Development Plan

2017-2019

CEB
COUNCIL OF EUROPE DEVELOPMENT BANK
BANQUE DE DEVELOPPEMENT DU CONSEIL DE L'EUROPE

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I. Development Plan 2014-2016: key features and achievements

Main tenets of the Plan

1. The Development Plan 2014-2016 was approved by the Governing Board in November 2013 as a roadmap for the Bank's activities over the three years beginning January 2014. It was elaborated in an environment in which the consequences of the financial and economic crisis were still keenly felt, with pronounced negative impacts on social cohesion, human capital and the development potential of future generations. The decline in new investments in the social sphere due to lack of fiscal space, and the on-going deleveraging in the financial sector that severely hindered MSME access to credit, started to weigh heavily on the CEB's traditional lending base.

2. In this context, the Development Plan 2014-2016 sought to maximise the CEB's contribution to strengthening social cohesion in Europe, thereby further enhancing the Bank's relevance and its role as a major instrument of solidarity policy promoting the values of the Council of Europe.

3. The strategic focus of the Plan was aimed at strengthening the Bank's mission to support social investments and at increasing the social content of its operations by:

   - enhancing support to social investments through additional technical assistance and greater flexibility;
   - strengthening co-operation with European Union Funds at country level;
   - contributing to bridging funding gaps in the social sectors;
   - increasing support for job creation and preservation by introducing "Supporting Micro-, Small and Medium Sized Enterprises" as a Sectoral Line of Action in its own right;
   - continuing to innovate in its current lending and non-lending activities.

4. Geared towards improving the Bank's operations in qualitative terms, the CEB's Development Plan 2014-2016 reflected the CEB's responsiveness to evolving borrower needs through an optimal and innovative use of resources, a judicious risk-taking approach and systematic screening of the social content of projects through a "two-pronged approach" (2PAP) methodology[1].

5. Importantly, the Plan introduced new financing instruments and adapted the existing ones in a bid to respond ever more efficiently to the needs of its member states in the social sectors. In particular, the introduction of the EU Co-financing Facility (ECF) enabled better articulation with the characteristics of EU Funds and supported their absorption, while the Public Sector Finance Facility (PFF) was intended for bridging the gaps in public entity funding in the social sectors. In addition, there was further reflection on the question of the CEB's participation in public – private partnerships (PPPs) and in equity programmes, and concerning the use of micro-credit.

6. In terms of operational benchmarks, and while maintaining the 60:40 ratio between the Target and Non-target Countries, the CEB's global disbursements under the Development Plan 2014-2016 were set to reach € 1.8 billion per year on average – including € 1 billion per year on average in the Target Group countries – over the plan's implementation period, allowing for +/-10% flexibility, justified by the unpredictability of market parameters.

7. In a difficult economic and financial environment that continued to require a policy of prudent risk management, the main tenets of the Development Plan were underpinned by the new prudential framework, adopted in 2013, which provided the necessary tools for addressing the emerging risks.

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[1] Starting in 2012, new impetus was given to increasing the added value of the Bank's actions by introducing screening instruments to better determine the social value of projects through a so-called "two-pronged approach" methodology and better use of lessons learned.

Key achievements of the current Development Plan

A. 2014 – 2015 achievements in line with expectations

8. Implementation of the current Development Plan has so far demonstrated the Bank's success in providing effective financing for high social value projects across its membership base. The operational objectives of the current Development Plan have remained on track over the implementation period, with results consistently meeting the established targets.

9. The baseline scenario was strictly respected over the period 2014-2015. Project approvals averaged € 2.2 billion, while loan disbursements averaged € 1.8 billion. Loans outstanding amounted to € 13.1 billion at year-end 2015, 58% of which consisted of operations in favour of Target Group countries.

10. In the context of shrinking public and private investments in the real economy, the Bank has continued to support investments in the public sector, particularly where the infrastructure stock has become depleted, obsolete or insufficient and is consequently in need of upgrading, renewal or expansion. The investments supported local infrastructure in general, education and health as well as enhanced energy efficiency and general improvements in operational efficiency.

11. These financings were often carried out via the ECF and the PFF. Financings through these instruments taken together accounted for 20% of all approvals in 2015. Fully in line with the Europe 2020 objectives, both new financing instruments have proved versatile in their practical application by the Bank and were welcomed by borrowers as tools for addressing investments in diverse sectors of action, conceived and planned in a coordinated manner and in accordance with each borrower's respective capabilities and available financial resources.

12. On-going support to job creation and preservation in micro, small and medium-sized enterprises has been reinforced, as the CEB has devoted particular attention to this sector: 16 out of 37 programme loans approved during the 2014-2015 period were concerned with this sector, representing a cumulative CEB financing volume of € 1.1 billion, with 74% in Target Group countries.

13. Support to social investments has been further bolstered through stronger use of Technical Assistance (TA) for project preparation and implementation. Consequently, technical assistance and investment grant disbursements almost doubled between 2014 and 2015, rising from € 30 million to € 59 million. The Bank's own technical services also provided increased support to help borrowers prepare and implement challenging projects; in 2015 a total of 82 missions were accomplished with most (82%) concentrated on projects in the Target Group of countries.

14. Enhanced cooperation with the EU, other multilateral development institutions and donor countries has been given particular importance through the CEB's participation in several international cooperation schemes. These covered 23 projects out of a total of 50 approved. Cooperation with the EU has enabled the Bank to provide increased support to its most social and challenging projects.

