Research Update:

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

July 16, 2021

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Overview

- EBRD has consistently expanded and diversified its membership base and shareholders continue to help the bank fulfil its public policy mandate through credit cycles, including in new areas of operations.
- The bank's robust financial indicators amid strong risk management practices underpin its extremely strong financial risk profile, which has enabled it to support its countries of operation through the pandemic-related economic crises.
- We are affirming our 'AAA/A-1+' long- and short-term issuer credit ratings on EBRD.
- The stable outlook reflects our expectation that, in the next 24 months, EBRD will maintain extremely strong financial indicators despite potential credit quality deterioration from the lasting effects of the pandemic. We also foresee it expanding its operations into other regions as it continues to fulfil its mandate.

Rating Action

On July 16, 2021, S&P Global Ratings affirmed its 'AAA' long-term and 'A-1+' short-term issuer credit ratings on European Bank for Reconstruction and Development (EBRD). The outlook is stable.

Rationale

The rating reflects EBRD's long record of public policy fulfilment, high governance standards, and robust financial indicators. The consistent increase of its membership base and support from its shareholders to achieve its mandate support our view of its very strong enterprise profile. The bank has also maintained an extremely strong financial profile; its ample capital and liquidity buffers have enabled it to mitigate instances of economic stress on its main borrowing members and increase its support throughout the pandemic. Moreover, EBRD's eligible callable capital provides it with an additional buffer against any unexpected deterioration in its risk-adjusted capital (RAC) ratio after adjustments.

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, it has widened its scope, strategically expanding its mandate and building a strong presence in Turkey since 2009, and during the last decade in the Southern and Eastern Mediterranean region (SEMED) including Egypt, Jordan, Lebanon, Morocco, and Tunisia.

Throughout the pandemic, the EBRD demonstrated its role as a countercyclical lender and expects activities from all its business lines to have provided total support of €21 billion by end-2021. This includes having increased its COVID-19 solidarity package to €4 billion of additional lending by April 2020, while the remainder represented a repurposing of the pipeline, largely to address pandemic-related liquidity shortages. The €11 billion of investments reported during 2020 represented a 9% increase compared with 2019 business volumes.

EBRD has grown substantially in SEMED, which has now become an important area for its operations. As of December 2020, the bank had €4.4 billion of loans and €436 million of equity exposure in this region, amounting to 14.5% of its total operating assets. The bank started operating in SEMED in 2012 through a special fund. In November 2013, EBRD granted Jordan, Morocco, and Tunisia the status of countries of operation. Egypt then received recipient country status in October 2015.

In 2020, the bank's board of governors affirmed its interest in a potential gradual expansion into Sub-Saharan Africa, a strategy that it will continue to explore subject to formal approval. We believe this could further strengthen its overall policy importance. Finding new markets of operations has been one of EBRD's priorities as its exposure to Russia has declined. The board imposed sanctions on Russia and since 2014 has not approved investments in the country. Despite this, Russia has not diluted its participation in the bank and therefore continues its 4% membership in EBRD. Meanwhile, EBRD members have supported the bank's mandate, including its expansion into other regions and its pandemic solidarity package.

Since its inception, no shareholder has left the bank and its membership continues to grow; from the original 40, shareholders increased to 71 after Libya joined the bank in July 2019. In January this year the United Arab Emirates was approved as the 72nd shareholder to join as a non-borrowing member. EBRD does not have private sector shareholding and the European Community and the European Investment Bank each hold a 3% share in the bank.

Although EBRD benefits from preferred creditor treatment (PCT) its business portfolio and strategy are oriented toward the private sector. We therefore consider that the PCT for sovereign exposure does not substantially improve EBRD's enterprise risk profile. Instead, we reflect PCT in the 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 PCT on more than 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. The bank announced its seventh president in November 2020. Odile Renaud-Basso replaced Sir Suma Chakrabarti, who stepped down in July 2020 after serving two full terms.

As of year-end 2020, EBRD maintained an extremely strong capital position, with a RAC ratio after adjustments of 30.4%, in line with the previous year's 30.3%. The ratio reflects the large geographical and sector diversification of the bank's exposures. The RAC ratio also benefits from EBRD's excellent track record of receiving PCT from sovereign borrowers and preferential treatment on private exposures. Further supporting the capital position is EBRD's strong internal capital generation, with S&P Global Ratings-adjusted return on equity averaging 4% over the past five years (our calculation uses a two-year average for total members' equity).

EBRD's asset quality remains reasonably stable. Its nonperforming loan (NPL) ratio was 5.4% at the end of first-quarter 2021 (5.5% at year-end 2020), up from 4.5% in 2019 but still lower than banks operating in the same regions and in line with 'AAA' rated peers that also focus on the private sector. In addition, the level of provisioning of impaired loans at the end of 2020 was 73% after including negative fair value adjustments.

The bank agreed that clients in the private sector operating in EBRD's borrowing countries that experienced temporary liquidity stress related to the pandemic could defer loan payments; the total outstanding as of the end of June 2021 is €772 million. We do not expect this to meaningfully weaken EBRD's credit quality because the bank has granted this support only to borrowers that had good credit standing before the pandemic, and whose liquidity pressures were temporary and pandemic-related. Only one of the deferred loans (€0.3 million) had become nonperforming as of end-2020.

As of March 2021, the main contributors to NPLs were from Turkey (39%), Ukraine (13%), Lebanon (10%), and Egypt (7%). The difficult economic conditions in Turkey continue to affect EBRD's portfolio, resulting in a significant increase in NPLs to €633 million at end-March 2021 from €450 million at year-end 2019. Write-offs on the corporate portfolio in Ukraine also increased substantially to €88.9 million in 2020. The net write-off as a percentage of operating assets increased to 0.67% for year-end 2020 from 0.05% in 2019.

EBRD's funding profile benefits from strong access to capital markets and a diversified investor base. 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 2020, our stressed liquidity ratios for EBRD were 1.8x at six months and 1.5x 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 (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.

Outlook

The stable outlook reflects our expectation that, in the next 24 months, EBRD will maintain extremely strong financial indicators despite potential credit quality deterioration from the lasting effects of the pandemic and expansion into other regions as it continues fulfilling its mandate. Our outlook is further supported by 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 the quality of EBRD's exposure deteriorates more than we currently expect, leading its NPL ratio to approach 10%. Such a deterioration of asset quality would not only change our view of the bank's financial profile but also of its risk management. We could also lower the ratings if, contrary to our expectations, relations among shareholders worsened, affecting the bank's policy importance.

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, Dec. 14, 2018
- 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

- Abridged Supranationals Interim Edition 2021: Comparative Data For Multilateral Lending Institutions, May 11, 2021
- Supranationals Special Edition 2020 Says Multilateral Lenders Are Addressing Challenges From COVID-19, Oct. 20, 2020
- Supranationals Edition 2020: Comparative Data For Multilateral Lending Institutions, Oct. 21, 2020
- Introduction To Supranationals Special Edition 2020, Oct. 20, 2020
- How Multilateral Lending Institutions Are Responding To The COVID-19 Pandemic, June 9, 2020
- Can Multilateral Lenders' Capital Bases Hold Up Against COVID-19?, June 9, 2020

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

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+