Research Update:

Eurasian Development Bank Outlook Revised To Negative On Deteriorating Capital Adequacy; 'BBB/A-2' Ratings Affirmed

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Overview

- The capital adequacy of multilateral lending institution the Eurasian Development Bank (EDB) declined in 2013, in our view.
- We consider that EDB's financial profile has weakened, although we still assess it as "strong" under our criteria.
- We are revising our outlook on the bank to negative from stable. At the same time, we are affirming the ratings at 'BBB/A-2'.
- The negative outlook reflects our view that there is at least a one-in-three chance that we could lower the ratings on EDB within the next two years if its financial profile continues to deteriorate at a fast pace.

Rating Action

On Jan. 29, 2014, Standard & Poor's Ratings Services revised the outlook on multilateral lending institution the Eurasian Development Bank (EDB) to negative from stable. At the same time, we affirmed the long- and short-term foreign currency issuer credit ratings on the bank at 'BBB/A-2'. We also affirmed the Kazakhstan national scale rating on the bank at 'kzAA+' and the Russia national scale rating on the bank at 'ruAAA'.

Rationale

The outlook revision reflects our view that there is at least a one-in-three chance that we could lower the ratings on EDB within the next two years if its financial profile continues to weaken, following the deterioration in its capital adequacy that we observed in 2013. We now consider the bank's financial profile to be "strong" rather than "very strong," as our criteria define these terms. The 'BBB/A-2' ratings on EDB reflect the financial profile assessment and our assessment of the bank's business profile as "weak." EDB's stand-alone credit profile is 'bbb'.

At the end of June 2013, Standard & Poor's risk-adjusted capital (RAC) ratio--our primary measure of capital adequacy--was 24.1% for EDB before adjustments, compared with 32.4% at end-2012. Taking into account adjustments specific to multilateral lending institutions (MLIs) under our criteria, the ratio was 13.7% at end-June 2013, down from 17.2% at end-2012. Given its mandate, EDB operates with high geographical and counterparty concentration.
risk, and most of its loans are to entities that are either not rated by Standard & Poor's or that we rate speculative-grade. EDB's total paid-in capital was $1.516 billion as of end-June 2013, which accounted for 0.7x of loans to customers at that date. This ratio had decreased from 0.8x six months previously owing to fast asset growth.

In 2013, EDB's Council--its supreme management body--approved the bank's strategy for 2013-2017, which presupposes an increase in the bank's capital to US$7 billion (an amount specified in the Council's decision). The bank expects the increase in capital to include the introduction of callable capital in 2014.

EDB was established in 2006 under an intergovernmental agreement between the presidents of Russia (BBB/Stable/A-2 foreign currency, BBB+/Stable/A-2 local currency) and Kazakhstan (BBB+/Stable/A-2). Since then, four more full members have joined: Armenia and Tajikistan in 2009, Belarus (B-/Stable/B) in 2010, and Kyrgyzstan in 2011. EDB has immunity against legal proceedings under jurisdiction of its member states, and the bank is exempt from any taxes, levies, duties, income taxes, or other payments on the territories of its member states.

The bank's mandate is to promote economic growth, external trade, and economic ties between the six member states. The mandate extends through the countries in the Eurasian Economic Community (EurAsEC). As of end-2013, EDB has 71 projects in its current investment portfolio, totaling US$3.9 billion.

Russia and Kazakhstan continue to dominate the EDB, and have significant control and a strong influence over decision-making. Voting rights are proportional to capital contributions. As of end-June 2013, Russia held a 65.97% stake, Kazakhstan 32.99%, Belarus 0.99%, Tajikistan 0.03%, Armenia 0.01%, and Kyrgyzstan 0.01%. EDB's operations are primarily located in the member states, mainly Russia and Kazakhstan, which leaves EDB exposed to the economic and financial markets of those countries.

In our opinion, the dominance of Russia and Kazakhstan exposes EDB to the limits of institutional and governance effectiveness in those member states. In our view, political institutions in both Russia and Kazakhstan remain comparatively weak and political power is highly centralized, particularly at the presidential level. The political environments are characterized by a lack of transparency.

EDB does not seek to maximize its net income, like other MLIs. However, the bank's profitability has continued to decline. In 2013 the decline primarily reflected an increase in provisions.

Our funding and liquidity ratios indicate that EDB is structurally able to cover its scheduled debt repayments and loan disbursements over the next year without recourse to new issuance. Despite its relatively small size, EDB has successfully issued several types of securities at different bond and money markets, even during times of market turbulence.
Outlook

The negative outlook reflects our view that there is at least a one-in-three chance that we could lower the ratings on EDB within the next two years if its financial profile continues to deteriorate at a fast pace. We could revise the outlook to stable if capital adequacy, as measured under our RAC framework, does not weaken further.

The ratings could also be affected positively or negatively by changes in the operating environment in the region. If this became more difficult—for example, if EDB's nonperforming loans were to rise or shareholder support were to weaken—we could lower the ratings. Conversely, the ratings would be supported by a strengthening in the institutional and governance framework in Russia and Kazakhstan, the main decision-making member states.

Related Criteria And Research

- Multilateral Lending Institutions And Other Supranational Institutions
  Ratings Methodology, Nov. 26, 2012
- Principles Of Credit Ratings, Feb. 16, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

To                   From
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Eurasian Development Bank
Issuer Credit Rating
Foreign Currency     BBB/Negative/A-2  BBB/Stable/A-2

Ratings Affirmed

Eurasian Development Bank
Issuer Credit Rating
Kazakhstan National Scale  kzAA+/--/--
Russia National Scale     ruAAA/--/--

Eurasian Development Bank
Senior Unsecured Debt    BBB

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Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by...
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