S&P Global Ratings

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Research Update:

International Investment Bank 'A-/A-2' Ratings Affirmed; Outlook Stable

March 27, 2020

Overview

- We expect that a global economic slowdown will somewhat delay IIB's progress in repositioning itself as a diversified European institution.
- We expect the bank's fundamental credit strengths--particularly its capital buffers and contained risk appetite--to protect it from the most severe impacts of anticipated economic volatility.
- Therefore, we are affirming the 'A-' long-term issuer and 'A-2' short-term issuer credit ratings on IIB.
- The outlook is stable and reflects IIB's comfortable capitalization, strengthening role and public policy mandate, contained risk appetite and relatively diverse funding options.

PRIMARY CREDIT ANALYST

Benjamin J Young
Dubai
(971) 4-372-7191
benjamin.young
@spglobal.com

SECONDARY CONTACT

Alexander Ekbom
Stockholm
(46) 8-440-5911
alexander.ekbom
@spglobal.com

Rating Action

On March 27, 2020, S&P Global Ratings affirming its 'A-' long-term and 'A-2' short-term issuer credit rating on the International Investment Bank (IIB). The outlook is stable.

Rationale

We do not expect IIB will be immune to significant economic uncertainty. As COVID-19 spreads and authorities implement safety measures that will impede total demand, S&P Global Ratings now expects a global recession in 2020. Furthermore, a related oil price shock is pressuring hydrocarbon exporters and adding to overall economic volatility. We anticipate that a very challenging operating environment will hamper the timely execution of IIB's reorientation strategy. We expect slower loan growth, weaker asset quality, and, more generally, a tighter liquidity and funding environment.

However, the affirmation reflects our belief that management has cautiously managed its risks and that the institution should be shielded from the downturn's most damaging effects. Supporting factors include a negligible currency mismatch, which will help protect the bank from losses associated with local currency depreciation (IIB matches its lending and borrowing currency); a strong capital buffer, augmented by recent payments of capital from shareholders and a firm capitalization plan; a diversified funding base, that include new bilateral facilities and a new medium-term note program; limited exposure to commodity-related projects; and a robust business continuity plan. Furthermore, although the bank has been reorienting its business toward a region whose economic prospects are firmly on the downside in 2020 (the EU now accounts for 57% of its loan portfolio, compared with 34% in 2015, and we expect the eurozone economy to contract by about 2% in 2020), numerous stimulus packages launched by regional authorities could offset some of the disruption to smaller private sector companies.

We base the ratings on IIB on the bank's moderate enterprise risk profile and very strong financial risk profile. We assess the bank's stand-alone credit profile (SACP) at 'a-'. Our ratings do not incorporate any explicit uplift for extraordinary shareholder support in the form of callable capital.

IIB's moderate enterprise risk profile incorporates the progress the bank has made in repositioning itself as a diversified European institution. This includes relocating its headquarters to Hungary and increasing European member countries' share in both the loan portfolio and paid-in capital. The assessment also incorporates the improvement in IIB's governance structure and the continued strong support from shareholders, such as with the approval of a capital injection of €200 million as part of the 2020-2022 capitalization plan.

In December 2018, the bank decided to relocate its headquarters to Budapest from Moscow. It signed the host country agreement with Hungary in February 2019 and the new headquarters have been operational since April 2019. IIB's Moscow office now operates as a branch. We think this move will help mitigate risks from the impact of sanctions on Russia. We also think it will enable easier access to funding. Furthermore, in 2018, the bank implemented a three-level corporate governance structure--similar to many other multilateral lending institutions--and established two new bodies: the board of governors and the board of directors. The board of governors includes higher representation from its member shareholders, which strengthens the relationship with shareholders, in our view.

However, IIB's shareholder concentration and small asset size continue to constrain our assessment. Although the bank has nine member state shareholders, four of them--Russia, Bulgaria, Hungary, and the Czech Republic--account for about 83% of paid-in capital. The other shareholders are Cuba, Mongolia, Vietnam, Slovakia, and Romania. In 2019, Romania contributed €3.65 million, as its final contribution for the capitalization plan, for 2013-2017. Through March 2020, Hungary and Russia have each contributed €10 million as part of the capitalization plan 2020-2022. The contributions have led to an increase in the share of European member countries to 52%. Russia continues to dominate the structure, with 44.5% of the paid-in capital, but this has decreased significantly from 58% in 2013. We have a more positive view of governance for institutions with diversified shareholders, particularly among borrowing member states.

IIB is improving its role and competitive position in its member countries, but it still remains very small compared to the economies of its nine members. The bank's loan portfolio increased to €884 million as of year-end 2019, 17% higher than the previous year. In line with IIB's strategy, the geographical split of the loan exposure also changed. Russia's share in the loan portfolio decreased to 16% as of year-end 2019 from 27% at year-end 2016. The bank now has no lending to Russian financial institutions. On the other hand, lending to European countries increased, with Romania now accounting for 14% of the loan portfolio, followed by Bulgaria (13%) and Slovakia (10%). The total volume of loans towards EU countries accounted for 57% of the portfolio as of March 13, 2020.

IIB was established in 1970 with the aim of promoting the social and economic development of its member states. Its credit lending covers lending to small and midsize enterprises, export-import operations, project financing, and mergers and acquisitions. It does this primarily through leading domestic publicly owned banks, development banks, and other financial institutions. The bank was formed by a treaty and it enjoys supranational status. IIB is exempt from custom duties, direct taxes, and restrictions on export and import operations. It is also immune to the sanctions on Russia.

