Supranationals Rating Criteria

Master Criteria

Scope

This report describes Fitch Ratings' criteria for assigning new ratings to and monitoring existing ratings of supranational issuers and issuances, most of which are multilateral development banks (MDBs). It also covers supranational concessional funds (SCF), supranational financial guarantors (SFGs) when their rating is support-driven, and supranational administrative bodies (SABs). These criteria are applied in conjunction with other criteria disclosed under *Related Criteria*.

Key Rating Drivers

The importance of quantitative and qualitative rating drivers varies between entities. Not all rating factors outlined in this report will apply to each individual rating. Each specific Rating Action Commentary or rating report will discuss the factors most relevant to the individual rating.

Standalone Credit Profile and Support: For MDBs, SCFs and SFGs, Fitch's approach is to determine the Standalone Credit Profile (SCP). The agency then assesses the likelihood of the MDB receiving extraordinary financial support from its shareholders, considering their capacity and propensity to provide such support. The Issuer Default Rating (IDR) is based on the SCP plus a credit uplift reflecting extraordinary support from shareholders; this adjustment will generally not exceed three notches.

Standalone Credit Profile: Fitch determines separate assessments for solvency and for liquidity, on a scale ranging from 'aaa' to 'd'. The SCP is derived from the solvency assessment and capped by the liquidity assessment (ie the lower of the two); it is then adjusted for the business environment, through a potential adjustment of three notches either up or down.

Solvency Assessment: The assessment of solvency is based on two broad factors: capitalisation and risks. Individual factors are assessed separately on a four-grade scale. Capitalisation depends essentially on capital ratio measures. The assessment of risks relies on five quantitative and qualitative sub-factors – credit risk, concentration, equity risk, market risk, and risk management.

Liquidity Assessment: Fitch's assessment of an MDB's liquidity aims at measuring the size and quality of its liquid assets relative to its present and future cash needs. The key indicators are the ratio of liquid assets to short-term debt and the quality of treasury assets. Other factors, such as access to capital markets, and alternative sources of liquidity, are also taken into account.

Business Environment: The assessment of the MDB's business environment leads to three possible outcomes: High Risk, Medium Risk and Low Risk. The assessment is based on two broad factors: business profile, which takes into account risks associated with the strategy and governance; and operating environment, which reflects risks associated with the MDB's countries of operation.

Extraordinary Support: The SCP is potentially adjusted by a credit uplift reflecting shareholders' capacity and propensity to provide extraordinary financial support. Capacity to provide support is measured by the rating of callable capital ensuring full coverage of net debt, or by the weighted average rating of key shareholders. Propensity to support is assessed via qualitative factors.

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This report updates and replaces *Supranationals Rating Criteria*, dated 20 May 2021.

Related Criteria

Sovereign Rating Criteria (April 2023)
Insurance Rating Criteria (November 2021)

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Supranational Institutions Rated by Fitch

Multilateral Development Banks

MDBs are public entities controlled by "member states". They are not subject to the national jurisdictions of the countries in which their head offices are located; governance rules are set by international treaties between member states. They generally operate in a defined region of the world, covering several countries – the countries of operations. MDBs can have borrowing or non-borrowing member states; the role of the latter is principally to provide support to the institution.

Most supranational entities rated by Fitch are MDBs. Their main activity is to provide loans or other types of financing to states or private entities. They therefore share a number of features with commercial banks. Their funds are generally raised on the capital markets. MDBs can be classified into four groups, according to the scope of their operations: global and regional MDBs, European MDBs, sub-regional MDBs and private-sector-focused MDBs.

MDBs differ from commercial banks in key respects: they are not subject to any form of bank regulation; and they are governed by their own prudential rules and the policies defined by member states. They generally benefit from preferred-creditor status (PCS): the repayment of sovereign debt due to MDBs takes precedence over other creditors. As public institutions, most do not distribute dividends, and their main objective is not to maximise profitability but to fulfil a general interest mission, which often includes counter-cyclical lending. Most MDBs generate low margins, and profits are generally either kept in reserves to strengthen the capital base or transferred to development funds.

Support for MDBs is in most cases granted through a specific mechanism – callable capital – which is specified in the founding treaty between member states. This capital, subscribed to but not paid in by member states, far exceeds paid-in capital. Callable capital constitutes an unconditional commitment from member states to pay in capital if the MDB is unable to repay its debt obligations.

The theoretical mechanism in most MDBs for capital calls is as follows: an MDB in difficulty will make a first-round call to all its member states, based on their respective share in the callable capital. If some do not provide the funds, successive calls can be made to the other member states until the necessary amount of capital is provided; this could result in changes to each member state's ownership of the MDB's capital. However, member states are not obliged to provide more than the predefined amount of callable capital they have committed; in other words, there is no joint and several liability between member states.

Supranational Concessional Funds (SCF)

SCFs are entities whose main mission is to extend concessional loans, grants and guarantees to low-income countries and/or for specific purposes. Most of them are administered by an institutional group including an MDB.

There are marked differences between an SCF and an MDB.

- SCFs have no capital: they receive contributions and subscriptions from donors. There is no callable capital.
- SCFs' loans are extended on very long-term maturities up to 50 years (including up to a 10-year grace period), and low interest rate, below the rates charged by MDBs.
- Beneficiaries of SCFs' loans and grants are the poorest member countries; they are generally low-income countries not eligible for loans from MDBs.
- Some SCFs, are dedicated to a specific purpose (e.g. agriculture).

SCFs accounts may be presented on a "special purpose basis": not a balance sheet, but rather a statement of net development resources, disclosing the resources received by the SCF (which are equivalent to shareholders' equity for an MDB) and the use of such funds, ie loans, grants and debt relief and liquid assets (equivalent of assets for an MDB). However, many SCFs have revised their financial reporting rules and use IAS / IFRS or US GAAP standards.

Supranational Financial Guarantors

SFGs' main activity is to provide guarantees and other forms of credit enhancement to debt issues – sovereign or private – or to structured operations. As they do not borrow funds, the rating applies to their ability to honour their guarantee commitments. The number of institutions classified as SFGs is far smaller than that of MDBs.

Supranational Administrative Bodies

Fitch also rates various supranational entities that cannot be classified as MDBs or SFGs. This category includes entities that are involved in financing activities but have no capital and therefore cannot be considered financial institutions.

This category also includes regional central banks. Like other SABs, regional central banks are owned by several states, which are all members of a monetary zone or by national central banks that are part of a common monetary zone.

Rating Approach for Supranationals

What Supranationals' IDRs Rate to: Definition of Reference Obligations

A supranational's IDR express Fitch's opinion on the risk of default on senior obligations to third-party private creditors. Obligations to entities under common control, member states or governments in general are excluded.

In accordance with Fitch's rating definitions and related criteria, a supranational default may take several forms, include non-payment of obligations beyond the available cure period, bail in, a Distressed Debt Exchange (DDE), or the issuer entering into liquidation or bankruptcy proceedings if applicable. Upon default, the supranational's IDR will be downgraded to 'RD' or 'D', and the relevant instruments to 'D' once the grace period elapses.

Non-Performance of Subordinated Debt

Supranationals' IDRs do not usually reflect default risk on subordinated or "junior" debt. However, if non-performance on such obligations is viewed by Fitch as indicative of broader stress that could result in the issuer defaulting on its senior obligations to third-party, private creditors, this may result in the supranational's Long-Term IDR being downgraded to a very low level, eg 'CCC+' or lower. Furthermore, if a default on subordinated debt triggers liquidation or bankruptcy procedures, if applicable, or results in acceleration of senior debt that the supranational is unable to redeem, non-performance on subordinated debt may very quickly result in the entity's IDRs being downgraded to default level.

Data Sources

Fitch's analysis of supranationals relies on public and private information disclosed by the rated entities. The information is shared by the management of the entities in meetings held at least once a year; the interaction between Fitch and the management of rated entities is extensive in most cases, and a significant flow of information is shared outside the annual review process.

Public information includes audited annual reports, which are reviewed at least annually, statutes and by-laws of the entity, statistics and other forms of economic information issued by recognised sources or by the issuer through various types of publication. Annual reports include audited accounts with annexes, explanation of the entity's strategy and objectives, and details on operations such as the sectoral and geographical distribution of operations.

Private information covers a vast range of topics. Key information analysed by Fitch includes a detailed list of financing disbursed and other commitments made by the rated entity (although several supranational institutions make this information public), a schedule of the largest single exposures, details on impaired financing and reserves provided, short- and medium-term financing plans, details of risk-management policies and procedures, biographies of senior managers, annual budgets and a business plans outlining the strategy over the medium to long term.

The key rating assumptions are based on information derived from Fitch's sovereign reports and studies, in particular sovereign ratings, projections for economic growth and other relevant indicators in the countries of operations of the supranational. They also rely on information, in particular ratings (public or private, credit opinions, assessments and scores) provided by other

Fitch groups, such as Financial Institutions, Insurance, and Corporates, on the credit quality of the supranational's treasury, derivatives or loan portfolio.

