Methodology

Rating Supranational Institutions

March 2015
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March 30, 2015

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A. Overview

This methodology applies to supranational institutions, or multilateral financial institutions (MFIs). MFIs are institutions established by two or more national governments for specific international public policy reasons. Their core mandate involves the provision of financial products, guarantees and services.

The mandate of each MFI permeates all aspects of the analysis of the institution’s creditworthiness. MFIs typically exist to finance investments that would often be unviable at market interest rates, to correct perceived market failures, and to pursue shared policy objectives. Some MFIs are born of major global events, ranging from the Bretton Woods institutions formed in the wake of World War II, to the European Stability Mechanism formed in response to the Eurozone financial crisis. Others are formed at the initiative of policymakers to address a specific regional policy priority. An MFI’s mandate and purpose typically determine its relative importance to its government shareholders, its capacity to generate stable profits, and the likelihood of receiving extraordinary support.

Because MFIs are typically involved in lending and borrowing activities, they share many characteristics with private financial institutions. However, they are typically not expected to generate market rates of return for their shareholders, and they derive much of their financial strength from shareholder policies. Financial activities may be narrow and carefully circumscribed, or broad in scope. Some MFIs lend exclusively to sovereigns or require sovereign guarantees on their exposures; others extend financing only to the private sector. Some MFIs have the advantage of being de facto or de jure preferred creditors, significantly reducing their exposure to credit risk. Regulatory frameworks applying to MFIs also tend to differ substantially from those applying to private financial institutions.1

Thus, while the analysis can use the tools applied to assessing private sector financial institutions, it must also take into consideration the impact of the MFI’s mandate on its credit fundamentals.

Under this methodology, MFI ratings depend on two interrelated assessments. The first, a support assessment, evaluates the creditworthiness of the MFI’s core group of shareholders and factors in the strength of their individual and collective support commitments to the institution. The second, an intrinsic assessment, evaluates the institution’s stand-alone financial strength, particularly the strength of its franchise, the strength of its capital base, its exposure to credit and liquidity risks, and its capacity to generate capital internally.2 The mandate of the institution is central to both assessments, because it affects the quality of shareholder support and the institution’s overall risk profile. Given the significant role that sovereign shareholders play in these institutions, the support assessment is presented first in this methodology. However, the two assessments are interrelated and the precise sequence of the analysis does not affect the rating outcome.

In combining the two assessments, the analysis seeks to conclude on the overall strength of the MFI. Given the nature of these institutions, the two assessments often arrive at very similar conclusions and an easily determined final rating. Depending on the nature of the MFI, however, one of the two assessments may provide a much better perspective on an MFI’s ability to meet its obligations. When one assessment is weaker than the other, the final rating depends somewhat on the reasons for the divergence in the two assessments. The support assessment typically plays the dominant role in determining the final rating, particularly when it is stronger than the intrinsic assessment. In essence, the ability and willingness of shareholders to meet the MFI’s obligations may be entirely unaffected by any shortcomings in the intrinsic strength of the institution, particularly given their non-profit policy role. In the opposite situation, when the support assessment is weaker than the intrinsic assessment, the intrinsic assessment plays an important role but the final rating usually will not exceed the support assessment by more than 3-4 notches. This reflects DBRS’ view that significant weaknesses in the creditworthiness of core shareholders are likely to also affect the financial strength of the MFI. Nonetheless, DBRS looks into the reasons for such divergence and, in some exceptional cases, may apply a weighting of the two assessments. If either assessment raises significant questions about the MFI’s capacity to honor its obligations, a lower overall credit rating may result.

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1 MFIs typically operate under an international treaty or charter that defines their mandate and establishes the rules under which they interact with governments and the private sector. Member governments may also grant them a degree of legal immunity within the countries they operate in.
2 The intrinsic financial strength assessment relies on similar criteria used within DBRS’ Global Methodology for Rating Banks and Banking Organizations, published June 29, 2012. Several adjustments have been made to take into account the unique financial characteristics of MFIs.
B. Rating Multilateral Financial Institutions: The Framework

Average credit quality within this sector is strong. Although there has been a significant proliferation of MFIs in the past couple of decades, DBRS has not identified any incidents of default by MFIs during the post-World War II era. Key reasons for the strong credit quality are that MFIs typically feature stable earnings, high levels of capital, strong risk management practices, preferred creditor status, and – most critically – the explicit backing of sovereign shareholders. MFIs are typically able to rely on their shareholders as a source of additional support, even if their own financial resources fall short. Moreover, with sovereign governments as their principal shareholders, the ability of shareholders to provide such support is usually very strong. The backing of sovereign shareholders also influences the overall MFI’s financial strength, as sovereign shareholders: (i) are often the MFI’s largest borrowers, (ii) typically demand a low return on capital, and (iii) positively impact the MFI’s own borrowing costs.

MFI ratings are consequently derived from two interrelated assessments, a support assessment and an intrinsic assessment. Each assessment is conducted separately and expressed as a rating on DBRS’ Long Term Obligations Rating Scale. However, the two assessments are interconnected and in the majority of cases the ratings generated through the two assessments will be similar.

Exhibit 1

Support assessments primarily reflect the overall creditworthiness of a core group of sovereign shareholders, consisting of the largest and most committed shareholders in the institution. A combined credit rating of core shareholders, usually close to the weighted median rating of the group, is used as the starting point to judge their individual and collective capacity to support the institution. However, the support assessment also reflects the specific shareholder structure of the institution and the credibility of their individual and collective support commitments. Support commitments are evaluated on the basis of a variety of domestic and international legal, political, economic, and financial considerations. In addition, the degree of reliance on a single shareholder or, conversely, the MFI’s ability to rely on a variety of different shareholders for support, is taken into account. Based on these factors, MFI support assessments often result in high ratings, either because the MFI has a few strongly committed AAA-rated or AA-rated shareholders, or because the MFI benefits from multiple credible sources of support. The process for determining the composition of the core shareholder group and evaluating other factors is discussed in detail in section C.
The strength of an MFI’s franchise is a key factor and an important starting point for its intrinsic assessment. A strong franchise enables an MFI to generate stable earnings, preserve its capital base, and deal with adverse conditions without external support. As with any commercial financial institution, a franchise reflects the overall organization, its nature, legal basis, purpose, ownership, management, characteristics, business mix, product range, and geographic reach. The intrinsic assessment may also be influenced by strengths or weaknesses in the remaining factors, namely earnings power, risk profile, funding and liquidity, or capital adequacy. MFI intrinsic assessments often result in high ratings, due to the strong franchises of most multilateral institutions, conservative risk management, high levels of liquidity and capitalization, and stable earnings. While AAA-level assessments would be unusual for private sector banks, the credit fundamentals of MFIs with exceptional characteristics, including very strong franchises, highly conservative risk profiles, preferred creditor status, and formidable balance sheets, may lead to a AAA-level intrinsic assessment. The process for evaluating the strength of an institution’s franchise and the impact of other rating factors is described in section D.

This methodology presents these factors in a step-by-step fashion and provides the framework for the determination of the support assessment and intrinsic assessment using a building block approach. However, it is important to note that in practice, the various factors are interrelated. This interconnection is a critical component in our approach. As a result, an independent scoring of each factor will not necessarily lead to a reliable final support assessment or intrinsic assessment. Because it is not possible to provide exact clarity on every unique situation, DBRS provides the key principles that are applicable to most circumstances and also provides guidance on the more important crossover considerations.

The final stage of analysis brings together the results of the two assessments and determines the MFI’s credit rating. In the majority of cases, both assessments are expected to lead to similar results, since highly rated sovereigns tend to establish strong MFIs. In most cases, assessment results map into the ratings as shown in Exhibit 2 below. Nonetheless, the final stage, discussed in section E, considers the relative importance of the two assessments and the cases in which the final credit rating may need to deviate from the mapping shown.

### Exhibit 2

<table>
<thead>
<tr>
<th>Support Assessment</th>
<th>Intrinsic Assessment</th>
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</thead>
<tbody>
<tr>
<td><strong>AAA</strong></td>
<td>AAA</td>
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<tr>
<td><strong>AA</strong></td>
<td>AAA</td>
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<tr>
<td><strong>A</strong></td>
<td>AA</td>
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<td><strong>BBB</strong></td>
<td>AA/A</td>
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<tr>
<td><strong>BB</strong></td>
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<td><strong>B</strong></td>
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Typical mapping of support and intrinsic assessments to MFI credit ratings
C. Support Assessment

The overall creditworthiness of the group of core shareholders is the starting point for the support assessment. The analysis identifies the core group, which includes the largest and most committed shareholders, usually accounting for at least 50% of outstanding shares. The analysis then calculates a combined credit rating for this group, and also considers three additional factors: the credibility of shareholder commitments, the impact of dominant or controlling shareholders, and the benefits of multiple sources of support. As noted above, the four factors are interrelated, and some factors from the intrinsic assessment may also have an impact on the support assessment. Nonetheless, the analysis is discussed sequentially below. The analysis generates a final support assessment expressed on DBRS’s long-term obligations rating scale, which ranges from AAA to C (low).

Exhibit 3

1) Creditworthiness of Core Shareholders

A preliminary shareholder support assessment is derived from a combined credit rating of the core group of shareholders. DBRS defines core shareholders as the group of sovereigns that individually and collectively constitute the largest and most committed MFI shareholders. Their credit ratings are the most accurate measure of the capacity of the shareholders to meet their obligations and to provide support to a multilateral institution. The group may not be entirely cohesive and may disagree on fundamental issues, including how to best achieve the institution’s mandate. However, the core shareholders are normally strongly united in support of the institution’s overall mission. Significant changes to the institution’s charter or operations are unlikely to occur without their consent, and some individual shareholders may be able to exercise a limited veto on major policy changes.