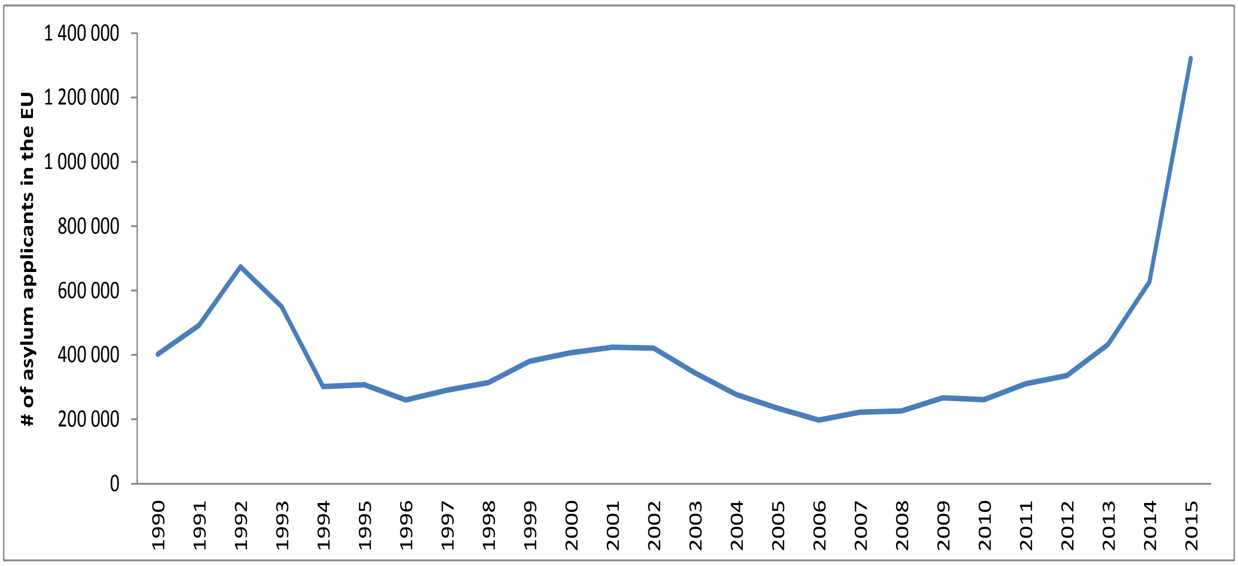
15. In line with its social mandate in the field of aid to refugees, migrants and displaced persons, the CEB has continued to play a major role in the Regional Housing Programme (RHP)[2]. Through its fiduciary role, the CEB provides assistance to the Partner Countries in preparing and implementing their housing projects and monitors the use of grants disbursed from the RHP Fund. The CEB is also responsible for managing the RHP Fund as well as facilitating coordination between all RHP stakeholders during the preparation and implementation phases. Since it was set up in 2012, a total amount of € 187 million in grants were committed to the RHP by donors, out of which an amount of € 124 million was contracted by the CEB with the beneficiaries at the end of June 2016.

[2] The Regional Housing Programme (RHP) is a joint initiative by the four partner Countries (Bosnia and Herzegovina, Croatia, Montenegro and Serbia) aimed at resolving the protracted displacement of refugees and displaced persons since the 1991-1995 conflicts in former Yugoslavia

B. Prospects for 2016: an exceptional year at the end of the current Development Plan

16. In 2015, Europe was faced with a massive influx of refugees and migrants and a resultant increase in the number of applications for asylum in some CEB countries, members of the EU (see Diagram 1 below). The dramatic numbers of arrivals led to a humanitarian crisis in Southern European transit countries with profound consequences for the entire continent. Immediate response was called for by the Council of Europe and provided for under the European Agenda on Migration, adopted by the EU in May 2015.

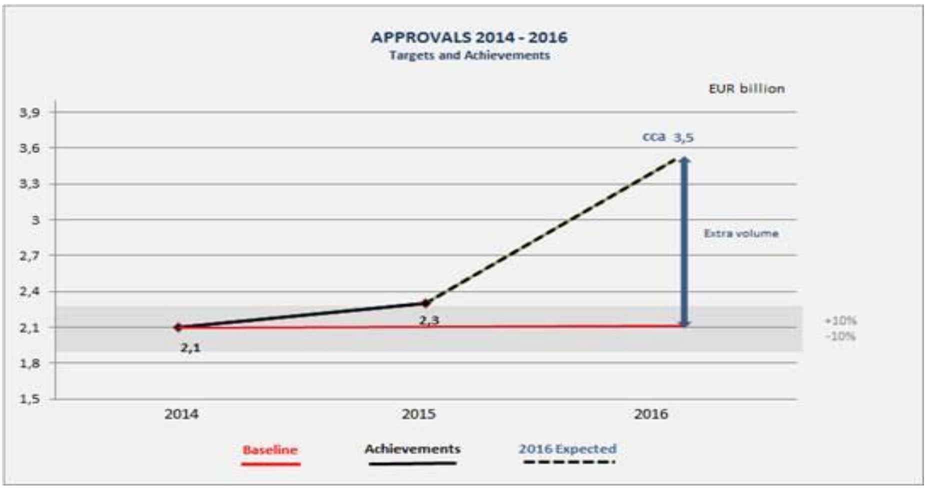
Diagram 1: Asylum applications in the EU, 1990-2015



Source: UNHCR (1990-1997), Eurostat (1998-2015)

17. In the midst of this crisis that erupted in the summer of 2015, the CEB – in line with its historic mandate – responded by setting up the Migrant and Refugee Fund (MRF), a grant-based financial instrument to help member countries deal with the unprecedented influx. MRF grants aim to support CEB member states' efforts to ensure that migrants and refugees who arrive on their territory enjoy basic human rights such as shelter, food and medical aid, as well as personal security.