Projections

The ratings are based on medium-term projections of supranationals' financial situations. Fitch's analysts prepare projections of key financial indicators (see Step 1(a): Solvency Assessment and Step 1(b): Liquidity Assessment below) for each issuer over the medium term, typically a three-year time horizon. Fitch bases its financial projections for supranationals on detailed discussions with the management teams of these institutions. Fitch's analysts use their experience of the sector and of global credit trends and conditions to assess the reasonableness of management projections and thereby to determine the agency's own projections. In some cases, Fitch's projections may be similar to those produced by the issuer, but in other cases they may be materially different, depending on our view of the underlying assumptions. When available, Fitch uses, for its projections, the ratings and outlooks assigned by other analytical groups. If a Negative (Positive) Outlook is assigned to an entity, the current rating is adjusted downwards (upwards) by one notch to obtain the projection.

Projected variables focus heavily on the evolution of the issuer's balance sheet, due to the importance of capitalisation and liquidity measures in the analysis. Projections of income statement variables are typically less relevant to the credit analysis of supranationals, as most of these institutions do not have a profit-maximisation mandate. However, projected earnings and cash flow are assessed in the context of capital generation and retention, and liquidity. The inherent challenge of making detailed forecasts of balance sheet variables means Fitch's projections represent our best estimate of future outcomes incorporating conservative judgement, rather than a detailed, model-based approach.

Assumptions

Fitch first prepares projections of the entity's financing portfolio over the medium term. This requires assumptions on the projected growth rate of lending and other types of financing operations (including both disbursements and approvals), as well as the breakdown of the portfolio by sectors and geographical zones, and the share of the largest borrowers in the overall portfolio.

As indicated above, the agency focuses on projecting the degree of leverage and capitalisation of the institutions; assumptions are needed for the amount of upcoming capital increases and the amount of debt raised on capital markets. Assumptions are also required for the institution's operating margin and administrative costs, to forecast internal capital generation.

Fitch also needs to make assumptions on the amount of liquid funds held in the portfolio, on the share of short-term versus medium- and long-term debt, and on the quality of treasury assets to forecast liquidity indicators.

Fitch then makes projections on the quality of the portfolio. This requires assumptions on the future average rating of assets and guarantees and on the amount and quality of equity. Assumptions are also needed on the ratings of shareholders, and on potential changes in the share-ownership structure.

Nomenclature

Throughout this report, Fitch uses reference to support factor and SCP, as well as making assessments for other analytical concepts, such as solvency and liquidity using the 'aaa' to 'd' rating scale. These notch assessments are intended to illustrate our assessment of the key elements of these criteria in the context of our traditional 'AAA' to 'D' rating scale, but they are not officially assigned or published in the way that we assign and publish IDRs and bond instrument ratings.

Rating Tool for Multilateral Development Banks

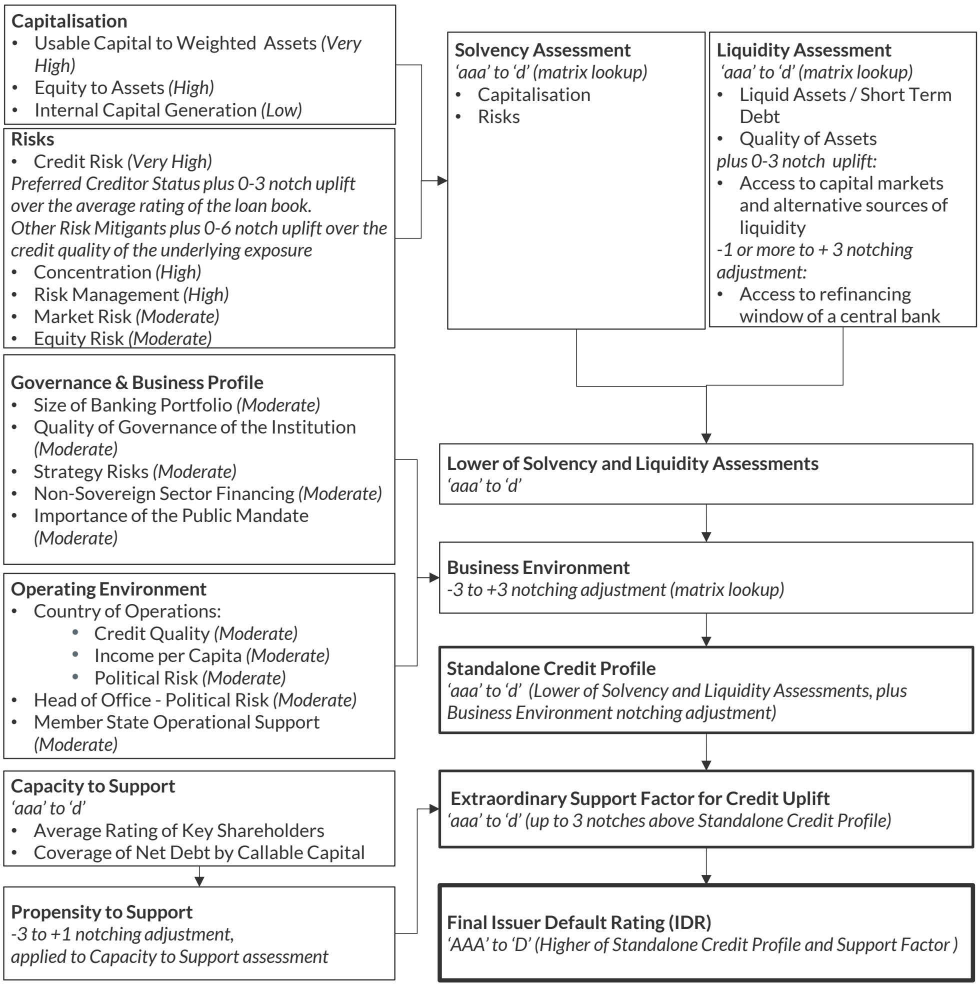
The SCP and support factor and their sub-components are summarised via a rating tool. The tool enables consistency in assessing each rating factor; based on the matrices that align the assessment of factors with Fitch's rating scale (displayed later in this report), this allows the agency to determine the final rating. The structure of the tool is summarised in the diagram below.

Fitch first determines the SCP of the institution, which reflects its standalone credit quality; this assessment uses the ('aaa' to 'd') rating scale. Fitch then assesses the level of potential support from member states and other shareholders. The IDR of the entity is equal to the SCP plus a rating uplift of between zero and three notches according to the level of extraordinary support from shareholders.

The SCP is derived from two broad factors, liquidity and solvency, each divided into sub-factors that include both quantitative and qualitative variables. The SCP is adjusted by the assessment of the MDB's business environment, which has two components: its governance and business profile and its operating environment. The adjustment of the SCP for business environment ranges from +3 to −3 notches.

Extraordinary support is assessed separately and reflects the likelihood that the entity will receive financial aid in case of need from its member states and other shareholders. In assessing the support factor, Fitch considers both the capacity and the propensity of potential supporters to provide assistance.

Representation of Rating Criteria for MDBs



Note: Each box represents a criteria component. Items in brackets denote the methodological approach for deriving the outcome of a given component. When multiple sub-components are listed in a single box, items in brackets denote indicative weights towards the parent component.
Source: Fitch Ratings

MDBs' Standalone Credit Profile

Step 1: Assessment of Standalone Credit Profile

Step 1(a): Solvency Assessment

The assessment of the solvency rating is based on two broad sub-factors: capitalisation and risks, which are each assessed on a four-grade scale.

The analysis includes both qualitative and quantitative measures; the latter are based on medium-term projections prepared by Fitch, and not solely on year-end audited figures.

The relative weights of individual factors in the assessment of SCP of MDBs are indicated in the diagram Representation of Rating Criteria for MDBs above. These weights are those generally used in the analysis of capitalisation and risk, but they can be adjusted if the entity has specific features that differentiate it from standard MDBs. For example, for entities with no or limited lending activity and a focus on equity investment, a 'Low' weight is assigned to credit risk, while a 'Very High' weight is assigned to equity risk.

Solvency Assessment Guidelines

		Capitalisation			
		Excellent	Strong	Moderate	Weak
Risks	Very low	aaa	aaa/aa	aa/a	a/bbb
	Low	aaa/aa	aa/a	a/bbb	bbb/bb
	Medium	aa/a	a/bbb	bbb/bb	bb/b
	High	a/bbb	bbb/bb	bb/b	b/ccc/d

Note: The cells in this table indicate the rating category ranges for each combination of capitalisation and risk
Source: Fitch Ratings

Capitalisation

Capitalisation is assessed through three indicators: the equity-to-assets ratio; Fitch's usable capital-to-risk-weighted assets ratio; and internal capital generation.

Fitch integrates in its analysis specific situations, such as an upcoming capital increase or the existence of conservative policies regarding capitalisation. The agency places importance on an MDB's self-imposed limits, as they constitute a measure of its risk appetite for the future.

Equity-to-Assets Ratio: This compares shareholders' equity to assets net of the fair value of derivative instruments recorded on balance sheet. In this ratio, the calculation of total assets includes the outstanding amount of guarantees granted by the bank, which are recorded off-balance sheet. Indicative values of this ratio for each rating category are presented in the Equity-to-Assets Ratio table in the side margin.