DBRS notes that shareholders regularly provide new capital to MFIs in order to bolster their lending capacity, but the domestic political process can delay the contributions of some shareholder governments. Nonetheless, sovereigns have demonstrated an ability to act quickly when new capital, or an entirely new institution, is needed. Furthermore, while it is difficult to identify any precedent for sovereigns providing emergency support to an MFI for the express purpose of avoiding a default, the provision of emergency support would very likely entail a different dynamic than routine capital increases. While the smallest shareholders may be entirely reliable in terms of their capacity and willingness to contribute, their individual contributions may fall short of the amount needed to avert a default in a stress scenario. The question of which sovereigns would be both able and willing to urgently deliver adequate amounts of new capital must be considered on a case-by-case basis and in light of the fundamental strengths of the core shareholders, the scope of the MFI’s obligations, and the importance of the MFI’s mandate to each shareholder. Therefore, the rationale for focusing on the core group lies in the expectation that the sovereigns in this group are the most able and willing to provide the necessary support in a stress scenario. This includes, but is not limited to, the willingness and ability of shareholders to support an MFI by providing any callable portion of subscribed capital when requested.
DBRS derives the list of core shareholders in several steps. Shareholders are first ranked by their percentage contribution of paid-in capital. The initial list usually includes the top 10 shareholders ranked by size, though the list may be expanded to 15 or 20 shareholders for large global institutions. The top 10 shareholders usually represent over 50% of the total shares, and the top 20 usually account for at least 70%. For example, the top ten shareholders of the World Bank (IBRD), the most widely held MFI in the world (along with its sister institution, the IMF), constitute 54.8% of the institution’s subscribed capital, and the top twenty shareholders represent 72.6%. In regional institutions, the top ten shareholders often account for a substantially larger share of total capital. DBRS may drop the smallest individual shareholders from this list if they account for less than 2% of the shares in a large regional or global institution, or less than 5% of the shares in a smaller regional institution.3

From the list of the largest shareholders, the analysis then centers on the strength of each shareholder’s commitment to lend support. The strength of this commitment is proxied first by the shareholder’s credit rating: highly rated sovereigns are typically more willing and able to meet financial commitments or to take on new obligations. However, analysts may make further adjustments to the list based on the importance of the institution to those individual shareholders. If the institution lends to its own members, the largest net borrowers may be added into the list of the most committed shareholders. If any individual shareholder on this list is viewed as significantly less committed to the institution or substantially at odds with the majority of large shareholders regarding the overall mandate of the institution, that individual shareholder may be eliminated from the core group, regardless of its credit rating. At the same time, DBRS ensures that the core group is collectively willing and able to cover the institution’s potential capital needs, as discussed in the next section, Credibility of Shareholder Commitments.

From the list of core shareholders, analysts calculate a combined credit rating, which is usually close to the weighted median credit rating of the core group. The objective is to identify the rating which most accurately reflects the likelihood that the core shareholders would be collectively able to provide the necessary support to the institution.

In most cases, the weighted median rating is the best reflection of the overall credit quality of the core shareholder group. The other common measure of central tendency, the mean, frequently generates skewed results.4 For example, a hypothetical core group with seven AAA-rated sovereigns and one B-rated sovereign of comparable size would have a median rating of AAA, but a substantially lower average rating. In such a situation, it is unlikely that the AAA-rated shareholders would fail to provide support just because the lower rated sovereign is unable to do so, and the AAA rating is a good reflection of the overall credit quality of the group. Indeed, if the AAA-rated shareholders are sufficiently strong and committed to the institution, it may be possible to exclude the lower rated sovereign from the core shareholder group. In the reverse situation (one AAA- and seven B-rated shareholders), the median rating of B is also likely to be an appropriate starting point for the support assessment. In such cases, a single upgrade or downgrade typically will not affect the combined rating.

Alternatively, if an MFI has a few large AAA-rated shareholders and a few large lower rated shareholders in its core group, the median rating could become highly sensitive to the precise size of the individual shareholders, and a single upgrade or downgrade could have an impact on the combined credit rating. Unless the higher rated shareholders are viewed as sufficiently committed to supporting the institution without the support of the lower rated large shareholders, a significant drop in credit quality close to the median core shareholder may lead DBRS to use the average rating between the two core shareholders closest to the median, or to simply adjust the median rating one or more notches in the direction of the mean. If a single sovereign upgrade or downgrade is expected to change the combined credit rating, DBRS will typically disclose this information in the rating report.

Some unique shareholding arrangements may require special consideration. For example, DBRS could include private or other institutional shareholders within the core group of some MFIs, as long as support commitments are viewed as sufficiently credible. In addition, if an MFI has a fully- or partly-owned subsidiary, DBRS will usually rate the subsidiary as an MFI under this methodology, even if it has only one direct owner. DBRS would likely treat the parent MFI as the core shareholder for purposes of evaluating the quality of support commitments and the existence of a dominant or controlling shareholder, as discussed below. That is, if MFI A is the

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3 The lower threshold in global institutions is a reflection of their nearly universal membership and their unique governance arrangements, in which one or two dozen of the largest shareholders lead constituencies in the institution’s Executive Board. Large regional institutions may have similar governance structures. Constituencies combine the voting power of all constituency members. This structure forces larger shareholders to take the views of the smaller shareholders within their respective constituency into account, but may also allow the leaders of constituencies to exert substantially more influence than their individual capital and voting shares would suggest. This might also result in some smaller shareholders being included in the core shareholder list. For example, in the IBRD, the Netherlands is the 12th largest shareholder, but it leads (with Turkey, the 20th largest shareholder) the 4th largest constituency in the IBRD’s Executive Board. Although the power for major organizational decisions is vested in the Board of Governors, which votes by country, not constituency, the Executive Board plays a significant role in the organization’s operations and countries leading a constituency may be inclined to lend emergency support, potentially even above their individual commitments.

4 An average rating could be computed by placing ratings on a simple numerical scale, or by computing an idealized weighted average probability of default from the sovereign ratings of core shareholders; both tend to produce skewed results when there are positive or negative outliers in the group.
majority owner of MFI B, MFI A’s credit rating would likely serve as the combined credit rating, and effective control by MFI A would likely also impose a ceiling on the rating of MFI B. Alternatively, if the governance and potential support of the subsidiary functions in much the same way as the parent institution, DBRS may ‘look through’ the parent and evaluate the commitment of the parent MFI’s shareholders to provide direct support to the subsidiary.

2) Credibility of Shareholder Commitments

As discussed in the previous section, the combined rating of core shareholders serves as the starting point for the support assessment. This starting point implicitly treats obligations to support an MFI as ranking equally with direct sovereign obligations. In some cases, however, shareholder commitments may be considerably weaker, or simply more ambiguous in nature. DBRS may make downward adjustments to the support assessment, if the reliability of sovereign guarantee or other commitments from core shareholders is in doubt. In other exceptional cases, the importance of the institution and the strong assurances that the highest rated shareholders would provide the necessary support may provide justification for narrowing the core shareholder group. This narrowing could in turn result in a higher combined credit rating.

For MFIs, support commitments are often explicitly enshrined in international treaties or domestic legislation. Capital subscriptions often include a “callable” portion, specifying how much support each sovereign will provide. Requirements for authorizing a capital call are usually also clearly specified. In some cases, the requirements for a particular government to meet a call on capital or other guarantees to a particular institution could be relatively simple and procedural in nature, due to some form of pre-authorization by the country’s legislative body, or due to the country’s form of government. In others, the national legislature may have to approve new appropriations or amend an existing budget, which could require difficult political negotiations. Thus, while many governments would reasonably be expected to take the necessary steps to meet an explicit international commitment, the commitments of some individual shareholders may not be as strong as their individual credit rating suggests. At the same time, some individual shareholders may be willing to contribute an amount in excess of their explicit commitment. To evaluate the credibility of shareholder support and prioritization relative to direct sovereign claims, DBRS first considers the overall mandate of the institution. Some common mandates and roles include:

- **Crisis prevention and resolution**: Providing direct financing for government budget deficits or for external deficits, reducing overall funding costs for borrowing countries and alleviating the impact of shocks. Financing may be combined with policy conditions intended to support the implementation of needed economic reforms.
- **Financing investment in fixed capital**: Extending loans and guarantees to increase investment in public and private infrastructure and other capital-intensive projects.
- **Private sector development**: Providing financial support to the private sector, particularly small and medium enterprises and other entities not able to access private financing sources at viable interest rates. Financing may take the form of equity, debt, or insurance.
- **Financing cross-border trade and investment**: Assisting companies seeking to enter foreign markets, either through trade or through direct investment. These MFIs typically provide insurance against specific risks or extend various types of credit to support the international expansion of private companies.
- **Other environmental and social objectives**: Financing environmentally friendly development, increasing the availability of social services, or otherwise supporting vulnerable communities.

Although there may be exceptions, institutions involved in crisis prevention and resolution often have the strongest – or most critical – mandate. The task of helping to resolve crises affecting other sovereigns is often an inescapable necessity for a variety of economic, financial and geopolitical reasons. These institutions take on added importance precisely when economies, governments, and financial systems are under severe stress. Other institutions playing a useful but less essential role in economic development or social policy may be treated as relatively lower priorities, particularly when a sovereign is facing financial difficulties.

