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Research Update:

New Development Bank Assigned 'AA+/A-1+' Ratings; Outlook Stable

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Overview

- Formed by the BRICS countries, New Development Bank (NDB) benefits from a very robust capital endowment and is likely to play a significant role in closing the large infrastructure gaps of its BRICS members.
- Although NDB has a short track record and its shareholder structure presents some agency risk, we expect the institution to focus on strengthening its operational capacity and to observe robust governance and risk management practices over the next few years.
- We are assigning our 'AA+' long-term and 'A-1+' short-term issuer credit ratings on NDB.
- The stable outlook reflects our expectation that NDB will make continuous strides to emerge from its start-up phase over the next 24 months supported by its extremely strong financial profile.

Rating Action

On Aug. 29, 2018, S&P Global Ratings assigned its 'AA+' long-term and 'A-1+' short-term issuer credit ratings on New Development Bank (NDB). The outlook on the long-term rating is stable.

NDB is a multilateral lending institution (MLI) established by Brazil, Russia, India, China, and South Africa (BRICS).

Rationale

The ratings reflect our opinion that NDB will establish itself as a catalyst in reducing the infrastructure deficits faced by its BRICS members. At the same time, we expect the institution to instill sound governance and risk management principles across its operations. This expectation supports our assessment of the institution's strong business profile and extremely strong financial profile. We do not factor any uplift into our issuer credit rating on the institution from extraordinary shareholder support, given that we rate all of NDB's members lower than the 'aa+' stand-alone credit profile (SACP) assessment on the bank.

NDB is a new MLI that was formed by BRICS countries with an international treaty signed in 2014. Headquartered in Shanghai, China, NDB started its operations in 2015. NDB's mandate is to mobilize resources for infrastructure and sustainable development projects in BRICS and other emerging economies and developing countries. The founding members have backed the institution with a considerable subscribed capital base of US$50 billion, of which US$10 billion represents paid-in amounts to be funded in full by January 2021. Each member is contributing an equal share (20%) of the capital. Our assessment incorporates our forward-looking view that NDB will deploy a significant portion of its resources to establish a track record and a strong footprint in BRICS countries.

We believe that the pressing need for infrastructure investment in BRICS countries underpins NDB's important role. NDB will support both public and private projects through loans, guarantees, equity participation, and other financial instruments. We note that sovereign loans will remain the key lending instrument throughout the next decade. As of March 2018, NDB had approved more than US$3.5 billion of loans in its sectors of focus: energy (40%), water/sanitation/irrigation (32%), transportation (15%), and social infrastructure (13%). NDB has charted an aggressive growth trajectory in its strategy for 2017-2021, which would validate the institution's role and importance if it succeeds in fulfilling its mandate.

NDB's current geographical scope of operations is somewhat limited. Although the bank's charter allows it to lend to all members of the United Nations (UN), it intends to focus on operations in BRICS countries for at least the medium term. While this exposes NDB to meaningful concentration risks, all BRICS countries have higher sovereign ratings (average BBB-) than many of the countries to which MLI peers are lending. We note that NDB's membership is open to all UN members and the institution finalized the terms for acceptance of new members in 2017. An increase in shareholders would help NDB to fulfil its mandate across a wider geographical scale and could support its key policy role, as well as reduce credit risk concentration.

Robust shareholder support is a key rating factor underpinning our assessment of NDB's business profile. The commitment of the five founding member nations to make an equally large paid-in contribution (US$2 billion each) strongly signals ongoing and likely future support. For all member countries, except China, the commitment represents the largest invested amount and the biggest stake in any multilateral institution. We note that by end-2017, NDB had received 38% of the paid-in capital. All members had been timely in making scheduled capital subscription payments and some member countries have made significant payments ahead of schedule. NDB has received additional support from China with the Government of China and Shanghai Municipal Government financing the construction of NDB's headquarter building. In addition, China's Ministry of Finance and the People's Bank of China (PBOC) facilitated NDB's first green bond issuance. The bank's no dividend policy also demonstrates shareholder support.

We assess NDB's risk management policies as sound and similar to its highly rated peers'. The bank has established prudent risk management policies, especially in terms of liquidity and capital adequacy, and has set various limits for single obligor, country, and sector concentration. NDB shall at all times hold sufficient liquid assets to meet net realizable cash flow needs for at least 12 months without additional financing from the markets or members. In terms of capital management, the institution needs to maintain equity-to-asset and equity-to-loan ratios of at least 25%. In addition, we expect NDB to abide by the same high standard as leading peers in terms of governance, procurement, and social responsibility. We note that the institution is new and much of its structure remains untested. But over time, we expect NDB to build expertise and further strengthen its risk management framework including systems.

