Article Title: ARCHIVE | Criteria | Governments | Sovereigns: Rating National Development Banks And Export Credit Institutions Data: (EDITOR'S NOTE: —This criteria article is no longer current. It has been superseded by the article titled "General Criteria: Rating Government-Related Entities: Methodology And Assumptions," published Dec. 9, 2010.) National governments—if only by virtue of their regulatory and supervisory responsibilities—typically interact with all domestic lending institutions. However, their involvement with national development banks (NDBs) and export credit institutions (ECIs) is generally more comprehensive, usually including ownership interests and having a direct impact upon the ratings of these institutions. The Sovereign Ratings Group of Standard & Poor's Ratings Services currently rates 26 government-related NDBs and ECIs (see table 1). Table 1 Ratings Of NDBs And ECIs And Their Countries Of Domicile LOCAL CURRENCY RATINGS FOREIGN CURRENCY RATINGS LONG TERM/OUTLOOK/SHORT TERM LONG TERM/OUTLOOK/SHORT TERM REGION BANK ABBREVIATION COUNTRY OF DOMICILE COUNTRY NDB/ECI COUNTRY NDB/ECI AMERICAS NDB Banco Nacional de Desenvolvimento Economico e Social BNDES Brazil BB+/Stable/B BB+/Stable/B BB/Stable/B BB/Stable/-- ECIS Banco de Comercio Exterior de Colombia S.A. BANCOLDEX Colombia BBB/Positive/A-3 --/--/-- BB/Positive/B BB/Positive/-- Banco Nacional de Comercio Exterior S.N.C. Bancomext Mexico A/Stable/A-1 NR/--/-- BBB/Stable/A-3 NR/--/-- Export Development Canada EDC Canada AAA/Stable/A-1+ AAA/Stable/A-1+ AAA/Stable/A-1+ AAA/Stable/A-1+ Private Export Funding Corporation PEFCO U.S. AAA/Stable/A-1+ A+/Stable/A-1 AAA/Stable/A-1+ A+/Stable/A-1 EUROPE NDBS Hrvatska Banka za Obnovu i Razvitak HBOR Croatia BBB+/Stable/A-2 BBB+/Stable/A-2 BBB/Stable/A-3 BBB/Stable/A-3 Instituto de Credito Oficial ICO Spain AAA/Stable/A-1+ AAA/Stable/A-1+ AAA/Stable/A-1+ AAA/Stable/A-1+ Kreditanstalt für Wiederaufbau KfW Germany AAA/Stable/A-1+ AAA/Stable/A-1+ AAA/Stable/A-1+ AAA/Stable/A-1+ Landwirtschaftliche Rentenbank LRB Germany AAA/Stable/A-1+ AAA/Stable/A-1+ AAA/Stable/A-1+ AAA/Stable/A-1+ Nederlandse Fin.-Maatschappij voor Ontwikkelingslanden N.V. FMO Netherlands AAA/Stable/A-1+ AAA/Stable/A-1+ AAA/Stable/A-1+ AAA/Stable/A-1+ Russian Bank for Development RBD Russia BBB+/Stable/A-2 BBB-/Stable/A-3 BBB/Stable/A-2 BBB-/Stable/A-3 ECIS Czech Export Bank CEB Czech Republic A/Positive/A-1 A/Positive/A-1 A-/Positive/A-2 A-/Positive/A-2 Oesterreichische Kontrollbank AG OKB Austria AAA/Stable/A-1+ AAA/Stable/A-1+ AAA/Stable/A-1+ AAA/Stable/A-1+ Eksportfinans ASA Eksportfinans Norway AAA/Stable/A-1+ AA+/Stable/A-1+ AAA/Stable/A-1+ AA+/Stable/A-1+ Export Credit Bank of Turkey Turk Exim Turkey BB/Stable/B --/--/-- BB-/Stable/B BB-/Stable/B Swedish Export Credit Corporation SEK Sweden AAA/Stable/A-1+ AA+/Stable/A-1+ AAA/Stable/A-1+ AA+/Stable/A-1+ ASIA-PACIFIC NDBS China Development Bank CDB China A/Stable/A-1 A/Stable/-- A/Stable/A-1 A/Stable/A-1 Development Bank of Japan DBJ Japan AA-/Positive/A-1+ AA-/Negative/A-1+ AA-/Positive/A-1+ AA-/Negative/A-1+ Development Bank of Kazakhstan DBK Kazahkstan BBB/Stable/A-3 BBB-/Positive/A-3 BBB-/Stable/A-3 BBB-/Positive/A-3 Korea Development Bank KDB Korea A+/Stable/A-1 --/--/A-1 A/Stable/A-1 A/Stable/A-1 ECIS Export Finance & Insurance Corporation EFIC Australia AAA/Stable/A-1+ AAA/Stable/A-1+ AAA/Stable/A-1+ AAA/Stable/A-1+ Export-Import Bank of India India Exim India BB+/Positive/B BB+/Positive/B BB+/Positive/B BB+/Positive/B Export-Import Bank of Korea Kexim Korea A+/Stable/A-1 --/--/A-1 A/Stable/A-1 A/Stable/A-1 Export-Import Bank of China China EXIM China A/Stable/A-1 A/Stable/A-1 A/Stable/A-1 A/Stable/A-1 Japan Bank for International Cooperation JBIC Japan AA-/Positive/A-1+ AA-/Positive/A-1+ AA-/Positive/A-1+ AA-/Positive/A-1+ AFRICA NDB Development Bank of Southern Africa Ltd DBSA South Africa A+/Stable/A-1 A+/Stable/A-1 BBB+/Stable/A-2 BBB+/Stable/A-2 NR-Not rated. Sovereign and institution ratings are as of August 17, 2006. The Raison D'Etre Of NDBs And ECIs NDBs and ECIs are generally policy-based institutions, established to perform functions or achieve results that purely commercial financial institutions are/were unwilling to do or unable to achieve. The range of their activities varies among institutions, and in many cases their activities have broadened through the years—in some cases organically, in others through mergers with other institutions. Responsibilities undertaken by these institutions include financing exports; providing long-term financing for infrastructure projects; supporting the growth and development of less-developed regions; developing domestic capital markets; backing "national champions"; supporting the establishment, growth, and development of small and midsize enterprises (SMEs); and providing emergency funding during financial crises or following natural disasters. While some academic literature casts doubt on these institutions as a suitable