Explicit legal commitments are also an important consideration. Commitments written into law are typically a direct reflection of the importance of the institution’s mandate. The existence of a legal commitment and a pre-authorized funding source may lower the domestic political cost of meeting those commitments, and increase the international political cost of failing to do so. If a government has not made an explicit legal commitment, or needs the approval of the national legislature in order to meet a commitment, the reverse may be true.

The overall performance of the MFI in pursuing its specific mandate and demonstrating progress in achieving results is also an important consideration. In many MFIs, evaluations and reporting mechanisms to shareholders can be quite demanding, and accountability to
governments and to the general public may be thoroughly ingrained into the institution’s operations. Though the measurement of results may be difficult and is at times subjective, these institutions are typically focused on demonstrating their value to shareholders. In other cases, a lack of transparency, poor institutional design, governance problems, regulatory impediments or even political interference could make an institution less successful in achieving its specific mandate. Failure to achieve the institution’s mandate, particularly if due to managerial incompetence, corruption, or politicized activities, could make governments less willing to support the institution to avert its failure. DBRS may consequently make downward adjustments to an MFI’s support assessment if serious failures are evident. Alternatively, if only a subset of the institution’s core shareholders is viewed as significantly dissatisfied with the institution and consequently less willing to extend support, DBRS may lower the ratings drawn from that particular subset of core shareholders for purposes of determining the combined credit rating of the core group.

The analysis considers the main priorities of core shareholder governments, the degree to which those priorities shift when political power changes hands, how the institution responds to shareholder priorities, and the degree to which the MFI is achieving the desired results. A healthy degree of internal criticism and debate over how to make an institution more effective is typically viewed as a positive sign. Downward adjustments are usually only warranted when the institution repeatedly fails to meet shareholder expectations, proves incapable of resolving internal disagreements over key policies, or exhibits significant management failures that are not being resolved through shareholder intervention. Exhibit 4 below summarizes the basic criteria used to evaluate sovereign commitments to individual MFIs, and the typical impact on the support assessment.

If explicit commitments appear to deviate significantly from the importance of the institution’s mandate to its core shareholders, the analysis will typically place greater emphasis on the importance of the institution’s mandate. That emphasis implies that DBRS’s evaluations of the credibility of support commitments could in some cases deviate from explicit statements made by government authorities, or even explicit legal commitments. This could work in either direction, either increasing or decreasing the final support assessment rating.
### Evaluating the Quality and Credibility of Shareholder Support Commitments

<table>
<thead>
<tr>
<th>Assessment</th>
<th>Criteria</th>
<th>Typical Impact</th>
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<tr>
<td>Very Strong</td>
<td>The institution’s mandate and role makes it essential to regional or global economic or financial stability. Explicit legal commitments may include joint and several support, wherein an individual shareholder could reasonably be relied upon to provide support above and beyond their explicit individual commitment. DBRS evaluates the credibility of this commitment by comparing MFI liabilities to the overall central government revenues and debt of the largest top-rated shareholders, in addition to the government’s willingness to pay. If domestic political considerations appear likely to get in the way of any individual core shareholder honoring its commitment in a timely manner, DBRS may exclude that sovereign from the core group as long as the remaining support commitments are credible.</td>
<td>Core group may be narrowed to the highest rated shareholder group able to provide a credible guarantee, potentially resulting in a higher combined credit rating.</td>
</tr>
<tr>
<td>Strong</td>
<td>The institution’s mandate and role makes it important to regional or global economic or financial stability. MFI obligations are expected to rank equally with other central government obligations. This usually includes an explicit legal commitment by each shareholder to provide a specified amount of support upon request by the institution’s management. Available support is viewed as sufficiently reliable to cover losses and liquidity needs even under an extreme tail risk scenario, and core shareholder government support is unlikely to be held back by domestic political considerations.</td>
<td>Combined rating of core shareholders typically applies (no adjustment).</td>
</tr>
<tr>
<td>Satisfactory</td>
<td>The institution’s mandate and role makes it important to regional economic and social policy priorities, but a default by the institution would not have a significant adverse impact on shareholders. Domestic political considerations may limit or delay the support available from core shareholders, or shareholder obligations to the MFI may be expected to rank lower than other central government obligations. Alternatively, shareholder guarantees may be capped and viewed by DBRS as insufficient to cover losses or liquidity needs in a tail risk scenario.</td>
<td>Lower support assessment, usually one notch from combined rating.</td>
</tr>
<tr>
<td>Passable</td>
<td>The institution’s mandate and role makes it a relatively low priority within core shareholders’ overall foreign and economic policy objectives and a default by the institution would not have a material adverse impact on shareholders. The capacity and willingness of sovereign shareholders to extend support in the event of significant losses or a liquidity crisis is questionable. Sovereigns may have issued explicit guarantees relating to a portion of MFI assets or liabilities, but have made no explicit commitment to guarantee MFI solvency.</td>
<td>Lower support assessment, usually two notches or more from combined rating.</td>
</tr>
<tr>
<td>Weak</td>
<td>The institution’s mandate and role is not particularly important to core shareholders, making them unlikely to provide support, or likely to require a debt restructuring before extending support. This may be reflected in explicit verbal or legal commitments to not provide extraordinary support to the MFI.</td>
<td>Lower support assessment, usually at least three notches from combined rating.</td>
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</tbody>
</table>
3) Impact of Dominant or Controlling Shareholders

As the term ‘multilateral’ suggests, individual shareholders usually do not have the ability to determine the mandate and major policies of MFIs. Some individual shareholders may have the capacity to block major organizational changes, but most policy decisions reflect the consensus of a simple or qualified majority of shareholders. Since individual shareholders tend to be protective of their sovereignty and of the use of their financial resources, that consensus is naturally limited to the mandate and set of institutional policies that serve the collective interests of the institution and its beneficiaries.

Nonetheless, as part of the analysis of the core group of shareholders, DBRS also evaluates the degree to which any single sovereign dominates decision-making within the institution. When a single shareholder is dominant, meaning that it has significantly more influence than any other single shareholder, the remaining shareholders may be unwilling to lend support unless the dominant shareholder does so first. Thus, while core shareholders are the sovereigns that are most likely to support an MFI, a dominant shareholder must support the MFI in order to persuade other shareholders to do the same. The existence of a dominant shareholder provides a compelling rationale to limit the support assessment at the level corresponding to the dominant shareholder’s sovereign credit rating.

The dominant shareholder’s credit rating may also impose a ceiling on the MFI’s overall credit rating, if the dominant shareholder is considered to exercise effective control of the MFI. A controlling shareholder typically has sufficient power within the organization to make decisions that serve its individual interests, even if other minority shareholders object. This is rare among MFIs, but the capacity to make unilateral decisions that affect the intrinsic strength of the institution creates a significant risk that the controlling sovereign would utilize the institution’s resources to meet its own objectives, particularly if in distress. The existence of a controlling shareholder implies that the MFI is not a truly multilateral institution and should be viewed through the same lens as a government-related entity, very closely connected to the credit quality of the controlling shareholder.

The analysis takes into account the relative and absolute size of the largest shareholders, and the degree of cohesiveness among various core shareholders. A dominant shareholder usually owns at least 25% of outstanding shares and plays a significant role in setting the institution’s policies and priorities. A controlling shareholder usually owns at least 50% of outstanding shares, or has other mechanisms in place to ensure its ability to control organizational decision-making. In order to be considered dominant, an individual shareholder typically cannot be rivaled in size or influence by any other individual shareholder.

4) Multiple Sources of Support

In the absence of a dominant shareholder, strong individual commitments from multiple shareholders could have additional positive effects on the support assessment and final MFI credit rating that are not fully reflected in the combined credit rating of core shareholders. When several individual core shareholders are likely to be willing and able to lend adequate support even if other core shareholders fail to do so, upward adjustments to the combined credit rating may be warranted.

Although sovereigns periodically provide new capital to fund the expansion of MFI operations, it is difficult to predict exactly how or how quickly sovereigns would respond to a request for capital necessary to avert an impending default. On the one hand, explicit financial commitments from investment grade shareholders are clearly of considerable value. On the other hand, there is some risk that the underlying cause of financial difficulties affecting an MFI could simultaneously create financial difficulties for its core shareholders and prevent them from raising the needed capital. Another concern is that government shareholders would consider contributing additional capital to an institution that has just suffered a catastrophic loss to be politically untenable. In such circumstances, the demonstration effect of some core shareholders withholding their contributions could persuade other sovereigns to do the same.

However, the reverse could also be true: the inability or unwillingness of some shareholders to provide support could make other sovereigns more likely to provide support. Capital cannot flow out of all countries at the same time. Financial outflows rendering one country less able to tap debt markets should, all else equal, simultaneously increase the supply of financing available in another. In addition, sovereigns both cooperate and compete for influence on the international stage. Consequently, if some sovereigns are unable to provide support due to their own financial difficulties or unwilling to provide support due to domestic political considerations, other sovereigns may be willing to either increase their support in exchange for increased influence within the MFI, or to temporarily aid the institution or other shareholders through extraordinary liquidity support. Thus, if a subset of core shareholders has ample financial capacity to cover an institution’s potential losses, the likelihood that the institution will fail to obtain enough support to avert a default may be lower than the risk of the median core shareholder failing to extend support. This may also be true if the institution has several smaller, highly-rated shareholders that would be expected to contribute support in tandem with one or more core shareholders.
The analysis considers the strength of the institution’s mandate and its importance to individual shareholders, the real and financial linkages among shareholders, including common exports or imports, and real and financial linkages between core shareholders and the MFI. The analysis of shareholder commitments also evaluates the willingness of individual core shareholders to act alone regardless of other sovereigns’ ability or willingness to extend support. Finally, the expected contribution from any additional minority shareholders whose ratings are at least equal to the combined credit rating of the core group are also taken into consideration. This requires an assessment of the overall relationship between the shareholders, and the importance of the institution to their individual and collective policy priorities.

