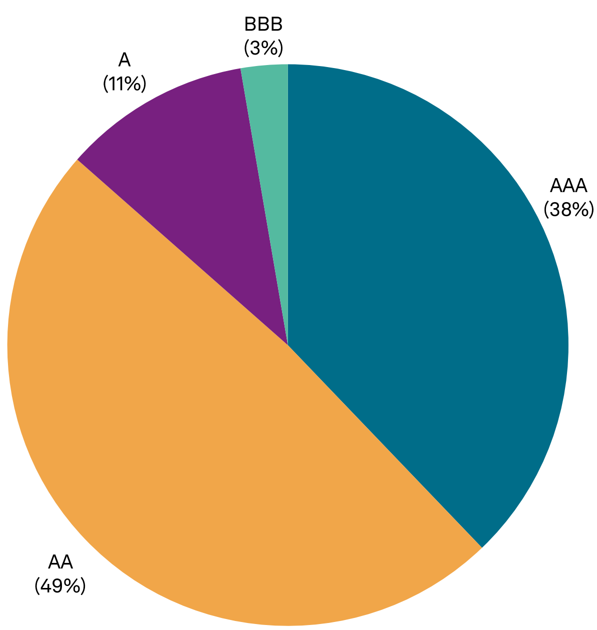
Supranationals Special Edition 2024 Features Summary Analyses And Compares Financial Data On The 37 Supranational Institutions We Rate

The 37 rated supranationals had a total combined balance sheet of $3.0 trillion at year-end 2023, compared with $2.8 trillion the prior year.

Credit quality among the 37 supranationals remains high. We rate 38% of them 'AAA' and most 'AA-' or higher (see chart 4).

Chart 4

Supranational ratings distribution 2024

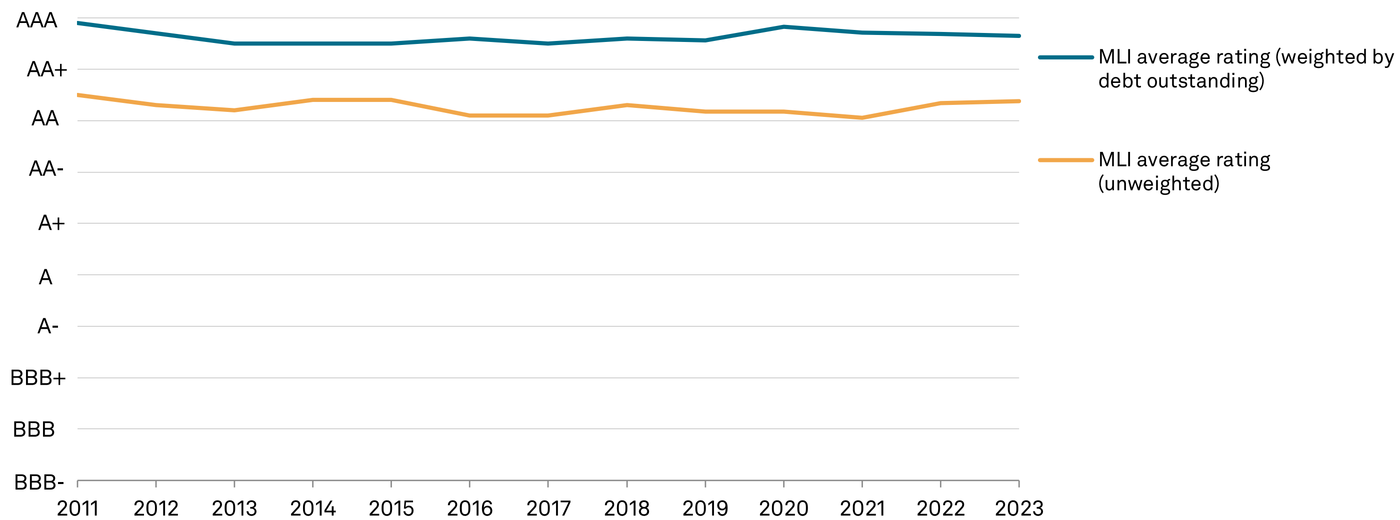


Ratings as of Oct. 11, 2024. Source S&P Global Ratings.

