Research Update:

# European Bank for Reconstruction and Development 'AAA/A-1+' Ratings Affirmed; Outlook Stable

**July 7, 2023**

## Overview

- We estimate that the European Bank for Reconstruction and Development (EBRD) will be able to sustain extremely strong capital adequacy on an intrinsic basis, despite our expectation that asset quality on its exposures could deteriorate further. In addition, the EBRD's ample buffer from callable capital supports our view.
- We expect that shareholder support would enable the bank to continue fulfilling its mandate by increasing its exposure to riskier assets, which would be mitigated by a potential increase in paid-in capital and donor funds.
- We affirmed our 'AAA/A-1+' long- and short-term issuer credit ratings on the EBRD.
- The outlook is stable.

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## Rating Action

On July 7, 2023, S&P Global Ratings affirmed its 'AAA' long-term and 'A-1+' short-term issuer credit ratings on the EBRD. The outlook is stable.

## Outlook

The stable outlook on the EBRD reflects our expectation that, in the next 24 months, the bank will continue receiving strong support from its shareholders that will enable it to fulfil its mandate and provide support to its countries of operation, while mitigating pressure on its exposures' credit quality. Our outlook is further supported by the EBRD's ample 'AAA' callable capital, which could mitigate a significant weakening of its financial profile and support the ratings at the current level.

### Downside scenario

We could consider lowering the ratings if we observed that the quality of the bank's exposure deteriorates more than we currently expect, for example due to a sharp rise in nonperforming loans (NPLs) that would not be followed up by mitigating risk management actions and shareholder support. We could also consider a downgrade if major shareholders left the bank or significantly reduced their support.

## Rationale

**The ratings on the EBRD reflect its long record of fulfilling its public policy, high governance standards, and robust financial indicators.** The bank's very strong enterprise profile reflects our expectation that shareholders will remain supportive of the bank's operations, despite the heated political environment exacerbated by the Russia-Ukraine war. While we see a risk that asset quality deteriorates further, we estimate that the EBRD will be able to sustain an intrinsic risk-adjusted capital (RAC) ratio after adjustments above 23% and an NPL ratio broadly in line with its peers. The EBRD's eligible callable capital provides it with an additional buffer against any higher-than-anticipated deterioration of its capital position.

**The EBRD has built a long track record of fulfilling its mandate.** The EBRD was established in 1991 to foster the transition toward open-market-oriented economies in central and eastern Europe and the Commonwealth of Independent States by promoting private and entrepreneurial initiatives. The bank has been active in supporting its member countries, and shareholders are supportive of the bank's mandate. To ensure that the bank can provide further support to Ukraine, both in wartime and reconstruction, the bank is looking at a potential capital increase from shareholders. We expect it will be in the range of €3 billion-€5 billion. The final decision and details will be announced by the end of this year.

**Shareholders have provided more than €1 billion of donor funds to mitigate risks arising from the bank's response to the war in Ukraine.** The EBRD uses these donor funds to guarantee around 50% of the bank's new investments in Ukraine since the outbreak of the war. The EBRD announced its "Resilience and Livelihoods Framework" in March 2022 as an immediate response to the war to support Ukraine and neighboring countries affected by the war. The framework had an initial value of €2 billion and since then, the overall envelope for new investments, both within the framework and alongside it, into Ukraine has been increased to €3 billion over 2022-2023. Contrary to legacy exposures in Ukraine, which were primarily focused on the broader private sector, the bank primarily disburses new loans to the public sector or affiliated companies supporting critical infrastructure. We expect that these will perform better than the legacy loans.

**Throughout the pandemic and as part of its COVID Solidarity Package, the EBRD demonstrated its role as a countercyclical lender.** Total annual bank investments from 2020 and 2021 added up to €21.4 billion and disbursements were close to €15.0 billion over the same period. The almost €11.0 billion of investments annually in 2020 and 2021 represent a 10% increase, compared with 2019 business volumes, which reinforces our view of the EBRD's important role for its members.

**Over the past decade, the EBRD has widened its scope and strategically expanded its mandate.** The bank has built a strong presence in Turkiye and the southern and eastern Mediterranean region (SEMED), which includes Egypt, Jordan, Lebanon, Morocco, and Tunisia. As of December 2022, the bank had an active portfolio of €9.2 billion in the SEMED region and invested in 358 projects in total in the region since 2012. In Türkiye, the operations started in 2009, and the bank has an outstanding portfolio of €7.4 billion. In 2023, the board of governors agreed to expand the bank's mandate to sub-Saharan Africa and Iraq. First investments could start from 2025, and we expect any potential expansion will be gradual. Successful expansion to the region could further strengthen the bank's overall policy importance. Finding new markets of operation has been one of the EBRD's priorities as its exposure to Russia has declined on the back of sanctions. In 2014, the EBRD decided that Russia would no longer be a recipient country and stopped approving investments in Russia. The board of governors reinforced this decision in 2017. In April 2022, after Russia invaded Ukraine, the board of governors decided to suspend Belarus' access to financing from the bank, due to the country's support of Russia in the war.

