Research Update:

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

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Overview

- EUROFIMA's decreasing loan book deleveraging strategy hampers our current assessment of its policy importance. However, amended statutes allow for an increase in the membership base that we expect to materialize in the following 12 months.
- Matched funding policies and a very strong liquidity position combined with a strengthening trend of its capital adequacy underpin its robust financial profile.
- We are affirming our 'AA+/A-1+' long- and short-term issuer credit ratings on EUROFIMA.
- The negative outlook reflects the risk of a downgrade in the next two years if EUROFIMA's membership expansion and lending activity shrinks below our estimations or if financial indicators slip.

Rating Action

On Oct. 9, 2019, 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 negative.

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

Rationale

The negative outlook reflects a potential weakening of EUROFIMA's role and policy mandate in the event of further reductions of EUROFIMA's already-shrinking balance sheet. While the onboarding of new members has been slower than originally planned since the change of EUROFIMA's statutes, we believe that the next 12 months could see some tangible results in this respect. Eventually, this should lead to a turnaround in the now-decreasing portfolio, and enhance EUROFIMA's relevance for its owners. If this does not materialize, it would likely trigger a downgrade.

The continued shrinking trend of EUROFIMA's loan book constrains our assessment of its role. The company deliberately undertook its deleveraging strategy after the 2008 financial crisis, in an effort to boost its position in the absence of capital increases from its members. Steady reductions mean its loan book has more than halved from Swiss francs (CHF) 26.4 billion in 2010 to CHF11.3 billion in June 2019, putting into question its relevance for shareholders.

While we would expect membership to expand over the next 12 months, we do not anticipate the company's loan book will reverse its shrinking trend before 2020, regardless of existing members still taking funding from EUROFIMA. Our overall assessment also assumes that no major shareholder will leave the company.

We believe the EU's IV railway package could be a very important source of new membership. The directive seeks to increase competition in the passenger railway market and secure financing for railway rolling stock to new market entrants. Aligning to these changes, EUROFIMA amended its statutes in September 2018, to open up for new shareholders and borrowers.

In amending EUROFIMA's statutes, the subsidiary shareholder guarantee (SSG) was partially removed. The SSG is a cross-guarantee scheme under which, if a defaulting railway's member state does not honor its obligations, and its obligations exceed EUROFIMA's guarantee reserve of CHF731 million as of June 2019, other shareholders guarantee the fulfilment of these obligations.

Before the amendments, the SSG covered the performance of all equipment finance contracts; after implementing the amended statutes, the SSG will only cover the performance of those loans provided by EUROFIMA before Jan. 1, 2018 (existing loans). The SSG will therefore cease to exist when all existing loans mature. Although this could differentiate between existing and new bondholders, in our view, the different layers of protection and the extraordinary shareholder support from callable capital continue to support the rating.

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

In our opinion, EUROFIMA rests on sound governance principles and the rigorous application of accounting standards. We do not foresee any changes to the company's risk management, and we expect policies around the implementation of the amendments to remain robust.

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, having either interest or principal that is 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.

Our view of a very strong financial profile before extraordinary shareholder support takes into consideration our view that the estimated risk-adjusted capital (RAC) ratio after adjustments for 2019-2020 will remain at 10%-15%. Under our revised methodology, as of June 2019, the RAC ratio after MLI-specific adjustments is 10.9%.

The largest adjustment to the RAC calculation is related to sovereign single name concentration, which captures the high concentration of EUROFIMA's lending book--five borrowers accounted for 88% of its portfolio as of June 2019. However, we acknowledge that these exposures are toward high creditworthy countries when compared with other MLIs.

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 rolling stock. The stock's estimated fair value provided a coverage ratio of 73% for the outstanding amount of the equipment finance contracts in June 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 June 2019 was 1.3x; the ratio is cumulative and based on scheduled receipts and payments.

Our liquidity ratio of 1.1x as of June 2019 assumes that the company would not have access to the capital markets due to stressed market conditions. Even in this case, we believe EUROFIMA would be able to meet its financial obligations over a two-year period, supported by the absence of scheduled loan disbursements over that time.

The ratings on EUROFIMA include potential extraordinary support from shareholders rated above the company's stand-alone credit profile (SACP). While EUROFIMA has total callable capital of CHF2,080 million, we incorporate CHF1,494 million eligible callable capital into our assessment and arrive at the enhanced financial risk profile of extremely strong, which provides one notch of uplift to the rating.

Outlook

The negative outlook reflects the risk of a downgrade in the next two years if EUROFIMA's membership expansion and lending activity falls short of our estimations for the coming 12 months, pointing to a weaker policy importance. A significant slip in financial indicators, capital or liquidity, could also trigger a rating change.

We could revise the outlook to stable if the implementation of statute changes enables EUROFIMA to broaden its shareholder base and finance a meaningful part of their rolling stock, with the company therefore reversing the shrinking trend of its balance sheet while maintaining high asset quality and strong market access.

Ratings Score Snapshot

Table 1

EUROFIMA European Co. for the Financing of Railroad Rolling Stock--Ratings Score Snapshot

Issuer credit rating	AA+/Negative/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

Table 1

EUROFIMA European Co. for the Financing of Railroad Rolling Stock--Ratings Score Snapshot (cont.)

Issuer credit rating	AA+/Negative/A-1+
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
- Supranationals Special Edition 2018, Oct. 11, 2018
- Abridged Supranationals Interim Edition 2019: Comparative Data For Multilateral Lending Institutions, July 15, 2019

Ratings List

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