These additional adjustments to the combined credit rating are typically limited to large regional and global institutions with a broad membership that represents a substantial share of global or regional economic output, and include a number of advanced economies that consistently receive safe haven flows during regional and global crises. Provided that (1) core shareholders view the institution as an important component of their policy priorities; (2) the group of core shareholders is highly unlikely to experience a simultaneous loss of market access; and (3) tail risk scenarios are unlikely to overwhelm the expected financial support derived from a subgroup of core shareholders, the MFI’s support assessment may be adjusted upwards by one or more notches, potentially rising above the combined credit rating of core shareholders.
D. Intrinsic Assessment

To evaluate the intrinsic financial strength of MFIs, DBRS uses the same building blocks described in DBRS’ Global Methodology for Rating Banks and Banking Organizations.\(^5\) As with commercial financial institutions, MFIs with a high degree of intrinsic strength feature strong franchises that generate consistent earnings while limiting risk exposure. High levels of capitalization and strong liquidity profiles provide additional assurances against a potential default.

The analysis covers five areas: franchise strength, earnings power, risk profile, funding & liquidity, and capitalization. As explained in the banking methodology, these blocks are interrelated. In addition, some have implications for the support assessment. Each requires some minor adaptation for the purpose of rating MFIs. This section summarizes the overall process and main rating considerations, and highlights the key differences in the analysis that are applicable to rating MFIs.

Exhibit 5

The most common differences between MFIs and commercial financial institutions include:
- Low risk profiles, often stemming from preferred creditor status but also from highly conservative risk management practices and from the alignment of interests between shareholders and borrowers;
- Low borrowing costs, stemming largely from the explicit backing by the strongest shareholders;
- High levels of capitalization, intended to help ensure stable access to financing, even during economic downturns and periods of financial market stress; and
- Stable but relatively weak earnings power, due to their focus on public policy mandates instead of maximizing profits.

The combination of the strengths of these five factors generates a preliminary intrinsic assessment on DBRS’s Long Term Obligations Rating Scale. The preliminary intrinsic assessment maps into the rating ranges shown above in Exhibit 5. However, when an MFI has exceptionally strong characteristics relative to its closest peers, particularly on earnings, the risk profile and capitalization, the final intrinsic assessment may be adjusted upwards (including, potentially, to AAA). Conversely, an MFI with significant weaknesses in one or more of these five areas may be rated lower than BB. The analysis behind each of the five factors is discussed in greater detail below.

(1) Franchise Strength

The concept of franchise strength may seem somewhat inapplicable to MFIs, given that they are established for public policy reasons and not to maximize returns on capital. However, for the narrow purpose of assessing an institution’s intrinsic financial strength – i.e., its ability to meet its own current and future obligations without recurring to shareholder support – DBRS considers this same emphasis on the institution’s franchise to be appropriate. For MFIs, possessing a strong franchise implies that the institution is able to efficiently provide desirable financial products and services which generate stable earnings, preserve their often sizeable capital bases and enable the MFI to withstand adverse events. Consequently, the main elements of franchise strength discussed in section III.1 of the banking methodology are generally applicable to MFIs. These include:

- Market/competitive positions
- Business mix and product range
- Distribution channels
- Management quality and depth
- Regulation and the operating environment

Nonetheless, some important differences must be taken into account. The strength of an MFI’s franchise is largely determined by its mandate, and usually stems from its unique role and position in the international financial system. Balance sheet growth may or may not be a priority for government shareholders; indeed, there may be legitimate reasons for shareholders to constrain the growth of the MFI and avoid expanding into new financial products. Instead, the strength of an MFI’s competitive position may be substantially enhanced by its low cost of capital and ability to provide countercyclical financing, which is in turn usually linked to the size of its current capital base and the expectation that sovereign shareholders would provide additional capital if necessary. In addition, preferred creditor status can provide a significant advantage to some MFIs, enabling them to charge lower interest rates than comparable private lenders and still generate stable profits.

While DBRS accords a special status to MFIs involved in crisis prevention and resolution when considering the implications for the support assessment, the mandates of these MFIs do not necessarily result in the strongest franchises. Indeed, an MFI with a narrow mandate for crisis prevention and resolution is likely to engage in highly countercyclical financial activities. The MFI’s lending, and hence its ability to generate profits, may be substantially curtailed during periods of strong economic growth, and it may wind up with extremely high exposures to a few large sovereign borrowers during economic downturns or financial crises. Consequently, in the context of the intrinsic assessment, this particular type of franchise does not necessarily provide any specific advantages over an institution with a different or broader mandate, and may entail several key disadvantages, as discussed below. Additional special considerations in applying the analysis of franchise strength to specific types of MFIs are discussed in two sections below; the first focuses on multilateral development banks (MDBs), the most common type of MFI, and the second focuses on other MFIs.

**Multilateral Development Banks**

**Market/competitive position:** Development banks are usually created by governments because the private financial sector is unable to meet a specific need for financing in a particular country, sector or region. As a result of their usually large base of public sector capital, unique legal status, low cost of funding, and often preferred creditor status, MDBs enjoy a uniquely competitive position which may amount to a monopoly. However, the number of MDBs worldwide has grown in recent decades and some governments have established national or subnational development banks as well – so MDBs may face some competition in specific markets. There may also be some elements of a MDB’s mandate that limit its competitiveness. For example, when a MDB’s mandate includes private sector development, shareholders may intentionally limit the scope of the MFI’s activities due to concerns that its lower cost of funding could instead cause it to crowd out the private financial sector. Overall, a MDB’s degree of competitiveness should be evident in the stability and strength of its earnings, and the cost of its funding relative to private sector banks and other development banks. Development banks may have increased opportunities to pursue profitable deals when private banks are deleveraging, but DBRS seeks to rate MFIs through the cycle.

**Business mix and product range:** This may also be largely defined by a MDB’s mandate. If shareholders have a fairly narrow set of objectives for the institution, this may imply a very limited range of products. This does not necessarily detract from the appeal of MDB financial products and services, since needs may persist over a long period of time and direct competition may be limited. Nonetheless, MDBs are likely to benefit from scale and product diversification just as large commercial banks do. And, as economies

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6 Though uncommon among MDBs, some national development banks tend to be vehicles for public subsidies and may incur regular and significant losses. This may at times make an MDB’s financing relatively less attractive within a particular country, but MDBs typically have the advantage of operating in multiple countries.
and financial markets evolve, a MDB needs some flexibility to develop new products or enter new markets. Otherwise, the MDB could be forced to gradually scale down its operations and risk losing its relevance to shareholders.

**Distribution channels:** Distribution channels are more akin to those of an investment or corporate bank, rather than a retail consumer banking institution. Close client and partner relationships, facilitated through a small network of representational offices in major cities, are the essential means of distributing the bank’s products and services. Since they are owned by governments and may lend directly to their shareholders or leverage sovereign guarantees, MDBs often have very strong relationships with member governments, subnational governments, and the private sector.

**Management quality and depth:** The analysis emphasizes management’s capacity to identify opportunities and manage risks while meeting shareholder priorities. As international organizations with an important public policy mandate, MDBs often attract highly competent and motivated professionals within their management and staff. The quality of financial reporting, risk management, internal controls and accountability tend to reflect the best practices of core shareholder governments. However, in some cases, internal bureaucracy, politically motivated decision-making, and the process for obtaining shareholder approval could lessen the organization’s effectiveness, create conflicts of interest, or weaken risk pricing. Board structures and oversight are often relatively immutable for political reasons, and could in some cases detract from the organization’s ability to respond to a changing environment. MDB governance arrangements may be complex and succession may be somewhat politicized. Also, because shareholders are not motivated by profit, this could at times result in Board decisions that sacrifice the institution’s ability to generate and retain earnings in order to pursue specific public policy objectives. When shareholders are providing a backstop for the institution, they may see little reason to avoid utilizing the institution to achieve their priorities. However, these actions could undermine an institution’s intrinsic financial strength and make the institution more likely to rely on shareholder support in the future.

**Regulatory and operating environment:** Conditions within individual countries of operation can be unstable, complicating an MDB’s delivery of financial products and services and potentially heightening the risks associated with its exposures. However, the overall regulatory framework applying to MDBs is typically established by international treaty among shareholder governments, and as such is usually stable and highly favorable to the institution. Some MDBs may nonetheless be given a set of objectives and constraints that are not fully consistent with the environment that they operate in. The regulatory and operating environment may also have an impact on management incentives. In some cases, political shifts within core member governments can have a direct impact on the institution. The analysis emphasizes the stability of the regulatory environment, the degree to which legal and other regulatory considerations could either enhance or detract from the organization’s effectiveness. The benefits associated with special legal immunities and the institutional tax exempt status are also taken into account.