**The EBRD's shareholder base is likely to continue expanding.** Despite the bank's measures, Russia and Belarus, who together hold about 4.2% of the shares in EBRD, have not left the EBRD or diluted their participation in the bank. In fact, no shareholder has left the bank since its inception. From the original 40 members, the bank's number of shareholders has increased to 73, after approving Algeria in October 2021. We believe that the expansion will continue, and therefore we could see a further increase in the shareholder base in the coming years. The EBRD does not have private sector shareholding. The European Community and the European Investment Bank each hold a 3.0% share.

**We consider that the preferred creditor treatment (PCT) awarded on sovereign exposure does not substantially improve the EBRD's enterprise risk profile.** Although the EBRD has benefited from PCT, the bank's business portfolio and strategy are more oriented toward the private sector. We reflect it in lower risk weights on its assets in our capital framework. We could reconsider this approach if the EBRD increased its sovereign exposure and had a longer record of keeping it above 25% of its total investments under the mandate. The government of Belarus decreed in April 2022 that it would repay debt to international financial institutions, including that owed to EBRD and to other multilateral lending institutions, in local currency. While we acknowledge the decision was taken due to operational challenges, it constitutes a default under our definitions as well as for the EBRD. Sovereign exposure to Belarus from the EBRD represents about 1.7% of the bank's total sovereign operating assets. As a result, our assumption of the EBRD's loss given default in our RAC calculation is 20%, compared with 10% prior to 2022.

**We assess the EBRD's governance and management as strong, based on its diversified shareholder base, transparent governance, experienced senior staff, and conservative risk management policy.** The capital position remains extremely strong and has improved to 30.2% per December 2022, from 29.7% in 2021. The improvement primarily reflects a 4% decrease in risk-weighted exposures, stemming from a reduction in the treasury portfolio and value adjustments to the equity portfolio. The ratio reflects the large geographical and sector diversification in the bank's exposures and a loss given default assumption of 20%. Further supporting the capital position is the EBRD's strong internal capital generation, with the return on equity averaging 3.9% over the past five years. Asset quality has deteriorated since the outbreak of the war in Ukraine last year. The NPL ratio increased to 7.8% in the first quarter of 2023, compared with 5.2% in the first quarter of 2022 and 4.9% at the end of 2021. Albeit at the higher end, the bank compared relatively well with 'AAA' rated peers with a similar focus on the private sector. We still see a risk of further deterioration in asset quality, especially in Ukraine, where NPLs already stood at 48% of total exposure to the country in December 2022. As a share of total outstanding impaired loans, Ukraine stood at 42% as per March 2023. Other than Ukraine, the largest contributors to NPLs per March 2023 were Turkiye (20%), Belarus (9%), and Lebanon (5%).

**We believe that prudent risk management will mitigate some of the risks associated with the increase in NPLs.** Most notably are the conservative approach to classify exposure as NPLs and management loss provisioning. In addition to specific provisions, the bank has included about

€500 million in so-called post-model adjustments to mitigate the increased risk, especially in Ukraine. Total impairment provisions in its loan book increased by about €1.4 billion in 2022 but decreased slightly in the first quarter of 2023, partly because donor-funded exposure requires lower provisions. As of the first quarter of 2023, the bank held €2.3 billion in general and specific provisions, €378 million in loan loss reserves, and €306 million in special reserve, which together represent 9.3% of total loan operating assets or 1.2x the gross value of the impaired assets. In addition, we view positively from a risk management perspective the ongoing shareholder discussion for capital injections from 2024 and that any new exposure in Ukraine in 2023 will carry partial donor guarantee. Moreover, we understand that, beyond the warzone, there are some positive trends in NPLs, with recoveries in, for example, Turkiye.

**The EBRD's funding profile benefits from strong access to capital markets and a diversified investor base.** Our funding and liquidity ratios for the EBRD indicate that the bank would be able to fulfil its mandate for at least one year, even under extremely stressed market conditions, without access to capital markets. In 2022, the bank reduced its treasury portfolio and therefore overall funding somewhat, but its overall liquidity position remains very strong, in our view. At year-end 2022, our stressed liquidity ratios for the EBRD increased to 2.8x at six months, from 2.4x, and remained stable at 1.9x at 12 months. Moreover, we estimate that the EBRD would not need to reduce the scheduled disbursements of its loan commitments even if it were to draw down half of the total commitments in one year. The EBRD's 'aaa' stand-alone credit profile (SACP) is buttressed by €6.1 billion (35% of adjusted common equity) in subscribed callable capital from members rated 'AAA'. Therefore, even if we revised down our assessment of the EBRD's SACP to 'aa+' or 'aa' because of a weakening in its cash capital position, it would probably not affect the issuer credit rating on the bank. In such a scenario, we could factor in shareholder support from eligible callable capital provided by members rated above the SACP, all other things being equal.