mechanism for undertaking these activities, governments appear to harbor few such doubts—and where they might, policy inertia and occasionally patronage considerations usually lead to their continued existence. Being policy-based, NDBs and ECIs—at least the majority, which are 100% government owned—are not profit-maximizing institutions. While almost all are consistently profitable, they are often less so than their closest domestic commercial counterparts. This lower profitability, in terms of returns on assets and/or equity, reflects several factors: Many lend at relatively low margins over their costs of funds; In most cases, in line with their raison d'être, these institutions are making at least some loans that their closest commercial counterparts eschew, either because the absolute level or the risk-adjusted rate of remuneration is unsatisfactory; They typically avoid some types of risk that commercial institutions willingly accept in an effort to boost their profitability. For instance, most do not seek to bolster their profitability by consciously mismatching their currency, interest-rate, or asset-liability maturity profiles or by actively trading their securities portfolios; They often have operating costs that are high relative to those of their closest commercial counterparts; and In some cases, they maintain more capital relative to assets or risk-weighted assets than their commercial counterparts, reducing their returns on equity. This lower profitability means that some of these institutions have more in common with MLIs—also policy-based institutions—than with purely commercial institutions. Government Influences On Ratings Governments influence the ratings of government-related NDBs and ECIs in three major ways. First, governments affect the stand-alone ratings of NDBs and ECIs. As explained below, this is done in a wide variety of ways, which vary by country and institution. Overall, government influence on stand-alone ratings is frequently positive; however, this influence can be negative, particularly in a time of general economic stress. Second, in the event that an institution finds itself under financial stress, a government may provide extraordinary financial support to enable it to avoid default. The probability of a bailout by the government—while sometimes less than 100%—is generally higher than that for purely commercial institutions. Third, the local and foreign currency issuer credit ratings on NDBs and ECIs generally will not be higher than the local and foreign currency ratings of the sovereigns in their countries of domicile. The Process Of Rating Sovereign-Supported Institutions Standard & Poor's methodology for rating government-related entities (GREs) has evolved in recent years. At one time, government support was the predominant, or even sole, basis for determining these ratings, which almost invariably resulted in equalization of an institution's ratings with that of its country of domicile. As is clear from table 1, the credit ratings of most NDBs and ECIs continue to be equalized with those of the sovereigns in their countries of domicile. Standard & Poor's now employs a two-stage approach to assigning ratings to NDBs and ECIs. First, the stand-alone rating of the institution is determined; then, the nature and strength of the sovereign support that might be expected in a time of institutional financial stress is assessed. As a consequence, a well-capitalized and highly liquid institution with less-certain support from its sovereign in a time of financial stress and a poorly capitalized and less-liquid institution with more certain support may, and often do, end up with the same ratings as their respective countries of domicile. Stand-Alone Ratings The first analytical step in assigning an issuer credit rating to an NDB or ECI is determining its stand-alone rating. Under Standard & Poor's criteria for rating GREs, stand-alone has a specific meaning. It does not mean what the rating would be in the total absence of special government relationships with these institutions. This would be difficult, if not impossible, to determine for virtually all of these institutions, since governments are typically involved in their affairs in a variety of ways. As a consequence, divining the ratings of government-related institutions under the assumption of no government involvement whatsoever would not only be counterfactual and difficult, but irrelevant. Instead, the stand-alone rating assumes that the entity's existing business profile is maintained, including whatever government support or intervention the entity typically enjoys in the normal course of business. However, it excludes any credit for extraordinary government assistance that might be forthcoming at a time of financial stress (i.e., it excludes the possibility of a bailout). This concept is essential, because it identifies the downside, or credit cliff, should the potential for extraordinary government support