Fitch Rates Eurasian Development Bank 'BBB+'; Outlook Stable

Fitch Ratings - London - 28 November 2019:

Fitch Ratings has assigned Eurasian Development Bank (EDB) a Long-Term Issuer Default Rating (IDR) of 'BBB+' with a Stable Outlook. A full list of rating actions is detailed below.

Key Rating Drivers

EDB's Long-Term IDR of 'BBB+' is solely based on the intrinsic features of the bank. Its intrinsic credit profile is driven by our solvency profile assessment of the bank, at 'a', which is the lower of its liquidity and solvency assessments. The bank's liquidity is assessed at 'aa-'. Fitch's assessment of a high-risk business environment translates into a negative adjustment of two notches below EDB's solvency assessment, to 'bbb+'. Our assessment of EDB's shareholders' capacity and propensity to support does not provide any uplift above the bank's intrinsic assessment.

Fitch considers EDB's 'excellent' capitalisation as a key rating strength, primarily driven by our view that EDB's equity / assets ratio will continue to far exceed the 25% 'excellent' threshold over a three-year forecast period ending 2021. As of FYE18, the equity/assets ratio was 47% and, while we expect this figure to decline over the medium term to around 35%-40%, significant headroom remains above the 25% threshold. Our assessment is also supported by the bank's usable capital / risk-weighted assets (FRA) ratio - which far exceeds the 35% 'excellent' threshold (FYE18: 65%).

Like other multilateral development banks (MDBs), profitability is not one of EDB's main priorities. Instead, it aims to build up sufficient reserves to fulfil its development role. At FYE18, EDB's internal capital generation (ICG) was 3.9%, which compares favourably with MDB peers', and we expect the bank's ICG to continue to average approximately 2.5% - 3% over the forecast period.

Our assessment of EDB's solvency combines the bank's 'excellent' capitalisation and 'high' risk profile. EDB's loan portfolio comprises solely private borrowers, a considerable portion of which are not rated by Fitch, and whose credit quality is assessed as very low. Consequently, the agency estimates EDB's loan portfolio average rating at 'B+'. The limited amount of sovereign guarantees, which cover specific projects and accounted for approximately 12.5% of EDB's total banking exposure at end-2018, means there is no rating uplift for preferred-creditor status, or for other credit-risk mitigating factors.

Non-performing loans (NPLs), as reported by the bank, fell markedly to 2.5% in 2018 from 6.7% in 2017. However, loans designated as Stage 3 under IFRS 9, which are closer to Fitch's own definition of non-performing loans NPLs, were significantly higher, at 16% as of end-2018, particularly owing to three large projects experiencing difficulties. Fitch expects Stage 3 loans as a percentage of total loans to decline during the forecast period, reflecting a combination of rapid growth in the loan portfolio, recoveries, write-offs and a large share of Stage 3 loans that were reclassified as performing, as of mid-2019 relative to end-2018, but we continue to expect a 'high-risk' NPL rate (defined as greater than 6%) by FYE21.

We assess EDB's concentration risk as 'low', reflecting the bank's ability to lend to private-sector borrowers, which translates into a more diversified loan portfolio than that of peers who are focused only on sovereign lending. Fitch expects the top-five exposures to amount to 25%-30% of the bank's total banking exposure by 2021, compared with 31.7% for end-2018. This projected reduction is chiefly driven by the bank's larger lending portfolio, which will improve its concentration metrics in the coming years. The bank's geographic
concentration, however, offsets a diversified individual borrower exposure, with significant borrower concentration in both Russia (46% of total loans as of August 2019) and Kazakhstan (38%).

Fitch assesses EDB's equity participation risks as 'very low', which reflects the expected share of equity stakes relative to the bank's total exposures of around 1% in 2021 (2018: 0%). Although the share is increasing, this level of equity investments still represents a 'very low' risk level - far below the 5% threshold for a 'low' assessment, with the small portion of equity stakes relating to one Russian bank and one Armenian bank - with shareholdings in each at less than 20%.

Market risks are assessed as 'low' for EDB owing to both limited interest-rate risk and FX risks, with the bank's primary market risk policy to match its funding and lending activities by currency and maturity to avoid any mismatch. To control its exposure to interest-rate risk, the bank raises predominantly fixed-rate financing and also lends at fixed rates, also using both EVE (economic value of equity) and GAP analysis to monitor any open positions. With regard to FX risk, the bank keeps its open currency positions close to zero. EDB utilises various types of derivative instruments (such as cross-currency swaps, FX swaps and forwards) to manage its foreign-currency exposures.

Risk management policies are assessed as 'moderate'. While the bank adheres well to its internal financial ratios, some limits are less conservative than those of rated peers (including a minimum capitalisation ratio of 16%). Furthermore, while EDB has an internally developed project rating methodology to grade loans, which comprises both the rating of the borrower and the rating of relevant collateral, the bank does not have an equivalent rating scale that can be used to map its ratings to those of external rating agencies.

