Research Update:

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

July 12, 2019

Overview

- The strong record of the European Bank for Reconstruction and Development (EBRD) in fulfilling its public policy mandate through credit cycles, together with its diversified and increasing membership and high governance standards, support our view of its very strong enterprise risk profile.

- The bank's robust financial indicators backed by strong risk management practices underpin its extremely strong financial risk profile, even though it is lending to some countries facing economic pressures.

- We are affirming our 'AAA/A-1+' long- and short-term issuer credit ratings on EBRD.

- The stable outlook reflects our view that EBRD will maintain extremely strong financial indicators despite increasing its exposure to countries that are at an intermediate stage of development. In addition, EBRD has ample 'AAA' callable capital that could mitigate a significant weakening of its financial profile, further supporting the ratings at the current level.

Rating Action


Rationale

The affirmation reflects EBRD's long record of fulfilling its public policy mandate, high governance standards, and robust financial indicators. In our view, EBRD has a very strong enterprise risk profile supported by its large presence in its regions of operation and its expanding membership base. We assess EBRD's financial risk profile as extremely strong, which results from the ample capital and liquidity buffers that enable the bank to mitigate instances of economic stress on its main borrowing members. Moreover, EBRD has 11 shareholders rated 'AAA' providing €6.1 billion of eligible callable capital that provides an additional buffer against any unexpected deterioration...
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. However, in the last decade, EBRD has widened its scope, working in countries in parts of the Middle East and North Africa as well. EBRD is owned by 68 countries plus the EU and the European Investment Bank, and has operations in 38 economies.

The bank has a strong record of more than two decades of operations and fulfilling its mandate throughout credit cycles, and has posted strong growth in its lending and equity portfolio even during financial crises. EBRD has strategically expanded its mandate and built a strong presence in countries like Turkey and the Southern and Eastern Mediterranean region, which includes Egypt, Jordan, Lebanon, Morocco, and Tunisia. Finding new markets of operation has been one of EBRD's priorities as its exposure to Russia has been declining due to sanctions imposed on Russia since 2014.

EBRD's expansion into new countries has contributed to an increase of its portfolio, with both outstanding loans and commitments continuing to grow in 2018 and the first half of 2019. We expect EBRD to continue increasing its business portfolio following its strategic 2019-2021 plan that foresees operating assets (loans and equity) and guarantees issued of €35.2 billion at the end of 2021, up from €30.4 billion at end-2018. Moreover, EBRD's direct private investment mobilization equaled around 11% of committed loans in December 2018.

Despite the situation in Russia, EBRD has benefited from substantial support from its shareholders since its establishment. EBRD has gradually increased its number of shareholders during the past 20 years; the original 40 shareholders have grown to 70 as of June 2019, and are predominantly European countries. No shareholder has left the bank. On the contrary, the shareholder base has continued to expand. In July 2018, India became a new member, and in June 2019, San Marino was confirmed as a shareholder of EBRD.

EBRD has increased its sovereign-related exposures to about 25% of the total, from about 15% some six years ago. Although EBRD clearly benefits 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 EBRD's enterprise risk profile. Instead, we reflect it in lower risk weights in our capital framework. We could reconsider this approach if EBRD increased its sovereign exposure and had a longer record of maintaining it above 25% of its sovereign-related assets.

We assess EBRD's governance and management as strong, based on its diversified shareholder base, transparent governance, experienced senior staff, and conservative risk management policy.

As of year-end 2018, EBRD has continued to post an extremely strong capital position, with an RAC ratio after adjustments of 29%. The ratio reflects the high adjustment for single-name concentration in the corporate and sovereign portfolio. Further supporting the capital position is EBRD's strong internal capital generation, with the return on equity averaging 4% over the past five years.

The RAC ratio also benefits from the EBRD's excellent track record of receiving PCT from sovereign borrowers. For example, EBRD, along with other multilateral lending institutions (MLIs), was excluded from the bond restructuring of the Export-Import Bank of Ukraine, Ukreximbank. EBRD also benefited from preferential treatment in 1998, when Russia excluded private-sector obligations to EBRD from restrictions on access to foreign exchange needed for debt service.
The recent economic deterioration in Turkey has had an impact on EBRD's portfolio, which saw a significant increase of nonperforming loans (NPLs) from €60 million at year-end 2017 to €359 million at year-end 2018. However, the bank's asset quality is in line with that of major MLI peers with an NPL history of about 5% and cumulative write-offs below 1%. As of March 2019, impaired loans constituted 4.8% of EBRD's total loan operating assets and were provisioned at 60%. While further asset quality issues may still emerge, we consider that EBRD's earnings capacity and capital levels are robust enough to navigate even a stressed situation.

However, we consider that EBRD's exposure to Turkey is subject to rising risks, not only from the deterioration in economic conditions, but also from geopolitical tensions that could lead to the imposition of sanctions or capital controls.

EBRD's funding profile benefits from strong access to capital markets and a diversified investor base. In addition, our funding and liquidity ratios for 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 the capital markets.

At year-end 2018, our stressed liquidity ratios for EBRD were 1.5x at six months and 1.2x at 12 months. Moreover, we estimate that EBRD would not need to reduce the scheduled disbursements of its loan commitments, even if half of the total commitments were to be drawn in one year.

EBRD's 'aaa' stand-alone credit profile (SACP) is buttressed by €6.1 billion (26% of adjusted common equity) in subscribed callable capital from members rated 'AAA'. A downward revision of our assessment of EBRD's SACP to 'aa+' or 'aa' because of a weakening in its cash capital position would probably not affect the issuer credit rating on the bank as we could then factor in shareholder support from callable capital, all other things being equal.

**Outlook**

The stable outlook reflects our expectation that in the next 24 months, EBRD will maintain extremely strong financial indicators despite increasing its exposure to countries that are at an intermediate stage of development. In addition, EBRD has ample 'AAA' callable capital that could mitigate a significant weakening of its financial profile while supporting the ratings at the current level.

We could consider lowering the ratings if the quality of EBRD's exposures deteriorates beyond our current expectations. We could also lower the ratings if, contrary to our expectations, relations among shareholders worsened, affecting the bank's policy importance.

**Ratings Score Snapshot**

Enterprise risk profile: Very Strong
- Policy importance: Strong
- Governance and management expertise: Strong

Financial risk profile: Extremely Strong
- Capital adequacy: Extremely Strong
- Funding and liquidity: Very Strong
Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- What Our New Criteria Has Meant For Multilateral Lending Institutions, April 12, 2019
- Guidance: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- Can Multilateral Lending Institutions Support Rising Demand In The Green And Social Bond Markets?, Oct. 29, 2018
- Supranationals Special Edition 2018, Oct. 11, 2018
- It's Time For A Change: MLIs And Mobilization Of The Private Sector, Sept. 21, 2018

Ratings List

<table>
<thead>
<tr>
<th>Ratings Affirmed</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>European Bank for Reconstruction and Development</strong></td>
</tr>
<tr>
<td>Issuer Credit Rating</td>
</tr>
<tr>
<td>Foreign Currency</td>
</tr>
<tr>
<td><strong>European Bank for Reconstruction and Development</strong></td>
</tr>
<tr>
<td>Senior Unsecured</td>
</tr>
<tr>
<td>Short-Term Debt</td>
</tr>
<tr>
<td>Commercial Paper</td>
</tr>
</tbody>
</table>

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. 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; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.
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