Research Update:

# East African Development Bank Assigned 'A/A-1' Ratings; Outlook Stable

**December 19, 2024**

## Overview

- East African Development Bank (EADB) has a unique mandate focusing on small and midsize enterprises in member countries of the East African Community, serving a market gap that is important for the development of member countries.
- Although there have been significant improvements to the EADB's governance structure and risk management during the last decade, we believe the concentrated nature and low creditworthiness of the sovereign shareholders, who are all borrowers, could create an agency challenge in an extreme scenario.
- EADB has a solid balance sheet with a risk-adjusted capital ratio of 47.3% and very strong liquid coverage of its limited borrowings.
- We assigned our 'A/A-1' long and short-term issuer credit ratings to EADB.
- The outlook is stable, based on our expectation that the bank will execute on its policy mandate and increase its footprint in member countries, while maintaining a robust financial profile.

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## Rating Action

On Dec. 19, 2024, S&P Global Ratings assigned its 'A' long-term and 'A-1' short-term issuer credit ratings to the East African Development Bank (EADB). The outlook is stable.

## Outlook

The stable outlook reflects our view that EADB will deliver on its policy mandate by increasing its footprint in member countries, while maintaining a robust financial profile. We expect all sovereign member states will continue providing EADB with preferential creditor treatment, as granted by the charter, and that nonperforming loans to the private sector will remain contained. We expect the banks' risk management and governance to continue strengthening and serve to uphold sound banking principles.

### Downside scenario

We could downgrade the bank if it does not execute its policy mandate by increasing purpose-related assets, which could suggest that its relevance was deteriorating. In addition, although unlikely, protracted arrears on any member's loan could result in a multi-notch downgrade. A significant drop in capital or liquidity could also put pressure our assessment of EADB's financial risk profile and could lead to a negative rating action.

### Upside scenario

We could upgrade the bank should it take significant steps to expand its operations, thereby deepening its impact in all member sovereign states. In addition, we could consider a positive rating action should EADB's shareholder base increase, especially through the addition of non-borrowing members with higher creditworthiness, which could balance the bank's concentrated nature.

## Rationale

**The ratings reflect our assessment of EADB's moderate enterprise risk profile and extremely strong financial risk profile.** EADB was established in 1967 as a key institution of the East African Community (EAC) and the three founding members of the EAC; Kenya, Uganda and Tanzania were also the founding shareholders of the bank. The bank was founded by treaty and enjoys special privileges, such as tax exemption, and other immunities. EADB's main focus has traditionally been on supplying financing through direct channels, but also via partner banks, to the small and midsize enterprise (SME) sector in primarily rural areas in member states. In 2024, it embarked on a new strategic plan, which expanded its scope to include financing solutions for infrastructure and regional development, where it would finance sovereigns or state-owned enterprises in projects that benefits the SME sector. We believe it fills a market gap for lending to primarily SMEs in rural areas, with longer tenors than banking systems in member countries can offer and at smaller loan sizes than other multilateral lending institutions (MLIs) provide. The SME sectors in member countries employ most of the population and are seen by shareholders as vital to enable growth and increased specialization for a more prosperous and inclusive economy.

**We believe the EADB has been successful at delivering on its mandate, which has been recognized by shareholders.** Although its loan book is small compared with that of other MLIs, we believe it reaches a large share of SMEs and, by its own estimates, its lending has created more than 60,000 jobs over the past five years as well as helped enable low-cost housing and schools in member states. We expect the bank's footprint will increase as it continues implementing its 2024-2028 strategy where sovereign lending will outgrow the private sector and represent about 60% of the balance sheet.

**The bank has received six recapitalizations by sovereign shareholders and Rwanda became a member in 2008, supporting its growth ambitions.** We recognize that, although member states have been supportive throughout the bank's history, they have limited resources to finance any significant capital increases. Coupled with delays on agreed recapitalization programs in the past and long instalment periods, we believe this is a constraint for our assessment. Nevertheless, EADB is contemplating a fourth capital increase and expects Burundi to join as its fifth sovereign shareholder once it has deposited its instrument of accession and paid the first installment. Beyond sovereign shareholders, the African Development Bank (AAA/Stable/A-1+) owns 7.7% of the shares and has supported both paid-in and callable capital increases over the years. In addition, several commercial banks have a small combined stake of just below 0.5%. We believe this helps balance ownership and provides for a good collaboration in member states.