Fitch's Usable Capital-to-Risk-Weighted Assets Ratio (FRA): Usable capital includes shareholders' equity plus a portion (10%) of callable capital subscribed by 'AAA'/'AA' rated shareholders.

Risk-weighted assets include loans, guarantees, equity participations and other assets; weights are inspired by the Basel Committee's Standardised Approach. The weights are applied to loans and guarantees exposures by rating category after ratings have been adjusted for PCS and other risk mitigants. For treasury assets, the weights are applied by rating category; see *Risk Weights by Asset Class* in the margin.

The thresholds applied to this ratio differ from those applicable to the equity to assets ratio; they are presented in *Usable Capital/Weighted Assets* in the margin.

For investments in bond funds Fitch could look through to the credit quality of underlying assets if certain conditions are met (e.g. non-leveraged, investment grade, stability).

The computation of this second capital ratio differs when the rating of the MDB is based on support and support rests on callable capital. In this case, the portion of callable capital used for the coverage of net debt (see *Coverage of Net Debt by Callable Capital*) is deducted from usable capital to avoid double-counting of such callable capital.

Equity-to-Assets Ratio

Indicative value	Assessment
25% and above	Excellent
15% to 25%	Strong
8% to 15%	Moderate
Below 8%	Weak

Source: Fitch Ratings

Usable Capital/Weighted Assets

Indicative value	Assessment
35% & above	Excellent
25% to 35%	Strong
15% to 25%	Moderate
Below 15%	Weak

Source: Fitch Ratings

For MDBs providing concessional loans funded by equity resources, a negative adjustment is applied to shareholders' equity for the computation of the usable capital to risk-weighted assets ratio. This adjustment reflects the opportunity cost incurred by the MDB for extending loans at a rate that is substantially below its cost of resources and the yield on non-concessional loans. It is based on the characteristics of the concessional loans granted by the bank, in particular the interest rate, the maturity, and the length of the grace period.

The adjustment is obtained by discounting the cash flow of the concessional loans portfolio at a rate consistent with the bank's opportunity cost. The negative adjustment rate is equal to the ratio of the discounted value to the nominal value of the loan.

No such adjustment is applied for when concessional loans are funded by resources that are not consolidated with the entity's own funds.

Internal Capital Generation (ICG): Profitability metrics are given low weight, as profitability is not an objective for most MDBs. However, they are not entirely discounted, as net earnings are generally used to strengthen capital – MDBs do not pay taxes and only a few of them distribute dividends. Profitability is measured by Fitch using the return on equity (ROE); other measures include the cost to income ratio and the net interest margin, which are less volatile than ROE, as they are not affected by fair-value adjustments, and provide a measure of operating efficiency.

In most cases, internal capital generation is of minor significance in our assessment of capitalisation, and the level of this variable will typically be insufficient to affect the capitalisation assessment indicated by the equity to assets ratio (see *Equity to Assets Ratio* table above). However, in situations when internal capital generation is either very weak or very strong, it can affect the assignment of the overall solvency assessment in terms of the range of potential outcomes in the *Solvency Assessment Guidelines* table. In other words, very strong internal capital generation would typically help support a solvency assessment at the higher end of the potential range, whereas a very weak level of internal capital generation would typically lead to an assessment towards the lower end of the range.

Risks

Fitch also assesses the risks to which the MDB is exposed: credit risk, concentration risk, equity risk, and market risk. In this context, the agency also evaluates the quality of the MDB's risk-management policies.

Credit Risk: This is by far the largest source of risk for MDBs, and it is given critical importance in the assessment of risk as a whole. Fitch's credit risk analysis focuses on the financial instruments which are part of an MDB's banking portfolio; credit risk of the treasury portfolio is covered in the analysis of an MDB's liquidity.

- The key indicator for credit risk is the weighted average rating of outstanding loans and guarantees issued by the MDB. Data on the credit quality of loans is generally available to Fitch; most MDBs' sovereign borrowers, and a large number of public institutions, local authorities and corporates, are rated by the agency. When borrowers are not rated by Fitch, the agency uses external ratings from other sources. It may also use internal credit assessments provided by the MDBs subject to the agency being satisfied that these are conservative and credible. In the absence of any indication on the rating on an exposure, Fitch would assume a very weak credit quality (typically equivalent to a rating in the 'CCC' category). The rating of loans is derived from the rating of the borrower; if a loan benefits from an irrevocable external guarantee, the rating of the guarantor is used.
- The average rating of loans and guarantees is then adjusted for PCS and for other credit risk mitigants – see below. Other mitigants typically include collateral used by the MDB and third-party guarantees or credit insurance.
- Loan impairment, as measured by the ratio of outstanding impaired (or non-performing) loans to total outstanding loans, also constitutes a key measure in the assessment of credit risk. Total loans and off-balance sheet commitments (including undisbursed committed loans and guarantees) in stage 3 as per the IFRS 9 standard are also taken into account, and compared to total loan and off-balance-sheet commitments.
- Fitch takes into consideration the level of allowances for credit losses on impaired loans relative to impaired loans. For banks reporting under IFRS 9, the agency considers

Weighted Average Rating of Loans and Guarantees
(After adjustment for risk mitigants)

Indicative value	Risk level
A to AAA	Very low
BBB	Low
BB	Moderate
B to D	High

Source: Fitch Ratings

Risk Weights by Asset Class (%)

Loans, guarantees, treasuries, bond funds[a]	
AAA	0
AA	20
A	30
BBB	50
B-BB	100
CCC and lower	150
Equity participations	250
Other assets	100

[a] Based on the look-through approach
Source: Fitch Ratings

allowances for stage 3 exposures in its computation. Fitch also considers broader measures based on total allowances for credit losses on loans and off-balance-sheet commitments.

Impaired Loans vs. Stage 3 Loans

Fitch considers a sovereign loan from an MDB impaired when it has been overdue (or in arrears) for more than six months; for private-sector loans, the threshold is generally set at three months. Such loans are placed in 'non-accrual' status; which means that interest is typically recorded only when actually paid and not accrued as for other loans (under IFRS, interest may be accrued if the loan has predicted future cash flow). Once a loan is impaired, Fitch accounts for the full exposure to the borrower as non-performing.

The classification of loans in three different stages (1, 2, and 3) based on expected credit losses (ECL) was introduced in 2018 by banks reporting under IFRS. This classification also applies to guarantees, undisbursed loans commitments and a portion of debt securities.

Stage 3 loans are typically made of impaired loans. However, in some rare cases, the amount of stage 3 loans and impaired loans may differ. Fitch's approach is to treat these situations on a case-by-case basis, and retain in its assessment of credit risk the amount which, in its view, best depicts the level of assets at risk.

PCS and Other Risk Mitigants:

PCS is assessed on a four-grade scale (weak, moderate, strong, excellent). The adjustment takes the form of a credit uplift of up to three notches based on Fitch's assessment, which takes into account two factors:

- The share of sovereign lending in the loan portfolio, as MDBs benefit from greater protection than other lenders for such loans.
- The empirical evidence of preferred treatment, based on the analysis of default history. Fitch has computed, for MDBs for which data are deemed sufficient, the sovereign relative default rate, which is obtained by comparing the history of sovereign defaults to the MDB and to other creditors. In the absence of a proven record, Fitch would typically take a conservative stance on the assessment of PCS.

PCS: Guidelines for Credit Uplift

		Non-sovereign exposure			
Notching uplift		Low	Medium	High	Very high
History of preferred treatment	Excellent	3	3	2	1
	Strong	3	2	1	0
	Moderate	2	1	1	0
	Weak	1	0	0	0

Note: The cells in this table indicate the number of notches added to the average rating of loans and guarantees for each combination of non-sovereign exposure (as a % of total exposure) and history of preferred treatment
Source: Fitch Ratings

MDBs with very high exposures to private sector may benefit from a +1 credit uplift for PCS to take into account protection against transfer and convertibility (T&C) risk. This adjustment has to be supported by evidence that the MDB benefited from exemption against foreign currency restriction in past crisis.

Other risk mitigants typically include collateral used by the MDB and third-party guarantees or credit insurance. Their assessment is based on an evaluation of the quality and liquidity of collateral attached to loans. The credit uplift from using these mitigants would be limited to six notches over the credit quality of the underlying assets covered by the credit protection. Fitch's assessment takes the following into account:

Strength of PCS – Notching Uplift for Weighted Average Rating of Loans and Guarantees

Assessment	Notching Uplift
Excellent	+3
Strong	+2
Moderate	+1
Weak	0

Source: Fitch Ratings

Loan Impairment Ratio

Indicative value	Risk level
Below 1%	Very low
1% to 3%	Low
3% to 6%	Moderate
6% and above	High

Source: Fitch Ratings

- The nature of the collateral. Fitch considers the liquidity and quality of the assets used as collateral. For example, for cash collateral the rating of the bank in which the collateral is held will be a key consideration in setting the level of uplift.
- Recourse to credit insurance may provide credit enhancement. The upward adjustment accounts for the conditionality of the policy and the rating of the insurer. A six-notch uplift would only be applied when the insurance is provided by a pool of highly rated insurers, covers both interest and principal payments, claims would be paid on demand and in a timely manner, and the policy may not be discontinued during the life of the covered exposure.

