FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms EUROFIMA at 'AA'; Outlook Stable

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Fitch Ratings - Frankfurt am Main - 04 Jul 2022: Fitch Ratings has affirmed EUROFIMA European Company for the Financing of Railroad Rolling Stock's Long-Term Issuer Default Rating (IDR) of 'AA' with a Stable Outlook and Short-Term IDR of 'F1+'. Fitch has also affirmed the rating of EUROFIMA's senior notes at 'AA'.

KEY RATING DRIVERS

Standalone Credit Profile Drives Ratings: EUROFIMA's ratings are driven by its standalone credit profile of 'aa', based on a 'aa-' solvency assessment, reflecting 'strong' capitalization and 'low' risk assessments, a 'aa+' liquidity assessment and a one-notch uplift over the lower of solvency and liquidity to reflect EUROFIMA's 'low' risk business environment. Fitch's assessment of extraordinary support from shareholders is 'a' and does not lead to an uplift to the rating.

Strong Capitalisation, High Leverage: EUROFIMA's strong capitalization is primarily based on its 'excellent' Fitch risk-weighted asset (FRA) ratio, at 60% at end-2021. This reflects the high credit quality of the institution's assets and callable capital (73% of which is guaranteed by sovereigns rated in the 'AAA' and 'AA' categories).

The 'excellent' FRA ratio is partly offset by a 'moderate' equity-to-assets ratio of 10% at end-2021, the lowest across Fitch's rated MDBs, reflecting EUROFIMA's high leverage (it has no leverage limit, relying instead on maximum annual borrowing limits). Fitch expects the two ratios to be fairly stable in the medium term, but the FRA ratio could be negatively affected by increased exposure to non-investment-grade borrowers, in line with EUROFIMA's medium-term plan.

Very Low Credit Risk: The 'low' risk assessment is primarily driven by a 'very low' assessment of credit risk. The average rating of loans was 'A+' at end-2021, based on the sovereign guarantors' ratings. Fitch assesses EUROFIMA's Preferred Creditor Status (PCS) as 'excellent', leading to a three-notch uplift above the average rating of loans, to 'AA+'. The PCS assessment reflects the institution's 100% exposure to sovereigns and the track record of loan performance, with no non-performing exposure since operations started in 1956.

High Concentration: Loan book concentration is the main weakness in EUROFIMA's risk profile. The five largest borrowers accounted for 93% of total loans at end-2021. EUROFIMA's concentration limits are based on risk-weighted measures that support high exposures towards highly rated borrowers. To reduce concentration, EUROFIMA has introduced a premium in the pricing of loans to borrowers with the largest exposures. Fitch expects concentration of the loan book to remain very high in the medium term.

Strong Risk Management: The very high credit quality of the loan portfolio (with all loans guaranteed by an entity with a minimum rating of 'BBB-', except for a limited portion of non-investment-grade exposure accounting for 1.5% of total loans at end-2021) mitigates the very high concentration. EUROFIMA match-funds its loans and passes through funding costs to its borrowers. Residual currency and interest rate risks are fully hedged through interest rate and currency swaps.

Medium Risk Business Profile: The 'medium' risk business profile is supported by the sovereign guarantees on the loan book and EUROFIMA's 'low' governance risk. The 'medium' risk assessment of the strategy reflects the de-leveraging and de-risking trend in the last decade, and the potential increase in exposures to non-sovereign and non-investment-grade borrowers in the medium term.

The assessment also factors in our expectation that the stated objective to diversify the loan book may only result in limited improvement in concentration metrics. Our assessment of EUROFIMA's policy importance is affected by its 'moderate' size (the loan book was EUR10 billion at end-2021) and the limited role of the supranational organization for its shareholders overall, with only half of them borrowing from it.

Low Risk Operating Environment: The 'low' risk operating environment reflects the strong creditworthiness and high income per capita of EUROFIMA's 25 countries of operations (19 are high-income countries, six are upper-middle income). World Bank Governance indicators of the countries of operations are also strong relative to those of rated peers. EUROFIMA's headquarters are located in Switzerland (AAA/Stable).

