Fitch Ratings

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Fitch Rates OPEC Fund 'AA+'; Outlook Stable

Fitch Ratings - Paris - 29 Jul 2021: Fitch Ratings has assigned The OPEC Fund for International Development (OPEC Fund) a Long-Term Issuer Default Rating (LT IDR) of 'AA+' with a Stable Outlook and a Short-Term IDR of 'F1+'.

Key Rating Drivers

OPEC Fund's LT IDR of 'AA+' is based on the Standalone Credit Profile (SCP) of the institution. Its SCP is driven by the lower of Fitch's assessment of the fund's solvency profile (aa+) and liquidity profile (aaa), combined with a medium-risk business environment that translates into a zero-notch adjustment to the IDR. Our assessment of OPEC Fund's shareholders' capacity and propensity to support does not provide any uplift above the fund's SCP.

OPEC Fund, founded in 1976, is a multilateral development bank (MDB) with a global mandate to provide both sovereign and non-sovereign financing to non-member countries. Up to now, assets have been almost exclusively funded by contributions from member countries, with all shareholders ineligible to borrow from OPEC Fund. On 1 January 2020, OPEC Fund established a special fund (SCR) to focus on sovereign lending to the least-developed countries in the world. The SCR is a legally independent fund from OPEC Fund's ordinary capital resources (OCR), on which our rating assessment is based. The OCR focuses on operations in medium-income countries and plans to diversify its funding via a gradual increase in leverage. OPEC Fund's key shareholders are Saudi Arabia (A/Negative; 34.1% of paid-in capital), Venezuela (NR; 13.5%) and Kuwait (AA/Negative; 12.3%).

Fitch views OPEC Fund's 'excellent' capitalisation as a key rating strength, primarily driven by our expectation that the fund's equity/assets ratio will continue to far exceed the 25% 'excellent' threshold over the medium term. As of end-2020, this ratio was around 91%. Our assessment is also supported by the fund's usable capital / risk-weighted assets (FRA) ratio - which also far exceeds the 35% 'excellent' threshold (end-2020: 92%). Fitch expects OPEC Fund's capitalisation ratios to remain well above the 'excellent' thresholds in the medium term, as the bank gradually increases its leverage.

Our assessment of OPEC Fund's solvency combines the institution's 'excellent' capitalisation and 'low-risk' profile. OPEC Fund's loan portfolio comprises both sovereign borrowers (68% of total exposure) and non-sovereign borrowers (32%). A considerable portion of borrowers, particularly in the non-sovereign portfolio, are not rated by Fitch, and their credit quality is assessed as very low. Consequently, the agency estimates OPEC Fund's loan portfolio average rating at 'B+' at end-2020. Fitch expects the average rating of the fund's lending portfolio to remain at this level over the medium term.

Fitch assesses OPEC Fund's strength of preferred-creditor status (PCS) as 'strong', which translates into a 2-notch positive adjustment above the average rating of loans. The average rating of OPEC Fund's lending portfolio after PCS adjustment, at end-2020, was therefore 'BB'. OPEC Fund's 'strong' PCS is anchored by a healthy 15-year history during which only two out of about 115 sovereign borrowers per year have reached non-accrual status with OPEC Fund (ie beyond 180 days in arrears). It also reflects sovereign borrowers representing approximately two thirds of the fund's lending portfolio.

Non-performing loans (NPLs), as defined by Fitch, represented 2.2% of total loans at end-2020 and were to nine non-sovereign borrowers spanning different geographies and different sectors. During 2020, OPEC Fund offered short-term Covid-19 payment deferrals to a number of private-sector borrowers, but by end-2020, all borrowers that had benefitted from this scheme had resumed payments to the fund.

We continue to expect the NPL rate to remain below 3%. While we expect an increase in the stock of NPLs, particularly over the short term, OPEC Fund's expanding operations (increasing total banking exposure by approximately 30% or USD1 billion over the next three years) dilute the impact of an increase in the stock of NPLs, and should maintain the NPL rate at below 3%. Further OPEC Fund's expansion is targeted towards better-rated sovereign and non-sovereign borrowers as set out in the fund's 2030 Strategy.

We assess OPEC Fund's concentration risk as 'very low', reflecting a well-diversified lending book. The fund's five-largest sovereign exposures (Egypt, Morocco, Bangladesh, Pakistan, Bosnia) account for 19.4% of total banking exposure. Fitch expects that OPEC Fund's top-five exposures will continue to represent below 20% of the institution's total banking exposure by 2023, particularly in light of the expansion of the fund's operations over the medium term.

Fitch assesses OPEC Fund's equity-participation risks as 'very low', with equity participations representing around 2% of the fund's total banking exposure. The majority of the fund's equity portfolio is to investment funds, rather than direct equity investments. Over the medium term, we understand from management that equity stakes will not be a target growth area for OPEC Fund and so as the fund's lending operations grow, we expect the share of equity participations to dilute further.

Market risks are assessed as 'very low' for OPEC Fund owing to both limited interest-rate and foreign-exchange (FX) risks. Although very limited, the expected introduction of borrowing activities will generate interest-rate risk. This will be mitigated in line with the fund's asset and liability management policy, whereby new loans (both floating- and fixed-rate) will be match-funded by borrowings to fully hedge interest-rate risk. In terms of FX risk, the loan portfolio includes a small portion of euro-denominated loans. The fluctuations in the exchange rate of the euro relative to the US dollar creates a small level of FX risk in the portfolio but this is regularly monitored and managed by the fund's hedging strategy.

Risk-management policies are assessed as 'strong' by Fitch. OPEC Fund has a broad range of board-approved policies that govern its risk-management framework in line with that of rated peers. Some of the rules, including on liquidity, have only recently been introduced as OPEC Fund transitions towards a new business model and gradually leverages its balance sheet. The assessment is further supported by the very high level of expertise of the fund's management.

