MOODY'S
INVESTORS SERVICE

CREDIT OPINION
1 November 2017

Update

Rate this Research

Analyst Contacts

Kristin Lindow +1.212.553.3896
Senior Vice President
kristin.lindow@moodys.com

Polina Gotmann +49.69.7073.0725
Associate Analyst
polina.gotmann@moodys.com

Dietmar Hornung +49.69.7073.0790
Associate Managing Director
dietmar.hornung@moodys.com

Yves Lemay +44.20.7772.5512
MD-Sovereign Risk
yves.lemay@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

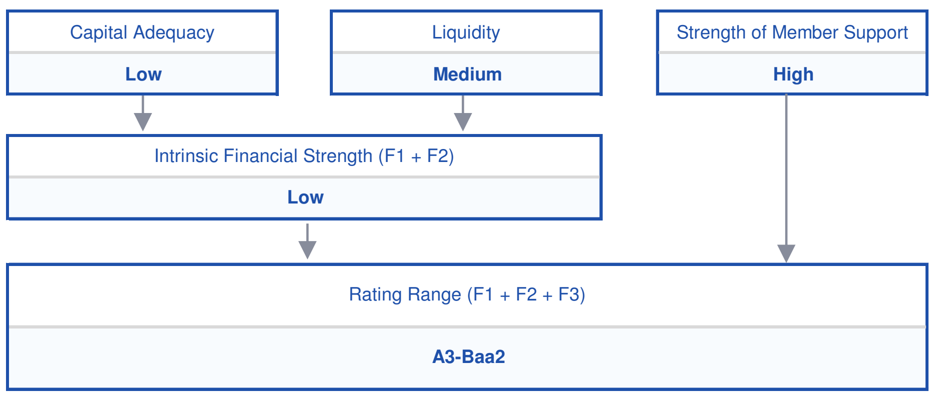
International Investment Bank (IIB) – Baa1 Positive

Regular update

Summary

The credit profile of IIB is supported by the increased diversification of its loan portfolio as well as its funding. The Bank continues to have large amount of usable equity relative to loans outstanding, sizable liquid assets to cover debt service and ample callable capital from investment-grade-rated shareholders relative to debt. IIB's credit profile is constrained by history of very high non-performing loans and relatively weak borrower quality, and the bank faces challenges related to preserving asset quality amidst rapid balance sheet expansion.

Exhibit 1
International Investment Bank's credit profile is determined by three factors



Source: Moody's Investors Service

Credit strengths

» Large amount of usable equity relative to loan portfolio

» Sizable liquid assets to cover debt service

» Ample callable capital from investment-grade rated shareholders relative to debt

Credit challenges

» Preserving asset quality amidst rapid balance sheet expansion

» Weak borrower quality

Rating outlook

On 5 May 2017, we changed the outlook on IIB's Baa1 rating to positive from stable. The key drivers of the decision to change IIB's rating outlook to positive were: (1) the increased diversification of IIB's loan portfolio and the maintenance of relatively strong asset quality on loans extended since the bank's re-launch in 2012 despite Russia's recession; and (2) the improved credit quality of IIB's treasury portfolio since the bank was downgraded in 2015 and the increased diversification of its funding sources.

Factors that could lead to an upgrade

Upward rating pressure would come from maintaining strong asset quality with NPLs at 6% or less of total loans; further diversification of the loan portfolio as lending expands; or a sustained improvement in the average borrower quality. Further improvement in the quality of the treasury portfolio and additional diversification of funding sources would be credit positive, as would the full pay-in of capital as already committed by IIB's members.

Factors that could lead to a downgrade

IIB's rating outlook would be changed back to stable should the bank begin to incur more NPLs on its post-re-launch portfolio, especially should NPLs rise above the bank's 6% of total loans target level for a period of two years or more. We would also negatively assess a further worsening of the bank's liquidity metrics beyond those of similarly rated MDB peers, or if the strength of member support deteriorates.