Liquidity is a rating strength for EDB, with the bank's 'aa-' liquidity profile reflecting its 'excellent' liquidity buffer, 'moderate' asset quality and 'moderate' access to capital markets. EDB's long-term funding sources are Eurobonds, local bonds in Russian roubles and the Kazakh tenge and tied-financing loans, with the bank issuing in various currencies depending on investor demand.

In terms of EDB's liquidity buffer, as of FYE18 the bank's coverage of short-term debt (including deposits) by eligible liquid assets stood at 230%, far above the 150% 'excellent' threshold outlined in our criteria. While we expect this ratio to fall over the forecast period to closer to 200%, EDB's expected liquidity buffer remains high and broadly in line with peers'.

EDB's treasury-asset quality improved considerably in 2019, with the portion of 'AAA-AA' rated assets representing 45% of treasury assets as of June 2019, compared with 22% as of FYE18. This improvement was driven by maturing securities being re-invested in higher-quality assets, such as US Treasuries. While EDB expects to maintain this higher quality of treasury assets over the medium term, Fitch's forecast is more conservative given that the improvements in 2019 were not driven by changes to EDB's policies relating to treasury assets.

EDB's business environment is deemed 'high risk', which translates into a two-notch negative adjustment below our solvency assessment of 'a', leading to an intrinsic rating of 'bbb+'. Our assessment of EDB's 'high risk' business profile is driven by the 'small' size of its banking portfolio (USD2.1 billion at FYE18), its focus on non-sovereign lending (88% as of end-2018) and the bank's expected high lending growth. Our 'high risk' assessment of EDB's operating environment reflects the political risk, average credit quality and a fairly high share of low-income countries within the distribution of EDB's countries of operations. The business climate in the head-office country (Kazakhstan) is considered 'medium' risk.

Support is currently not a rating driver. In terms of capacity to support, given the sovereign ratings of both Kazakhstan and Russia are currently 'BBB' / Stable Outlook, and we do not expect the bank's shareholding structure to change materially over the medium term, we expect EDB's net debt to remain covered by 'BBB' rated callable capital over the forecast period. In terms of the bank's weighted average rating of key shareholders, with 65.97% of ownership, Russia is the bank's sole 'key shareholder', leading to an overall capacity to support assessment of 'bbb'.

Fitch assesses EDB's shareholders' propensity to support the bank as 'strong'. The bank has had callable capital since 2014, a key signal of shareholders' support under Fitch's Criteria. The supranational status of
EDB leads us to believe that the bank will benefit from immunities and privileges in its countries of operations.

EDB's Short-Term IDR of 'F1' reflects our liquidity assessment of 'aa-' which is higher than 'a', the minimum liquidity assessment at which the higher of two Short-Term rating options (F1 or F2) would apply at the 'BBB+' Long-Term IDR level.

EDB's Long-Term IDR is one-notch above the 'BBB' sovereign rating of Kazakhstan, with a Stable Outlook. Therefore, the MDB is rated 'AAA(kaz)' on our Kazakhstan national rating scale.

The National Long Term Rating of EDB is at the highest point of its national scale and therefore there is no upside potential. As EDB's Long-Term IDR is one notch above the sovereign rating of Kazakhstan, the latter would need to be downgraded by a least two notches for there to be any impact on EDB's National Rating.

RATING SENSITIVITIES

The Outlook is Stable. Consequently, Fitch's sensitivity analysis does not currently anticipate developments with a material likelihood, individually or collectively, of leading to a rating change. However, future developments that may, individually or collectively, lead to positive rating action include:

- Stronger assessment of the business environment reflected in an improved business profile or operating environment, for example reflecting more measured medium-term growth of the loan portfolio or an improvement in sovereign ratings and governance in the bank's countries of operations.

- A significant improvement in EDB's 'credit risk' profile, most notably by a marked and sustained decline in the bank's NPL rate to below the current 'high risk' level (defined as above 6%) and an improvement in the average rating of loans.

- Increased diversification in the loan portfolio evidenced by a marked decline in the share of the top-five borrowers in the loan portfolio that partly offsets the high geographic concentration.

- Stronger assessment of the bank's risk-management policies. This could be supported by the introduction of an internal credit rating system that could be mapped to corresponding Fitch ratings.

Conversely, future developments that may, individually or collectively, lead to negative rating action include:

- A substantial increase in leverage or marked increase in loan impairments that erode the bank's capital and affect our 'excellent' capitalisation assessment.

- Weakening in the assessment of the risk profile that could stem from deterioration in credit risk or failure to adhere to the bank's own risk-management rules.

- Evidence of a weakening of the bank's business environment, for example via increased risks in the countries of operations, weaker governance standards or a higher-risk lending strategy.

Key Assumptions

- EDB will remain compliant with its internal prudential limits.

- Fitch assumes no substantial changes in the bank's strategy over the forecast period.
## RATING ACTIONS

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## Applicable Criteria

National Scale Ratings Criteria (pub. 18 Jul 2018)  
Supranationals Rating Criteria (pub. 23 May 2019)

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