dissipate. For institutions that are very strong on a stand-alone basis—whether simply as a result of their financial profiles or because these profiles are strengthened by government support that is expected to continue even during a time of financial stress—the credit cliff is low, or even nonexistent; for others whose ratings are more dependent upon extraordinary government support, the cliff may be high. Financial Profiles Of NDBs And ECIs The stand-alone analysis begins with an examination of these institutions' financial profiles. One area of focus is the on- and off-balance sheet risk undertaken by these institutions. In more highly rated countries, the focus is almost entirely on the institutions' purpose-related assets (PRA)—primarily loans, but also any lower-rated securities (as opposed to government or other highly rated securities held for liquidity purposes) and equity investments that are held pursuant to the institutions' raison d'etre. In lower-rated countries, in addition to the risk embedded in their PRA, there is generally substantial risk embedded in the securities of the government of domicile typically held for liquidity purposes. Purpose-related exposure (PRE), which adds guarantees (which are off-balance-sheet) to PRA, is a broader measure of risk undertaken by these institutions. A second area of focus is institutions' risk-bearing capacity, i.e., their reserves for losses plus their shareholders' equity, adjusted where necessary. Obviously, other things being equal, an institution with higher risk-bearing capacity is better positioned to absorb losses from its PRE and other assets than one with less. A third area of focus is liquidity, since other things being equal, institutions with greater liquidity can meet their obligations for a longer period of time should events damage their ability to fund themselves. These institutions vary widely in their risk-bearing capacity relative to their total assets. Especially well capitalized institutions in terms of these ratios at year-end 2005 include the Republic of Turkey's Export Credit Bank of Turkey (Türk Eximbank), the Republic of Kazakhstan's Development Bank of Kazakhstan (DBK), and the Republic of South Africa's Development Bank of Southern Africa (DBSA), all of whose ratios exceeded 50%. Institutions with especially low ratios, less than 2%, include the Republic of Austria's Oesterreichische Kontrollbank AG (OKB), the U.S.'s Private Export Funding Corporation (PEFCO), and the Kingdom of Sweden's Swedish Export Credit Corporation (SEK). NDBs and ECIs also differ substantially in their PRA as a share of total assets. For instance, at year-end 2005 a number of institutions had PRA equaling more than 95% of their total assets, including the Republic of Croatia's Hrvatska Banka za Obnovu i Razvitak (HBOR), Japan's Development Bank of Japan (DBJ), and the People's Republic of China's China Development Bank (CDB). At the other end of the spectrum, both SEK and the Kingdom of Spain's Instituto de Credito Oficial (ICO) had PRA less than 36% of their total assets. More relevant from a credit perspective are the ratios of risk-bearing capacity to PRE. Those institutions with especially high risk-bearing capacity relative to PRE include the State of the Netherlands' Nederlandse Fin.-Maatschappij voor Ontwikkelingslanden N.V. (FMO), DBSA, and DBK, whose ratios exceed 60%. Institutions with especially low risk-bearing capacity relative to PRE include OKB, PEFCO, and Federal Republic of Germany's Landwirtschaftliche Rentenbank (LRB), whose ratios are less than 3%. The other key component of creditworthiness is liquidity, for the purposes of this article the assets that institutions can convert quickly into cash without major loss of value. As in other respects, these institutions differ very substantially in the liquid assets they hold on their balance sheets. Basically the counterpart of low PRA, the ratios of liquid assets to total assets of FMO, ICO, and the Russian Federation's Russian Bank for Development (RBD) are relatively high; those of DBJ and OKB are relatively low. Finally, profitability (as measured by the return on average assets plus guarantees, or the return on average shareholders' equity) also varies widely across institutions. As noted above, profitability is not the raison d'être of most of these institutions. Moreover, the shares of these institutions generally are not publicly traded, and most of them do not pay dividends. As a consequence, most are ordinarily under less pressure than commercial institutions to be highly and consistently profitable and, for most of these institutions, profitability is most important because of the contribution it makes to their risk-bearing capacity and their ability to expand their activities. Varieties Of Government Influence On Stand-Alone Ratings While the financial profiles of these institutions are a useful starting point for assessing their creditworthiness, under normal conditions their