**Other MFIs (non-MDBs)**

The analysis of franchise strength requires more extensive adaptation for other MFIs. Non-MDBs typically have a narrower mandate than MDBs. Some relevant examples include the European Financial Stability Facility (EFSF), European Stability Mechanism (ESM), European Union (EU), and Latin American Reserve Fund (FLAR). Some of these MFIs have limited franchises, in that they have a limited capacity to deploy capital in profit generating activities. Although this usually implies that intrinsic assessments would not be particularly strong, this does not necessarily detract from the strength of shareholders’ individual and collective commitments to support the institution (the support assessment). Indeed, for institutions that lack their own capital base (e.g., the EU and EFSF), DBRS typically conducts a streamlined intrinsic assessment focused only on the risk profile of the institution and its funding and liquidity, which have direct relevance to the adequacy of support commitments. Their ratings will normally be entirely dependent on the support assessment. In contrast, DBRS conducts a full intrinsic assessment for institutions that manage their own capital base (e.g., the ESM and FLAR), making additional adjustments to the evaluation of franchise strength and other factors as discussed below. The relevant question for these types of institutions is whether the intrinsic assessment is sufficiently strong (or weak) relative to the support assessment to have an impact on the final credit rating.

**Market/competitive positions** are typically derived only from an MFI’s unique legal status, ability to fill an essential gap in the regional or global financial architecture, and preferred creditor status. A lender of last resort will generally be considered to be strongly competitive, and low funding costs may also provide a significant advantage. If an institution’s primary earnings are a reflection of conservatively invested capital and direct credit exposures are limited, due to preferred creditor status or otherwise, an institution may still be assured of reasonably stable profitability.

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7 The International Monetary Fund is also a relevant example, but it does not borrow from private creditors.
**Business mix and product range** is usually even more narrowly constrained by the institution’s mandate. Although the MFI’s products may at times be high in demand, the limited scope of products could restrict the MFI’s capacity to generate earnings, and this factor may constrain the franchise strength of some MFIs. At the same time, a conservative approach to investing excess liquidity, combined with a low cost of capital, may ensure stable profitability for the institution in spite of a temporary lack of demand for its limited range of products.

**Distribution channels** are often largely irrelevant; the limited scope of financing activities and limited number of potential counterparties may eliminate the need for a network of offices, and active marketing is typically unnecessary. This is particularly the case if the MFI’s management has limited autonomy in making lending decisions, and functions largely as an asset and liability manager operating under very specific guidelines and constraints. This element of franchise strength may consequently be considered relatively less important or dropped from the analysis entirely.

**Management quality and depth** may be more directly tied to the institutional strengths and weaknesses of shareholder governments, particularly when management has limited autonomy in lending decisions and deploying the MFI’s resources. DBRS is unlikely to rate management quality highly in such circumstances, since political considerations may dominate MFI lending decisions. However, preferred creditor status may substantially offset these potential weaknesses in the franchise, because most loans will ultimately be fully repaid even if some borrowers are unable to meet all of their other obligations.

**Regulation and the operating environment** are also expected to be highly stable and favorable for the MFI, due to its close ties to sovereigns.

In sum, MFI franchises typically have a mix of advantages and disadvantages relative to commercial financial institutions. In spite of the constraints imposed by their mandate and the potentially subpar profitability associated with some of the activities their shareholders may impose, the legal, regulatory, preferred creditor treatment and funding advantages of most MFIs are usually sufficient to compensate for those constraints. As a consequence, many MFI franchises are likely to be rated ‘strong’ or ‘very strong.’ The typical criteria used for the evaluation of franchise strength are presented in the grid below.
<table>
<thead>
<tr>
<th>BUILDING BLOCK</th>
<th>Very Strong</th>
<th>Strong</th>
<th>Satisfactory</th>
<th>Passable</th>
<th>Weak</th>
</tr>
</thead>
<tbody>
<tr>
<td>Franchise Strength</td>
<td>The MFI's mandate enables the provision of products and services on terms not widely available at other institutions, granting the institution a top tier position in its respective market. The institution has strong brand recognition and typically fills an important gap in the market for financial services.</td>
<td>The MFI's mandate enables the provision of products and services on terms not widely available at many other institutions, granting the institution a top or second tier position in its respective market. The institution has moderately strong brand recognition and typically fills a meaningful gap in the market for financial services.</td>
<td>The MFI's mandate is somewhat limiting but enables the provision of products or services on competitive terms, granting the institution a mid-tier presence in some markets.</td>
<td>The MFI's mandate is limiting and does not allow the provision of products or services on competitive terms, granting a moderate presence in some markets.</td>
<td>The MFI's mandate is very limiting and does not allow the provision of products or services on competitive terms, granting a limited presence in a few markets.</td>
</tr>
<tr>
<td>Market/competitive positions</td>
<td>The products or services offered offer significant value added to counterparties and are tailored to their needs. The institution has adequate flexibility in adjusting its core products and services to meet the needs of counterparties.</td>
<td>The products or services offered have high value added to the counterparties. The institution generally has adequate flexibility in adjusting its core products and services to meet the needs of counterparties.</td>
<td>The products or services offered are not unique, but offer some value added to the counterparties. The institution may have limited flexibility in adjusting its core products and services to meet the needs of counterparties.</td>
<td>The products or services offered are not unique, and have limited value added to the counterparties. The institution generally has inadequate flexibility in adjusting its core products and services to meet the needs of counterparties.</td>
<td>The products or services offered are not unique, and have very limited value added to the counterparties. The institution has very little flexibility in adjusting its core products and services to meet the needs of counterparties.</td>
</tr>
<tr>
<td>Business mix and product range</td>
<td>Wide or nearly complete distribution network, including very strong working relationships with clients and (as necessary) representation offices located in national and subnational jurisdictions. Alternatively, the institution may have an effective monopoly in providing an important financial product or service.</td>
<td>Robust distribution network, including strong working relationships with clients and (as necessary) representation offices located in key markets. Alternatively, the institution may be in a quasi-monopolistic position in providing an important financial product or service.</td>
<td>Robust distribution network, including good working relationships with clients and (as necessary) representation offices located in major markets.</td>
<td>Moderate distribution network, including working relationships with clients and (as necessary) representation offices located in most major markets.</td>
<td>Limited distribution network, including limited working relationships with clients and a lack of adequate representation offices.</td>
</tr>
<tr>
<td>Distribution channels</td>
<td>Well-articulated and consistent strategy; high degree of management stability and experience; credible succession plan; clear and appropriately organized reporting lines, and an effective Board of Directors.</td>
<td>More average performance or Minor weakness in one or more of the following: articulation and consistency of strategy; management stability and experience; succession plan; reporting lines, and Board of Directors.</td>
<td>Some level of weakness in one or more of the following: articulation and consistency of strategy; management stability and experience; succession plan; reporting lines, and Board of Directors.</td>
<td>Higher level of weakness in several of the following: articulation and consistency of strategy; management stability and experience; succession plan; reporting lines, and Board of Directors.</td>
<td>Poorly articulated and inconsistent strategy; high management turnover and relative inexperience; lack of a succession plan; unclear and inappropriately organized reporting lines, and an ineffective Board of Directors.</td>
</tr>
<tr>
<td>Management quality &amp; depth</td>
<td>Strong ability to cope with and adapt to changes in the environment or regulatory areas.</td>
<td>Well positioned to cope with possible future environmental or regulatory changes.</td>
<td>Has the capacity to handle change but major changes could be challenging.</td>
<td>Limited capacity to handle change and major changes could be materially challenging.</td>
<td>Not well positioned for any major changes in the operating environment or regulation.</td>
</tr>
</tbody>
</table>
(2) Earnings power

In contrast to commercial financial institutions, an MFI’s pursuit of a public policy mandate tends to take precedence over a strong focus on profitability. Nonetheless, for purposes of evaluating an MFI’s intrinsic strength, earnings remain an important driver of credit quality and many of the same considerations apply to the analysis.

To assess the strength and resiliency of an MFI’s earnings power, the analysis looks at:

- The components underlying an MFI’s earnings and their ability to withstand stress;
- Ways through which the business mix and the franchise contribute to earnings resiliency and growth;
- How effectively an MFI utilizes its franchise to generate earnings;
- What trends reveal about the bank’s prospects;
- What comparisons to any similar multilateral, national or private financial institutions reveal about the MFI’s performance.

The analysis is forward looking, although it utilizes historical financial and other information as the foundation of the analysis. In a period when an institution is under stress and earnings are reduced, the analysis seeks to establish the extent to which the MFI can sustain its underlying revenues, control costs and generate the earnings to cope with the elevated provisions, write-offs and other charges arising from the stress.

Earnings are important as the first line of defense to absorb adverse events such as credit losses or asset write-downs. A key earnings measure is income before provisions and, where applicable, taxes and required dividends, which provides insight into an MFI’s ability to absorb credit losses. The analysis typically evaluates the strength and consistency of revenue generation, asset yields, funding costs, and net interest margins. Expense control and the ability to absorb credit and other charges are also emphasized. Core earnings metrics and benchmarks may vary somewhat by type institution, since the nature of MFI operations can vary significantly. However, many of the same metrics applicable to private banks or insurance companies are used. For MFIs primarily engaged in insurance activities or the issuance of guarantees, greater emphasis is placed on consistency of underwriting profitability and investment income.

Many MFIs feature very low levels of risk and a limited degree of balance sheet leverage, combined with the expected support of sovereign shareholders. These characteristics tend to significantly lower funding costs for MFIs. Consequently, even when asset yields are relatively low in comparison to those of private sector banking institutions and shareholders are not particularly focused on pursuing the business lines with the highest earnings potential, MFIs may still have reasonably strong and stable profits. Furthermore, credit charges may be variable and directly linked to the institution’s cost of funding, protecting some MFIs from the interest rate risks affecting many other financial institutions that lend at fixed rates. Profitability metrics that are evaluated relative to total equity are usually expected to be quite modest, because MFIs often have unusually large capital bases. However, provided that earnings volatility is sufficiently low and average earnings are positive, earnings power will usually be deemed at least satisfactory and downward adjustments to the preliminary intrinsic assessment are unlikely. In comparison to private financial institutions, most MFI ratings are expected to derive relatively more uplift from their strong capitalization and relatively sound risk profile than from earnings.