Diagram 2: Outlook for CEB Project Approvals in 2016



18. The initiative met with strong shareholder support and the mobilisation of members and non-members alike provided more than € 18.8 million in contributions[3], fully allocated as emergency aid to a number of "transit" countries[4], as of 1st of September 2016.

19. Moreover, the crisis has brought to the forefront the broader issues of longer-term integration of refugees, migrants and other vulnerable groups. Beyond the already approved projects related to emergency support, mainly financed via the MRF, the CEB has started to provide financial support to projects that facilitate access to housing, labour markets, education, and healthcare as key to avoiding segregation and to facilitating the long-term integration of migrants and other vulnerable populations.

20. Already, the level of operations has surged as projects approved by the end of September 2016 represented € 3.3 billion and additional projects amounting up to € 200 million are expected to be submitted for Administrative Council approval in November. To a large extent, this exceptional development reflects the additional demand from the countries of Western and Northern Europe and is largely linked to the current immigration situation. In this respect, the year 2016 promises to prove extraordinary in terms of project approvals, close to 50% increase over the previous levels. Moreover, since in some countries not directly concerned by migration flows the economic environment shows signs of improving, the governments have begun to invest more in social sectors such as education, health and local infrastructure, and thus have revived the cooperation with the CEB (see Diagram 2 above).

21. The fact that the Bank may record an additional € 1½ billion more in its operations than the operational orientations set out in the Development Plan 2014-2016 underlines the fact that social needs remain pressing across the CEB's membership base, despite different national contexts. These trends also pay tribute to the CEB's capacity to adapt rapidly to the needs of its member states and emphasize its social mandate.

C. Improvement in key prudential ratios

22. From the credit risk point of view, the composition of the CEB's loan portfolio has improved during implementation of the current Development Plan so far.

23. The CEB Capital Adequacy Ratio (CAR)[5] improved steadily in the two years of the implementation of the current Development Plan. It reached 26.3% at the end 2015, up from 22.6% at the end 2013 due to improved creditworthiness of the loan portfolio (resulting in lower risk-weighted assets) and a steady increase in equity from earnings. Meanwhile the Indebtedness Ratio[6] also improved by going down from 7.7% at the end 2013 to 6.2% at the end 2015.

24. These improvements reflect the result of the Bank's prudent risk management, especially given the CEB's relatively narrower capital base compared with that of its peers, which, in the rating agencies' view, makes it more exposed to shocks.

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[3] As of 30th of September 2016, contributions were committed by Germany, France, Sweden, Luxembourg, Norway, Slovak Republic, Ireland, Lithuania, Poland, Cyprus, Albania, Czech Republic, Holy See, San Marino, Malta, Iceland, Liechtenstein, the European Investment Bank (EIB) and the CEB Social Dividend Account (SDA).

[4] "the Former Yugoslav Republic of Macedonia", Greece, Serbia, Portugal, Slovenia, Croatia and Albania.

[5] Review of the CEB's Prudential Framework: Capital Adequacy Ratio is calculated as usable equity over risk weighted assets. The CAR measures the capacity of the bank to cover any losses that might arise from its assets (loans and treasury portfolios).

[6] Review of the CEB's Prudential Framework: Indebtedness Ratio is calculated as total debt outstanding (debt evidenced by security after swap, ECPs, bank advances and term deposit accounts without collateral) after swap compared to Prudential Equity (paid-in capital, reserves and net profit).

D. Cost-to-Income Ratio

25. The CEB's policy over recent years has been to keep the cost-to-income[7] ratio within a bracket of 25-30%. For 2015, the ratio stood at 28.5%, after 24.3% for the previous year. The ratio should reach a level of around 30% in 2016, and will be under further pressure in the coming years. Besides moderate but steady budget growth, the reason for the increase in the ratio is first and foremost the gradual decline in the Bank's income in the current low-interest rate environment.

26. However, an annual benchmarking exercise has been conducted which shows that the CEB compares favourably to its peer group composed of 10 IFIs. It should be noted that most IFIs are facing increasing pressure on their profitability, stemming from the low-yield market context.

II. The current context

27. The lingering effects of the 2009 financial crisis, still keenly felt across Europe, doubled by the shock created by the United Kingdom's vote to leave the European Union, are marking the current context. The "Brexit" vote brought with it important uncertainties with economic implications, heightened volatility in financial markets and lower confidence levels and a consequent impact on growth. All these might affect monetary policies and investment in several CEB countries with consequences in the social sectors. In addition, the United Kingdom's vote could fuel nationalistic sentiment (and Euroscepticism) across several CEB countries. Thus programmes related to long-term integration of people with a migrant/refugee background are more important than ever.

28. In this context, in response to the on-going migrant and refugee crisis, added public investments in the social sphere (especially housing) are already taking place in several countries. Moreover, according to the European Commission, the Investment Plan for Europe (so-called "Juncker Plan") is expected to provide an up-tick in public and private investments as implementation is expected to start on a growing number of projects under the scheme. Nevertheless, narrow fiscal space and tighter debt control continue to curtail public spending in many CEB member states.