Fitch may take into account schemes to synthetically transfer credit risk to third parties if these are significant enough to provide an uplift to the average rating of the entire loan portfolio or affect Fitch's usable capital-to-risk-weighted assets ratio.

Climate Risk

The analysis of the potential impact of climate change on supranationals ratings is at an early stage and the uncertainties are very high. There are several elements to assessing supranationals' exposure to climate change.

Supranationals are indirectly exposed to 'Physical'' risks arising from climate change, primarily because the creditworthiness of their borrowers may be affected by changing trends in global climate or extreme weather events (e.g. storms, floods, droughts). The degree to which supranationals are exposed to such risk depends on the countries and sectors in which they operate.

Supranationals are also indirectly exposed to 'Transition' risks as they could lend to projects and borrowers whose business model or creditworthiness might be affected by changes in global policies, technology or the costs of transitioning to a lower-carbon economy.

Fitch captures these risks (Physical and Transition) to the extent that they are reflected in the ratings (sovereign and non-sovereign) used by the agency to assess the creditworthiness of a supranational loan portfolio. As supranationals primarily lend to sovereign borrowers, the ability of Fitch to reflect climate risk in supranational ratings will grow as these climate risks are reflected in sovereign ratings.

Concentration: As a result of their public interest mission, MDBs may have to extend large amounts of financing to a country or a private entity in difficulty; they therefore generally have high levels of single counterparty concentration, especially compared to commercial banks. Concentration is measured by the ratio of the five largest exposures to the total banking portfolio, which includes loans, equity participations and guarantees. Fitch also pays attention to geographical and sectoral concentration.

Concentration Ratio

Indicative value	Risk level
Below 20%	Very low
20% to 40%	Low
40% to 60%	Moderate
60% and above	High

Source: Fitch Ratings

Equity Risks: A growing number of MDBs take equity participations in private-sector entities. In Fitch's view, equity participations are more risky than loans, not only because of the bankruptcy risk, but also due to the volatility inherent in the valuation of these assets and therefore on the MDB's own equity.

Exposure to equity risk is measured by the share of equity participations in the total banking portfolio, which includes loans, guarantees and equity stakes. The assessment also takes into account equity stake valuation techniques, and policies regarding maximum share ownership and the involvement of the MDB in the management of participations.

Market Risks: These are not, in general, a major source of risk for MDBs, as these institutions are not involved in market activities. However, FX or interest rate exposures can sometimes be difficult to hedge, especially for institutions operating in emerging markets that do not offer derivative products such as swaps. Risks are assessed based on published accounts that provide details on banks' exposures, generally gap analysis by interest rate repricing period or currency. However, the volatility of market movements means these sources are not sufficient to assess market risk, and qualitative judgement is also needed.

To appraise market risk exposure, Fitch examines the gap analysis provided by the bank as well as the rules governing interest rate risk and exchange rate risk, especially the maximum authorised exposures. Interest rate and/or FX mismatches are measured relative to the bank's shareholders' equity. The tools used for hedging these risks are also assessed: Fitch considers the use of sophisticated techniques. Fitch also pays particular attention to the volatility of gains and losses on financial instruments recorded in the profit and loss account, and to the institution's record of losses due to market risk.

Risk-Management Policies: The MDB must ensure that adequate risk-management policies are implemented to control the development of its activities – MDBs are not subject to bank regulations and they therefore set their own internal rules.

To assess the quality of risk management policies – as 'excellent', 'strong', 'moderate' or 'weak' – the agency considers the risk-management policies and the track record of operations under these policies.

Risk Management Policies

		Track Record of Operations			
Notching Uplift		**Excellent**	**Strong**	**Moderate**	**Weak**
Risk management policies relative to peers	Conservative	Excellent	Strong	Moderate	Weak
	Moderately conservative	Strong	Moderate	Moderate	Weak
	Not conservative	Weak	Weak	Weak	Weak

Source: Fitch Ratings

Fitch pays close attention to the degree of independence of the risk management team in relation to the operational teams.

Fitch also reviews policies and internal limits set by the bank for each type of risk: credit risk, concentration risk, market risk, operational risk and limits set for capital adequacy. The main indicators and benchmarks retained by each MDB are compared to sector best practice.

Fitch factors in its analysis the institution's counterparty risk policy. Fitch reviews the list of counterparties eligible for derivative and other off-balance sheet operations, and the instruments used by the bank to assess their credit quality. As for other risk management policies, this is compared to the sector best practices.

Fitch pays particular attention to the adequacy of policies aimed at mitigating credit risk, in particular provisioning policies, quality of collateral, and risk concentration limits. The maximum lending limit set by the MDB is a key indicator; it is often measured against the institution's total capital or its risk-bearing capacity (equity plus reserves). The agency also examines the internal procedures used to approve loans and other types of financing.

Fitch also examines the policies for identifying and mitigating operational risk. The latter relates to human or technical risk associated with deficiencies within organisations. The existence of a business continuity plan has a clear positive impact on the assessment of this type of risk.

Fitch also considers how supranationals account for climate risk in their underwriting and risk-management process, including identifying and mitigating physical or transition risk. The unregulated nature of supranationals means they do not face direct obligations to comply with new policies and prudential rules introduced to support the transition towards a low-carbon economy. However, supranationals are coming under rising pressure to direct lending towards contributing to net-zero emissions, especially those operating in countries with well-defined net-zero emission objectives and/or whose mandates specifically support government environmental policies.

Step 1(b): Liquidity Assessment

Fitch's assessment of an MDB's liquidity aims at measuring the size and quality of its liquid assets relative to its present and future cash needs, but also the MDB's access to market and other sources of funding. As with the solvency assessment, liquidity is assessed on a 'aaa' to 'd' scale. Its assessment follows a two-step approach: (i) internal liquidity assessment, based on the assessment of the liquidity buffer and liquid asset credit quality; and (ii) assessment of the alternative sources of liquidity and access to capital market, which complements the internal liquidity assessment.

Equity Stakes as a Percentage of Banking Portfolio

Indicative value	Risk level
Below 5%	Very low
5% to 10%	Low
10% to 20%	Moderate
20% and above	High

Source: Fitch Ratings

Liquid assets include:

- Bank deposits and debt securities held in the treasury portfolio rated investment grade, unless there are clauses limiting their sale on the secondary market or Fitch has doubts about the liquidity of the secondary market. Unlike banks, most MDBs have no access to central bank refinancing. Fitch may also include bank deposits and debt securities rated below investment grade, based on a case-by-case assessment of their degree of liquidity. Fitch will base its judgement on the maturity, the currency, and the credit quality of the bank or issuer of the security. Fitch would typically take into account assets denominated in hard currency and with a short-term maturity.

  Fitch excludes from liquid assets the deposits in banks and securities denominated in currencies that are not convertible, except if loans and capital are denominated in the same currency. Fitch also excludes securities and bank deposits rated 'CCC' to 'D', irrespective of their maturity.

- Trade finance loans with maturity of less than one year; a discount of 40% is applied to reflect the fact that such assets are less liquid than treasury assets.

- Investments in bond funds that meet certain conditions (e.g. non-leveraged, investment grade, stability, maturity). Fitch would apply a haircut of at least 30% to the investments' face value, based on an assessment of the liquidity of the investment. Fitch applies no haircut to investment in money market funds in developed markets.

- The assessment of liquidity is underpinned by the two following sub-factors, for which a four-grade scale (Excellent, Strong, Moderate and Weak) is used.

Liquidity Buffer: This is measured by the ratio of liquid assets held in treasury, and using accounting value, to short-term debt. For MDBs involved in trade finance, liquid assets include unimpaired trade finance loans with a maturity of less than one year. Fitch also pays attention to the liquidity stress test provided by MDBs, where the liquidity buffer is compared to cash needs (for operations and debt repayment) for a period generally of 12-18 months.

As the liquidity ratio only provides a point-in-time measure that can rapidly change, the assessment takes into account the entity's policies to manage liquidity. The key criterion is the limit internally set regarding the size of the liquidity buffer. Typical policies include the ratio of liquidity reserve to projected cash disbursements, or stress tests imposed by the MDB's risk management policies.

Liquid Asset Quality: The credit quality of liquid assets influences the capacity of the MDB to liquidate them without incurring losses. The key measure is the share of treasury assets rated 'AA-' and above on the long-term scale or 'F1+' on the short-term scale.

Secondary indicators are used to assess liquidity from the range of potential outcome (see *Internal Liquidity Assessment Guidelines* table below). Secondary indicators include:

- The share of securities and bank deposits rated in investment-grade category; this indicator is given particular importance for entities that hold a relatively high share of 'A' and 'BBB' rated liquid assets, and have a share 'AA-' and above/'F1+' treasury assets assessed as weak.

