Fitch Affirms European Investment Fund at 'AAA'; Outlook Stable

Fitch Ratings - Paris - 25 May 2021: Fitch Ratings has affirmed European Investment Fund’s (EIF) Long-Term Issuer Default Rating (IDR) at 'AAA' with a Stable Outlook and Short-Term IDR at 'F1+'.

Key Rating Drivers

As a supranational financial guarantor, EIF's ratings are driven by the strong extraordinary support Fitch believes it would receive from its shareholders, including European Investment Bank (EIB; AAA/Stable; 58.8% of subscribed capital at end-2020), the European Union (EU, AAA/Stable; 29.7%) as well as from 38 large financial institutions based in the EU, the UK and in Turkey.

Fitch assesses EIF's shareholders' capacity to support at 'aaa', in line with the rating of its key shareholder, the EIB. Additionally, Fitch views shareholders' propensity to support EIF as 'strong'. This assessment reflects its strategic importance for its shareholders: EIF has played a key role in leveraging funds for small and medium sized enterprises (SME) in the EU, through its participation in the European Fund for Strategic Investments (EFSI) and expected involvement in long-term EUR26 billion InvestEU programme.

The EIF's strategic importance has also been illustrated by its mandate in the EU's and EIB group's Covid-19 policy response initiative, which aims at mobilisation of up to EUR200 billion of financing to businesses in the EU. The EIF agreed to extend about half of the EUR25 billion guarantees foreseen by the Pan-European Guarantee Fund (the other half is covered by the EIB). Guarantees and other blended financing provided by the EIF are fully backed by guarantees from EU member states, meaning the impact on EIF's leverage and risk is minimal.

Fitch assesses EIF's Standalone Credit Profile (SCP) at 'AA-' based on its Insurance Rating Criteria. The SCP reflects EIF's exceptionally strong capitalisation, and very strong business profile.

The EIF acts as an implementing vehicle of EU policies with a mandate to provide debt, equity and guarantee products to SMEs, and to act as an intermediary for realising the development and cohesion initiatives of the EU through special mandates. The EIF therefore has no direct competitors.

Fitch views EIF's capitalisation as exceptionally strong. The fund's net par-to-capital ratio strengthened to 1.0x at end-2020 (2019: 1.9x) as guarantee exposure at risk decreased by 50% due to a temporary counter-guarantee provided by the EIB. The EIB's counter-guarantee was terminated in February 2021 with the receipt of cash from the capital increase. The EIF's shareholders approved a EUR2.87 billion
increase in authorised capital in February 2021 (to EUR7.37 billion from EUR4.5 billion), 20% of which was in the form of paid-in capital. New shares are issued at a premium increasing the expected total cash receipt to EUR1.25 billion by end-3Q2021. As of May 2021, 89% of the new capital increase had already been subscribed by shareholders, a strong evidence of support, in our view. Fitch expects the fund's net par-to-capital to weaken in 2021 driven by business growth, but to remain in line with the 'AAA' rating category.

Fitch assesses EIF's own risk guarantee portfolio as 'Medium Risk'. The majority of EIF's own risk exposures are investment grade, mainly in the low 'A' and 'BBB' categories, based on EIF's internal risk assessment. Although EIF's guarantees mainly relate to SMEs, the credit quality of the portfolio has meaningfully improved through credit enhancement (mostly first loss tranche held by the European Commission). As a result, non-investment grade exposure remains low.

The EIF was exposed to EUR982 million in private equity investments at end-2020 (end-2019: EUR776 million), which is a key driver of the fund's risky asset ratio (2020: 58%; 2019: 45%). The private equity portfolio is layered, and EIF is mostly exposed to senior tranches which reduce the risk of potential losses to the fund. EIF's bond portfolio entirely consists of investment grade sovereign and corporate debt with an average credit rating of 'A', which we expect to be maintained over the forecast period.

Fitch assesses EIF's liquidity profile as 'very strong' based on typically low liquidity needs from a cash flow perspective, and the high level of on balance sheet liquid assets (cash and equivalents and easily marketable debt securities). The expected receipt of EUR1.25 billion paid-in capital in 2021 from the capital increase will further reinforce the EIF's liquidity.

Fitch assigns 'low' importance to the financial performance and earnings credit factor for EIF. We primarily consider the fund's financial performance from a viability perspective. Compared with other profit-oriented institutions, the EIF does not have a return on equity (ROE) target. The five-year average ROE stood at 6.8%. However, Fitch expects run-rate ROE to be in the 4%-5% range post capital increase and over the forecast period.

**RATING SENSITIVITIES**

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

- Adverse change in our assessment of EIF's key shareholders' capacity or propensity to provide support to the EIF.

- Downward revision of EIF's SCP, which could result from weakening in capitalisation and/or pressures on liquidity and investment risks.

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

The ratings are at the highest level on Fitch's scale and cannot be upgraded.
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

- Fitch assumes the new capital increase will be fully subscribed by shareholders and the paid-in portion disbursed within a short period.

- Callable capital would be provided by EIF's shareholders on a timely basis in case of need.

- The strategic relationship between EIF and the EIB and EU remains strong.

- No significant amount of debt will be issued by EIF in the medium term.

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

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RATINGS KEY

OUTLOOK  WATCH

POSITIVE  ♦  ♦
NEGATIVE  ♣  ♦
EVOLVING  ♣  ♦
STABLE    ♥

Applicable Criteria

Insurance Rating Criteria (pub.15 Apr 2021) (including rating assumption sensitivity)
Supranationals Rating Criteria (pub.20 May 2021) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

European Investment Fund  EU Issued, UK Endorsed
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