In regulated commercial institutions that rely on deposit funding, dividends and the distribution of earnings are likely to be constrained by regulatory capital requirements. Since MFIs are typically regulated only by their shareholder governments, DBRS pays additional attention to policies regarding the allocation of profits and the ease with which shareholders could change those policies. If these policies are viewed as a potential means of undermining an institution’s intrinsic strength, the MFI’s intrinsic assessment may suffer as a result, leaving the institution more reliant on shareholder support.
<table>
<thead>
<tr>
<th>BUILDING BLOCK 2</th>
<th>Assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Very Strong</td>
</tr>
<tr>
<td><strong>Earnings Power</strong></td>
<td></td>
</tr>
<tr>
<td>Expense control</td>
<td>Well-established cost control culture with demonstrated ability to manage costs over time.</td>
</tr>
<tr>
<td>Ability to absorb credit and other charges</td>
<td>A proven capacity to generate earnings/IBPT to consistently absorb credit costs with little or no history of capital invasion while considering the MFI's risk profile.</td>
</tr>
</tbody>
</table>
(3) Risk profile

MFIs typically face a broad range of credit, interest rate, market, counterparty and other risks. A critical element of the process for rating MFIs is, therefore, the evaluation and quantification of the nature and extent of the risks that MFIs face and how well the MFI manages these risks.

In this building block, the ratings process seeks to evaluate an MFI’s risk exposures and its processes for managing various types of risk inherent in the MFI’s activities. An MFI’s track record in managing risk through economic cycles and/or crises is an important consideration. Depending on the type of MFI, the MFIs capacity to sustain a sound credit profile in the intermediate future may be important.

The analytical framework starts with assessing an MFI’s risk governance and how it manages risk. It then focuses on assessing an MFI’s profile across the major categories of risk – credit risk, market risk, including interest rate risk and ALM, and operational risk. Classes of exposure may include securities portfolios, direct sovereign lending, sovereign-guaranteed lending, other guaranteed lending, collateralized lending, non-guaranteed lending to private or subnational entities, revolving credit lines, insurance and guarantees issued, and equity investments. The analytical approach is generally similar to that for private institutions.

In evaluating the risk profile of MFIs, several significant differences from private financial institutions often need to be addressed. One common differentiating characteristic is that MFIs are often treated as preferred creditors. A second differentiating characteristic is that certain types of MFIs have highly concentrated exposures. In general, evidence of preferred creditor status can be seen in the MFI’s loss history, and often compensates for any weaknesses in the risk profile of the institution, including a high degree of borrower concentration.

- **Preferred creditor status (PCS):** Sovereigns that are near or in default on their obligations to private creditors often continue to fully service their debt obligations to MFIs. In part, this reflects the ability and willingness of some MFIs to extend new financing when new financing from the private sector is unavailable. In addition, running arrears to MFIs often has other negative consequences for the country’s foreign policy priorities and its standing among other nations. Although this special status is technically unenforceable and varies significantly by institution, it is an enduring custom that tends to significantly enhance the financial strength of some MFIs. DBRS rates PCS according to the criteria laid out in Exhibit 8 below and may make significant adjustments to its assessment of risk in an MFI’s profile to reflect this preference relative to expectations based on the experience of private sector lenders. DBRS tends to focus on the borrowers’ own interests in treating the institution as a preferred creditor, but if borrowers have made explicit legal commitments promising to treat the institution as a preferred creditor, this may influence the final assessment.

<table>
<thead>
<tr>
<th>Assessment</th>
<th>Preferred Creditor Status (PCS) Criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very strong</td>
<td>An institution established exclusively for mutual assistance of member states. Lends only in response to crises and members consistently treat the institution as a preferred creditor.</td>
</tr>
<tr>
<td>Strong</td>
<td>The mandate typically includes extending crisis support to sovereigns. Sovereigns almost always treat the institution as a preferred creditor, but arrears and net present value (NPV) reductions may be somewhat more common.</td>
</tr>
<tr>
<td>Satisfactory</td>
<td>Extends only limited support during crises, but may provide essential financing before or after debt defaults to promote trade, investment or other important services that benefit the borrower’s economy.</td>
</tr>
<tr>
<td>Passable</td>
<td>Status as preferred creditor hinges on bilateral relationships between sovereign borrowers and core shareholders, and the lenders’ willingness to roll over claims.</td>
</tr>
<tr>
<td>Weak</td>
<td>No reliable evidence of preferred creditor status.</td>
</tr>
</tbody>
</table>

- **Exposure concentration:** Some MFIs may exhibit higher exposure concentration than typical private financial institutions. MFIs that lend directly to sovereigns, in particular, are often heavily exposed to a few large borrowers. Although these exposures may benefit from preferred creditor status, highly concentrated exposures increase the likelihood of a large, catastrophic loss, if one sovereign borrower or homogenous group of sovereign borrowers becomes unwilling or unable to pay. If concentration risks are relatively high, this may offset much of the benefit associated with being a preferred creditor. A particular concern arises when outstanding exposure to a single obligor exceeds 50%, and especially 100%, of paid-in capital and reserves. This may make the institution vulnerable to a single credit event, and could reduce the intrinsic assessment down
to the level of the obligor’s credit rating. If the institution is vulnerable to a single credit event associated with a sub-investment
grade sovereign but is a preferred creditor, the obligor’s credit rating may still weigh on the intrinsic assessment. However,
PCS may substantially lower the risk of a default to the MFI and allow for an intrinsic assessment that is considerably higher
than the obligor’s credit rating.

Other differences in the risk profile may need to be taken into consideration as well. For example, payments to MFIs may be exempted
from the imposition of exchange controls by a country, implying that private sector borrowers within non-investment grade countries
may also have a greater capacity to repay the MFI than some other external creditor. The analysis seeks to determine if an MFI can be
demonstrated to have loss experiences that differ substantially from comparable exposures in private firms for other clearly identifiable
reasons. These advantages or disadvantages are factored into the assessment of risk in the MFIs exposure profile. DBRS may use the
various classes of risk exposure to conduct stress tests and other simulated loss scenarios, to further evaluate concentration risks and
obtain a more holistic view of the MFI’s solvency position.

Although this analysis of the risk profile relies on the institution’s latest available financial statements, historical and projected risk
exposures are also taken into account, the latter particularly when an institution is in the midst of a strategic reorientation or expansion.
If an MFI exhibits highly cyclical financing activities, DBRS may need to make substantial adjustments to projected exposures to avoid
excessive cyclicality in the rating. Cyclical lending is a defining characteristic of crisis lenders in particular; claims tend to rise sharply
in times of stress, and may recede just as quickly when borrowing countries regain financial market access. Outstanding claims also
tend to be highly concentrated, with just a few sovereigns accounting for a large proportion of the MFI’s claims. A common approach
taken with crisis lenders is to recalculate risk exposures based on the assumed extension of a large proportion (70-90%) of the MFI’s
total lending capacity. For example, an institution like the European Stability Mechanism (ESM) might be assessed against hypothetical
risk exposures of 80% of its total lending capacity, with perhaps three to five borrowers assumed to account for all outstanding loans. 8