- Fitch takes into account the share of securities categorised in stage 3 under IFRS 9, as well as the amount of allowance for credit losses to cover these. For trade finance loans, the assessment of credit quality also takes into account the quality of collateral.

- Fitch also takes into account the maturity of liquid assets. Fitch gives particular attention to the share of securities and bank placements with a maturity of up to one year. For longer maturity instruments, Fitch takes into account the liquidity of the market on which they are traded.

- Special attention is paid to the limits set internally for asset quality and maturity of treasury assets and counterparties for treasury operations. Such limits generally take the form of minimum rating requirements for counterparties and maximum maturity for treasury assets.

Share of Treasury Assets Rated 'AA-' and above or 'F1+'

Indicative value	Assessment
70% and above	Excellent
40% to 70%	Strong
10% to 40%	Moderate
Below 10%	Weak

Source: Fitch Ratings

Liquidity Buffer: Liquid Assets as a Percentage of Short-Term Debt

Indicative value	Assessment
150% and above	Excellent
100% to 150%	Strong
50% to 100%	Moderate
Below 50%	Weak

Source: Fitch Ratings

Internal Liquidity Assessment Guidelines

Assessment Range		Liquidity Buffer: Excellent	Strong	Moderate	Weak
Liquid assets quality	Excellent	aaa/aa	aaa/aa	a/bbb	bb/b
	Strong	aaa/aa	aa/a	a/bbb	bb/b
	Moderate	aaa/aa	aa/a	bbb/bb	bb/b
	Weak	aa/a	a/bbb	bbb/bb	b/ccc/d

Source: Fitch Ratings

Access to Capital Markets and Alternative Sources of Liquidity – Notching Uplift

Assessment	Notching Uplift
Excellent	+3
Strong	+2
Moderate	+1
Weak	0
Very Weak	-1 or more

Source: Fitch Ratings

Access to capital markets and alternative sources of liquidity: Fitch makes a qualitative judgement on the access of the MDB to funding from local and international debt markets and financial institutions, based on factors such as track record and market conditions. The main factors that Fitch takes into account include the bond spread on the debt market, the valuation of financial instruments, the frequency and ease of placement of debt on the market, and the diversification of the investor base.

Our assessment accounts for the ability of an issuer to issue through the cycle and would be affected by episodes of marked increases in bond spreads relative to peers of the same rating category. Deterioration in ability to issue long-term bonds or to access international capital markets could also lead to a weaker assessment. For sub-regional MDBs, which do not have easy access to debt markets, access to long-term funding from development institutions is critical.

Alternative sources of liquidity can take the form of unused bank facilities, access to private placement or, rarely, access to a central bank's re-financing window. Alternative liquidity sources can also originate from the high liquidity of loans – this is especially the case for MDBs involved in the provision of trade finance facilities.

Combining the assessments of liquidity buffer and treasury asset quality provides a range for the internal liquidity assessment on the 'aaa' to 'd' scale.

To assess overall liquidity, the initial assessment is adjusted by the access to capital markets and alternative sources of liquidity and secondary indicators. The adjustment may be negative should Fitch believe access to capital markets and/or other liquidity resources would be very limited in a stress scenario. Fitch would not expect this adjustment to exceed one rating category (ie three notches), except for those MDBs that have access to the refinancing windows of a central bank, in which case the uplift can go up to two rating categories (six notches) in part depending on the share of assets eligible for central bank refinancing.

Step 2: Assessment of the Business Environment

Our assessment of the business environment depends on two factors: business profile and operating environment.

These two factors are assessed independently, on a scale composed of three grades: High Risk, Medium Risk and Low Risk.

The business environment assessment is derived from the matrix below. Three outcomes are possible: High Risk, Medium Risk and Low Risk.

The outcome of the business environment assessment leads to an adjustment of up to three notches up or down. The outcome of the assessment and the range of the adjustment are shown in the Business Environment Assessment Guidelines table below. The numbers in each cell indicates the range of the potential adjustment (in notches).

Business Environment Assessment Guidelines

		Operating Environment		
		High risk	Medium risk	Low risk
Business profile	High risk	High risk (−3 to −2)	High risk (−2 to −1)	Medium risk (−1 to +1)
	Medium risk	High risk (−2 to −1)	Medium risk (−1 to +1)	Low risk (+1 to +2)
	Low risk	Medium risk (−1 to +1)	Low risk (+1 to +2)	Low risk (+2 to +3)

Source: Fitch Ratings

Business Profile

The assessment of business profile considers the following sub-factors:

- Size of the banking portfolio; this includes outstanding loans, equity participations and guarantees – the smaller the portfolio, typically the higher risk in terms of business profile. The assessment is based upon projected data.
- The quality of governance of the institution. This can be measured through an assessment of the complexity of the organisational structure, and of the transparency and coherence of internal rules governing the institution. Particular attention is paid to independent audit bodies put in place by the MDB to ensure the enforceability of rules and to the experience and proven skills of senior management. For regional and sub-regional MDBs, Fitch considers that high share-ownership by non-borrowing countries has a positive impact on governance. By contrast, when an MDB's capital is majority-owned by borrowers, this may negatively affect our assessment of governance. The presence of one large shareholder, which may exert significant influence on an MDB's strategy, can also negatively affect our assessment of governance.
- The risks associated with the strategy followed by the MDB, accounting for the expansion of the balance sheet, in terms of both the pace of growth and the degree of riskiness of activities and countries of operations. For the purpose of this assessment, we typically consider countries that are not rated high risk. Fitch determines whether an MDB clearly identifies its long-term growth objectives and the path it expects to follow to achieve them. Given the constraints under which the institution operates, Fitch also assesses the strategy's coherence and the credibility of the business plan.
- The involvement of the MDB in private-sector financing, measured by the relative share of non-sovereign sector operations, ie loans to the private sector and equity participations. In general, private-sector operations are inherently more risky than sovereign lending; their share in the total banking portfolio provides evidence of the overall risk appetite of the bank.
- The importance of the MDB's public mandate. As supranational institutions, MDBs hold a public policy mandate. Their role can be assessed by measuring the importance of their participation in the financing of the local economy, the relationship they maintain with public authorities and the backing by supranational organisations. Their record of fulfilling their mandate and the quality of their relationships with government are also key indicators.

Business Profile

Sub-factor	High risk	Medium risk	Low risk
Size of banking portfolio	Less than USD5bn	USD5bn to USD30bn	USD30bn or more
Quality of governance	Opaque organisational structure; insufficient enforcement of governance rules	Organisational structure complex; some limitations in internal policies and difficulties in enforcement of policies	Very transparent organisational structure; comprehensive set of policies; good enforcement of internal policies
Strategy – growth objectives, sectoral/ geographical targets	Rapid growth in operations relative to resources; rapid	Moderate growth relative to resources; controlled development	Slow growth relative to resources; focus on

Business Profile

Sub-factor	High risk	Medium risk	Low risk
	development in risky sectors/geographical areas	in risky sector/ geographical zone	sectors/geographical areas with low risk
Relative size of non-sovereign sector financing (loans, guarantees, equity participations)	Accounts for a large share of operations (50% or more)	Accounts for a moderate share of operations (10% to 50%)	Accounts for a marginal share of operations (10% or less)
Importance of the public mandate	Weak relationship with authorities; relatively minor role in the financing of the region	Good relationships with governments; moderate importance in financing of the region	Excellent relationship with government; key role in financing of the region

Source: Fitch Ratings

Operating Environment

The assessment of the operating environment considers the following sub-factors:

- The credit quality of the countries of operations. This is determined by computing the simple average of the sovereign ratings of the countries of operations; when this rating is not publicly available, Fitch uses its own credit assessment.
- Income per capita in the countries of operations. Fitch uses the classification published by the World Bank, and determines the simple average income level for the MDB's countries of operations.
- The political risk and business climate in the country where the MDB's head office is based. This is based on Fitch's own assessment of political risk, which is addressed in its sovereign rating reports. This assessment relies largely, but not wholly, on the World Bank worldwide governance indicators (see Fitch's *Sovereign Rating Criteria*).
- The overall political risk and business climate in the countries of operations. The assessment of this risk is again based upon analysis performed by Fitch's sovereign team on the political and business climate risk in the region, which relies on individual country analysis.
- The operational support provided by the authorities of the member states of the MDB in the course of its operations. This analysis is based upon evidence – and not only from the MDB's charter – of privileges, immunities and priorities granted to the MDB by local government, such as PCS.

Operating Environment

Sub-factor	High risk	Medium risk	Low risk
Credit quality of countries of operations	'B' and lower or unrated	'BB'	'BBB' and higher
Income per head category in countries of operations	Low income	Middle income	High income
Political risk and business climate in country of head office	High risk	Medium risk	Low risk
Political risk and business climate in countries of operations	High risk	Medium risk	Low risk
Operational support provided by countries' authorities to the MDB in the course of its operations	Low or limited. No evidence of specific advantages or privilege granted to the MDB relative to other local actors	Moderate. Governments allow some form of priority to the MDB relative to other business operators	Strong. Evidence of substantial privileges and priorities granted by local governments to the MDB

Source: Fitch Ratings

MDBs' Extraordinary Support

Step 3: Determining Credit Uplift for Support

MDBs' member states are committed to provide extraordinary support in case of need. This commitment generally takes the form of unpaid subscribed capital, known as callable capital, which can be called in situations of financial stress. However, some MDBs have no callable capital. Support can take other forms, such as guarantees, or the MDB can be part of a supranational group that is committed to provide support.