Large Liquidity Buffers: EUROFIMA's liquid assets accounted for 123% of short-term debt at end-2021. Fitch expects the ratio to remain at least in the 'strong' range in the medium term. EUROFIMA must hold at least 12 months' coverage of net disbursements (after accounting for a haircut on securities).

Fifty-five percent of treasury assets were rated 'AAA'/'AA' at end-2021 and 99% were investment grade; the remaining 1% were unrated. EUROFIMA is a regular bond issuer in various currencies, primarily euros (43% of funding), Swiss francs (20%) and US dollars (22%). EUROFIMA is not eligible for European Central Bank's bond-buying programmes.

No Support Uplift: Fitch assesses extraordinary support from shareholders at 'a'. The shareholders' capacity to support is based on the average rating of key shareholders (the national railway companies of Germany, France and Italy), assessed at 'AA-' after accounting for the guarantee of callable capital by their respective sovereigns.

Fitch applies a two-notch negative adjustment to the capacity to support, to 'a', to reflect a 'weak' propensity of shareholders to support. The 'weak' propensity accounts for callable capital not fully covering net debt and the termination of the cross-shareholders' joint and several guarantee in 2018. The assessment also accounts for the fact that EUROFIMA has paid dividends to its shareholders in recent years, which is unusual for a supranational institution.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Business Environment (Business Profile): A strengthening in our assessment of EUROFIMA's policy importance. This could arise if the gradual liberalization of the railway markets in Europe supported demand for EUROFIMA's financing by a more diversified pool of borrowers.

Solvency (Risk): Success in EUROFIMA's strategy to achieve stronger diversification of its loan book demonstrated by the share of loans to the five largest borrowers converging towards 60% of total loans from the current level of 93%.

Solvency (Capitalization): Stronger capitalization driven by significant reduction in EUROFIMA's leverage, bringing the equity-to-assets ratio towards the 15% threshold for 'strong'.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Solvency (Capitalization): A deterioration in our assessment of capitalization, for example if the equity-to-assets ratio fell below the 8% threshold for a 'moderate' assessment.

Solvency (Credit Risk): Deterioration in our assessment of credit risk due to a decline in the average rating of loans and/or a breach in EUROFIMA's PCS if an exposure covered by a sovereign guarantee became non-performing.

Business Environment (Business Profile): Deterioration in EUROFIMA's business profile. This could stem from lower demand for EUROFIMA's financing by its shareholders and/or failure to diversify its pool of borrowers.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

EUROFIMA has an ESG Relevance Score of '4'[+] for Policy Status and Mandate Effectiveness. All loans extended by EUROFIMA to its shareholders are guaranteed by the shareholders' respective sovereigns, in line with EUROFIMA's status. The sovereign guarantee also applies to the callable capital subscribed by shareholders. This has a positive impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

EUROFIMA has an ESG Relevance Score of '4' for Rule of Law, Institutional & Regulatory Quality. All supranationals attract a score of '4'. Supranationals are neither subject to bank regulation nor supervised by an external authority. Instead, supranationals comply with their own set of rules. Fitch pays particular attention to internal prudential policies, including compliance with these policies. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

The ESG Relevance Score for 'Labour Relations and Practices' has changed to '2' from '3' as Fitch no longer considers restrictions on recruitment based on nationality or quotas relevant to multilateral development banks' ratings.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
EUROFIMA European Company for the Financing of Railroad Rolling Stock	LT IDR	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable
	ST IDR	F1+	Affirmed	F1+
senior unsecured	LT	AA	Affirmed	AA

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Supranationals Rating Criteria (pub. 11 Apr 2022) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

EUROFIMA European Company for the Financing of Railroad Rolling Stock	EU Issued, UK Endors

DISCLAIMER & DISCLOSURES

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Sovereigns   Supranationals, Subnationals, and Agencies   Europe   Switzerland