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Research Update:

International Investment Bank Downgraded To 'BBB+' On Reducing Policy Relevance; Outlook Negative

March 30, 2022

Overview

- The International Investment Bank (IIB) is reducing its balance sheet in response to heightened financial and market confidence risks following Russia's military actions in Ukraine.
- Although deleveraging should bolster IIB's capital and liquidity positions in the short term, it raises concerns about the bank's policy relevance, including its ability to act as a countercyclical lender and its capability to sustainably access international capital markets.
- In addition, key shareholders have announced their intention to withdraw from the institution, which we believe could reduce IIB's policy role further and require IIB to make a significant strategic shift to maintain its policy relevance.
- We have therefore lowered our long-term ratings on IIB to 'BBB+' from 'A-'. The outlook remains negative.

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Rating Action

On March 30, 2022, S&P Global Ratings lowered its long-term foreign and local currency issuer credit ratings on the International Investment Bank (IIB) to 'BBB+' from 'A-'. The outlook remains negative.

At the same time, we affirmed our 'A-2' short-term ratings on IIB.

Outlook

The negative outlook reflects the risks of a material erosion of IIB's shareholder base due to the announced exit of several key shareholders. If executed, we believe this will erode the bank's policy role, raising concerns regarding its institutional depth and requiring significant changes to its fundamental strategy to avoid losing its policy relevance. These factors pose significant risks to the bank's enterprise risk profile. We believe the shareholder withdrawal process could materialize within the next 12 months, leading to an adverse scenario that could result in a multi-notch downgrade.

Downside scenario

We could lower our ratings if shareholders follow through on their intentions to withdraw from the institution, leading to a material erosion of IIB's shareholder base while altering its policy role and institutional underpinnings. Aside from the developing shareholder situation, we could downgrade the bank if financial pressures heighten, for example from a material deterioration of asset quality or disruption to counterparts' payment abilities that depletes IIB's liquidity buffers.

Upside scenario

We could revise the outlook to stable if the withdrawing shareholders reverse course and the bank takes successful steps to reposition its policy function and overall policy relevance while containing asset-quality deterioration.

Rationale

The downgrade reflects our assessment that IIB's policy relevance is reducing as it downscales its operations to manage the repercussions of the Russia-Ukraine conflict on its operations. These include heightened risks to asset quality; reputation risk from its ownership structure and lending book where Russia holds dominant positions, which has disrupted IIB's access to financial markets; and considerable uncertainty regarding IIB's public policy relevance and its relationship with shareholders.

We expect IIB's efforts to preserve its financial position will support its financial resilience in the short term as it reduces its balance sheet. We understand that IIB is taking steps to preserve its financial standing to navigate through the fallout of the Russia's military actions in Ukraine conflict. These include an indefinite pause of all new loan disbursements, the selloff of loans equivalent to at least 20% of the total portfolio, and likely introduction of bond-buyback arrangements. We believe this imminent deleveraging will sustain IIB's liquidity and risk-adjusted capital (RAC) ratio over the short term. We expect IIB would still be able to service its debt obligations, while institutional changes regarding its policy mandate and shareholder structure unfold.

After Russian troops entered Ukraine, several of IIB's shareholders announced they intend to withdraw their participation of the bank. A formal exit process has not yet started, but the announcements imply that some of these shareholders will likely do so. If all of those shareholders withdraw from IIB as announced, those would reduce IIB's shareholder base by 30%.

The withdrawal of several EU shareholders would erode IIB's shareholder base sufficiently to weaken IIB's policy mandate and potentially also its governance structure, while materially altering its geographic reach. Such a development would require IIB to make a significant strategic shift to avoid a material erosion of its policy mandate. We believe the exit process, if initiated, will take place over the next 12 months, during which the remaining shareholder base will become clearer. We understand that the bank's statutes would ensure that the paid-in capital remains in the bank, even if a shareholder withdraws from the institution.

We anticipate that the public-sector nature of IIB's Russian exposures and IIB's preferred creditor characteristics would allow service of loan commitments, amid deteriorating macroeconomic conditions and capital controls. About 23% of IIB's loan portfolio represents Russian counterparts. We understand that about 80% of these exposures are to state-owned entities and consider that this mitigates payment concerns. We also note that about 75% of its lending is denominated in Russian ruble and understand that there has been no payment disruption for loans denominated in rubles or hard currency so far. This illustrates IIB's preferential treatment and statutory exemption from capital controls. That said, we consider the deteriorating economic environment and still-elevated uncertainties regarding borrowers' payment abilities, poses risks to IIB's financial profile.

Ratings Score Snapshot

Issuer credit rating: BBB+/Negative/A-2

Stand-alone credit profile: a-

Enterprise risk profile: Moderate

- Policy importance: Moderate
- Governance and management expertise: Adequate

Financial risk profile: Very strong

- Capital adequacy: Extremely strong
- Funding and liquidity: Adequate

Extraordinary support: 0

- Callable capital: 0
- Group support: 0

Holistic approach: -1

Environmental, social, and governance (ESG) credit factors for this change in credit rating/outlook and/or CreditWatch status:

- Governance structure

Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Jan. 31, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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

Ratings List

Downgraded; Ratings Affirmed

	To	From
International Investment Bank		
Sovereign Credit Rating		
Foreign Currency	BBB+/Negative/A-2	A-/Negative/A-2