We believe the management is balanced and capable of delivering on its mandate. NDB's senior management team has wide experience in multilateral institutions with significant hands-on involvement in running the critical departments of development institutions. Rapid growth will produce challenges while the institution's operational structures are established, but we expect the management to continue its currently prudent approach.

The shareholder structure, with borrowing-eligible members holding all the voting shares, could present a certain degree of agency risk, in our view. This potential conflict of interest constrains our assessment of NDB's governance and management expertise. However, we note that no member holds veto power. A special majority (four out of five members) is required for milestone decisions, including earnings distributions and increases in capital subscriptions. NDB has a nonresident board, unlike many other peers, but we do not see this as undermining its oversight or decision-making in a meaningful way.

Given NDB's very short period of operations, it has not yet built a track record of strong repayment behavior and preferred creditor treatment from borrowing countries. However, we believe the founding members' large upfront capital contributions, coupled with their material shareholdings in the institution, will encourage the institution to adhere to strong governance principles. We therefore expect that borrowing members will grant NDB preferred creditor and preferential treatment. We would likely reassess the rating if we see significant deviation from this.

NDB's financial profile is extremely strong, reflecting its robust capitalization and ample liquidity. NDB has a risk-adjusted capital (RAC) ratio before MLI adjustments of 146%, and after adjustments of 135% as of end-2017, using parameters as of Aug. 9, 2018. The exceptionally high RAC ratio reflects the equity financing of its balance sheet. While we expect the RAC ratios to drop as NDB increases its lending, we believe that they will stay above our 23% threshold for the extremely strong assessment.

The criteria correction explained in "Criteria For Assessing Bank Capital Corrected," published on July 11, 2017, on RatingsDirect, is not factored into the RAC ratio after diversification. The impact of the correction on the ratio is not material to the rating.

We expect NDB to become a regular benchmark issuer over the medium term as it builds its standing in the market. However, NDB's need for funding is limited for the time being, given its solid capital base. To date, NDB's issuance has been limited to a green bond in China in 2016 for Chinese yuan (CNY) 3 billion (US$449 million). We assess funding as neutral for the rating because we weigh NDB's strong and stable equity financing against its untested access to market.

NDB's liquidity is very robust and currently placed as deposits with various financial institutions in China, Hong Kong, and Singapore. Over time, NDB expects to build its treasury management operations. While we expect liquidity to deteriorate as the portfolio grows, we estimate that NDB currently, as well as in the foreseeable future, could survive an extremely stressed scenario without market access for 12 months and without withdrawing any principal resources from borrowing members.

Outlook

The stable outlook reflects our expectations that, over the next two years, NDB will establish itself as a key player in the funding of infrastructure in BRICS countries. Our rating on NDB is based on a prospective view of its profile, considering its short track record of operations.

We expect NDB to make material and continuous progress in deploying its significant resources toward its loan commitments. Although NDB's shareholder structure could present agency risks, we believe the institution will manage potential conflicts through governance best practices and prudent risk management.

Over the rating horizon, NDB's capital adequacy metrics may fall as it ramps up its operations. However, we expect the financial profile to remain at an extremely strong level given the robust capital base.

Upside scenario

We would raise the rating if NDB is able to increase its public policy profile and importance. In this scenario, we envisage a substantial geographical expansion of NDB's operations through an increase in the number of shareholders with more than token stakes. Likewise, such a development could strengthen our assessment of the bank's governance and management expertise. Given the structure of NDB's current shareholding and its intention to restrict operations to within members in its initial start-up phase, we view the likelihood of this scenario occurring to be limited in the medium term.

Downside scenario

We would lower the ratings on NDB if we believe its relationship with shareholders has deteriorated. This could take the form of members not making significant capital payments on schedule, or any of the founding members withdrawing their membership. Such a scenario will cast serious doubts on NDB's ability to fulfil its mandate to deliver on infrastructure funding among BRICS and developing economies.

In addition, any material deviation from NDB's business plan or from the best-practice application of policies could have a negative rating impact. Furthermore, a failure to make a significant contribution to funding infrastructure in the BRICS countries could result in downward rating pressure.

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Governments - General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Nov. 26, 2012
- Criteria - Financial Institutions - Banks: Multilateral Lending Institutions Capital Methodology And Assumptions, Dec. 6, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Introduction To Supranationals Special Edition, Oct. 20, 2017
- Supranationals Special Edition 2017: Comparative Data For Multilateral Lending Institutions, Oct. 20, 2017
- Credit FAQ Discusses MLIs' Lending Capacity And Current Capital Endowment, May 18, 2017

Ratings List

New Ratings

New Development Bank	
Issuer Credit Rating	AA+/Stable/A-1+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.