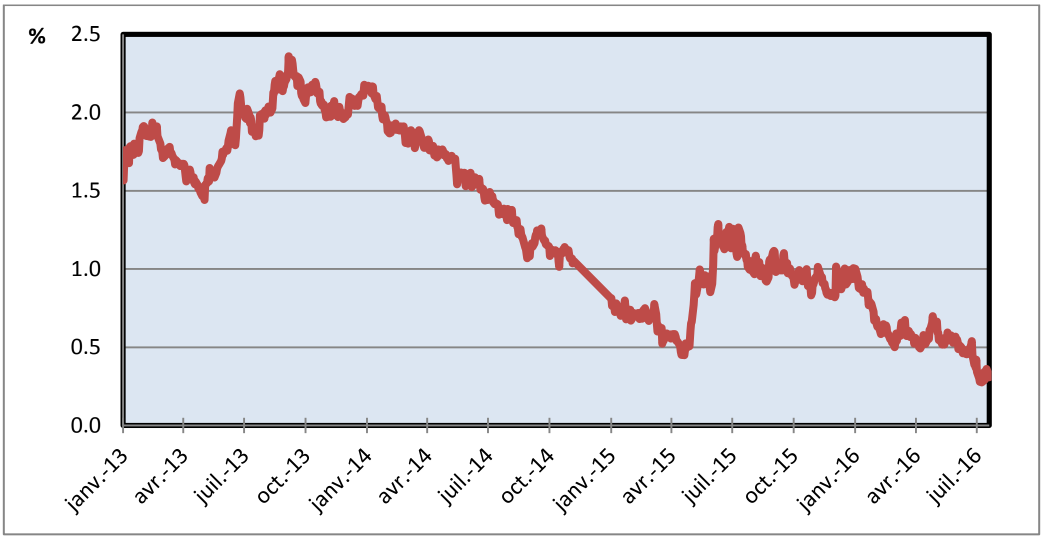
29. Although high structural unemployment, especially among the young, represents a still very tangible legacy from the crisis, improved cyclical conditions, contained wage growth and labour market reforms in some places have been contributing to positive trends in the labour markets. Thus, while unemployment disparities among countries (and regions) are set to persist, the unemployment rate in the euro area is expected to shrink from 10.9% in 2015 to 9.9% in 2017[8].

30. The European economic outlook is nevertheless exposed to considerable downside risks on the back of several factors, such as a sudden increase in the price of oil, slower than expected world growth, especially in China, or more pronounced geopolitical tensions.

31. Given the on-going accommodative monetary policy stance, a low interest rate environment continues to persist in Europe (see Diagram 3 below). Meanwhile, the easing of borrowing conditions and reduced financing costs, coupled with the waning of corporate deleveraging pressures and capacity utilisation rates above their long-run average have set the stage for acceleration in MSME and corporate investments. However, as the EU financial sector continues to underperform, the accommodative monetary policy stance will make for a more challenging environment for the CEB in the years to come.

[7] The cost-to-income ratio assesses the operational performance of a banking entity. It corresponds to the share of the net banking income that is consumed by administrative expenses. For the purpose of monitoring the ratio effectively over time and making it comparable with those of peer institutions, adjustments are made by eliminating "fair-value" effects in the net banking income, and by netting certain management fees from fiduciary activity against administrative expenses.
[8] Source: European Commission European Economic Forecast Spring 2016.

Diagram 3: Trends in Euro 10-year interest rates since 2013



32. The continually changing banking regulation environment may impact IFIs, including the CEB. Requirements in line with IFRS 9 rules, especially as regards provisions on loans at inception, will have an effect on the interplay between capital requirements and the required level of provisions, and, among other things, will result in the creation of loan loss provisions. This in turn could impact the profitability of IFIs, including the CEB's.

33. At the same time, the adoption of the post-2015 Development Agenda and the global agreement reached at the Paris Climate Change Conference gave new impetus to sustainable development for the years and decades ahead. In a joint statement released at COP21[9], the world's six largest Multilateral Development Banks (MDBs) pledged to increase their climate finance, to leverage funds from other sources, and to support the outcomes of the Paris conference through 2020. For its part, the European Union's 2030 climate & energy framework, agreed in October 2014, sets key targets for the year 2030: a minimum 27% share for renewable energy and a minimum 27% improvement in energy efficiency. Such commitments will necessitate substantial additional investments in the area of climate change adaptation and mitigation measures in the years to come.

III. Strategic Orientations

Lines of Action

34. In preparation for the Bank's new Development Plan, the Collegial Organs commenced the debate on the CEB's strategic perspectives in June 2015. The thematic debates focused on the CEB's response to the major long-term challenges facing Europe today as well as on ways in which the Bank can continue to pursue its mission and reaffirm its relevance, effectiveness and distinctiveness in the face of a fast-changing, complex environment.

35. The lines of action approved by the Administrative Council and confirmed by the Governing Board are as follows:

- Sustainable and inclusive growth with emphasis on socially oriented components and particularly on public infrastructure with a social vocation, job creation and preservation, access to labour markets, housing and integration of vulnerable groups.
- Integration of refugees, displaced persons and migrants.
- Climate action: developing mitigation and adaptation measures.

[9] http://www.worldbank.org/content/dam/Worldbank/document/Climate/Joint%20MDB%20Statement%20Climate_NOV%2028_final.pdf

36. The Governing Board agreed that these lines of action are to underpin the upcoming Development Plan and give the general direction for the Bank's activity without prioritising one above the others. Meanwhile, the Organs underlined the importance of strengthening the social content of CEB actions and of the CEB's comparative advantage as "the social development bank" in Europe. Acting within the framework of the Council of Europe, the CEB supports its social and environmental priorities and principles aimed at protecting human rights and the rule of law.