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8 Institutions like the ESM are designed to lend up to 100% of their lending capacity. Despite this, DBRS usually assumes that the maintenance of forward lending
capacity would remain important to core shareholders. Consequently, if an institution such as the ESM were to enter into commitments representing over 70-90% of its
total lending capacity, DBRS believes that shareholders would be likely to consider expanding its capital base. Assumed concentration risks may also vary to reflect the
size of the institution and the characteristics of its membership.
<table>
<thead>
<tr>
<th>BUILDING BLOCK</th>
<th>Assessment</th>
<th>Risk Profile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit Risk</td>
<td>Very Strong</td>
<td>Low loss history, combined with (a) a well-diversified portfolio mix by geography, sectors &amp; product, with characteristics such as granularity, high quality of collateral/secured loans, and strong borrower characteristics; or (b) evidence of preferred creditor status that adequately compensates for any attributes of the very weak risk profile.</td>
</tr>
<tr>
<td></td>
<td>Strong</td>
<td>Strong risk profile. MFI is typically characterized by the attributes of the very strong risk profile with limited attributes of the very weak risk profile.</td>
</tr>
<tr>
<td></td>
<td>Satisfactory</td>
<td>Moderate risk profile. MFI is typically characterized by attributes of the very strong risk profile balanced by some attributes of the very weak risk profile.</td>
</tr>
<tr>
<td></td>
<td>Passable</td>
<td>Weak risk profile. MFI is typically characterized by attributes of the very weak risk profile.</td>
</tr>
<tr>
<td></td>
<td>Weak</td>
<td>Material loss history, combined with concentrated portfolio by geography, sector &amp; product, a high level of unsecured loans, weak borrower characteristics, limited recourse/ guarantees. Portfolios have characteristics such as: non-granular/large single-name concentrations, low quality of collateral/security. In addition, MFI exhibits no evidence of preferred creditor status.</td>
</tr>
<tr>
<td>Market Risk</td>
<td>Very Strong</td>
<td>Very low risk reflects either limited trading activities along with very well hedged interest rate risk, very highly rated securities portfolio, and low FX risk; OR very well managed market risk which typically consists of: well diversified trading businesses, low VaR, few negative trading days, appropriate MTM requirements relative to balance sheet (incl. insurance), very well hedged interest rate risk, very highly rated securities portfolio, and low FX risk.</td>
</tr>
<tr>
<td></td>
<td>Strong</td>
<td>Strong risk profile typically characterized by market risk with many of the attributes of the very strong risk profile and few attributes of the weak risk profile.</td>
</tr>
<tr>
<td></td>
<td>Satisfactory</td>
<td>Satisfactory risk profile is typically characterized market risk with attributes of a very strong risk profile balanced by some attributes of a weak risk profile.</td>
</tr>
<tr>
<td></td>
<td>Passable</td>
<td>Passable risk profile is typically characterized by market risk with some attributes of the weak profile with a few attributes of the very strong profile.</td>
</tr>
<tr>
<td></td>
<td>Weak</td>
<td>High risk reflects either sizeable trading activities along with ineffectively hedged interest rate risk, poorly rated securities portfolio, and high FX risk; OR poorly managed market risk, which typically consists of: poorly diversified trading businesses, high VaR, numerous negative trading days, sizeable MTM requirements relative to balance sheet (incl. insurance), ineffectively hedged interest rate risk, poorly rated securities portfolio, and high FX risk.</td>
</tr>
<tr>
<td>Operational Risk</td>
<td>Very Strong</td>
<td>Very strong operational capabilities and track record across organization, immaterial regulatory issues and significant adaptability, successful history of managing reputational risk and legal risks effective/harmonized technology and infrastructure.</td>
</tr>
<tr>
<td></td>
<td>Strong</td>
<td>Strong operational risk FI has many of the attributes of the very strong risk profile with limited attributes of the weak risk profile.</td>
</tr>
<tr>
<td></td>
<td>Satisfactory</td>
<td>Satisfactory operational risk FI has many of the attributes of the very strong risk profile balanced by some attributes of the weak risk profile.</td>
</tr>
<tr>
<td></td>
<td>Passable</td>
<td>Passable operational risk FI typically has some attributes of the weak profile with a few attributes of the very strong profile.</td>
</tr>
<tr>
<td></td>
<td>Weak</td>
<td>Weak operational capabilities and track record, especially if operating in numerous jurisdictions, material regulatory issues and weak adaptability, poor history of managing reputational risk and legal risks, poor technology and infrastructure.</td>
</tr>
<tr>
<td>Risk Management</td>
<td>Highly Effective</td>
<td>Highly effective and established policies and processes, appropriate reporting lines, strong underwriting, proven loan loss reserve management, effective counterparty risk management, and sound remedial credit management.</td>
</tr>
<tr>
<td></td>
<td>Strong</td>
<td>Strong risk management FI typically has many of the attributes of the very strong risk profile with limited attributes of the weak risk profile.</td>
</tr>
<tr>
<td></td>
<td>Satisfactory</td>
<td>Satisfactory risk management FI typically has attributes of a very strong risk profile balanced by some attributes of a weak risk profile.</td>
</tr>
<tr>
<td></td>
<td>Passable</td>
<td>Passable risk management FI typically has some attributes of the weak profile with limited attributes of the very strong profile.</td>
</tr>
<tr>
<td></td>
<td>Weak</td>
<td>Ineffective and poorly defined policies and processes, inappropriate reporting lines, weak underwriting, unproven loan loss reserve management, ineffective counterparty risk management and weak remedial credit management.</td>
</tr>
</tbody>
</table>
(4) Funding and Liquidity

Although MFIs typically do not have any retail operations and their need for liquidity may differ from the needs of private financial institutions, funding and liquidity management remains critical to their creditworthiness. This building block assesses the MFI’s funding mix, the alignment of funding sources and their uses, and the MFI’s ability to withstand a stressed environment.

Funding and liquidity are linked. The funding analysis focuses on an MFI’s mix of funding and how well the MFI aligns its funding with its asset mix. An MFI’s liquidity reflects both its funding mix and its asset profile, including lending, securities and investments. Typically, it is the unexpected withdrawal of funding or the inability to roll over liabilities that initiates liquidity crises that can lead to extreme stress or failure, even for large financial institutions. The analysis seeks to understand an MFI’s liquidity position, considering both the potential cash needs and the sources and ability of the bank to meet these demands even under a stressed environment.

Funding and liquidity are connected to the prior building blocks. For example, they are connected to the institution’s cost of funding and the opportunity cost of holding liquid assets. One issue is how an MFI balances the benefit of having more liquidity with the cost of holding liquid assets that usually yield less than other assets, such as loans, that have additional risk and are less easy to sell at face value.

In evaluating an MFI’s liquidity, the analysis considers the resources available to meet maturing obligations, withdrawals, calls on commitments and address maturing funding that cannot be rolled. To the extent that information is available, assessing an MFI’s preparedness for a liquidity crisis includes consideration of liquidity contingency plans, the processes in place to meet unexpected needs for cash and contingency liquidity resources. Market perceptions of weak liquidity can result in elevated funding costs for an MFI. Even when it does not cause severe funding problems, the perception of illiquidity can affect an MFI through a loss of market confidence. An MFI can suffer losses if forced to sell marketable assets at a discount. Its access to funding and its cost of funding may deteriorate if it faces a rising risk premium for short-term money market funding.

Liquidity considerations typically only have an impact on the intrinsic assessment. If the MFI lacks access to central bank liquidity facilities, this may result in the MFI being held to a higher standard than comparable private banks. Most MFIs tend to be prudent in managing their liquidity, and in most cases liquidity and funding concerns will have only a minor negative impact on the intrinsic assessment. However, if liquidity risks are significantly higher than solvency risks, this may result in MFI reliance on sovereign support for liquidity purposes, and completely override any benefits to financial strength derived from earnings or a large capital base. A fragile liquidity position could also undermine the value of shareholder support, unless there is strong evidence that support would be mobilized within a short time horizon.
<table>
<thead>
<tr>
<th>BUILDING BLOCK</th>
<th>Very Strong</th>
<th>Strong</th>
<th>Satisfactory</th>
<th>Passable</th>
<th>Weak</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funding and Liquidity</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Funding mix</td>
<td>Very strong and resilient funding profile characterized by highly diversified and reliable wholesale funding sources.</td>
<td>Strong funding profile typically characterized by well diversified and relatively reliable wholesale funding sources.</td>
<td>Satisfactory funding profile typically characterized by fairly well diversified and relatively reliable funding sources.</td>
<td>Less robust funding profile typically characterized by less well diversified and relatively less reliable funding sources.</td>
<td>Weak funding profile typically underpinned by poorly diversified, relatively less reliable funding sources.</td>
</tr>
<tr>
<td>Alignment of funding sources and their uses</td>
<td>Funding profile is appropriately aligned with the nature, scale and maturity of the assets being funded.</td>
<td>Funding profile is broadly aligned with the nature, scale and maturity of the assets being funded.</td>
<td>Generally well-aligned funding profile with some mismatches in the nature, scale and maturity of the assets being funded.</td>
<td>Generally aligned funding profile with some sizeable mismatches in the nature, scale and maturity of the assets being funded.</td>
<td>Overly reliant on limited funding sources; significant mismatches in the nature, scale and maturity of the assets being funded.</td>
</tr>
<tr>
<td>Ability to withstand a stressed environment</td>
<td>A high level of unencumbered assets relative to potential liquidity needs supported by a readily accessible liquidity buffer and reliable emergency liquidity sources.</td>
<td>A solid level of unencumbered assets relative to potential liquidity needs supported by an accessible liquidity buffer and relatively reliable emergency liquidity sources.</td>
<td>A lower level of unencumbered assets relative to potential liquidity needs supported by an accessible liquidity buffer and relatively reliable emergency liquidity sources.</td>
<td>Limited unencumbered assets and/or a high level of encumbered assets relative to potential liquidity needs supported by a modest liquidity buffer and less reliable emergency liquidity sources.</td>
<td>Very limited unencumbered assets and/or a high level of encumbered assets relative to potential liquidity needs with a limited liquidity buffer, and unreliable emergency liquidity sources.</td>
</tr>
</tbody>
</table>
5) Capitalization

The fundamental purpose of capital for an MFI is typically to provide a buffer to protect its liability holders from loss. Strong capitalization is important for retaining the confidence of investors, counterparties and other relevant parties. A simple measure of capital is the difference between an MFI’s assets and liabilities. A larger difference makes it more likely that liability holders would be paid in full, if the MFI were to be wound up. In practice, an MFI’s capitalization is more complicated. Adjustments to capital are necessary, because this difference may not reflect the resources that would be available. Capital may have to be adjusted for potential calls on capital that the MFI has committed to. For MFIs that are highly levered, the level of capital can vary substantially with only modest changes in the values of its assets or liabilities. Strong capital for these MFIs bolsters the confidence of counterparties and investors helping strengthen funding stability and reducing the risk of increased liquidity pressure.

The strength of an MFI’s capitalization is linked to the other building blocks and to its support assessment. For some MFIs, strong earnings power with resilient underlying earnings is an important attribute that provides the best protection, as these resources can absorb the impact of adverse events without invading capital. An important consideration in assessing the need for capital is the scale of losses that an MFI could absorb out of income before provisions and, if applicable, taxes on a current basis, as well as in a stressed environment. An important consideration is the ability of the MFI to increase its capital through external sources, typically through its shareholders. This aspect is addressed more fully in the support assessment, but one of the conclusions of that analysis is the ability of the MFI to receive capital when needed.