The average rating on supranational debt is 'AA' but ranges from 'BBB' to 'AAA'. On a debt-weighted basis, the average creditworthiness of this asset class has been stable since 2011, and 'AAA' rated MLI debt represented 70% of all supranational debt, based on year-end 2023 data and excluding debt from the EU (see chart 5).

Chart 5

Average supranational rating versus average debt-weighted rating



S&P Global Ratings.

Over the past year, we took various rating actions (see table 2), including assigning a new rating to IFFEd and suspending the rating on Eurasian Development Bank (EDB) for business reasons. Our 'AA+' rating and stable outlook on IFFEd indicate our view of its important and niche policy mandate as it provides portfolio guarantees to support MLIs' capital optimization efforts as eligible education loans are approved. However, IFFEd does have a limited track record.

Table 2

Rating actions since October 2023

	Rating to*	Rating from
BSTDB	BBB/Stable/A-2	BBB+/Watch Neg/A-2
EDB	NR/--/NR	BBB-/Negative/A-3
EFSF	AA-/Stable/A-1+	AA/Negative/A-1+
EUROFIMA	AA/Stable/A-1+	AA/Negative/A-1+
FONPLATA	A/Stable/A-1	A/Negative/A-1
ICIEC	AA-/Stable/--	NR/--/NR
IDB Invest	AA+/Positive/A-1+	AA+/Stable/A-1+
IFFEd	AA+/Stable/A-1+	NR/--/NR
IFFIm	AA/Stable/A-1+	AA/Negative/A-1+
OFID	AA+/Stable/A-1+	AA/Positive/A-1+

*Ratings as of Oct. 11, 2024. Source: S&P Global Ratings.

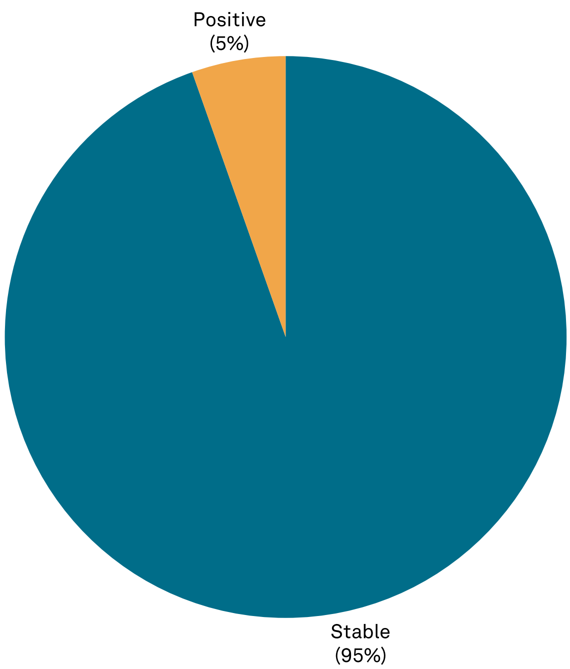
As of October 2024, 95% of our supranational ratings have stable outlooks (see chart 6) and 5% (BADEA and IDB Invest) have positive outlooks. We revised our outlook on Arab Bank For Economic Development in Africa (BADEA) to positive on Sept. 20, 2023, to reflect our expectation that it will continue expanding lending in sub-Saharan Africa, backed by broad shareholder support, indicative of a stronger overall role and relevance. We revised our outlook on IDB Invest to positive on June 26, 2024, given the recent capital increase, which could augment its policy relevance in private-sector multilateral lending, consistent with a larger role within the broader global development agenda.

