S&P Global
Ratings

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Research Update:

EUROFIMA Downgraded To 'AA' On Weakening Enterprise Profile; Outlook Stable

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Overview

- EUROFIMA's policy importance has been eroding over time and shareholder support compares unfavorably with its peers.
- Matched funding policies and a very strong liquidity position, combined with the strengthening trend of its capital adequacy, underpin its robust financial profile.
- We are lowering to 'AA' from 'AA+' our long-term issuer credit ratings on EUROFIMA.
- The stable outlook reflects our expectation that EUROFIMA's loan book will steadily increase over the next two years. We also expect its asset quality and liquidity positions will remain solid as it navigates the current economic slowdown related to COVID-19.

Rating Action

On June 15, 2020, S&P Global Ratings lowered to 'AA' from 'AA+' its long-term foreign currency issuer credit rating on EUROFIMA European Co. for the Financing of Railroad Rolling Stock. The outlook is stable.

We also lowered to 'AA' from 'AA+' our issue rating on EUROFIMA's senior unsecured notes, and affirm the 'A-1+' short-term issuer credit rating and issue rating on its commercial paper.

Outlook

The stable outlook reflects our expectation that EUROFIMA's loan book will continue to increase steadily during the next two years. We also expect its asset quality and liquidity position will remain solid as it navigates the current economic slowdown related to COVID-19.

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 in order to underpin the expansion. Maintaining high asset quality and strong market access would also build rating upside.

We could lower the rating if, in the next two years, EUROFIMA's membership expansion is unsuccessful and if lending activity declines, pointing to weaker policy importance. A significant slip in financial indicators, capital, or liquidity could also trigger a downgrade.

Rationale

In our view, EUROFIMA's relationship with shareholders has evolved unfavorably when compared to other peers. We do not expect any member to leave EUROFIMA or neglect any critical duties, such as answering a potential capital call if it were ever be needed, and we note that members have supported recent amendments to EUROFIMA statutes. However, unlike other multilateral institution (MLIs), after the 2008 financial crisis shareholders opted for a deleveraging strategy of stopping financing to its weaker rated members instead of considering a capital injection into EUROFIMA. Subsequently, the shareholders passed amendments to EUROFIMA's statutes that included the gradual removal of the Subsidiary Shareholder Guarantee (SSG), which has been a unique feature of EUROFIMA. More recently, in 2019, members decided to start distributing dividends after having foregone payouts since 2009.

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.

While 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 develop fully. 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 2019 and we think it will continue gradually increasing its lending to existing members during 2020.

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 by 180 days or more. Based on this 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 view EUROFIMA's financial profile before extraordinary shareholder support as very strong. Our risk-adjusted capital (RAC) ratio for fiscal 2019 was 10.8% and we believe it will remain steadily above 10% for 2020. This calculation incorporates parameters as of June 6, 2020.

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 deleveraging process, the loan book became more concentrated; in December 2019 the top-five borrowers accounted for 89% of the total loan portfolio.

We note that even after the SSG 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 73% for the outstanding amount of the equipment finance contracts in December 2019.

EUROFIMA's robust funding strategy is based on a matching principle in 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 2019 was 1.3x; the ratio is cumulative and based on scheduled receipts and payments.

Our liquidity ratio of 1.1x as of December 2019 assumes that the company would not have access to the capital markets in stressed market conditions. Even in this case, we believe EUROFIMA would be able to meet its financial obligations over a one-year period.

Both the funding and liquidity ratios have declined slightly from our previous-year assessment due to an unusually large maturity in May 2020, which we have accounted for in our calculations. However, we note that these ratios should remain robust considering EUROFIMA's financial policies.

The ratings on EUROFIMA include potential extraordinary support from shareholders rated above the company's SACP of 'aa-'. While EUROFIMA has total callable capital of CHF2,080 million, we incorporate CHF1,523.8 million eligible callable capital into our assessment and arrived at the enhanced financial risk profile assessment of extremely strong, which provides a one-notch uplift to the rating.

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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- What Our New Criteria Has Meant For Multilateral Lending Institutions, April 12, 2019
- Criteria Guidance: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- Abridged Supranationals Interim Edition 2020: Comparative Data For Multilateral Lending Institutions, May 8, 2020
- Supranationals Special Edition 2019, Oct. 25, 2019

Ratings List

Downgraded; Outlook Action; Ratings Affirmed

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

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