**EADB was granted preferred creditor treatment by charter in 2012 but shareholders have always been current on their loans, indicating a pristine track-record.** Although sovereign lending has not been EADB's mainstay product, no loan to a member state has ever been in arrears despite several challenging economic periods when some shareholders defaulted to other creditors. We believe this indicates member states' strong commitment to the bank and we expect this key feature to continue as sovereign lending increases under the EADB's new strategy.

**We believe the EADB's concentrated nature and its sovereign borrowers' low ranking in governance indicators could create an agency challenge in an extreme situation.** The bank has undergone a significant overhaul of its governance standards and risk management in the past 15 years. This followed a period of turbulence in which loans to politically exposed persons went into non-accrual and triggered a reshuffle of the bank's management team. This situation unfolded despite the charter explicitly prohibiting any loans to be granted for political purposes. We believe the bank has since taken actions to prevent this from occurring again and establish protocols and polices to deal with these situations. Even though significant improvements have been made and we believe the bank has a conservative risk appetite and balance-sheet management, we believe the concentrated nature of its shareholder base could, in an extreme scenario, potentially create an agency challenge, posing risk to good governance.

**We believe the bank's management team is experienced and capable.** EADB is led by Vivienne Yeda, who has been at the helm since 2009. We believe she has been instrumental in leading the change of the bank into its current state. There are slightly more than 50 full-time employees, and we don't consider there to be any significant key-person risk because information sharing and knowledge about the duties of co-workers are well established in the bank. We believe the team has been executing in line with the shareholders' directives to clean up legacy problems and is now ready to expand the bank's activities.

**The EADB has a robust balance sheet and its risk-adjusted capital ratio stood at 47.3% as of year-end 2023.** The bank has an extremely strong capital position and equity is the main source of financing the balance sheet, standing at 71% of total assets. We believe that, although business expansion under its ongoing strategy will reduce the high capital ratio, this change will not be large and we expect the capital ratio to remain comfortably over 23%, our threshold for an extremely strong capital assessment. The bank's net income has been relatively stable over the past five years with an average return on equity of about 3%, but we do expect it to increase as the loan book expands. Considering the bank's very large equity base, we believe this is a competitive return compared to peers'.

**The EADB has a low amount of borrowings and funding comes mainly from other MLIs and development finance institutions (DFIs).** We regard funding as neutral to our ratings because we think the EADB's significant paid-in capital base is counterbalanced by the bank's lack of access to the wholesale market. EADB's borrowing is in the form of facilities provided by other MLIs and DFIs with tenors of up to 12 years, but about six years on average. We expect borrowings to ramp up over the next three years but not significantly, and we expect the composition will remain broadly the same. Although EADB has issued bonds in local currency markets in the past, we don't expect issuance on international markets in the coming years.

**Liquidity coverage of liabilities is very robust and comprises deposits with mainly non-regional highly rated banks.** EADB keeps all of its liquid assets in the form of deposits with several banks. They currently cover borrowings by more than 2x. Based on data at year-end 2023, and incorporating our liquidity haircuts, our liquidity coverage ratios for EADB, including scheduled loan disbursements, are 25.2x for six months and 15x for 12 months. This is very strong compared to peers'. Although we expect these ratios may decline in the next few years, we expect them to remain very high. Because EADB has recently started increasing sovereign lending, it typically has no meaningful undisbursed loan commitments. Coupled with the very strong ratios, we believe the bank can survive an extreme stress scenario without market access for 12 months and without withdrawing any principal resources from borrowing members.

## Ratings Score Snapshot

| Issuer credit rating | A/Stable/A-1 |
|---|---|
| Stand-alone credit profile | a |
| Enterprise risk profile | Moderate |
| Policy importance | Strong |
| Governance and management | Weak |
| Financial risk profile | Extremely strong |
| Capital adequacy | Extremely strong |
| Funding and liquidity | Strong |
| Extraordinary support | 0 |
| Callable capital | 0 |
| Group support | 0 |
| Holistic approach | 0 |

## Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, July 26, 2024
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Ratings List

| New Rating | |
|---|---|
| **East African Development Bank** | |
| Sovereign Credit Rating | |
| Foreign Currency | A/Stable/A-1 |

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.