Box 1 – The CEB and the Council of Europe. Set up under a Partial Agreement of Member States of the Council of Europe, the CEB is subject to the Council's "supreme authority" (Article I "Establishment of the Bank" of the CEB's Articles of Agreement).The CEB has nonetheless a separate legal identity and full financial independence, both essential conditions for operating as a fully-fledged bank. Acting within the framework of the Council of Europe, the CEB supports its principles, values and overall objectives. Successive Council of Europe Summits, held at the highest political level of Heads of State and Government, have each given new impetus to the Bank's action and contributed to shaping its current identity as the social development bank in Europe. In all, relations with the Council of Europe are at the very core of the CEB's identity and, in some ways, they constitute the Bank's distinctive "brand" within the community of international financial institutions. The preparation of the Development Plan 2017-2019 has duly considered key European priorities addressed by the Council of Europe: at the Joint Meeting in June 2015, the CEB's collegial Organs debated on the ways in which the Bank can best address the challenges of ensuring "renewed and sustainable growth in Europe", improving "social cohesion in order [inter alia] to reduce the risk of radicalisation" and supporting "the collective fight against climate change". These challenges were thus taken up by the Bank as a basis, among others, for designing the Bank's revised lines of action. Consequently, the sectoral challenges of particular relevance for the Bank's role and contribution in the years ahead have been defined as: "Sustainable and inclusive growth" with focus on socially oriented projects, "Integration of refugees, displaced persons and migrants" with emphasis on medium to long-term integration, and "Climate action: developing mitigation and adaptation measures".

37. In parallel, the Administrative Council also approved proposals related to adopting a cross-sectoral approach that will enable the CEB to better encompass both the greater complexity of the development projects it finances and the full added value of its own contribution.

38. Taken together, the new sectoral lines of action for the upcoming Development Plan serve to translate the CEB's social mandate into operational terms. While mirroring the core long-term challenges facing Europe today, they also take account of a rapidly changing context, making it possible to improve and adapt the instruments at the Bank's disposal so as to ensure it can provide an effective response to borrowers and make a contribution to social development.

39. As emphasised by the Administrative Council, the financial instruments, both lending and non-lending, as well as the methodologies related to screening, monitoring and assistance to project preparation and implementation, should reflect the Bank's trademark and socially-oriented specificities and yield comparative advantages for the CEB with respect to its peers.

A. Sustainable and inclusive growth

40. This line of action, in alignment with the key long-term objectives for Europe, reflects sustainable and inclusive growth with a socially oriented approach as the overarching goal of the CEB as a social development bank. Consistent with the EU and non-EU member states' long-term strategic investment initiatives, sustainable and inclusive growth also integrates environmental safeguards and energy efficiency considerations into the objectives and priorities of any given investment. Having consistently promoted this approach, the Bank is well-positioned to strengthen its position as a privileged partner in social development areas that increasingly require cooperation due to the sheer scale of the issues at stake.

41. Under the general heading of "sustainable and inclusive growth", the Bank has identified several fields of particular focus, namely public infrastructure with a social vocation, job creation and preservation, access to the labour market, housing and integration of vulnerable groups.

42. The tenets of sustainable and inclusive growth place particular emphasis on vulnerable groups and the importance of reducing inequality and poverty. Projects related to access to the labour market[10], social and solidarity economy services, housing, local infrastructure and energy efficiency all provide solutions for alleviating vulnerability situations. Since they often share complementary objectives, they are better served when tackled through a global approach rather on a stand-alone basis.

43. For instance, increasingly considered by public authorities as an instrument for fighting and preventing poverty[11], housing programmes often address important cross-sector needs of different categories of populations and cohesive communities, including but not limited to vulnerable groups, including migrants/refugees.

44. Integrated projects that combine housing and community services – such as education, health, accompanying child or social welfare facilities – provide more focused support and may thus contribute in a more substantive manner to social cohesion or to solving gender inequality issues.

45. Gender inequality will be addressed by the Bank as a cross-cutting, structural disadvantage, considered in the framework of the social aspects of the projects it finances. The Bank will deploy efforts for the identification and mainstreaming of gender equality actions during the appraisal of its projects in an effort to influence gender dynamics, reduce inequalities and improve the social outcome of its investments.

46. In response to severely curtailed investment levels following the global financial and economic crisis, the Investment Plan for Europe, introduced in 2014, seeks to provide a mechanism for coordinating efforts at European level to bring investments back in line with their historical trends by removing obstacles to investment, providing visibility and technical assistance to investment projects and making better use of new and existing financial resources. Within this, the CEB sees its role as a provider of "downstream", i.e., close to final beneficiaries, support to local development banks and local communities in order to fill the financing gaps for successful implementation of socially-oriented investments registered as national priorities.

B. Integration of refugees, displaced persons and migrants

47. The CEB's Articles of Agreement state that the primary purpose of the Bank is to help in addressing the social problems with which European countries are or may be faced as a result of the presence of refugees, displaced persons and/or migrant flows.

48. The CEB's emergency assistance focuses mainly on the provision of accommodation facilities. In the longer term perspective, the CEB provides financing for local infrastructure, decent and affordable housing, language acquisition, skills development and job creation to help those entitled to stay to integrate as effectively and quickly as possible. Depending on the type of assistance needed, the CEB provides loans and, in occasional specific cases, grants.

