Research Update:

Ratings On International Bank for Reconstruction and Development Affirmed At 'AAA/A-1+'; Outlook Stable

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Table Of Contents

Overview
Rating Action
Rationale
Outlook
Related Criteria And Research
Ratings List
Research Update:

Ratings On International Bank for Reconstruction and Development Affirmed At 'AAA/A-1+'; Outlook Stable

Overview

• We are affirming our long- and short-term issuer credit ratings on the International Bank for Reconstruction and Development (IBRD) at 'AAA/A-1+'.
• We assess IBRD's stand-alone credit profile at 'aaa', reflecting its extremely strong business and financial profiles, under our criteria.
• IBRD incurred a $1.1 billion comprehensive loss during fiscal 2014, mainly driven by unrealized losses on non-trading portfolios and net actuarial losses on benefit plans, as well as potential losses on its investment in Austrian bank Hypo Alpe-Adria's subordinated bond.
• The bank nevertheless shows a steady allocable income and an extremely strong Standard & Poor's risk-adjusted capital (RAC) ratio, after adjustments, of 25%, though IBRD's comprehensive losses and the lowering of ratings on some borrowing member countries contributed to a decrease compared to last year.
• The stable outlook reflects our view that IBRD's credit strengths will remain in place.

Rating Action


Rationale

The ratings on IBRD reflect its extremely strong business profile and extremely strong financial profile, the highest qualifiers for both factors defined in our criteria. We therefore consider IBRD to have a 'aaa' stand-alone credit profile (SACP).

Our extremely strong business profile assessment is based on IBRD's governance, role, and public-policy mandate. IBRD's unrivalled franchise value, the countercyclical nature of its lending, and the continuous commitment of its shareholders support our expectations that the bank will continue to benefit from preferred creditor treatment (PCT). IBRD is the keystone of the World Bank Group, which includes the International Development Association, International Finance Corporation (IFC), the Multilateral...
Investment Guarantee Agency, and the International Centre for Settlement of Investment Disputes. Commencing operations in 1946, IBRD is the oldest and largest multilateral lending institution (MLI). At fiscal year-end June 30, 2014 (fiscal 2014), it had 188 member countries, more than twice that of any other rated MLI except its affiliate, the IFC.

IBRD had US$359 billion in total assets in fiscal 2014, of which 43% were loans—the main activity of the bank. Disbursements increased by 17% during fiscal 2014 to $18.8 billion, and IBRD expects to increase disbursements further in early fiscal 2015. In March 2014, the World Bank Group announced that it would provide up to $3.5 billion of new financing to Ukraine. Furthermore, loans to Argentina are still performing and we expect IBRD to commit between $1.0 billion and $1.2 billion per year to the country over the coming four years, under the recently concluded partnership framework.

To support the larger anticipated disbursements and improve the bank's margin, IBRD's executive directors approved new measures during fiscal 2014 within a new "financial sustainability framework". This framework entails, in particular, an increase in the Single Borrower Limit (SBL), an extension of the maximum final maturity and average maturity for IBRD loans. The bank has also increased its maturity premium charges and introduced a 50 basis points (bps) surcharge per year on loan exposures previously exceeding the SBL. It has reinstated a 25 bps commitment fee on the undisbursed balances on its loans. We note that IBRD has otherwise maintained undifferentiated loan pricing, consistent with its mandate.

The bank is being restructured, and we expect a few hundred departures as a result. Owing to the depth of the restructuring, the most important in the last two decades, significant tensions between some staff and management have emerged. We expect those to settle in the next few months as the bank completes the restructuring plans.

Our assessment of IBRD's financial profile as extremely strong rests on our calculation of its RAC ratio of 30% before, and 25% after, adjustments for concentration risk and PCT, as well as the bank's funding and liquidity profiles. The main adjustment is its single-name concentration to borrowing member countries, partially offset by our expectation for PCT and geographic diversification. In March 2011, IBRD's board of governors approved a 44% increase in both subscribed capital (US$86.2 billion) and paid-in capital ($5.1 billion). At fiscal year-end June 30, 2014, $42.6 billion additional capital had been subscribed and $2.5 billion had been paid-in, 23% of which was paid-in during fiscal 2014.

