Research Update:

Eurasian Development Bank Ratings Raised To 'BBB/A-2' On Criteria Revision; Outlook Stable

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Overview

• We are reviewing multilateral lending institutions under our revised criteria.

• Based on our review, Eurasian Development Bank's (EDB's) risk-adjusted capital ratio improved.

• EDB's financial risk profile is now extremely strong, in our view, also supported by strong internal capital generation and continued ability to attract financing.

• We are therefore raising our ratings to 'BBB/A-2' and removing them from criteria observation.

• The stable outlook reflects our expectation that EDB will effectively manage anticipated growth without hampering its risk position.

Rating Action

On March 28, 2019, S&P Global Ratings raised its long- and short-term issuer credit ratings on Eurasian Development Bank (EDB) to 'BBB/A-2' from 'BBB-/A-3'. The outlook is stable.

We also affirmed our 'kzAAA' Kazakhstan national scale rating on EDB.

At the same time, we removed the ratings from under criteria observation (UCO), where we placed them on Dec. 14, 2018, after publishing the revised criteria.

Rationale

The ratings on EDB are based on its very weak enterprise risk profile and extremely strong financial risk profile. The financial profile has strengthened since we recalibrated our approach to preferred creditor treatment (PCT). This in turn affected our calculation of the risk-adjusted capital (RAC) ratio. The long-term rating does not incorporate extraordinary shareholder support from EDB's callable capital, since we rate all of EDB's sovereign shareholders lower than EDB's 'bbb' stand-alone credit profile (SACP). In addition, our assessment of the bank's policy importance as moderate precludes the notion of extraordinary support. We outline these factors in our revised criteria, "Multilateral Lending Institutions And Other

Our improved assessment of EDB's financial risk profile reflects our calculation of its RAC ratio at 27.8% after adjustments for concentration risk and PCT, as well as the bank's strong funding and liquidity. The RAC ratio incorporates all new parameters as of Feb. 18, 2019, based on financial data as of June 30, 2018. The ratio increased from 21% previously, mainly driven by the standard enhancement to the risk weights on EDB's exposures to financial institutions and corporate entities to capture the effects of PCT and the reduction of single-name concentration, which under our new approach disregards treasury assets. The capital ratio is also supported by the increase in earnings and internal capital generation. EDB reported net income of $66.4 million in 2018, 59% higher than in 2017. We expect this ratio to decrease over the next few years owing to the expected growth in the lending portfolio in line with 2018, but still remain above our threshold of 23% for an extremely strong assessment.

EDB's current investment portfolio increased significantly over 2018, by 47% to $3.4 billion by the year-end. This was a result of growth in the number of new projects and increased disbursements to the existing projects. Although we expected growth this year, the significant increase was clearly beyond our expectations. We note that it partly relates to other multilateral lending institutions (MLIs) having reduced their activities in Russia. We recognize the risk that, although our base case is that the RAC ratio will remain above 23%, EDB's high-growth strategy could make it volatile.

While a significant increase in the loan portfolio is generally a constraint for the RAC ratio and potentially negative for asset quality, it can be have a positive influence on our opinion of an institution's enterprise risk profile, and more specifically of its role and public policy mandate, should it strengthen the developmental impact. Historically, in the case of EDB, we have observed a volatile development of the loan portfolio (for example, the on-balance loan portfolio dropped by 30% in 2015 compared with 2014) and underperformance against targets in subsequent years. We have also taken note of the very limited geographic diversification outside Russia and Kazakhstan. We therefore are refraining from incorporating meaningful improvements until we have more solid evidence that the recent increase will rest on strong foundations and that EDB's role is cemented as an influential provider of financing to private sector development projects.

We note that economic pressures on EDB's main shareholders, Russia and Kazakhstan, have abated. On Jan. 18, and March 8, 2019, we affirmed our ratings on Russia and Kazakhstan (see "Russia 'BBB-/A-3' Ratings Affirmed; Outlook Stable" and "Kazakhstan 'BBB-/A-3' Ratings Affirmed; Outlook Stable"). We view these rating actions as positive for the quality of the loan book. Over the past couple of years, EDB has actively worked to improve the quality of its loan exposures and the situation has improved significantly. On Dec. 31, 2018, nonperforming loans (defaulted and overdue more than 90 days) stood at $23 million, representing 1.2% of EDB's on-balance portfolio, down from 6%
on Dec. 31, 2016. In line with management's expectations, we don't anticipate this ratio will rise over the next 12-24 months. We note that as of year-end 2018, Stage 3 loans (under International Financial Reporting Standard 9) represented about 18% of EDB's gross on-balance portfolio (down from 26% as of year-end 2017). We expect most of these loans will not default, as they service all the payments and have sovereign or quasi-sovereign guarantees covering all the obligations. We expect Stage 3 loans to decrease further by about 25% in absolute terms over 2019.

Our assessment of EDB's enterprise risk profile rests on our view of its role and public policy mandate, the strength and stability of its relationship with shareholders, and our governance and management expertise assessment. EDB's very weak enterprise risk profile is constrained by its relatively shorter track record and limited geographic diversification in comparison with other supranational peers and its unusual ownership structure, with Russia and Kazakhstan accounting for 99% of the shares.