49. Above and beyond the current unprecedented migrant and refugee crisis in Europe, migratory pressures across CEB member countries are expected to increase over the coming decades, driven by economic and non-economic (e.g. demographic, political and environmental) factors. The integration of migrants and refugees is in itself a complex multi-dimensional, long-term challenge that goes

[10] See various projects related to micro-credit, or preparatory steps for labour market integration as those related to vocational training or the support for student loans programs or the "business incubators" initiated by the local authorities.

[11] In 2013, 24.5% of the population of the CEB member states, members of EU, were at risk of poverty or social exclusion. See also: http://ec.europa.eu/eurostat/statistics-explained/index.php/People_at_risk_of_poverty_or_social_exclusion

beyond economics and labour markets. It implies social, educational and spatial aspects – all closely interrelated, with failure in one area having negative implications for the rest.

50. Multi-sector integrated programmes will become an essential element of the response by recipient countries in the years to come. While not explicitly labelled as projects in favour of refugees, migrants and displaced persons, the added value of such projects is based on their direct and indirect social impact on migrants in addressing different but essential and complementary needs.

51. A multi-sector approach in the field of integration of refugees, displaced persons and migrants will require enhanced financing instruments that can facilitate blending mechanisms combining grants and loans, increased reactivity on emergency aid, and bridge finance, since a timely, customised response remains extremely important in such programmes.

C. Climate action: developing adaptation and mitigation measures

52. This line of action is of a more crosscutting nature, since the underlying objective is to mainstream climate action measures in all of the Bank's activities and projects. In so doing, the CEB is playing its part in the global effort to fight against climate change and to foster the environmental transition to low-carbon economies; here the Bank can usefully build on the steps already taken to tackle environmental issues, while maintaining its social focus.

53. The CEB already has a long history and broad experience of tackling environmental challenges both through its "Managing the Environment" – sectoral line of action and via the environmental screening and impact assessment carried out on all its projects.

54. "Aid to victims of natural or ecological disasters" constitutes one of the CEB's two statutory priorities. Its scope, as that of other environmental projects financed by the Bank, has widened over time from immediate emergency response to long-term preventive action:

- Environmental protection: upgrading infrastructure (solid waste, water and wastewater management).
- Climate change mitigation: "greening" the built environment (energy efficiency in buildings, cleaner and renewable energy, and sustainable public transport).
- Climate change adaptation: strengthening resilience to (extreme) climate events (urban and rural adaptation), and disaster risk management.

55. The CEB has gradually tightened its screening of the environmental standards and policies adopted and implemented by intermediating financial institutions, both for public investments and for MSME financing. These rigorous standard procedures act as safeguards, providing additional assurance that the CEB's Environmental Policy standards are respected during project appraisal and implementation.

56. The bulk of climate protection and mitigation investments, ranging from energy efficiency in transportation or buildings to the treatment of solid or liquid waste, are expected to be promoted by the public sector. Although many may be of a smaller scale, when taken collectively, these programmes have a considerable socio-economic and environmental impact, tying in closely with the theme of sustainable and inclusive growth.

57. With rare exceptions, all CEB-financed projects and programmes already include climate adaptation and mitigation measures; particularly since necessary measures are incorporated during the appraisal stage. In addition to continuing to address environmental investment needs with a social focus, the CEB intends to further mainstream environment and climate change considerations across all projects registered in the Bank's pipeline.

Further emphasis on quality, added value and innovation

A. Making projects financially sustainable

58. Grants provide a way for the CEB to overcome the lack of financial capacity of borrowers. The Bank uses grants in various ways to achieve this result, in the first instance with grants being used to finance the early stages of project preparation. The CEB may thus finance, through a grant, part or even all of a project. Alternatively, the CEB may, by means of a grant, subsidise the interest on the loan it provides. Both grants reduce the project implementer's financial burden, by decreasing the amount of capital or interest that must be paid back. Alternatively, the Bank may set aside grant funds to guarantee a loan that it provides. Loan guarantees reduce the risk of a loss for the Bank if the borrower defaults on its loan. They enable the Bank to provide a loan to a project sponsor who, on their own, would not meet the Bank's stringent risk management requirements.

B. Ensuring project quality and social outcomes

59. The CEB's Staff Resources are key to ensuring quality and representing the CEB's Added Value. In recent years the CEB has significantly changed its operational modalities to address the increased need to improve the design and quality of the challenging projects it is called upon to finance, particularly in the Target Group of countries. CEB services are called to work much more closely with borrowers to improve design, scope and implementation modalities, at an earlier stage in project development. Most of the projects implemented needed several technical missions – often involving the use of specialist consultant support – before the project could be ready for consideration for financing by the Administrative Council. The need for this close and staff-resource intensive support continued throughout implementation; it is for this reason that 82% of the reviews of the Bank's technical services were focused on projects developed in the Target Group of countries.

60. Technical assistance grants complement the work of CEB staff on these difficult projects. They are used both to improve project quality at entry and to enhance the project sponsors' implementation capacity. This support enables project implementers to meet the Bank's requirement that projects are implemented in accordance with best practices, while keeping project ownership with the implementers. Both the staff work and the technical assistance grants represent the CEB's added value, and through the focus on institution building, deliver enduring benefits in terms of capacity building.

