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Ratings

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Research Update:

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

July 20, 2022

Overview

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

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Rating Action

On July 20, 2022, S&P Global Ratings affirmed its 'AAA' long-term and 'A-1+' short-term issuer credit ratings on the European Bank for Reconstruction and Development (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 to allow it to fulfil its mandate and providing support to its countries of operation, mitigating the likely deterioration 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 perceive that support from shareholders has lowered or if the quality of the bank's exposures deteriorates more than we currently expect.

Rationale

The rating on the EBRD reflects 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 Ukraine-Russia conflict. While we expect that asset quality is likely to deteriorate, we estimate that the EBRD will be able to sustain a risk-adjusted capital (RAC) ratio after adjustments above 23% and a non-performing loan (NPL) ratio 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 was established in 1991 to foster the transition toward open-market-oriented economies in countries in Central and Eastern Europe and the Commonwealth of Independent States by promoting private and entrepreneurial initiatives. It has built a long track record of fulfilling its mandate. Over the past decade, the EBRD has widened its scope, strategically expanded its mandate, and built a strong presence in Turkey and the Southern and Eastern Mediterranean region, which includes Egypt, Jordan, Lebanon, Morocco, and Tunisia. As of December 2021, the bank has invested close to €16 billion in 320 projects in the region since 2012.

The bank has been active in supporting its member countries and shareholders are supportive of the bank's mandate. Shareholders' intention is to provide close to €1 billion of donor funds to mitigate risks arising from the bank's response to the war in Ukraine. The EBRD will use these donor funds to guarantee around 50% of the bank's investments in Ukraine and neighboring countries affected by the war under a framework called "The Resilience and Livelihoods Framework." Although we don't expect a step-up in lending until the conditions improve, the EBRD announced the framework in March 2022 as an immediate response to the war on Ukraine for an initial value of €2 billion.

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 billion over the same period. The almost €11 billion of investments each year represent a 10% increase compared with 2019 business volumes, which reinforces our view of the EBRD's important role and policy importance.

In 2020, Board of Governors affirmed its interest in a potential gradual expansion into Sub-Saharan Africa. The bank will continue exploring this strategy, which is subject to formal approval and which we believe could further strengthen its overall policy importance. Finding new markets of operation has been one of EBRD's priorities as its exposure to Russia has declined on the back of sanctions. The EBRD made the decision in 2014 that Russia would no longer be a recipient country and stopped approving investments in Russia. This decision was reinforced by the Board of Governors in 2017 and more recently in April 2022 after Russia invaded Ukraine, when at the same time, the Board of Governors voted to stop access to financing from the bank to Belarus.

Despite this, Russia and Belarus have not stepped out of EBRD or diluted their participation in the bank. Since inception, no shareholder has left the bank and, on the contrary, the shareholder base continues increasing. From the original 40 members, the bank now has 73 shareholders after approving Algeria to join the bank in October 2021. The EBRD does not have private sector shareholding. The European Community and the European Investment Bank each hold a 3.0% share.

Although the EBRD has benefited from preferred creditor treatment (PCT), the bank's business portfolio and strategy are more oriented toward the private sector. We therefore consider that the PCT awarded on sovereign exposure does not substantially improve the EBRD's enterprise risk profile. Instead, we reflect it in lower risk weights in our capital framework. We could reconsider this approach if the EBRD increased its sovereign exposure and had a longer record of maintaining it above 25% of its total investments under the mandate.

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 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 (MLIs), 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. Because we don't expect Belarus to solve its operational challenges in less than 180 days, we anticipate that the MLIs, including EBRD, will likely not be treated as a preferred creditor on Belarusian sovereign exposures. Sovereign exposure to Belarus from EBRD represents about 2% of the bank's total sovereign operating assets. As a result, we have revised our expectation of the EBRD's loss given default (LGD) to 20% from 10% in our last review.

While maintaining an extremely strong capital position, the revised LGD assumption is the main driver of our calculation that EBRD's RAC after adjustments has reduced to 29.7% for fiscal 2021 from above 30% in 2020. The ratio reflects the large geographical and sector diversification on the bank's exposures. Further supporting the capital position is EBRD's strong internal capital generation, with the return on equity averaging 4.2% over the past five years.

Asset quality as of March 2022 remains relatively stable. The NPL ratio increased to 5.2% for first quarter 2022 from 4.9% at the end of 2021 (5.5% for year end 2020) and compares well to its 'AAA' rated peers with a similar focus on the private sector. While we expect that asset quality will likely be under higher pressure, we anticipate NPLs will remain contained below 10%.

At year end 2021, write-offs had reached only €26 million after they increased significantly in 2020 to €194 million (the bank did not report write-offs in first-quarter 2022). In addition, in March 2022, general loan loss provisions increased to €1,296 million from €230 million. This figure excludes provisions on fair value through other comprehensive income loans and is not inclusive of a debt fair value adjustment. Therefore, as of the end of March 2022, increases in the general and specific provisions, together with the loan loss and special reserves, increased to 1.6x of impaired loans from 1.1x at the end of 2021. The concentration of NPLs remains largely unchanged from last year. The largest contributors to NPLs were Turkey (40%), Ukraine (11%), Lebanon (9%), and Egypt (7%).

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.

At year-end 2021, our stressed liquidity ratios for the EBRD increased to 2.4x at six months (from 1.8x) and 1.9x at 12 months (from 1.5x). Moreover, we estimate that 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.

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 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.

Ratings Score Snapshot

Issuer Credit Rating: AAA/Stable/A-1+

SACP: aaa

Enterprise Risk Profile: Very Strong

- Policy Importance: Strong
- Governance and management: Strong

Financial Risk Profile: Extremely Strong

- 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

Related Research

- How The Russia-Ukraine Conflict May Affect Multilateral Lenders, June 16, 2022
- Abridged Supranationals Interim Edition 2022: Comparative Data For Multilateral Lending, May 26, 2022
- Introduction To Supranationals Special Edition 2021, Oct. 27, 2021
- Supranationals Special Edition 2021 Says Boost In Multilateral Lending Support May Not Last, Oct. 27, 2021

- ESG Industry Report Card: Supranationals, Feb. 11, 2020

Ratings List

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