Table 1

### European Bank for Reconstruction and Development--Selected indicators

| | 2022 | 2021 | 2020 | 2019 | 2018 |
|---|---|---|---|---|---|
| **Enterprise profile** | | | | | |
| **Policy importance** | | | | | |
| Total purpose-related exposure (loans, equity, etc.) (mil. €) | 39,177 | 37,492 | 35,173 | 33,383 | 30,318 |
| Public-sector (including sovereign-guaranteed) loans/purpose-related exposure (%)* | 33 | 32 | 32 | 22 | 20.72 |
| Private-sector loans/purpose-related exposures (%) | 67.0 | 68.0 | 68.0 | 78.0 | 79.3 |
| Gross loan growth (%) | 7.3 | 3.8 | 5.9 | 9.8 | 7.0 |
| PCT ratio | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Governance and management expertise** | | | | | |
| Share of votes controlled by eligible borrower member countries (%) | 14.5 | 14.5 | 14.5 | 14.5 | 14.5 |
| Concentration of top two shareholders (%) | 18.7 | 18.7 | 18.7 | 18.7 | 18.7 |
| Eligible callable capital (mil. €) | 6,088 | 6,088 | 6,088 | 6,088 | 6,088 |

Table 1

## European Bank for Reconstruction and Development--Selected indicators (cont.)

| | 2022 | 2021 | 2020 | 2019 | 2018 |
|---|---|---|---|---|---|
| **Financial risk profile** | | | | | |
| **Capital and earnings** | | | | | |
| RAC ratio | 30.2 | 29.7 | 30.4 | 30.3 | 28.9 |
| Net interest income/average net loans (%) | 3.9 | 3.2 | 2.9 | 3.3 | 3.3 |
| Net income/average shareholders' equity (%) | -6.3 | 12.7 | 1.0 | 7.7 | 1.3 |
| Impaired loans and advances/total loans (%) | 6.9 | 4.8 | 5.5 | 4.2 | 4.6 |
| **Funding and liquidity** | | | | | |
| **Liquidity ratios** | | | | | |
| Liquid assets/adjusted total assets (%) | 42.6 | 45.4 | 45.4 | 46.9 | 46.8 |
| Liquid assets/gross debt (%) | 70.3 | 69.2 | 67.5 | 69.8 | 71.1 |
| Liquidity coverage ratio (with planned disbursements): | | | | | |
| Six months (net derivate payables) | 2.8 | 2.4 | 1.8 | 1.4 | 1.5 |
| 12 months (net derivate payables) | 1.9 | 1.9 | 1.5 | 1.2 | 1.2 |
| 12 months (net derivate payables) including 50% of all undisbursed loans | 1.5 | 1.5 | 1.3 | 1.2 | 1.0 |
| **Funding ratios** | | | | | |
| Gross debt/adjusted total assets (%) | 60.6 | 65.7 | 67.3 | 67.2 | 65.9 |
| Short-term debt (by remaining maturity)/gross debt (%) | 29.6 | 29.9 | 30.2 | 37.4 | 36.9 |
| Static funding gap (without planned disbursements) | | | | | |
| 12 months (net derivate payables) | 2.5 | 2.4 | 1.9 | 1.4 | 1.4 |
| **Summary balance sheet** | | | | | |
| Total assets | 71,625 | 74,773 | 69,772 | 68,201 | 61,851 |
| Total liabilities | 52,289 | 54,428 | 51,881 | 50,371 | 45,568 |
| Shareholders' equity | 19,336 | 20,345 | 17,891 | 17,830 | 16,283 |

PCT--Preferred creditor treatment. RAC--Risk-adjusted capital. *Excluding committed undrawn loans. N.A.--Not available.

Table 2

## European Bank for Reconstruction and Development--Ratings score snapshot

| Issuer credit rating | AAA/Stable/A-1+ |
|---|---|
| Stand-alone credit profile | aaa |
| Enterprise risk profile | Very strong |
| Policy importance | Strong |
| Governance and management | Strong |
| Financial risk profile | Extremely strong |

Table 2

### European Bank for Reconstruction and Development--Ratings score snapshot (cont.)

| Issuer credit rating | AAA/Stable/A-1+ |
|---|---|
| Capital adequacy | Extremely strong |
| Funding and liquidity | Very strong |
| Extraordinary support | 0 |
| Callable capital | 0 |
| Group support | 0 |
| Holistic approach | 0 |

## Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology , Jan. 31, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings , Oct. 10, 2021
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology , July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011

## Ratings List

| Ratings Affirmed | |
|---|---|
| **European Bank for Reconstruction and Development** | |
| Issuer Credit Rating | |
| Foreign Currency | AAA/Stable/A-1+ |
| Senior Unsecured | AAA |
| Commercial Paper | A-1+ |

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914