C. CEB fiduciary operations

61. All in all, grants and guarantees act as catalysts. They enable the CEB to support highly social projects it could not otherwise finance and helps ensure that such projects are effectively implemented. In the coming years, the Bank will continue to increase its grant support, alongside its loan operations. To do so, the CEB will focus on several major areas: first, raising more funding from Donors, second, further aligning the Bank's fiduciary activities with its evolving strategic priorities and third, deploying further efforts on risk-sharing instruments with donors/member states and international organisations.

D. Sustainable funding

62. The CEB strives to remain innovative not only in terms of the lending instruments it offers to its borrowers but also in terms of keeping pace with market developments. In this respect, and as "the" social development bank in Europe, the CEB is also considering the possibility of issuing its first Sustainability Bond.

E. Raising supplementary funds from Donors

63. The blending of grants and loans has become an important tool for the CEB to increase the quality and sustainability of its projects, as detailed above.

64. The Bank will therefore continue to participate in EU facilities such as the Western Balkans Investment Framework, the Neighbourhood Investment Facility and the Eastern Europe Energy Efficiency and Environment Partnership (E5P), and will seek closer cooperation with the managing authorities in member states since they manage a large share of European Union Funds. The CEB may also seek to benefit from EU guarantees or other risk-mitigation mechanisms, when and where deemed appropriate and provided that adequate conditions are met in the future.

65. In parallel, the CEB will strive to raise more donor funding, develop its fiduciary accounts and respond to needs with specific instruments, as in the case of the MRF.

F. Further strengthening European and international cooperation

66. The EU and its institutions are partners of choice for the CEB, given the numerous and deep geographic, statutory and sectoral interactions between them. First, 26 of the Bank's member states are already members of the EU and a majority of the remaining 15 may aspire to join it. Furthermore, the CEB shares many objectives endorsed by the European Commission and by the European Investment Bank (EIB). As a result, the Bank's partnerships with European institutions reinforce its operational capacity and expertise. In the context of its Development Plan, the CEB will therefore be striving towards strengthened cooperation with the EU, which will ensure that it continues to promote its now generally acknowledged distinctiveness.

67. The CEB also intends to intensify and deepen its relations, in terms of financing and expertise, with other international financial institutions (IFIs) such as the EBRD, the World Bank Group or the Nordic Investment Bank (NIB) in areas of common interest. The Bank may partner on a case-by-case basis with international organisations such as the agencies of the United Nations whose mandates and activities are close to its own (UNHCR, UNDP, UNICEF) or the International Organization for Migration (IOM).

68. Since 2014, the CEB has been added to the list of ODA-eligible international organisations by the OECD, which testifies to recognition of the Bank's role in the field of social development. In addition to this, the CEB envisages enhancing its cooperation with the OECD, especially on matters related to growth, unemployment and migration to grasp the many social issues affecting its member states and to be in a position to respond to them with adequate project financing.

69. To sum up, the CEB will be seeking to enhance its visibility and to promote its specific know-how among all social development stakeholders in Europe.

IV. Lending activity constraints

Limited fiscal space

70. High debt, low inflation and low growth have increased the fiscal pressures in most CEB member states. Fiscal space is limited and, in many countries, the burden of public debt remains higher than previously forecast[12] with consequences on the capacity of these countries to borrow for investments related to the social sectors.

71. Indeed, in several CEB members states faced with budgetary constraints, governments are continuously concentrating their efforts on sectoral restructuring and structural reforms rather than on new investments.

[12] IMF 14/4/2016 "As a result, the ratio of debt to national income in Europe - currently 107.6 per cent of national income - is now only expected to begin to decline in 2017"

Considerable level of uncertainty

72. The CEB's environment is affected by a high level of economic and political uncertainty, stemming from both inside and outside Europe:

    i. In 2016, higher than budgeted spending on issues related to the integration of refugees and migrants is pushing up the demand for CEB loans in certain recipient countries. Nevertheless, in the current fragile political context, a sharp turnaround in national policies regarding the willingness to continue receiving and integrating refugees and migrants might bring about a sudden softening of this demand or lower its social content – one more reason for the Bank to strengthen its upfront social screening.

    ii. The on-going process of restructuring the banking sector in Europe might affect CEB business and the financial profile of the countries concerned. In several countries the process is mainly driven by the important efforts deployed by the banks to free up capital and concentrate resources where they can earn the best returns or generate business growth. In some cases the important share of non-performing loans is negatively affecting the process. In addition to the financial profile of some CEB borrowers, banks or countries concerned, the process might also affect the appetite of the banks for SME lending.

    iii. Important economic downside risks affecting CEB member states might come from the slowdown in emerging market growth which could turn out to be more pronounced than currently forecast and trigger considerable spill-overs with consequences on Europe's economy[13].

    iv. Meanwhile, uncertainty regarding the evolution of spreads might affect the CEB's competitive position in terms of spreads in certain countries vis-à-vis the EIB and other major AAA/AA development banks, and have a "crowding-out" effect on the CEB.

Highly competitive environment

73. The highly competitive environment in the banking sector, favoured by the ECB's target long-term refinancing operations (TLTROs) – first put in place in 2014 and currently extended to 2016-2017 – remain unchanged. Under TLTRO II announced in March 2016 by the ECB, the commercial banks will have access to ECB loans at a zero nominal rate further discounted depending on their activity in terms of the amount they lend[14].

74. Moreover, governments and local authorities can finance themselves on the local markets, in many cases at very competitive rates and without onerous monitoring requirements and quality constraints. In fact, local commercial banks are keen to lend to the public sector, especially given the existing difficulties in the corporate and SME sectors.