In Fitch's approach for MDBs, extraordinary support translates into a credit uplift. As a general rule, this credit uplift does not exceed three notches. Upward notching of more than three notches is possible, but would be applied and recorded through a criteria variation (see *Variations from Criteria* below). The credit uplift is determined as follows:

Assessment of the capacity of shareholders to provide extraordinary support in case of need: this takes the form of an assessment on the 'aaa' to 'd' scale, reflecting the credit quality of the support providers.

The capacity to support is adjusted to reflect the propensity of shareholders to support (from +1 to −3 notches relative to the capacity to support assessment, subject to a hard constraint of +3 notches, reflecting both capacity and propensity to support).

Assessment of credit uplift for support: the rating reflecting capacity to support adjusted by the propensity to support (the 'support factor') is compared to the SCP. Two outcomes are possible:

- a. The support factor is lower than the SCP. In this case, no credit uplift is considered, and the IDR is equal to the SCP.
- b. The support factor is higher than the SCP. The credit uplift is equal to the difference between the support factor and the SCP, with a maximum three notches' uplift, reflecting both capacity and propensity to support.

In all cases, the IDR is equal to the SCP plus up to a maximum of three notches.

Step 3(a): Capacity of Shareholders to Provide Extraordinary Support

Capacity to support can be assessed by comparing callable capital from highly rated shareholders to debt, or by assessing the credit quality of the main providers of support (or key shareholders.

Coverage of Net Debt by Callable Capital

For MDBs whose shareholders have subscribed callable capital, the capacity to provide extraordinary support can be measured in relation to an MDB's net debt. This provides a measure of the potential quality of support on which the MDB can rely. Fitch's approach is to determine the rating of the lowest-rated shareholder whose callable capital, when added to that of higher-rated shareholders, ensures full coverage of outstanding net debt.

Net debt is defined as outstanding debt minus liquid assets from issuers rated 'AAA' to 'AA−' or 'F1+' on the short-term scale. Exceptions can be considered case by case, for example for assets rated in the 'A' category, if they are considered highly liquid, denominated in a reserve currency, and to the extent that they match debt raised in the same currency.

If callable capital is lower than net debt, capacity to support will be equal to the average rating of key shareholders (see definition below).

Weighted Average Rating of Key Shareholders

If there is no callable capital, support can rely on other forms of commitment from shareholders. This is particularly the case when the MDB is part of a group (the World Bank Group for instance, which includes several financially autonomous entities such as IDA and the IFC) or is controlled by a parent institution or a small number of large shareholders. In Fitch's view, the reputational risk associated with a default is such that other group entities would likely provide support in case of need, under the form of emergency loans or a capital increase.

In this case, the capacity to support is equal to the weighted average rating of the ultimate providers of support, ie the countries or institutions that Fitch considers most likely to provide extraordinary support to the MDB if needed (the factors allowing Fitch to assess shareholders' willingness to support are outlined below – see *Step 3(b): Propensity of Shareholders to Support*). Their ratings are weighted by their relative share in the subscribed capital of the institution.

Providers of support are generally the MBD's key shareholders. Fitch defines key shareholders as the countries or institutions that own the largest shares of subscribed capital or that have a strategic interest in the MDB. In Fitch's definition, they include member states or institutions whose cumulative share ownership accounts for at least 50% of total capital. Fitch may include some other member states if it appears that they have a vested interest in supporting the MDB.

However, in some instances support may originate from other institutions that have close relationships with the rated entity and that have set up an intra-group support mechanism. This is the case for MDBs that are part of a group of financially autonomous institutions, such as the World Bank Group. The support from the most highly rated entity of the group will be assessed by Fitch and, if stronger than that provided by key shareholders, factored into the assessment of capacity to support.

Key considerations for assessing support from entities of the same organisational group structure are:

- the assessment of the degree of intra-group relationships between the entities: sharing of human, financial or physical resources, use of the same premises, existence of common institutional bodies; and
- the existence of support mechanisms within the group such as callable capital subscriptions, credit facilities and guarantees.

Selection of Approach

Coverage of net debt by callable capital is typically used when callable capital is available. However, if it appears that the average rating of key shareholders leads to a higher assessment of capacity to support, then the latter approach is retained.

The weighted average rating of key shareholders can be used if support relies not only on callable capital but also on other forms of tangible commitments from providers of support that enhances the capacity to support – for example, this can take the form of back-up financing made available by one or several shareholders.

Capacity to support can be enhanced by mechanisms to secure the payment of callable capital, such as guarantees, insurance or other type of collateral. To assess their impact, Fitch takes into consideration: the credit quality of the collateral; and the risk associated with its enforceability. Any potential weaknesses in the enforceability of such support mechanisms will be reflected in a downward adjustment of the credit rating of the collateral. The downward adjustment could extend to offset the entire benefit of the collateral in cases in which Fitch considers enforceability particularly weak.

Step 3(b): Propensity of Shareholders to Support

Fitch adjusts shareholders' capacity to support by their propensity to provide extraordinary support. This is assessed through qualitative factors, and leads to an adjustment of between −3 and +1 notches.

If propensity to support is assessed as exceptionally strong, a one-notch credit uplift is applied. This only applies if: (i) the shareholders have demonstrated very strong willingness to provide potential support; (ii) the by-laws of the bank provide an exceptional support mechanism, such as allowing senior management to call capital without referring to the board of shareholders; or (iii) the institution plays a critical role in the financing of shareholders, to an extent when the financial stability of the region would be severely impacted in the event of a default.

A 'strong' propensity means that expected support would be forthcoming and therefore no notching up or down is applied. Notching down is applied if the propensity to support is assessed as 'moderate' (−1 notch), 'weak' (−2 notches) or 'very weak' (−3 notches).

The assessment of the propensity to support is based on the following factors:

Propensity of Shareholders to Support

Assessment	Notching
Exceptionally strong	+1
Strong	0
Moderate	-1
Weak	-2
Very Weak	-3

Source: Fitch Ratings

- Importance of the MBD's role for member states. This can be assessed by the size of the institution relative to the region's economy and its role in the financing of key projects in member states.
- The frequency and amount of capital increases that member countries have subscribed to and disbursed to accompany the growth of the institution. This provides clear evidence of member states' willingness to support.
- The ratio of paid-in capital to callable capital. This reflects the willingness of key shareholders to provide additional resources to the institution. Although subscription of callable capital is evidence of support from member states, when the share of callable capital relative to paid-in capital reaches a high level, it can also signal hesitation on the part of shareholders to inject cash.
- The level of callable capital relative to debt (see *Step 3(a): Capacity of Shareholders to Provide Extraordinary Support*). Net debt not being fully covered by callable capital translates into a 'weak' shareholders' propensity to support, which corresponds, if not offset by other factors outlined in this section, to a discount of two notches.
- The enforceability of the capital call, which can be assessed by an analysis of the institutional process to call capital. The issue here is to determine what the steps are between the identification of the need to make the call and the actual disbursement of capital.

Application of Supranationals Rating Criteria to Two Hypothetical MDBs

	Standalone Credit Profile					Support			
	Solvency	Liquidity	Lower of solvency and liquidity	Business environment, −3/+3 notches	Final SCP	Capacity (CC coverage of net debt OR average rating of key shareholders)	Propensity, +1/−3 notches	Support adjustment (up to 3 notches)	Final rating
MDB 1	a	a+	a	+1 notch	a+	aa	+1 notch	+3 notches	AA+
MDB 2	bbb+	bbb	bbb	-1 notches	bbb−	bb	0 notch	0 notch	BBB−

Source: Fitch Ratings

SCF Ratings

SCF rating approach is also based on the principles guiding the rating of MDBs. The main difference is that a haircut is applied to concessional loans, which is deducted from shareholders' equity (see *Capitalisation* above). This translates into a downward adjustment of capitalisation ratios.

SFG Ratings

The SFG rating approach is based on the same principles as MDBs: determination of the SCP, and credit uplift of up to three notches reflecting extraordinary support. However, the criteria used for the assessment of SCP are specific to Fitch's financial guarantors' approach, as outlined in its *Insurance Rating Criteria*.

The assessment of the capacity to support is based on the weighted average rating of key shareholders as SFGs have no or limited debt and calculating the coverage of net debt by callable capital is meaningless. As for MDBs, support from other institutions, especially for SFGs that are part of a group of development institutions, may be incorporated into the assessment of support.

SAB Ratings

The rating approach for SABs is based on the same broad principles as the rating of MDBs but reflects their unique nature. The approach is tailored to the specifics of the rated entity, but is predominantly driven by support from member states.