Key indicators

Exhibit 2

IIB	2010	2011	2012	2013	2014	2015	2016
Total Assets (USD million)	470	460	484	567	740	879	930
Return on Average Assets (%)	7.1	0.5	0.6	0.7	0.8	0.3	0.1
Usable Equity/Gross Loans Outstanding + Equity Operations (%) [1]	257.0	292.3	279.9	365.5	159.7	125.8	103.2
Gross NPLs/Gross Loans Outstanding (%) [2]	68.3	77.5	67.6	0.0	3.3	4.7	3.9
ST Debt + CMLTD/Liquid Assets (%) [3]	0.0	0.0	0.0	0.0	31.6	16.2	40.9
Total Debt/Discounted Callable Capital (%) [4]	0.0	0.0	0.0	0.0	20.8	124.9	124.9

[1] Usable equity is total shareholder's equity and excludes callable capital

[2] Non performing loans

[3] Short-term debt and currently-maturing long-term debt

[4] Callable capital pledged by members rated Baa3 or higher, discounted by Moody's 30-year expected loss rates associated with ratings

Source: Moody's Investors Service

Detailed credit considerations

IIB is assessed as having 'low' capital adequacy, a score pulled down by a track record of very high NPLs prior to its 2012 re-launch. With such a 'new' institution growing its balance sheet from very low levels, we assume that maintaining strong asset quality will be challenging, although the track record so far is good. The assessment also reflects the loan portfolio's weak average borrower quality and a moderate portfolio concentration related to the share of the 10 largest loans. On the other hand, IIB has a well-diversified loan portfolio whether judged on a country, sector or regional basis.

IIB is assessed as having 'moderate' liquidity. While the nominal amount of the bank's treasury assets amply covers near-term debt-service requirements, the borrowing associated with the expansion of its loan portfolio is expected to lead to a continued decline of debt-service coverage by liquid assets.

That said, IIB has enhanced its liquidity risk management framework by introducing a new liquidity management instrument, the `liquidity buffer,' in 2015. The liquidity buffer focuses on control and maintenance of the size and composition of liquidity to enable the bank to withstand a liquidity stress for a period of up to 12 months, which has been recently extended from 6 months. Indeed, when IIB backcasted its liquidity buffer since the re-launch, it determined that its liquidity buffer had already met the 12-month requirement all along.

IIB has also significantly improved and expanded its sources of funding in the last two years, obtaining a syndicated bank loan at favorable terms, issuing new bonds in the local markets of Russia and Romania and Slovakia and more recently a multi-tranche private placement in the German market. IIB's borrowers have also already repaid €370 million in debt obligations since its re-launch, which exceeds the size of its outstanding loan book at the end of 2016.

IIB's liquidity position is still somewhat constrained by the credit quality of the treasury portfolio, although that too has improved substantially over the past two years. As of midyear 2017, 41% of treasury assets were held in Aaa-to-A3 rated deposits or securities and another 20% in Baa-rated assets.

Finally, IIB's Baa1 rating is underpinned by our assessment of 'high' member support, in part due to its sizeable callable capital from investment-grade rated shareholders relative to its debt. The changes taking place with respect to membership support are also positive, specifically the plans to update and expand IIB's authorized capital base from EUR 1.3 billion to €2.0 billion. At the same time, IIB has updated its constituent documents (Agreement for the Establishment of IIB and Statutes) to better align with best practices at other MDBs.

IIB's relevance to its shareholders is strong, ironically because of its small size and small number of members, and the power that each member wields within the bank as a result, compared to their lack of importance in the decisions made by larger IFIs. The management also intends to keep the bank relatively small: they would accept another three members at most. By establishing a double majority for voting, the pending revisions to the IIB's statutes amidst the expansion of authorized capital mean that the influence of both small and large members is preserved.

We assess IIB's shareholders' ability and willingness to provide extraordinary support (i.e. beyond contractual obligations) as 'moderate'. This reflects its low weighted median shareholder rating of Ba1, as well as our view of a moderate propensity and priority of support by IIB's shareholders. For example, two of IIB's higher-rated members have yet to pay in their capital commitment.

Recent developments

Member states approve unanimously IIB's new 2018-2022 strategy

The member countries of IIB unanimously approved the new strategy for 2018-2022, its second five-year strategy since the re-launch, and re-elected IIB's chairman for another five-year term. This is credit positive, because it implies policy continuity for the next four years. The mission of the new strategy is defined as "facilitating connectivity and integration between the economies of the Bank's member states in order to ensure sustainable and inclusive growth, competitiveness of national economies, backed by the existing historical ties".

Within this new strategy, the Bank aims at establishing itself as an institution to provide lending for medium-size projects with the ultimate objective of promoting economies of its nine member states. The key instruments are (1) direct lending to corporates and financial institutions, (2) guarantees, (3) financing of export/import transactions, (4) financing of small and medium-sized enterprises via intermediaries, and (5) diversified trade finance and money market transactions.