We assess positively the stability and strength of the relationship between IIB and its shareholders. For example, the board of governors approved the capital injection of €200 million as part of the 2020-2022 capitalization plan, and Hungary and Russia have already made capital contributions of €10 million each through March 2020. In the past 16 years, the only change in the number of shareholders has been Hungary's rejoining IIB. The bank is open to new members, and aims to expand its shareholder base by one or two countries in the next two years.

IIB's financial risk profile benefits from very strong capital adequacy and strong funding and liquidity. For the fiscal year ended Dec. 31, 2019, the bank's risk-adjusted capital (RAC) ratio after diversification--which we calculate using the parameters as of March 21, 2020--decreased moderately to 24.4%, from the 24.8% as of Dec. 31, 2017 and 25% as of June 30, 2019. The change is mainly driven by the increase in single name concentration in the corporate loan book. The capital payments due in 2020 as part of the capitalization plan 2020-2022 should benefit the RAC calculation, but we remain cautious of the sustainability of the RAC ratio above our 23% threshold, given the significant increase in loans previously and the high single-name concentration. That said, we think the ratio will still stay comfortably above 15%, supporting our assessment of the bank's very strong capital position.

We also note IIB's continued improvement in its asset quality. Nonperforming loans (NPLs; loans overdue by 90 days or more) accounted for 1.6% of the loan portfolio as of year-end 2019, lower than the 4.5% reported at year-end 2017 (1.9% at end-2018). This level is below the peer group average. IIB's relaunch in 2012--when it replaced its entire management team--fundamentally shifted the risk appetite and monitoring of risk at the bank. NPLs made up more than 70% of IIB's gross loan portfolio when the bank was turned over in 2013, and most of its toxic loans were either written off or sold. We view positively that management is committed to keeping NPLs below 5% of the gross loan portfolio.

We do not incorporate preferred creditor treatment in our assessment of IIB's enterprise risk profile, because the bank fully focuses on private sector lending. However, we think it will benefit from preferential treatment, such as exemption from capital restrictions and sanctions for all its shareholder members. We incorporate this in our capital framework by applying lower risk weights to corporate and financial institutions exposure.

The abovementioned portfolio expansion prompted a need to raise significant amounts of new funding in 2018 and 2019. We think IIB benefits from an increased diversification trend in its funding sources. New placements in 2018 included a Czech koruna (CZK)-denominated debt issue that was listed on the Prague and Vienna stock exchanges. The total issuance amounted to CZK750 million and was tapped twice. In 2019, it continued to access new markets with its debut bond issuance on the Budapest Stock Exchange of 24.7 billion Hungarian forints. We estimate that IIB's sound funding profile has no gaps for the next five years, excluding loan disbursements. The bank swaps most issues in local currency into dollars or euros, except for its newly developed currency lending, which is increasing from a relatively small base.

Our liquidity ratios for IIB indicate that the bank would be able to cover all committed lending and debt repayments for at least one year, even under stressed market conditions, without accessing capital markets. IIB has, for the third year in a row, improved the quality of its treasury portfolio, with the share of 'A' to 'AAA' rated assets increasing to 70% as of year-end 2019, from 57% the previous year. Management is committed to increasing the share of 'A' to 'AAA' instruments to

75% by year-end 2022.

Outlook

The stable outlook reflects IIB's comfortable capitalization, strengthening role and public policy mandate, contained risk appetite and relatively diverse funding options.

We could lower the ratings over the next 12-24 months if, contrary to our expectations, the bank faces material asset quality problems because of the global slowdown or liquidity issues related to ongoing strains in capital markets and cannot draw on its additional funding sources. We could also reassess IIB's policy importance should payments under its capitalization program be postponed, again, relating to potential risks from the ongoing economic challenges. Furthermore, we could lower the ratings if the bank falls short of its own expansion plans, which could include a failure to attract new membership. We could view this as a sign of limited policy importance.

We could consider an upgrade in the next 12-24 months if IIB materially raises and broadens its loan book and further strengthens its shareholder base, following an increase in authorized capital intended to attract new members. For an upgrade to materialize, the bank would also likely need to secure sufficient capital to retain an RAC ratio above 23%.

Rating Score Snapshot

International Investment Bank--Ratings Score Snapshot

Issuer credit rating	A-/Stable/A-2
Stand-alone credit profile	a-
Enterprise risk profile	Moderate
Policy importance	Moderate
Governance and management	Adequate
Financial risk profile	Very strong
Capital adequacy	Very 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
- 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- COVID-19: The Steepening Cost To The Eurozone And U.K., March 26, 2020
- S&P Global Ratings Cuts WTI And Brent Crude Oil Price Assumptions Amid Continued Near-Term Pressure, March 20, 2020
- COVID-19 Macroeconomic Update: The Global Recession Is Here And Now, March 17, 2020
- ESG Industry Report Card: Supranationals, Feb. 11, 2020
- Supranationals Special Edition 2019: Report Says MLIs Are Focusing On Sustainable Development Goals, Oct. 25, 2019
- Supranationals Special Edition 2019: Comparative Data For Multilateral Lending Institutions, Oct. 16, 2019
- Introduction To Supranationals Special Edition 2019, Oct. 16, 2019

Ratings List

Ratings Affirmed	
International Investment Bank	
Sovereign Credit Rating	
Foreign Currency	A-/Stable/A-2

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. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 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.