Liquidity is a rating strength for OPEC Fund, with the institution's liquidity profile assessed at 'aaa', reflecting an 'excellent' liquidity buffer, 'excellent' asset quality but 'weak' access to capital markets. To date, OPEC Fund has not tapped international capital markets, with its sole funding source being capital replenishment contributions from member states (MS). However, OPEC Fund is taking steps to diversify its funding profile and borrowing instruments and it expects to issue approximately USD1 billion by end-2022 following the launch of its GMTN programme. OPEC Fund is also in the process of establishing an ECP programme but has no set timeline as to when the first issue will be made under this programme.

As of end-2020, the fund had no short-term debt. Given the very limited debt burden expected for OPEC Fund over the medium-term, we expect its liquidity buffer to remain comfortably in excess of the 150% 'excellent' threshold over the medium-to-longer term.

Its treasury asset quality is assessed as 'excellent' based on the implementation of its liquidity policy, which will see the totality of the fund's treasury portfolio invested in either 'AAA-AA' securities or cash held at highly-rated banks based primarily in the UK, EU and Canada. At end-2020, the share of 'AAA-AA' rated treasury assets was around 45%, owing to the significant legacy investment portfolio still on the fund's books. By end-March 2021, significant progress has been made in the sale of these high-risk, legacy assets and the proceeds of these sales are in the process of being re-invested into better-rated assets in the fund's core liquidity portfolio.

OPEC Fund's business environment is deemed 'medium risk', which translates into a zero-notch adjustment to the solvency assessment of 'aa+', therefore leading to an SCP of 'aa+'. Our assessment of OPEC Fund's business profile is driven by the 'medium risk' policy importance, which is affected by its limited size (banking portfolio forecast to be just over USD5 billion by 2023) relative to rated peers'. Around a third of the banking portfolio is to the non-sovereign sector. The assessment benefits from the 'low' risk quality of governance, supported by none of the MS being able to borrow from OPEC Fund. Our "medium risk" assessment of OPEC Fund's operating environment reflects that countries eligible to borrow from OPEC Fund's OCR are broadly middle-income countries, with eligibility criteria comparable to those from IBRD, although IBRD's borrowers are more highly rated (BB+ on average as of June 2020 vs. 'B+' as of end-2020 for OPEC Fund).

OPEC Fund's rating is fully driven by the fund's standalone credit strengths, and support is not currently a rating driver. OPEC Fund's support rating is assessed at 'bbb-'. This assessment is anchored by the weighted average rating of OPEC Fund's key shareholders (bbb), which Fitch defines as those MS contributing over 50% of the fund's total replenishments. OPEC Fund has no callable capital. Our assessment of a 'moderate' propensity to support the institution, based on the infrequency and material delays of contributions from MS over the course of the fund's history, leads to a '-1' notch adjustment to the average rating of key shareholders, resulting in an overall support rating of 'bbb-'.

OPEC Fund's Short-Term IDR of 'F1+' is the only short-term option mapped to Long-Term IDR of 'AA+', as outlined in Fitch's criteria.

ESG CONSIDERATIONS

OPEC Fund has an ESG Relevance Score of '4' for Rule of Law, Institutional & Regulatory Quality. All supranationals attract a score of '4'. Supranationals are neither subject to bank regulation nor supervised by an external authority. Instead, supranationals comply with their own set of rules. Fitch pays particular attention to internal prudential policies, including compliance with these policies. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

OPEC Fund has an ESG Relevance Score of 4 for 'Governance Structure'. Similar to other MDBs where one shareholder owns a significant share of the capital, Saudi Arabia, (34% of paid-in capital), as the largest shareholder, exerts a strong influence on the bank's board, management, and strategy. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Solvency (Credit Risk): Resilience of the loan portfolio that would result in a stronger credit-risk profile than currently anticipated, particularly an improvement in the fund's loan impairment ratio relative to Fitch's current expectations, to a level commensurate with a 'very low' assessment and/or material improvement in the average rating of the lending portfolio.

- Solvency (Risks): A sustained record of operations under the recently revised risk-management framework as the bank transitions to a more leveraged balance sheet, including full compliance with all internal risk ratios over the medium term, could lead to an upward revision of the current assessment of 'strong' risk-management policies.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Solvency (Credit Risk): Worse-than-expected impact of the Covid-19 crisis on the fund's loan portfolio that would lead to a higher loan impairment ratio (above 3%) and/or deterioration in the average credit quality of the loan portfolio.

- Business Environment: A deterioration in the fund's business profile or operating environment assessments, which could lead to a weakening of our current 'medium' risk assessments. This could, for example, stem from potential weakening in the fund's strategy risk amid the transition towards a more leveraged balance sheet and/or failure to increase lending towards medium-income countries with stronger credit-risk profiles.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

Key Assumptions

The global economy will develop in line with Fitch's Global Economic Outlook published on 16 June 2021, including marked improvement in GDP growth in 2021 as economies adapt to social distancing and vaccination programmes gather momentum.

OPEC Fund will gradually increase its leverage in the medium term. Its debt-to-equity ratio will remain limited to 50% over the medium-to-long term.

OPEC Fund will continue to sell-down the remaining stock of its legacy Investment portfolio, re-investing the proceeds into 'AAA-AA' rated securities by end-2022.

Date of Relevant Committee

02 July 2021

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
The OPEC Fund for International Development (OPEC Fund)	LT IDR	AA+ (Stable)	New Rating		
	ST IDR	F1+	New Rating		

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	⊙	◆
STABLE	⊙	

Applicable Criteria

Supranationals Rating Criteria (pub.20 May 2021) (including rating assumption sensitivity)

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