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INVESTORS SERVICE

# Rating Action: Moody's assigns first-time Baa3 rating to the IBEC

**24 Jan 2020**

London, 24 January 2020 -- Moody's Investors Service, ("Moody's") has today assigned a first-time Baa3 foreign currency long-term issuer rating to the International Bank for Economic Co-operation (IBEC). The outlook is stable.

IBEC is focused on providing financing to support its member states' foreign trade and facilitate their economic development. The main areas of activities are trade finance operations and financing to support export and import operations of the bank's member states, including operations within both member countries and third countries. The organisation was re-launched in 2018 with the aim to increase the product line and geography of operations as well as a reorganisation of the business, including the appointment of a new chairman and management.

The rating of the IBEC is derived using Moody's Multilateral Development Banks and Other Supranational Entities rating methodology. The key drivers of the Baa3 rating are:

1. IBEC's relatively strong capital position which is balanced by weak but improving asset quality;

2. The bank's limited high-quality liquid assets and gradually diversifying funding sources; and

3. IBEC's low strength of member support given the absence of a formal callable capital mechanism.

The stable outlook reflects Moody's expectation that the risks associated with the bank's planned sizeable expansion of the loan book in the coming years will be managed without significant detriment to leverage and asset quality parameters.

RATINGS RATIONALE

RATIONALE FOR THE Baa3 RATING

IBEC's RELATIVELY STRONG CAPITAL POSITION IS BALANCED BY WEAK BUT IMPROVING ASSET QUALITY

IBEC's capital adequacy is assessed at "baa3" which balances its relatively strong capital position with weak but improving development asset credit quality (DACQ).

Moody's assessment of IBEC's capital position, which considers the available capital relative to the fund's assets, reflects the institution's moderate levels of leverage while also taking into account the institution's planned expansion over the coming years. For example, the unaudited interim financial statements show that total assets rose around 18% over the first half of 2019. As a result, Moody's adjusts IBEC's capital position assessment downwards to reflect that excessive development asset growth will lead to a notable increase in Moody's definition of leverage from its three-year average of 109% at the end of 2018. Moody's leverage ratio focuses on useable equity as the relevant capital buffer in the denominator against development assets and treasury assets rated A3 and lower.

The credit quality of IBEC's loan portfolio is comparatively low, with a weighted average borrower rating of B1 at the end of 2018. The loan portfolio is also highly concentrated, with the top 10 exposures accounting for 88% of total development assets at the end of 2018. The portfolio benefits from a high share of lending to state-owned entities although, despite their quasi-sovereign nature, Moody's doesn't expect IBEC to benefit from preferred creditor status. That said, Moody's expects IBEC's credit quality indicators will likely gradually improve as the institution builds out its development assets as part of its relaunch, including into higher credit quality exposures, and the portfolio diversifies further.

Moody's assessment of IBEC's asset performance reflects the bank's weak track record of non-performing assets (NPA) but also the relaunch of the institution under new management.

The appointment of a new chairman of the board and management team was accompanied by the full write-off of IBEC's legacy non-performing loans, such that Moody's anticipates a decline in the three-year NPA ratio which stood at 23.3% at the end of 2018, given that these legacy non-performing loans were incurred under the bank's previous business model. That said, the credit portfolio will likely remain concentrated and the institution's risk management policies, while recently enhanced, are untested.

IBEC'S LIMITED HIGH QUALITY LIQUID ASSETS AND GRADUALLY DIVERSIFYING FUNDING SOURCES

IBEC's liquidity and funding, assessed at "ba1", reflects its limited availability of high quality liquid assets and a limited but gradually diversifying funding structure, together with the benefit of a naturally high asset turnover implicit in its focus on trade finance.

Moody's assessment of IBEC's liquidity is weighed down by the relatively weak availability of unencumbered high quality liquid resources which would be available in a stress scenario and with minimal loss. Under Moody's definition, IBEC's cash and short-term bank deposits as well as securities rated A2 or higher as at end 2018, covers a relatively low proportion of the 18-months net cash outflows (starting from Q3 2019).

IBEC's funding structure consists predominantly of loans from commercial banks on a short term basis, although the bank is continuing to gradually diversify its funding structure following its first RUB7 billion bond issue on the Russian domestic market in October 2019. Moody's expects that funding maturities will gradually lengthen as part of the bank's new strategy which forecasts long-term funding to rise to around half of total funding by the end of 2020.