We resolved all negative outlooks (accounting for 17% of ratings as of October 2023) over the past year. We downgraded BSTDB to 'BBB', and the outlook is stable, because of its weaker public policy role following the unwinding activity in response to the Russia-Ukraine war. We downgraded European Financial Stability Facility (ESFS) to 'AA-' after a similar action on France, its second-largest guarantor, and the outlook is stable.

We revised our outlook on EUROFIMA to stable from negative because of the institution's steps to diversify its concentrated loan book, combined with stronger equity generation leading to an improved capital position. We revised our outlook on FONPLATA to stable from negative after Argentina's intention to withdraw from the institution--a decision made under the previous administration--was reversed.

Chart 6

Supranationals outlook distribution 2024



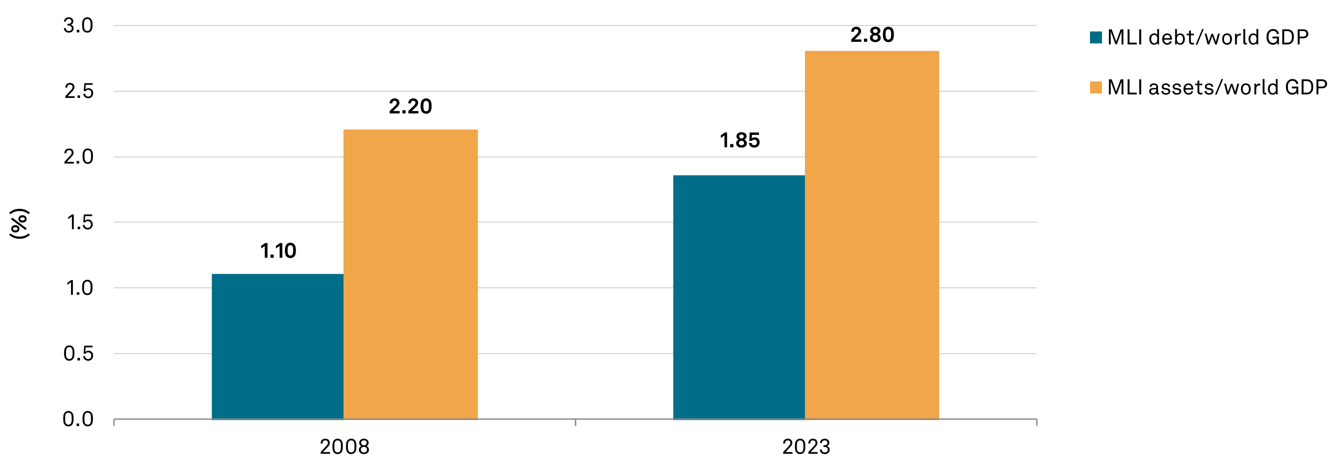
Outlooks as of Oct. 11, 2024. Source: S&P Global Ratings.

Supranational Debt Totaled $2.0 Trillion At The End Of 2023

Supranationals' outstanding debt increased to $2.0 trillion at the end of 2023, from $1.8 trillion the year prior, reflecting significantly larger issuance volumes from the EU given the Next Generation EU program. Total outstanding debt at year-end 2008 was less than $800 billion. The $2.0 trillion represents close to 1.9% of the world's GDP at year-end 2023.

Chart 7

MLI debt and assets to world GDP--2008 and 2023



Source: S&P Global Ratings.

The pace of rated supranationals' debt growth has peaked three times, in 2009 at 16%, in 2012 at 24%, and in 2021 at 20%. This reflects their countercyclical role.

Most MLIs increased lending after the 2008 financial crisis to support investments in their countries of operation. In 2012, the EFSF began operating and its outstanding debt surged to $208 billion from $23 billion in 2011. Many MLIs also benefited from a capital increase during the crisis and could then increase their borrowings accordingly. The 2021 increase in debt outstanding followed the sustained higher disbursement volumes from the pandemic.