This strategy will lead to a significant expansion of total assets, driven by strong growth in the bank's loan portfolio. The ultimate aim is to increase the dominance of loans, raising their share of total assets to 70% from 41% as of end 2016. Specifically, total assets are planned to increase to €1,707 million by 2022 from €881 million at end of 2016, of which €1,200 million will consist of loans (up from €363 million at the end of 2016). In our view, this strategy is ambitious and -- given the short lifetime of the institution after its re-launch -- will test its risk management framework.

Risk management and liquidity management frameworks have been enhanced

On a positive note, the IIB continues to improve its processes related to its risk management and liquidity management framework. This year it created an "Early Warning Mechanism" and a new dedicated risk management team. As already mentioned, IIB extended the period for the liquidity buffer to twelve months from six months, which is intended to enable the Bank to withstand liquidity stress without a need to change its business model.

According to the IIB's rules, the liquidity buffer is never supposed to drop below a so-called 'necessary liquidity buffer', which is calibrated to cover unforeseen outflows including demand and rollover deposits, partially long-term borrowings (put option) and loans to clients. The liquidity buffer contains highly liquid securities that can easily and quickly be converted into cash or be used as collateral for repos or cash-buy operations. The tool follows the guidance set down by the Committee of European Banking Supervisors. This enhancement is credit positive, bringing it in line with other MDBs.

Asset growth in line with the bank's plan; first NPL appears in the new loan portfolio

IIB's development assets, which mainly consist of loans (net of non-performing loans), increased by around 38% y-o-y to roughly €501 million in the first half of 2017 from €363 million in 2016. This was largely driven by growth in long-term loans to banks, which increased by 73% to around €164 million, against 25% growth in direct lending to corporates amounting to €337 million (net). As a result the share of direct lending (to corporates) in the loan book decreased to 67% from 74% as of end 2016, but it still remains much higher than in 2013-2015 (46% on average).

Against the background of strong loan growth, the IIB encountered its first non-performing loan (NPL) in its portfolio extended after the bank's re-launch 2012. The NPL amounts to €15 million and represents 3% of gross loans. This loan facility to the Romanian company ROMCAB S.A. was signed in 2015 with a 3-year maturity. IIB has established a loan loss provision in the amount of €5.255 million as of the end of the June 2017.

IIB's two NPLs from the "old" loan portfolio were written off this year, after having been fully provisioned over the last two years. These loans amounted to 14,769 million or 3.9% of gross loans at year-end 2016.

Funding diversification improved, quality of the treasury portfolio unchanged

In order to strengthen the credit quality of its treasury assets, IIB raised the share of Aaa-to-A3-rated assets in its treasury portfolio from 23% in at the end of 2014 to 41% as of the end of 2016, which remained at this level in the first half of 2017. Another 21% are rated Baa1-to-Baa3. In addition, IIB continues to pursue its new strategy of keeping the treasury portfolio less correlated to its loan portfolio with regard to exposure to member and non-member countries.

IIB has expanded its funding to eleven countries now from only two in March 2015, with 52% of funding stemming from EU countries as of the first half of 2017. Diversification by products increased to seventeen (up from four as of end 2014). The bank plans to continue to increase the size of its investor base and the range of financing products every year, after initially having raised most of its funding in Russia. IIB is also targeting to issue in more member states over time, as a sign of its commitment to the development of those countries' capital markets.

Rating methodology and scorecard factors

Rating Factors - International Investment Bank (IIB)

Rating Factors	Factor Weight	Factor Score
Factor 1: Capital Adequacy	60%	Low
Factor 2: Liquidity	40%	Medium
Intrinsic Financial Strength (F1 + F2)	**Preliminary Rating Range**	**Low**
Factor 3: Strength of Member Support	+3, +2, +1, 0 notches	High
Rating Range (F1 + F2 + F3)		**A3-Baa2**
Assigned Rating		**Baa1**

Note: While the information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the rating range. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the indicative rating range.

For more information please see our Multilateral Development Banks and Other Supranational Entities rating methodology.

Footnotes:

(1) Rating Range: Factor 1, Capital Adequacy, and Factor 2, Liquidity, combine according to the weights indicated into a construct we designate as Intrinsic Financial Strength (IFS). A notching system combines IFS and Factor 3, Strength of Member Support.

(2) 5 Ranking Categories: Very High, High, Medium, Low, Very Low.

Moody's related publications

- **Rating Action:** Moody's changes IIB's rating outlook to positive from stable; affirms Baa1 rating, 5 May 2017
- **Credit Analysis**: International Investment Bank, 8 June 2017
- **Rating Methodology**: Multilateral Development Banks and Other Supranational Entities, 29 March 2017

REPORT NUMBER 1098361

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

MOODY'S INVESTORS SERVICE