FitchRatings

RATING ACTION COMMENTARY

Fitch Revises EBRD's Outlook to Stable; Affirms at 'AAA'

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Fitch Ratings - London - 30 Nov 2021: Fitch Ratings has revised the Outlook on European Bank for Reconstruction and Development Bank's (EBRD) Long-Term Issuer Default Rating (IDR) to Stable from Negative and affirmed the IDR at 'AAA'.

KEY RATING DRIVERS

The revision of the Outlook to Stable from Negative reflects reduced downside risks to EBRD's solvency profile. The bank's capitalisation and risk metrics have been more resilient to the coronavirus pandemic than we anticipated at the previous rating review. Fitch now expects the bank to continue to maintain 'excellent' capitalisation levels over the medium term. Given the bank's expansion in 'high risk' countries in recent years, Fitch forecasts EBRD will operate with a higher level of non-performing loans (NPLs) relative to the historical trend over the medium term.

EBRD's 'AAA' rating reflects its Standalone Credit Profile (SCP) of 'aaa'. The SCP is driven by the bank's liquidity and solvency assessments of 'aaa'. The solvency assessment balances the bank's 'excellent' capitalisation and 'low' risk profile.

The bank's capitalisation ratios have improved since 2020 given the strong profitability recorded year-to-date in 2021 and moderate growth in banking exposures. As of end-September 2021, the bank reported a record EUR 1,986 million in net profit, boosted by positive revaluation of its equity portfolio and reversal of provisions owing to lower expected credit losses.

The bank's equity-to-adjusted assets and guarantees (e/a) ratio and Fitch's usable capital to risk-weighted assets (FRA) ratio had marginally improved at end-June 2021 compared with a year prior. The e/a ratio stood at 26.9% (against an 'excellent' threshold of 25%) while the FRA ratio was 39.2% (against an 'excellent' threshold of 35%). Fitch now expects both capitalisation metrics to remain above the 'excellent' thresholds over the medium term, given lower projected disbursements (relative to 2020 levels) and strong internal capital generation.

EBRD responded to the coronavirus pandemic by redirecting its lending envelope in 2020 and 2021 to support trade and provide liquidity to its borrowers. The bank also extended temporary payment deferrals to borrowers that accounted for 2.8% of total loans at its peak. The majority of borrowers with payment deferrals have resumed principal repayments to the bank and only a limited portion have become impaired.

The Covid-19 crisis has negatively affected the performance of EBRD's loan book. The bank's reported NPL ratio improved to 5.4% at end-June 2021 from 6.1% a year prior but remains above the pre-pandemic five-year average of 4.9%. These figures exclude exposures benefiting from payment deferrals not classified as impaired by the bank as well distressed restructured loans (DRLs), which rose to 3.5% of total loans at end-2020 from 1.8% at end-2019. The NPL ratio, as defined by Fitch, which includes deferred loans yet to resume principal repayments, was 5.8% at end-June 2021.

The large stock of NPLs, DRLs, and loans benefiting from payment deferrals highlights the credit stress faced by the bank's weakest borrowers, despite stability in the average portfolio credit quality. Fitch estimates that EBRD's average credit quality of loans and guarantees was 'B+' as of end-June 2021, in line with previous years. Despite increased exposure to 'high risk' countries, as measured by on average lower ratings, Fitch expects the average rating of the portfolio to remain stable over the medium term.

EBRD's preferred creditor status primarily applies to the bank's sovereign loans, which are fully performing, but Fitch also considers it would provide protection against the imposition of capital controls on its private sector exposures. This leads to a one-notch uplift over the assessment of the average rating of the loan book to 'BB-'.

The share of loan exposures in countries where the sovereign has a Negative Outlook has reduced to 11% of the total from 37% while sovereign downgrades have been limited. This reflects improved macroeconomic conditions and should support stability of the portfolio's credit quality.

Fitch expects EBRD to operate with a higher level of NPLs (close to but above 6%) over the medium term relative to the historical trend. This partly reflects the lingering effects from the Covid-19 crisis as well as the bank's expansion and focus on 'high risk' countries.

NPLs in Turkey (BB-/Stable), the Southern and Eastern Mediterranean (SEMED) region, which includes Egypt (B+/Stable), Jordan (BB-/Negative), Morocco (BB+/Stable), Tunisia (B-/Negative), and Lebanon (RD), and Central Asia, which includes Kazakhstan (BBB/Stable), Kyrgyz Republic (NR), Mongolia (B/Stable), Tajikistan (NR), Turkmenistan (NR), and Uzbekistan (BB-/Stable), account for 70% of the bank's total NPLs, despite these countries only accounting for 40% of loans.

Undisbursed loan commitments to these regions are higher than the existing stock and account for 50% of the total. This may put further pressure on the bank's NPL ratio given higher NPL rates compared with other regions in which the bank operates in. Furthermore, the bank is also exploring options to invest in Iraq (B-/Stable) and Sub-Saharan Africa, which could also negatively affect asset quality prospects.

Despite 'moderate' credit risks, Fitch's assessment of EBRD's 'low' risk profile is also supported by the bank's 'very low' obligor concentration metrics, 'excellent' risk management policies and 'very low' market risk exposure.

EBRD's liquidity is assessed at 'aaa'. The bank's coverage of short-term debt by liquid assets was 2.7x at end-June 2021 and is expected to remain above the 1.5x threshold that we deem as 'excellent' coverage. EBRD operates with a higher level of treasury assets (45% of total assets at end-June 2021) than comparable peers and this weighs positively on our assessment on liquidity. The quality of treasury assets is 'strong', with the share of treasury assets rated 'AAA'-'AA' at 58% as of end-June 2021. In Fitch's view, EBRD has 'excellent' access to capital markets.

Fitch assesses EBRD's business profile as medium risk, balancing 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. The latter was illustrated by the bank's response to the pandemic, which played a key role in providing liquidity support and financial advice to its borrowers. The operating environment is also assessed as medium risk, reflecting the moderate average credit quality and political risk in most countries of operations, as measured by the World Bank governance indicators, and strong operational support from member states.

RATING SENSITIVITIES

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.

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 at a level 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): Sustained higher levels of NPLs (above 6%) leading to significant credit losses, a breach of preferred creditor status on sovereign loans, or a decline in the average rating of loans and guarantees below 'B+'. This could stem from substantial and protracted credit quality deterioration in one or several countries of operations of EBRD, weaker-than-expected performance on deferred/restructured loans, and/or higher exposure to borrowers in countries with lower creditworthiness.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

Sources of Information

The sources of information used to assess these ratings were EBRD's financial statements and other information provided by EBRD.

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 provide temporary liquidity support, the bank has allowed payment deferral for some of its borrowers affected by the coronavirus crisis but that had not experienced payment delays before the deferral was granted. This 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.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT	RATING	PRIOR
European Bank for Reconstruction and Development	LT IDR AAA Rating Outlook Stable Affirmed	AAA Rating Outlook Negative
	ST IDR F1+ Affirmed	F1+
senior unsecured	LT AAA Affirmed	AAA
senior unsecured	ST F1+ Affirmed	F1+

VIEW ADDITIONAL RATING DETAILS

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PARTICIPATION STATUS

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APPLICABLE CRITERIA

Supranationals Rating Criteria (pub. 20 May 2021) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

European Bank for Reconstruction and Development	UK Issued, EU Endorsed

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SOLICITATION STATUS

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