Support from member states is assessed by the following factors:

Capacity to support: The rating of member states is, as for MDBs, the key driver of the capacity to support. However, as SABs have no callable capital – in many instances, they have no capital, as they are not incorporated as companies – other measures are used, such as:

- The rating of member states whose potential additional contributions ensure full coverage of debt service. Fitch's approach is to determine the rating of the lowest-rated member state whose contributions, added to those of higher-rated member states, ensure full coverage of debt service. This is the case for the EU/Euratom.
- The rating of key member states, defined as those playing a predominant role in the support to the entity. This is the case for IFFIm.

Propensity to support: As for MDBs' support analysis, this is the key factor for the assessment of support. Its assessment relies on the same principles as for MDBs.

Liquidity: Fitch takes into account the mechanisms put in place by the institution to ensure timely payment of debt service in case the payment of expected revenues or resources is interrupted.

- If support relies on a regular stream of contributions from member states, as for the EU, Fitch's approach is to review the different layers of support set by the institution and place them in a situation of stress, such as a combined default of all borrowers on their loans from the institution or a default of certain member states. The agency determines under what scenarios funds would be insufficient, and assesses the likelihood of such scenarios.
- If liquidity relies on a cash cushion, as for IFFIm, Fitch determines under what scenarios the cash cushion would be insufficient to cover debt service in the event the payment of pledged contributions is delayed. The assessment of support will rely on the likelihood of such scenarios transpiring.

The methodology is then adjusted for special cases, such as the rating of regional central banks.

The rating of a regional central bank is based on the rating of the providers of support to the bank, including its member states and any other support provider.

Short-Term Ratings

Supranational entities typically hold large buffers of liquid assets that can be used to pay short-term liabilities. This is reflected in Fitch's liquidity assessment (measured on a lower case 'aaa' scale) often being higher than the Long-Term IDR. When there is more than one option for the short-term rating, Fitch will differentiate between short-term ratings based on the liquidity assessment. In addition, when the rating is support-driven, Fitch will take into account the propensity of the shareholders to support to choose between the two Short-Term IDR options.

Ratings Driven by Standalone Credit Profile

Under Fitch's supranationals rating criteria, the liquidity assessment is one of the three pillars that determine the SCP of an issuer (the two others being the solvency assessment and the business environment). The liquidity assessment primarily reflects the size and quality of liquid assets measured, respectively, by the ratio of liquid assets to short-term liabilities and the share of treasury assets rated 'AA' and above in total treasury assets. The liquidity assessment also factors in access to capital markets and alternative sources of liquidity (such as unused bank facilities or, rarely, access to a central bank's re-financing window).

For supranational ratings based on SCP, we use the liquidity assessment to make the distinction between the baseline and higher option for short-term ratings at a cusp point. When the liquidity assessment (measured on a lower case 'aaa' scale) matches or exceeds the level in the table below, Fitch chooses the higher option. Otherwise, Fitch chooses the baseline option.

Minimum Liquidity Assessment to Achieve Higher Short-Term Rating When the Long-Term Rating Is at a Cusp Point

Short-Term Rating	Liquidity assessment
F1+	aa-
F1	a
F2	bbb+

Source: Fitch Ratings

For SFGs, we adopt the same approach, but the variable to assess liquidity is 'investment and liquidity risk' rather than the liquidity assessment. (For SFGs, the SCP analysis is based on the *Insurance Rating Criteria*.)

Ratings Driven by Support

For supranational ratings based on support, Fitch applies the following for all short-term ratings where there are two options:

- If the liquidity assessment matches or exceeds the level in the table above, Fitch chooses the higher option.
- Otherwise, Fitch chooses the higher of the two options only if the propensity of shareholders to support, as per Fitch's criteria, is assessed as 'exceptional' or 'strong'. If the propensity to support is 'moderate' or lower, Fitch chooses the lower option.

Supranational Administrative Bodies

Given that SAB ratings are primarily driven by support, Fitch applies the higher option for the short-term rating when it considers that support from member states is highly likely to be forthcoming in the short term. In addition, Fitch applies the higher option when liquid assets fully cover short-term debt repayments. This assessment takes into account any mechanism put in place to ensure timely payment of debt service in case the payment of expected revenues or resources is interrupted. In other cases, Fitch applies the baseline option.

Rating Correspondence Table

Long-Term Rating	Short-Term Rating
AAA	F1+
AA+	F1+
AA	F1+
AA–	F1+
A+	F1 or F1+
A	F1 or F1+
A–	F2 or F1
BBB+	F2 or F1
BBB	F3 or F2
BBB–	F3
BB+	B
BB	B
BB–	B
B+	B
B	B
B–	B
CCC+	C
CCC	C
CCC-	C
CC	C
C	C
RD/D	RD/D

Source: Fitch Ratings

Hybrid Securities

The criteria provide general guidelines to assign equity credit and rate hybrid instruments issued by supranationals.

Hybrids issued by supranationals may qualify for equity credit if certain conditions are met. Equity credit is an analytical concept that expresses the extent to which Fitch views a security as containing debt- or equity-like qualities. The equity credit assigned to a hybrid can be 0%, 50% or 100%. The debt- or equity-like qualities will be evaluated assuming the issuer is experiencing financial distress, irrespective of the probability of such financial distress occurring.

Instruments that are reported as debt or as equity on an issuer's balance sheet will be reallocated from that category and classified as entirely debt, entirely equity, or 50% debt and 50% equity for Fitch's ratio analysis. Fitch uses the resultant adjusted capitalisation and leverage ratios in its assessment of an issuer's credit quality. Fitch does not exclude coupons paid on hybrid securities from its interest or fixed-charge coverage ratios, irrespective of the equity credit assigned to the instrument, because the assumption is that the interest on such instruments will be paid.

Fitch will allocate equity credit to instruments that are subordinated to all senior debt, senior only to equity (deep subordination) and have an unconstrained ability for at least five years of consecutive coupon deferral. To benefit from equity credit, the terms of the instrument should not include mandatory payments, covenant defaults or events of default that could trigger a default of the supranational issuer. The security must have a remaining effective maturity (i.e. the date when Fitch expects the redemption of the instrument is highly likely. If the issuer has incentive to call the instrument before the initial maturity because of step-up coupons, we will consider the call date as effective maturity) of at least five years. Structural features that constrain an entity's ability to activate equity-like features of a hybrid make an instrument more debt-like.

The factors retained by Fitch to assign equity credits are listed below. We treat separately the securities that contain conversion features.

Criteria for Assigning Equity Credit

Deep Subordination: The security must be subordinated to all senior debt and senior only to equity. Qualification for equity credit implies that there is no assurance that holders will recover principal and coupon in the event of a default of the entity.

Inability to Trigger a Default: Hybrids qualifying for equity credit generally also do not have any events of default or only limited events of default. Acceptable events of default include: events of bankruptcy and liquidation; failure to redeem the securities after the invalidation of a guarantee or other forms of credit support; failure to pay amounts due after application of all permitted deferrals; accelerated conversion (in the case of mandatory convertibles).

Absence of Material Covenants: Affirmative or negative covenants can lead to 0% equity credit, if they have the potential to lead to acceleration or prepayment of the hybrid notes or place limitations on management in terms of day-to-day operations.

Long Maturity: The securities must be perpetual instruments with no step up or incentive to redeem, or have a remaining effective maturity that is not less than five years, unless it converts to equity during this timeframe (as in the case of mandatory convertibles).

Discretion to Defer Coupons: Issuers should have an unconstrainted ability to defer or omit coupons for at least five years before effective maturity. Cumulative hybrids, where deferred coupons accumulate and will have to be paid later, are less equity-like than non-cumulative hybrids, which allow omission of coupons. Hybrids that enable deferability for at least five years receive no more than 50% equity credit, while non-cumulative hybrids that enable omission for at least five years are entitled to up to 100% equity credit.

Permanence: Permanence of the capital structure is necessary for equity recognition. Fitch applies judgment in determining whether the hybrids' features are conducive to maintaining them as a permanent part of the capital structure. Hybrids with questionable permanence may be denied equity recognition. It is important that hybrids remain a part of the capital structure in a time of financial stress with management retaining flexibility to utilise instruments' loss-absorption features if needed.

Fitch's qualitative assessment of permanence considers legal obligations, economic incentives, replacement language or covenants and analytical discussions with management. When Fitch assumes permanence without a publicly stated intention from management, we would communicate in our Rating Action Commentary the basis of our permanence assumption.

Redemption Options: Fitch's focus is on the permanence of the issuer's capital structure and the specific instrument is typically only a vehicle to achieve such a capital structure. Therefore, early refinancing or redemption of a hybrid instrument will generally not affect the equity credit Fitch gives to a replacement instrument unless it believes the issuer's commitment to a specific capital structure has changed.

Share of Hybrids in Capital Structure: An excessive share of hybrids in the total capital structure may reduce favourable equity treatment. In Fitch's view, a disproportionate share of hybrids in a bank's capital structure may affect governance (amongst other things it may lead to a disconnect between the shareholders that own voting rights and the holders of loss-absorbing capital).