Established in 2006 by an intergovernmental agreement, EDB is owned by Russia (66%), Kazakhstan (33%), Belarus (1%), Armenia (0.01%), Tajikistan (0.03%), and Kyrgyzstan (0.01%). It is the key MLI for the Eurasian Economic Union (EAEU) countries and its purpose is to contribute to the development and growth of market economy in the member states and to promote trade and economic integration among them by engaging in investment activities. EDB is improving its role and competitive position in its member countries, as witnessed by the significant increase in the loan portfolio in 2018, but it still remains very small compared with the economies of its members.

EDB also manages the resources of the Eurasian Fund for Stabilization and Development, which provides budgetary and balance-of-payments support to its member states, as well as financing national and regional projects and was established specifically to address the impact of the global financial crisis on member states of the EAEU. In our view, EDB's role as the manager of the EFSD, which has $8.5 billion under management, underscores its importance for member states, in particular for Russia, the dominant member. EFSD had disbursed $4.8 billion in loans as of Dec. 31, 2018. The EFSD has its own balance sheet, managed separately from EDB's balance sheet.

EDB's private-sector focused mandate excludes it from being treated as a preferred creditor, given that private-sector companies cannot selectively default to one group of creditors while paying others as sovereigns can. Hence, we do not incorporate PCT in our assessment of the enterprise risk profile. However, given EDB's status as an MLI, we do consider preferential treatment granted by the governments of countries in which it operates and we incorporate this into our assessment of EDB's financial risk profile. EDB has been exempted from sanctions placed on Russia.

Over the past few years, we have seen a gradual increase in EDB's bond issuance. After a gap of more than a year due to a tenge (KZT) liquidity deficit in Kazakhstan's local bond market, on May 24, 2017, EDB issued KZT15 billion ($41 million) of three-year bonds. This was followed by an issuance of
KZT20 billion in October 2017 and five more issuances of tenge-denominated bonds with a total value of KZT90 billion in 2018. More recently, on Feb. 22, 2019, EDB again issued a three-year tenge-denominated bond of KZT20 billion. While the Kazakh local bond market is narrow and shallow (representing less than 15% of GDP), we see the recent surge as relatively stable, although we acknowledge the historical volatility of the tenge market. In addition, EDB attracts funding mainly in Russian ruble and Kazakhstani tenge, and we believe it will continue to be able to access funds in different currencies at reasonable rates.

EDB has historically maintained a conservative liquidity management policy. On Dec. 31, 2018, liquid assets totaled approximately $1.3 billion, or 34% of its balance sheet. This enabled the bank to meet its policy target, which stipulates that liquid assets should cover at least one year's projected net loan disbursements (loans disbursed less repayments) if greater than zero, less bilateral commitments, plus the annual cost of financial debt. Our stressed 12-month liquidity ratio indicates that EDB would need to access the market to be able to continue providing scheduled loans over the next 12 months (with a liquidity ratio of 0.83x) but could comfortably cover six months, with a ratio of 1.53x. However, its ability to access central bank funding in Russia and Kazakhstan supports our liquidity assessment.

Outlook

The stable outlook reflects our expectation that EDB will effectively manage anticipated growth without hampering its risk position in the next 24 months.

Upside scenario

We could raise the ratings if EDB maintains its extremely strong capital position while fostering portfolio growth that supports its role and public policy mandate.

Downside scenario

We could lower the ratings if continued quick portfolio growth was not compensated by additional capital plans or if it resulted in a deterioration in asset quality, which in turn would imply weak governance and management standards.

Ratings Score Snapshot

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<thead>
<tr>
<th>Issuer Credit Rating</th>
<th>BBB</th>
</tr>
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<tbody>
<tr>
<td>SACP</td>
<td>bbb</td>
</tr>
<tr>
<td>Enterprise Risk Profile</td>
<td>Very weak</td>
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<tr>
<td>Policy Importance</td>
<td>Moderate</td>
</tr>
</tbody>
</table>
Governance and management  Weak

Financial Risk Profile  Extremely strong
Capital Adequacy  Extremely strong
Funding and Liquidity  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
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 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

- Criteria Guidance: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- Ratings On 32 Multilateral Lending Institutions And Supranationals Placed Under Criteria Observation On Criteria Update, Dec. 14, 2018

Ratings List

<table>
<thead>
<tr>
<th>Entity</th>
<th>Type</th>
<th>Rating Before</th>
<th>Rating After</th>
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<tbody>
<tr>
<td>Eurasian Development Bank</td>
<td>Issuer Credit Rating</td>
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<td>BBB/Stable/A-2</td>
</tr>
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<td>Foreign Currency</td>
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<td></td>
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<tr>
<td>Senior Unsecured</td>
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<td>BBB</td>
<td>BBB-</td>
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Ratings Affirmed
Eurasian Development Bank
Kazakhstan National Scale              kzAAA/--/--

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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.