Finally, Moody's liquidity and funding assessment is adjusted upwards to reflect the bank's intended focus on trade finance, which leads to a naturally high turnover of assets, such that its comparatively short maturities allow for a rapid adjustment to shocks, as well as IBEC's access, albeit on a short term basis, to lines of credit and repo arrangements with prime lenders.

IBEC's LOW STRENGTH OF MEMBER SUPPORT GIVEN ABSENCE OF FORMAL CALLABLE CAPITAL

Moody's assesses IBEC's strength of member support as "Low". The ability of shareholders to support the bank is captured by the weighted average shareholder rating of Baa2 of its eight shareholders (Bulgaria (Baa2 positive), Czech Republic (Aa3 stable), Mongolia (B3 stable), Poland (A2 stable), Romania (Baa3 stable), Russia (Baa3 stable), Slovakia (A2 stable) and Vietnam (Ba3 negative)).

In Moody's assessment, IBEC does not benefit from the possibility to call upon shareholders to provide more capital under a formal callable capital mechanism, in case it is needed. This is an important weakness in Moody's view. IBEC's authorized share capital of €400 million is larger than the amount paid-in but shareholders are under no contractual obligation to fulfill a capital call in line with their shareholding. Furthermore, a portion of the authorized capital has remained unassigned to any shareholder after the quotas held by previous shareholders were not reallocated.

That said, we assess non-contractual support as 'medium', to reflect the mutual shareholder benefit from IBEC's objective to improve trade links between its member states, and that with few member states they benefit from relatively strong representation compared to participation in larger multilateral development banks. This is similar to Moody's assessment of non-contractual support at International Investment Bank (IIB, A3 stable), which has seven shareholders in common.

Furthermore, the support from shareholders for the relaunch of the institution, including agreeing to write-off the entire amount of non-performing loans in 2018, demonstrates a degree of commitment to the institution. While Russia remains the largest single shareholder, all member states are represented equally on IBEC's Council which retains authority on strategic issues and has to approve loan disbursements under certain conditions, while each member state has the ability to object to any loan extended to a resident borrower.

RATIONALE FOR THE STABLE OUTLOOK

Moody's initiates IBEC's rating with a stable outlook, which reflects Moody's expectation that the risks associated with the bank's planned sizeable expansion of the loan portfolio in the coming years will likely be managed without significant detriment to leverage and asset quality parameters.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

Environmental and social considerations are not material for IBEC's rating.

Governance considerations are material for IBEC given the important role of enhancements to its risk management practices in managing the challenges posed by a rapid growth in the credit portfolio.

WHAT COULD CHANGE THE RATING UP/DOWN

IBEC's rating would come under positive pressure from a substantial improvement in development asset quality, for example if the growth in the loan portfolio were to be accompanied by a marked improvement in the average borrower rating, including through a diversification in the lending portfolio which considerably reduces credit risk. A marked increase in IBEC's high-quality liquid assets buffer, which remains one of the lowest amongst rating peers, helping to increase the availability of liquid resources in a stress scenario, would also be positive. The introduction of a formal callable capital framework in line with industry practice would also give rise to positive rating pressure.

IBEC's rating would come under negative pressure if its sizeable expansion were to weigh on its credit metrics, resulting in a marked deterioration in Moody's assessment of capital adequacy, including from a substantially larger than expected increase in the bank's leverage or if asset quality pressures were to rise materially. Increased liquidity pressures denoting the possibility of impaired access to funding sources would also likely put downward pressure on the rating.

ISSUER PROFILE

IBEC was established in 1963 and operates under an intergovernmental agreement registered with the United Nations Secretariat.

IBEC is focused on providing financing to support its member states' foreign trade and facilitate their economic development. The main areas of activities are trade finance operations and financing to support export and import operations of the bank's member states, including operations within both member countries and third countries.

The organisation was re-launched in 2018 with the aim to increase the product line and geography of operations as well as a reorganisation of the business, including the appointment of a new chairman and management.

At the end of June 2019, according to unaudited interim accounts, IBEC's total assets were €475 million including €42 million in loans issued to banks under trade financing and €89 million in loans to corporate customers mostly in Russia, Romania and Bulgaria.

The principal methodology used in this rating was Multilateral Development Banks and Other Supranational Entities published in June 2019. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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