Convertible Hybrid Securities: Additional Considerations

Conversion Date: To qualify for equity credit, conversion must be established at a predetermined date and not hinge on a trigger event (for contingent convertible securities, see below). The date and entity in charge of the trigger test must be clearly identified. The earlier the date of conversion, the more likely Fitch will consider the hybrid as equity-like.

For mandatory convertibles that convert in the near future, deep subordination is not a condition for equity credit. This is because conversion to equity increases the issuer's financial flexibility and does not result in the obligation to repay principal. Mandatory convertibles that convert within one year but are senior obligation are eligible for up to 50% equity credit.

Limitations for Low-Rated Issuers: Senior-ranking mandatory convertibles will not be eligible for equity recognition if the issuer's IDR is 'B-' or below, and there is no automatic conversion to the resulting instrument upon the issuer's bankruptcy. This is due to Fitch's concerns about the near-term viability of issuers rated 'B-' and below.

Established Conversion Ratio: The conversion rate or ratio also must be fixed at issuance or have limited flexibility within a predetermined band. To achieve 100% equity credit, the instruments must convert to common equity or a hybrid that would receive 100% equity credit under this criteria report. Instruments that convert to a hybrid that would achieve 50% equity credit under these criteria are eligible to a maximum of 50% equity credit.

An issuer must usually have authorisation/capacity to issue the required number of shares to complete any conversion.

Optional Convertibles (whether the option is with the issuer, instrument holder, or both), will be treated as debt in all cases, unless the instrument has other features described in this criteria report and conducive to equity credit that would enable it to qualify for equity credit.

Contingent Convertible Securities ('Cocos'). Conversion into equity may be achieved only if a pre-determined trigger is met.

The conditions to assign equity credit to cocos are the following:

- If the conversion to capital occurs at early sign of stress (high trigger), and there is no restriction to coupon omission, then the securities qualify for 100% equity credit. If the instruments are high trigger and the coupon is non-deferrable, they qualify for 50% EC
- Securities where loss absorption arises only at the "point of non-viability" (low trigger) are not "contingent capital" for the purposes of these criteria.

Key Features to Achieve Equity Credit

Debt-based hybrids	
0%	• No deep subordination • No ability to differ coupon for at least five years • Terms contain mandatory payments, covenant defaults or events of default that could trigger a default of the supranational issuer • Questionable permanence of the instrument in the capital structure • Excessive share of hybrids in the capital structure
50%	• Subordinated to all senior debt • Inability to trigger a default • No material covenants and no maturity, investor put rights, or other features that would force repayment of principal within five years • Remaining effective maturity of more than five years or conversion to equity within five years • Unconstrained ability to defer coupon for at least five years • Permanence of capital structure
100%	All of the above + • Coupon deferral is non-cumulative
Mandatory convertibles	
0%	• Lack of pre-determined date for conversion • No deep subordination, unless conversion is within one year • Issuer's IRD is 'B-' or below and no automatic conversion upon the issuer's bankruptcy • Optional convertibles • No ability to defer or omit coupon until conversion of hybrid • Terms contain mandatory payments, covenant defaults or events of default that could trigger a default of the supranational issuer • Questionable permanence of the instrument in the capital structure • Excessive share of hybrids in the capital structure • **Cocos:** conversion only arises at a point of non-viability (low trigger)
50%	• Subordinated to all senior debt (unless mandatory convertible and the conversion is set to take place within 1 year) • Inability to trigger a default • No material covenants and no maturity, investor put rights, or other features that would force repayment of principal within five years • Unconstrained ability to defer coupon for at least five years or until conversion of hybrid • Predetermined conversion date and conversion rate • Instruments receive 50% equity credit on conversion • **Cocos:** high trigger and non-deferrable coupon
100%	All of the above + • Instruments receive 100% equity credit on conversion (i.e. conversion to common equity or coupon deferral is non-cumulative) • **Cocos**: high trigger and no restriction to coupon omission

Source: Fitch Ratings

Criteria for Notching Hybrid Instruments

The notches primarily represent incremental risk of non-performance relative to other senior obligations (for example the risk of deferral on coupon payment).

Fitch uses the SCP (rather than the IDR) as the anchor for the notching. This is because when the IDR is support-driven, and therefore higher than the stand-alone credit profile, it is highly unlikely, in Fitch's view, that such support would extend to the repayment of a hybrid instrument. When an entity has no SCP (this is the case of SABs), Fitch would not be able to assign a rating to a hybrid instrument (and would also not be able to assign equity credit to this instrument).

Hybrids that qualify for equity credit are most likely to be notched at least three notches below the SCP for instruments that qualify for 50% equity credit and five notches below the SCP for instruments that qualify for 100% equity credit. The notching reflects the significant higher risk of non-performance relative to a senior obligation. As a general rule, the notching would increase with the likelihood that the coupon on the hybrid instrument will be differed. It is possible that hybrids are devised with special features that require a modification of this notching approach, such that the notching will be reduced or, more likely, expanded. Fitch will not assign to a hybrid instruments a rating above the 'A' category.

Fitch will not rate the hybrid if loss-absorption triggers are constructed in such way that Fitch does not have the necessary visibility or ability to adequately assess the risk of loss absorption being initiated. For example, Fitch will not rate a hybrid that had a loss-absorption trigger related to a commodity price or equity valuation. The agency does not assign ratings to mandatory convertible instruments, or similar instruments, which are exclusively redeemable into shares.

Guideline for Notching of Hybrid Instruments from Standalone Credit Profile

Key features of hybrid instrument	Notching to SCP
• Deep subordination, cumulative coupon deferral (may qualify for 50% equity credit)	At least -3
• Deep subordination, non-cumulative coupon deferral (may qualify for 100% equity credit)	At least -5

Source: Fitch Ratings

Once a hybrid issue becomes non-performing (but have not defaulted according to the contractual terms) it is assigned a rating in the 'CCC'/'CC'/'C' categories, depending on the type of loss absorption being suffered (eg, cumulative coupon deferral against coupon omission and any mitigating factors, temporary or permanent principal write-down) and the level of the MDB's SCP. A rating of 'CCC' would be assigned if the rated instrument is expected to return to performing status. A rating of 'C' would be assigned if the rated instrument is not expected to return to performing status.

A failure to pay a coupon of a hybrid instrument would not be considered a default for the IDR (as the reference obligations for the IDR are senior unsecured obligations). However, such a situation would likely signal deterioration in an issuer's financial situation and, as such, would likely lead to negative rating action. Hybrid deferrals or cancellations in the case of non-cumulative instruments may not constitute a default if they are contemplated in the contractual terms. Nevertheless, such events have a strong signalling function and are a clear indication that preserving liquidity is a key-priority for the issuer. In a situation in which using the flexibility of the hybrid security is needed to preserve liquidity, the SCP of the issuer – absent any support considerations – is likely to be at a low speculative-grade rating.

Variations from Criteria

Fitch's criteria are designed to be used in conjunction with experienced analytical judgement exercised through a committee process. The combination of transparent criteria, analytical judgement applied on a transaction-by-transaction or issuer-by-issuer basis, and full disclosure via rating commentary strengthens Fitch's rating process, while assisting market participants in understanding the analysis behind our ratings.

A rating committee may adjust the application of these criteria to reflect the risks of a specific transaction or entity. Such adjustments are called variations. All variations will be disclosed in the respective rating action commentaries, including their impact on the rating where appropriate.

A variation can be approved by a ratings committee when the risk, feature, or other factor relevant to the assignment of a rating and the methodology applied to it are included within the scope of the criteria, but when the analysis described in the criteria requires modification to address factors specific to the particular transaction or entity.

Additional Considerations

Limitations

Ratings, including Rating Watches and Outlooks, assigned by Fitch are subject to the limitations specified in Fitch's Ratings Definitions and available at https://www.fitchratings.com/site/definitions.

In addition, ratings within the scope of these criteria are subject to the following specific limitations. The projections within these criteria do not take into account the occurrence of fundamental change of law or change of regulations, fundamental changes in demand due to extreme events, such as terrorism, or the collateral consequences of extreme events, because they are considered highly remote and it is not possible to quantify their impact. Upon an occurrence of such an event, the projections prepared for affected entities will be revised and this may have an impact on assigned ratings.

The ratings do not:

- predict a specific percentage of default likelihood over any given time;
- give a view on the liquidity of the issuer's securities;
- give a view on the possible loss severity on an obligation should an issuer default;
- give a view on the suitability of an issuer as a counterparty to trade credit; or
- give a view on any quality related to an issuer's business, operational or financial profile, other than the agency's opinion on its relative vulnerability to default.

Rating Assumption Sensitivity

Ratings are sensitive to changes in the capitalisation of the supranational and to modification in its risk profile; the latter includes its credit risk exposure, the size of its equity participation portfolio, its exposure to market and operational risk, and the quality of its risk management policies.

Ratings are sensitive to shifts in the operating environment of the supranational, as well as changes in its business profile and its governance system.

Ratings are sensitive to changes in the extraordinary support provided by shareholders. This includes changes in the average rating of key shareholders or in the rating of callable capital ensuring full coverage of net debt. Ratings are also sensitive to a change in the propensity of member states to provide extraordinary support to the supranational.

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