In addition to payments from capital increases, comprehensive income reconciles the bank's shareholders' equity from one year to the next. Whereas IBRD's allocable income is relatively steady, its comprehensive income is more volatile than that of many of its peers, mainly because of its large derivatives portfolio. The institution considers as "allocable" the income excluding unrealized gains or losses outside the trading portfolio, or on benefit plans (respectively $1 billion and $424 million in fiscal 2014).
Consequently, transfers approved by the board of governors held steady at 88% ($676 million) of allocable income at fiscal year-end 2014, up from 68% ($663 million) in the previous year, despite the institution's comprehensive loss.

Comprehensive income was negative in fiscal 2014: a $1.1 billion loss (2.8% of adjusted common equity [ACE]), compared to a $1.7 billion profit (4.3% of ACE) in fiscal 2013. This negative comprehensive income was partly due to asymmetric accounting treatment of derivatives hedges, which does not take into account some offsetting gains. Yet, the comprehensive loss also includes unrealized losses on the fair value of non-trading portfolios, net actuarial losses on benefit plans, and a $141 million unrealized mark-to-market loss mostly related to a security issued by the Austrian bank, Hypo Alpe-Adria (HAA), initially guaranteed by the state of Carinthia. The guarantee on HAA was removed by the Austrian national parliament when cancelling the underlying debt securities after the bank was nationalized. IBRD is pursuing its claims in national and international forums, which could inform our view of PCT.

Our funding ratios indicate that, unlike at June 30, 2013, IBRD had no more refinancing needs at the six-month and one-year horizon at the end of fiscal 2014. The bank more than doubled its medium- and long-term funding volume during fiscal 2014 to $51 billion ($23 billion in 2013) in view of large, expected loan disbursements and debt service in early fiscal 2015. Furthermore, we view IBRD's funding program as broadly diversified by both geographic market and type of investor, given IBRD's frequent issuance in many markets and currencies. We also note that investors perceive IBRD as a safe haven.

Our liquidity ratios indicate that under extremely stressed market conditions, IBRD would be able to fulfil its obligations for at least one year but would need to significantly spread out its scheduled disbursements, even though IBRD significantly increased the size of its liquid asset portfolio by 28% to $41.6 billion in 2014.

Even without accounting for extraordinary shareholder support, we assess IBRD's SACP at 'aaa', our highest level. However, should IBRD's stand-alone capital adequacy weaken, we consider that shareholders would be ready and willing to answer one or more calls on their subscribed callable capital. Ten 'AAA' rated shareholders could be called on to provide up to $39.7 billion of callable capital (11% of total liabilities, at fiscal 2014) to repay any IBRD debt coming due. If IBRD's stand-alone capital ratios were to decline, the effect on its SACP could be counterbalanced by up to two notches. This would reflect the (currently latent) benefit of IBRD's 'AAA' callable capital.

Outlook

The outlook is stable. In our view, IBRD's business profile, capital levels including callable capital, funding, and liquidity are sufficiently robust that there is a less than one-in-three probability that we would lower our issuer credit rating on IBRD in the next two years.
That said, if IBRD's business profile weakened or the liquidity and funding portion of its financial profile deteriorated, the ratings would come under pressure. This could happen if management—contrary to our expectations—adopted more-aggressive financial policies, if IBRD's derivative activities generated significant losses, or if several large members ceased treating IBRD as a preferred creditor.

Related Criteria And Research

Related Criteria

• Multilateral Lending Institutions And Other Supranational Institutions
  Ratings Methodology, Nov. 26, 2012

Related Research

• Supranationals Special Edition 2014, Oct. 8, 2014
• How An Erosion Of Preferred Creditor Treatment Could Lead To Lower
  Ratings On Multilateral Lending Institutions, Aug. 26, 2013

Ratings List

Ratings Affirmed

International Bank for Reconstruction and Development
Issuer Credit Rating

Foreign Currency AAA/Stable/A-1+
Senior Unsecured AAA
Senior Unsecured AAAp
Senior Unsecured cnAAA
Short-Term Debt A-1+
Short-Term Debt cnA-1+

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