stand-alone creditworthiness is generally stronger than that of purely commercial institutions with the same financial profiles in the same countries due to government support. The principal avenues of government support for MLIs are much the same for almost all of these institutions. They consist of shareholder governments permitting them to operate with unusually high ratios of risk-bearing capacity to PRE; maintaining high levels of liquid assets; accepting relatively low returns on shareholders' equity; exempting them from income taxes and the payment of dividends; and affording preferred creditor treatment on sovereign and sovereign-guaranteed loans. The avenues of government support for NDBs and ECIs are more varied. This support falls primarily into one of three categories: enhancement of the quality of PRE (most notably loans, which reduces the credit risk in their operations); enhancement of the ability of institutions to fund themselves on advantageous terms (which reduces liquidity risk and contributes to profitability); and enhancement of the capital, and thus the risk-bearing capacity, of these institutions. This government support makes the creditworthiness of these institutions higher than a strictly number-driven analysis might suggest. Enhancement of asset quality NDBs and ECIs execute their mandates primarily by making loans. The financing of exports traditionally has been a priority sector for most governments, in both developed and developing countries, and is the focus of export credit institutions. Many development banks also finance exports; however, their mandate is wider and their focus may include financing infrastructure projects, specific industrial sectors, specific regions, and, more recently, SMEs. One form of government support for NDBs and ECIs thus takes the form of guarantees by the central government, or a government agency, of all or a portion of an institution's loans. For instance, while it is entirely privately owned, all of PEFCO's export loans made with the approval of the Export Import Bank of the United States (U.S. Eximbank) are guaranteed by U.S. Eximbank (while U.S. Eximbank is not rated, its obligations are full faith and credit obligations of the U.S. government). Similarly, almost all of the loans of OKB are guaranteed by the government of Austria; and much of the direct customer lending of HBOR is guaranteed directly or indirectly by the state. These guarantees have the effect of reducing the risk embedded in the institutions' loan portfolios, improving their implicit ratios of risk-bearing capacity to risk in their loan portfolios, and hence enhancing their creditworthiness. In some cases, institutions in effect act as agents of the government in making loans, with the government bearing all of the expense and risk of the loans. This is the case of the Netherlands' Investment Bank for Developing Countries N.V., a subsidiary of FMO. Enhancement of funding It is common for governments to support the stand-alone creditworthiness of NDBs and ECIs by enhancing their ability to fund themselves, which they do in a variety of ways. Among the strongest of such enhancements is that applicable to EDC, which has access to the Consolidated Revenue Fund of the government of Canada to repay its borrowings. In this case, the issuer credit rating is irrelevant to bondholders, since all bonds are essentially government of Canada debt and carry Canada's AAA/Stable/A-1+ ratings and outlook. A second method is for the government to guarantee an institution's obligations. A number of institutions benefit from such guarantees, among them ICO, HBOR, and FMO. In most cases, the timeliness of payment under such guarantees is not assured. However, under most circumstances, the expectation of government support for NDBs and ECIs is higher than that for commercial financial institutions. Standard & Poor's may expect that governments guaranteeing the obligations of these institutions would act in such a way as to enable them to make timely payment. A third method of funding support is for the government to provide funding aside from that made in the form of capital injections. For instance, KfW's loans in developing countries are disbursed in its name; however, funds are provided from the federal budget. A fourth method of funding support is for the government to sponsor lending to NDBs or ECIs by MLIs. For instance, the Federative Republic of Brazil's Banco Nacional de Desenvolvimento Econômico e Social (BNDES) is a major recipient of funds from MLIs, and loans from the Inter-American Development Bank (IADB) are its cheapest source of external funding. Since IADB loans are made to nongovernment entities only with the guarantee of the government, government support is essential for BNDES to receive this funding. Still another source of funding support is provided by governments in the form of privileged access to short-term funding from the central bank. CDB has unconditional access to