S&P Global Ratings

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Research Update:

EUROFIMA 'AA/A-1+' Ratings Affirmed; Outlook Stable

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Overview

- EUROFIMA European Co. for the Financing of Railroad Rolling Stock's (EUROFIMA's) risk-adjusted capital (RAC) ratio after adjustment slightly decreased over 2020 following the expansion of its loan book.
- At the same time, matched funding policies and a robust liquidity position underpin its still very strong financial profile.
- We therefore affirmed our 'AA/A-1+' long- and short-term issuer credit ratings on EUROFIMA.
- The stable outlook reflects our expectation that EUROFIMA's capital adequacy will remain strong during the next two years, with asset quality and the liquidity position also remaining solid.

Rating Action

On June 29, 2021, S&P Global Ratings affirmed its 'AA' long-term and 'A-1+' short-term foreign currency issuer credit ratings on Switzerland-based multilateral lending institution (MLI) EUROFIMA European Co. for the Financing of Railroad Rolling Stock (EUROFIMA). The outlook remains stable.

We also affirmed our 'AA' issue rating on EUROFIMA's senior unsecured notes, and our 'A-1+' rating on its commercial paper.

Outlook

The stable outlook reflects our expectation that EUROFIMA's capital adequacy will remain strong during the next two years. We also expect its asset quality and the liquidity position will remain solid.

Upside scenario

We could raise the rating if EUROFIMA meaningfully expands its member base, so as to finance a meaningful portion of its rolling stock, and reinvigorates its engagement with all members, to create a stronger platform for wider inclusion and to the benefit of all shareholders, while retaining all earnings to underpin the expansion. Maintaining high asset quality and strong market access would also build rating upside.

Downside scenario

We could lower the rating if EUROFIMA continues to increase lending in the next two years, specifically to the top five borrowers, which could further constrain the adjusted capital adequacy ratio unless retained earnings or a capital injection mitigate the pressure. A significant slip in financial indicators, or liquidity, could also trigger a downgrade.

Rationale

EUROFIMA increased lending during 2020 with €2.9 billion of new disbursements (or 7% loan book growth). We believe such growth during the COVID-19 pandemic year signals the relevance of the company to member countries. We note positively that EUROFIMA has approved a maximum limit for lending to member states with noninvestment grade ratings like Serbia, Montenegro, and North Macedonia--therefore possibly diversifying its currently concentrated loan book. At the same time, EUROFIMA limited the amount it will lend to such countries to €200 million after insurance (€800 million before insurance), which we believe further exemplifies its prudent risk management policies.

Following EUROFIMA's loan book increase, our risk-adjusted capital (RAC) ratio for fiscal 2020 dropped to 9.8% from 10.8% in fiscal 2019. We believe it will hover at about 10% over the next two years. At the same time, we note that the RAC ratio, before adjustments, remains robust. Our largest adjustment to the RAC calculation relates to sovereign single-name concentration, which captures the high concentration of EUROFIMA's lending book. As a result of the lending increase to top borrowers, the loan book became even more concentrated at year-end 2020, with the top-five borrowers accounting for 91% of the total loan portfolio (up from 89% a year ago).

EUROFIMA's role has also gradually weakened and much of its lending is highly exposed to direct price competition from commercial banks and other MLIs. Some larger shareholders finance themselves through established bond programs or with other banks, and smaller shareholders have not been able to borrow due to risk considerations and capital constraints. Five borrowers have underpinned EUROFIMA's niche mandate--namely the state-owned railways of Spain, Austria, Belgium, Italy, and Switzerland. These continue to use the institution for a significant part of their rolling stock financing.

Although the amended statutes better position EUROFIMA to attract new members and expand its balance sheet, it has proven a slow process. We understand that, as of very recently, EUROFIMA has decided to again extend loans to all shareholders and actively work with them to explore financing opportunities. We consider these developments positive but in a nascent stage that will take time to fully develop. Moreover, as in previous financial crises, and unlike peers, we do not expect EUROFIMA to play a countercyclical role during the current economic slowdown. However, we note that, for the first time since 2008, it managed to increase its loan book in 2020 and 2019.

Our strong enterprise risk profile assessment factors in our view of EUROFIMA's management and governance and the track record of borrowing members affording EUROFIMA preferred creditor treatment (PCT).

We assess EUROFIMA's governance and management expertise as strong because of its well-balanced shareholding structure, its members' high ranking in World Bank governance indicators when compared to other MLIs, and its conservative risk management and liquidity policies. We also highlight that the average rating of its lending portfolio is one of the highest among our rated MLIs.

Our PCT assessment considers, on a country-by-country basis, whether over the past 10 years a borrowing country has been in arrears; that is, either interest or principal overdue 180 days or more. Based on our definition of arrears, no country to which EUROFIMA lends has been in arrears over this period. As such, we consider EUROFIMA's PCT assessment to be very strong and all its borrowing members qualify in the strongest PCT category.

We note that even after the subsidiary shareholder guarantee ceases to exist, EUROFIMA will benefit from other layers of protection. These differentiate it from other MLIs we rate. In particular, physical collateral is attached to the equipment finance transactions in the form of the financed rolling stock. The stock's estimated fair value provided a coverage ratio of 86% for the outstanding amount of the equipment finance contracts in December 2020.

We believe EUROFIMA's funding and liquidity ratios should remain robust considering its financial policies. The company's robust funding strategy is based on a matching principle under which it uses derivatives to fully match interest and principal cash flows on its obligations with the proceeds received on the loan book. EUROFIMA's one-year funding gap in December 2020 was 1.3x; the ratio is cumulative and based on scheduled receipts and payments.

Our liquidity ratio of 1.2x at December 2020 assumes that the company would not have access to the capital markets in stressed market conditions. Even in this case, we believe EUROFIMA would meet its financial obligations over a one-year period.

The ratings on EUROFIMA include potential extraordinary support from shareholders rated above the 'aa-' stand-alone credit profile. Although EUROFIMA has total callable capital of Swiss franc (CHF) 2,080 million, we incorporate CHF1,524 million of eligible callable capital into our assessment and arrive at the enhanced financial risk profile assessment of extremely strong, which provides a one-notch uplift to the rating. We cap the uplift to one notch because of the adequate policy importance assessment.

Ratings Score Snapshot

Issuer credit rating: AA/Stable/A-1+

Stand-alone credit profile: aa-

Enterprise risk profile: Strong

- Policy importance: Adequate
- Governance and management: Strong

Financial risk profile: Very Strong

- Capital adequacy: Strong
- Funding and liquidity: Very Strong

Extraordinary support: +1

Callable capital: +1

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: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Abridged Supranationals Interim Edition 2021: Comparative Data For Multilateral Lending Institutions, May 11, 2021
- Supranationals Edition 2020: Comparative Data For Multilateral Lending Institutions, Oct. 21, 2020
- How Multilateral Lending Institutions Are Responding To The COVID-19 Pandemic, June 9, 2020
- Can Multilateral Lenders' Capital Bases Hold Up Against COVID-19?, June 9, 2020
- ESG Industry Report Card: Supranationals, Feb. 11, 2020
- What Our New Criteria Has Meant For Multilateral Lending Institutions, April 12, 2019

Ratings List

Ratings Affirmed

EUROFIMA European Co. for the Financing of Railroad Rolling Stock	
Issuer Credit Rating	AA/Stable/A-1+
Senior Unsecured	AA
Commercial Paper	A-1+

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

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