As with banks, no single measure captures the strength of an MFI’s capitalization, so several measures may be used as appropriate for the characteristics of the MFI. The complexity of measuring capital and assessing an MFI’s risk profile limits each measure. The analysis evaluates the composition of an MFI’s capital. MFIs typically have a relatively simple capital structure and balance sheet. Preferred shares and hybrid securities are not very common. MFIs typically do not engage in mergers and acquisitions, and are thus less likely to have various intangible assets such as goodwill. They also typically enjoy a tax exempt status, eliminating the possibility of adjustments due to deferred taxation or tax credits. Accounting practices and asset valuations must nonetheless be taken into account. The adequacy of callable and other forms of committed capital are taken into account in the support assessment. The intrinsic assessment focuses exclusively on the adequacy of existing equity in the form of paid-in capital and reserves.

For MFIs, DBRS’ preferred measures of capital adequacy include total equity to total assets and total risk-weighted exposures to capital. However, MFIs are typically not subject to regulatory capital requirements and they are not under any obligation to calculate and report risk-weighted assets. Furthermore, as discussed above, their risk profiles may differ in fundamental ways, particularly due to the preferred creditor status of many institutions. Nonetheless, DBRS’ analysis of MFI capitalization usually includes the application of a basic risk weighting framework for different types of potential loss exposures. The Basel framework typically provides a common starting point for risk weights and for evaluating the level of exposures to which the risk weights are applied. DBRS applies some adjustment factors to the standard risk weights to reflect the unique characteristics of each MFI. For example, if loss rates on lending are influenced by the institution’s preferred creditor status, discounts may be applied to the risk weights on the MFI’s exposures versus what would apply for private banks. Once the appropriate risk weights have been determined, they are applied to current exposures to come up with a measure of risk-weighted exposures.

Due to the wide range of risk profiles and financial reporting practices in the universe of MFIs, DBRS does not have a rigid set of benchmarks for risk-weighted assets to capital, or for the resulting adjustments to the intrinsic assessment. However, the adjustments to risk weights discussed above are intended to make this ratio a reasonably reliable basis for comparison among similarly situated MFIs and private financial institutions. Since it is common for MFIs to have relatively high levels of capital or relatively limited levels of risk, upward adjustments due to a strong capital position may be relatively more common than for commercial banking institutions. If capitalization appears inadequate, or if stress test results reveal additional vulnerabilities stemming from correlated risk factors or concentrated exposures that could overwhelm the MFI’s capital base, larger downward adjustments to the intrinsic assessment may be warranted.
## Exhibit 11

<table>
<thead>
<tr>
<th>BUILDING BLOCK</th>
<th>Capitalisation</th>
<th>Mix &amp; Quality</th>
<th>Generation and Flexibility</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Assessment</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Very Strong</td>
<td>Strong</td>
<td>Satisfactory</td>
</tr>
<tr>
<td></td>
<td>Strong</td>
<td>Passable</td>
<td>Weak</td>
</tr>
<tr>
<td>Capital cushion and the ability to absorb losses</td>
<td>Capital levels provide a solid buffer to absorb losses.</td>
<td>Capital is almost completely comprised of tangible common equity</td>
<td>Powerful and consistent internal capital generation ability and/or appropriate dividend policy provides flexibility with given business and capital requirements</td>
</tr>
<tr>
<td></td>
<td>Capital levels provide an ample buffer to absorb losses.</td>
<td>Capital contains largely of tangible common equity, with small levels of non-core equity elements, such as intangibles, hybrids and preferreds</td>
<td>Solid and consistent internal capital generation ability and/or an appropriate dividend policy given business and capital requirements</td>
</tr>
<tr>
<td></td>
<td>Capital levels provide a limited buffer to absorb losses.</td>
<td>Capital contains a moderate level of non-core equity elements, such as intangibles, hybrids and preferreds</td>
<td>Adequate internal capital generation ability and an appropriate dividend policy</td>
</tr>
<tr>
<td></td>
<td>Capital levels provide a limited buffer to absorb losses and leverage is elevated relative to peers.</td>
<td>Capital contains a material level of non-core equity elements, such as intangibles, hybrids and preferreds</td>
<td>Limited and less consistent internal capital generation ability and/or a more aggressive dividend policy</td>
</tr>
<tr>
<td></td>
<td>Capital levels offer minimal protection against losses and leverage is very high relative to peers.</td>
<td>Capital contains a sizeable levels of non-core equity elements, such as intangibles, hybrids, and preferreds</td>
<td>Weak and inconsistent internal capital generation ability and/or an inappropriate dividend policy</td>
</tr>
</tbody>
</table>

**Capitalisation**
- Weak and inconsistent internal capital generation ability and/or an inappropriate dividend policy
- Limited and less consistent internal capital generation ability and/or a more aggressive dividend policy
- Adequate internal capital generation ability and an appropriate dividend policy
- Solid and consistent internal capital generation ability and/or an appropriate dividend policy given business and capital requirements
- Powerful and consistent internal capital generation ability and/or appropriate dividend policy provides flexibility with given business and capital requirements
- Capital cushion and the ability to absorb losses
- Capital is almost completely comprised of tangible common equity
- Capital contains largely of tangible common equity, with small levels of non-core equity elements, such as intangibles, hybrids and preferreds
- Capital contains a moderate level of non-core equity elements, such as intangibles, hybrids and preferreds
- Capital contains a material level of non-core equity elements, such as intangibles, hybrids and preferreds
- Capital contains a sizeable levels of non-core equity elements, such as intangibles, hybrids, and preferreds
E. Determining the Credit Rating

Exhibit 2, copied below for ease of reference, summarizes how the results of the two assessments are expected to map into ratings in most cases. Only rating ranges are shown, for illustrative purposes.

Because of the interrelationships between the two assessments, the results usually do not vary widely and DBRS expects that the majority of MFIs will place near the diagonal. In particular, highly rated sovereigns tend to establish financially strong MFIs. If an MFI suffers from unexpected intrinsic weaknesses, highly rated shareholders are likely to require policy and management changes and to provide increased resources to the institution to strengthen its capacity to meet its obligations. In contrast, MFIs sponsored by non-investment grade sovereigns are more likely to suffer from the same governance problems and weaknesses in financial management that exist within their shareholders. For these reasons, MFIs are not expected to place in the extreme upper right and bottom left corners (i.e., having one assessment in the AAA or AA range and the other assessment in non-investment grade territory). Modest differences between the two assessments may be relatively more common.

Exhibit 12

| Typical mapping of support and intrinsic assessments to MFI credit ratings |
|-----------------------------|-----------------------------|-----------------------------|---|---|---|---|
| Support Assessment | Intrinsic Assessment | AAA | AA | A | BBB | BB | B |
| AAA | AAA | AAA | AAA | AAA/AA | -- | -- |
| AA | AAA | AA | AA | AA | AA/A | -- |
| A | AA | AA | A | A | A/BBB | BBB/BB |
| BBB | AA/A | A | A | BBB | BBB | BB |
| BB | -- | BBB | BBB | BBB/BB | BB | BB/B |
| B | -- | -- | BB | BB | BB/B | B |

A difference of one notch usually results in a rating that corresponds to the stronger of the two assessments. For example, if an MFI has an intrinsic assessment of AA but a support assessment of AA (high), the rating will typically correspond to the support assessment. When the two assessments diverge by a more substantial margin, of two or more notches, additional analysis may be needed to determine the relative importance of the two assessments and the weight that will be applied to each. The main considerations of the analysis are presented below.

There are at least two scenarios in which the support assessment might significantly exceed the intrinsic assessment (above and right of the diagonal). First, as mentioned in the discussion on franchise strength (section D.1), some MFIs may have a narrow and specific mandate that restricts the MFI’s franchise strength and prevents it from generating profits. Second, some MFIs could become overly exposed to risks without necessarily undermining the strength of the support they receive from shareholders. In both cases, the final analysis places special emphasis on the scope of the MFI’s obligations relative to the financial capacity of its core shareholders, the MFI’s liquidity position and cash flows, and the expected timeliness of support. If the analysis concludes that the combination of a consistently strong liquidity position and cash flows and the anticipated support available to the institution are sufficient to ensure the institution’s ability to meet its financial obligations, the support assessment will usually play the dominant role in determining the final rating. As suggested in the typical mapping shown above, this is expected to be the case with a typical MFI placing above and right of the diagonal. However, the intrinsic assessment may negatively impact the rating if shareholders have failed to make adequate arrangements to meet the MFI’s potential demands for liquidity.

Similarly, there are at least two scenarios in which the intrinsic assessment might significantly exceed the support assessment (below and left of the diagonal). First, highly rated sovereigns might avoid explicit commitments to an institution, resulting in a support assessment well below the combined credit rating of the core shareholder group. Second, lower rated sovereigns might have legitimate reasons for pooling their resources into an MFI that is financially strong and can leverage lower cost financing than the sovereigns themselves, perhaps as a means of mutual support or risk sharing. In these circumstances, the final analysis tends to focus on the quality of governance and management within the institution and within core shareholder governments. Governments with a short-term focus
could have less of an incentive to preserve the long-term viability of the institution. If core shareholders are especially prone to crisis, they may have an incentive to drain liquidity or capital from the institution to meet their own pressing needs. If the analysis concludes that core shareholders form a reasonably cohesive group, face common vulnerabilities and demonstrate a willingness to push the institution into making high risk loans and investments, the support assessment may take on added weight in determining the rating. However, if the MFI has very sound governance practices, a diverse membership that is unlikely to experience similar and simultaneous economic and financial challenges, and is highly effective at managing risk (possibly due in part to its preferred creditor status), the intrinsic assessment is likely to exert greater influence over the final rating. As suggested in the typical mapping above, the final rating is usually not expected to exceed the support assessment by more than four notches. However, the considerations mentioned above could result in a final rating that deviates from the mapping shown.