Research Update:

European Investment Fund Ratings Affirmed At 'AAA/A-1+'; Outlook Stable

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Overview

• Following the U.K.’s triggering of Article 50 to leave the EU, we consider probable that the U.K. will also withdraw from the European Investment Bank (EIB), of which the European Investment Fund (EIF) is a core subsidiary.

• We believe any direct impact on the EIF of the U.K. exiting as a shareholder in the EIB will be manageable, since we expect the EIB's shareholders, the EU member states, will continue to support the EIF's strong role as a catalyst for financing small and midsize enterprises in Europe.

• In our view, the EIF benefits from an extremely strong financial profile and a very strong business profile.

• We are therefore affirming our 'AAA/A-1+' ratings on EIF.

• The stable outlook on EIF mirrors that on EIB.

Rating Action


Rationale

The ratings reflect our assessment of EIF's business profile as very strong and its financial profile as extremely strong, resulting in a stand-alone credit profile (SACP) at 'aa+'. Our 'AAA' long-term rating on EIF includes one notch of uplift for extraordinary shareholder support to reflect our opinion that EIF is core to the European Investment Bank (EIB) group, which we rate 'AAA'. Therefore we equalize our ratings on EIF with those on EIB.

Established in 1994, EIF is a supranational financial institution focusing on small and midsize enterprises (SMEs) in the EU and candidate countries. It fulfills its mandate by taking credit exposures or providing management for three business lines: private equity investments, guarantees and securitization credit enhancement, and microfinance. As of Dec. 31, 2016, EIB owned 60% of EIF's subscribed capital. The supranational entity, the European Union (EU), is the main minority shareholder, with 28% of the capital. The remaining 12% is divided among 28 public and private financial institutions across EU member states and Turkey.

In our base-case scenario, the U.K.’s likely withdrawal from the EIB will have no significant implications for EIB's financial strength or lessen the EIB's value to other member governments. Hence we also expect EIF's intrinsic strengths to remain intact. Our assessment of the EIF's business profile as very strong rests on our view of its role, mandate, and governance, as well as the strength of its relationship with shareholders. We understand that a U.K. withdrawal from EIB would
not affect the capital subscribed by EIF's main shareholders, the EIB and the European Commission. Likewise, it is currently not expected to affect the capital held by two U.K. financial institutions, Barclays Bank PLC and Scottish Enterprise, which each own 0.1% of EIF. Moreover, we don't expect it will hinder EIF's delivery of its 2017-2019 corporate operational plan, its important medium-term private equity exposures, or its guarantees to entities based in the U.K.

In our view, EIF's business profile continues to be reinforced by the role it plays in delivering the SME portion of the European Fund for Strategic Investments (EFSI). Through EFSI's second initiative, the EIB group is expected to bridge market gaps and unlock about €500 billion of investments until 2020, supporting strategic infrastructure, innovation, and small businesses. As a result, EIF will deploy €5 billion of additional financing over 2015-2020 through equity investments and credit enhancement. In 2016, the fund increased its approved volume for equity, guarantees, securitization, and microfinance to about €9.5 billion, up by 35% compared with the amount in 2015.

We continue to assess EIF's financial profile as extremely strong. A capital increase in 2014 helped further strengthen its risk-adjusted capital (RAC) ratio, our primary metric for capital adequacy. The RAC ratio decreased to 22.7% as of year-end 2016, before our adjustments for supranationals, owing primarily to a significant increase of EFSI exposures, but also to the revaluation of the pension plan discount rate that impaired earnings. Factoring in our adjustments—notably our expectation of preferred creditor treatment and a cap on high-risk exposures, such that capital allocated does not exceed the exposure amount—the RAC ratio improves to 36.5% (compared with 43.5% at year-end 2015). We expect the decline in capital will continue but that balance sheet growth will slow down, with the adjusted RAC ratio staying firmly above 23% in the next 24 months. (The criteria correction explained in "Criteria For Assessing Bank Capital Corrected," published on July 11, 2017, is not factored into the RAC ratio after diversification. The impact of the correction on the ratio is not assessed as being material to the rating.)

Our assessment of EIF's funding and liquidity informs our view of its financial profile. Shareholders' equity funds EIF's activities for its own account. We believe that equity, which is a strong and stable source of funding balances the lack of proven access to the capital markets. Our liquidity ratios indicate that EIF would be able to continue disbursing private equity commitments and paying on guarantees for more than five years, under stressed market conditions, without recourse to liquidity facilities from shareholders or the market. This level of liquidity is among the strongest of the supranational institutions we rate. EIF's liquid assets, amounting to €1.28 billion including securities, are managed by the EIB.

The EIF has no outstanding debt. Our credit ratings indicate EIF's capacity, with the backing of its shareholders, to service outstanding guarantees and provide other forms of off-balance-sheet credit enhancement to enable SMEs to obtain financing on attractive terms.

The notch of uplift in our long-term rating on EIF stems from our view that EIF is core to EIB and integral to the EU's strategy with regard to SMEs, as its central
role in the delivery of the EFSI's SME portion currently illustrates. However, we
would remove this notch of uplift if EIB were downgraded to the level of EIF's SACP
or lower.

**Outlook**

The stable outlook on EIF mirrors that on EIB. We could lower our ratings on EIF if
we lowered our ratings on EIB in the next 24 months.

We could also consider lowering the ratings if EIF's two main shareholders, the EIB
and the EU, no longer saw the EIF as integral to their strategy, although this
scenario currently appears remote, in our view.

**Related Criteria And Research**

**Related Criteria**

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April
  07, 2017
- General Criteria: Group Rating Methodology - November 19, 2013
- Criteria - Governments - General: Multilateral Lending Institutions And Other
  Supranational Institutions Ratings Methodology - November 26, 2012
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And
  Assumptions - December 06, 2010
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

**Related Research**

- Criteria For Assessing Bank Capital Corrected, July 11, 2017
- Credit FAQ: Key Considerations For Supranationals' Lending Capacity And Their
  Current Capital Endowment, May 18, 2017
- How Brexit Could Impact Ratings On Supranational Institutions, April 10, 2017

**Ratings List**

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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.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this
rating action can be found on S&P Global Ratings' public Web site at
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