short-term liquidity from the central bank to support debt-service payments, although this has never been called upon; similarly, in 1998 the Korean government revised the Bank of Korea Act to grant the Korean Development Bank (KDB) immediate funding support from the central bank, if needed. Assurances of support of this nature are tantamount to a central bank guarantee that an institution will be bailed out, if necessary, in a time of financial stress; however, the value of a central bank guarantee reflects the creditworthiness of the government. Finally, another source of funding support can be favorable regulatory treatment, such as exempting liabilities of NDBs or ECIs from concentration limits for commercial financial institutions—although this could be a mixed blessing under certain circumstances. Enhancement of capital The third principal means of government credit support for stand-alone creditworthiness is through the maintenance of strong risk-bearing capacity. Most NDBs and ECI are wholly owned by central governments. In some cases, central governments, government corporations, and/or local governments share ownership. In a few cases (PEFCO, OKB, and LRB), there is no government ownership. Usually, the contribution of capital is most easily accomplished when the central government is the only shareholder. Most of the recent contributions of capital have been made for institutions in developing countries, including BNDES, HBOR, the Russian Federations' Russian Bank for Development (RBD), DBK, the United Mexican States' Banco Nacional de Comercio Exterior S.N.C. (Bancomext), and KDB. However, recent capital contributions have also been made for DBJ. There are two more subtle ways for governments to bolster the capital of government-related institutions other than through a simple capital injection. The first is by eschewing the payment of dividends. This method, which is shared by virtually all MLIs, is also very common for NDBs and ECIs that do not have private sector ownership. It is politically palatable, since it avoids the budgetary process. A second method, which is also shared with MLIs, is by exempting NDBs and ECIs from payment of income taxes. It is also a common means of support, although less so than not requiring dividends . There are thus a wide variety of ways in which government support strengthens the stand-alone creditworthiness of NDBs and ECIs, some of them are not easily reflected in purely number-driven analyses. Government Bailouts NDBs and ECIs are not immune from financial stress, particularly in lower-rated countries. One can consider two different circumstances under which such institutions come under stress: Institution-specific stress. An institution finds itself under financial stress as a consequence of its difficult mandate or the execution of that mandate, while the macroeconomic environment in which it operates is unexceptional. Coming at a time when the government itself is not under unusual stress may increase the probability that support will be forthcoming. These factors tend to move institutions' ratings toward or to those of the country in which they are domiciled General economic/financial stress. In times of widespread economic/financial stress that affects not only the NDB or ECI but other financial institutions, other entities dependent on government support, and the government itself. Under these circumstances, the probability of government support may diminish; indeed, the government itself may take resources from NDBs or ECIs to help meet its own obligations, thereby also weakening the stand-alone rating. This helps to account for the low likelihood that the ratings of such institutions will be higher than those of the sovereigns in their countries of domicile. In sum, while their financial profiles vary widely, the stand-alone strength of most NDBs and ECIs may be stronger than a purely number-driven analysis might suggest. However, the strong relationship with the government of most of these institutions also makes the likelihood of extraordinary government influence high in a time of financial stress. Therefore, there are factors inherent in NDBs and ECIs that tend to move their ratings toward, and in many cases to, but no higher than, those of the sovereign in their countries of domicile. Note National governments are also involved with multilateral lending institutions (MLIs) such as the World Bank, the European Bank for Reconstruction and Development, and the Islamic Development Bank. Rating criteria, summary analyses, and comparative data on MLIs may be found in Standard & Poor's Ratings Services' "Supranationals Special Edition," which is published each fall and available on RatingsDirect, Standard & Poor's Web-based credit research and analysis system, and at www.standardandpoors.com (enter Supranationals Special Edition 2005 (or 2006, beginning September 2006) in the search box and click on title under "Credit Ratings" in the center of the screen).