75. Close-to-zero or even negative interest yields on some parts of the yield curve in the case of several CEB borrowers might further affect the CEB's competitive position. In addition, the close-to-zero lending rates are pushing the banks, including the CEB's peer IFI group, to seek yields in longer tenors.

Financial limitations

76. For reference, a CAR of 20% is the minimum expected of an AAA-rated IFI by the rating agencies. It should also be noted that, although the CEB's prudential framework puts the CAR limit at 10.5%, in line with Basel Committee Banking Supervision requirements, in practice the Bank strives to keep its CAR above the 20% limit, in line with its peers.

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[13] Study European Economic Forecast, Spring 2016.

[14] The interest rate applied to TLTRO is fixed for each operation at the rate applied in the main refinancing operations prevailing at the time of allotment. All operations have a maturity of four years from their settlement date.

77. It should be noted that the Bank's capital base is strengthened exclusively by the incorporation of profits and reserves. However, in the context of low interest rates and intense competitive pressures, the Bank's net profit is expected to trend downwards.

78. Considering the still slow pace of global macro-economic recovery and the lagging improvement of credit risk in Europe, the CEB will be required to carefully balance the future volume of activity with its risk profile. Identifying and financing a greater proportion of projects with high social content and acceptable levels of credit risk – be it on a stand-alone basis, with guarantees or risk sharing instruments – will thus remain a persisting challenge for the Bank. Meanwhile a periodic review of the CEB's capital adequacy is recommended, in line with peer best practices.

V. The CEB Response

Support solutions to socially-oriented challenges

79. The CEB operates within the institutional framework established under the supreme authority of the Council of Europe; it therefore supports the Council's social and environmental priorities and principles aimed at protecting human rights and the environment. The Bank's approach in terms of social responsibility thus draws upon the principles enshrined in the Council of Europe Convention for the Protection of Human Rights and Fundamental Freedoms and the European Social Charter.

80. In the current context, the need to address the significant economic disequilibria and related long-lasting deterioration in the social situation in most of the Bank's member states remains a pressing challenge. The CEB's mandate is more relevant than ever and its response for the forthcoming Plan is therefore set around increasing the responsiveness and cohesion with CoE policies, and standing ready to respond to higher demands on "the" CEB's historical mandate.

Strengthening social screening and introducing new social safeguards

81. One of the CEB's most important specificities and comparative advantages is its capacity to screen upfront the social aspects of the projects it finances, and therefore to identify the social added value and ways to increase it during appraisal. Under the new Development Plan, screening will be fine-tuned according to type of project and lending instrument; the current "two-pronged Approach" project screening will therefore be revised and adapted to the particularities of each lending instrument. The screening will also include aspects related to climate change[15].

82. Also under the new Development Plan, the Bank will introduce Social Safeguards Screening during appraisal to ensure that potential adverse social impacts are addressed in a formal and timely manner. Its revised project appraisal process will thus include a step that screens for the likelihood of such social risks which may trigger application of the safeguard requirements to undertake further risk analysis and prepare mitigation measures when appropriate.

83. By combining this strengthened project screening (related to the project's expected direct social added value) with the new social safeguards dedicated screening (related to the potential negative consequences that the project might have during implementation), the Bank creates a strong basis for evaluation, covering both appraisal and implementation, which are the main phases of the Bank's direct responsibility on projects in the project cycle.

84. In light of the above the Bank will modify its Environmental Policy and related methodologies.

[15] Approved by the Administrative Council in March 2016 and the Governing Board in April 2016

Emphasis on the historical mandate

85. In the current context, the CEB underlines the importance of its historical social mandate with particular interest in socially oriented investments in all the countries in need and, in some of them, with particular focus on refugee/migrant hosting communities.

86. To emphasise the importance of fostering labour market integration for vulnerable groups, including people of migrant/refugee origin and facilitating job creation and preservation, the Bank will modify its Social Dividend Account Policy and allow micro-credit projects access to its risk-sharing instrument. Thus the Bank will get closer to CoE Resolutions related to microcredit and its role in the integration of these categories of population by facilitating access to the labour market for vulnerable groups.

Adjusted lending instruments

87. With the Development Plan 2014-2016, the Bank introduced two new lending instruments, namely the PFF and the ECF. Both new financing instruments have proved versatile in their practical application by the Bank and have been welcomed by borrowers as tools for addressing investments in diverse social sectors.

88. In an effort to respond to cross-sectoral needs, with the new Plan the Bank will introduce the Cross-sectoral Loan Programme (CSL) as a new type of Programme Loan. The CSL will cover eligible costs related to the development of social infrastructure in several sectors of action linked through a set of related aims and objectives as a cross-sectoral element defined during appraisal. This element will define the project's social added value; it should therefore be quantifiable and measurable in its various vectors e.g. number of beneficiaries from a vulnerable group, energy savings, etc.

89. CSLs will respond to the cross-sectoral needs of public authorities with the ultimate scope of facilitating access to the financing of socially oriented projects and thus boosting public investments in these areas. In preparing CSLs, particular attention will be paid to the country- specific situation and social priorities, with priority being given to disadvantaged areas, social and solidarity economy services, national or local priority programmes in social sectors as well as to communities hosting refugees and migrants.

90. CSLs will be available to public authorities, whether national, regional or municipal, as well as to state-owned development banks and other intermediating financial institutions in parallel with the other CEB lending instruments.

91. Under the new Development Plan, the CSL will be mentioned in the Loan Policy together with the Public Finance Facility (PFF) and EU Co-financing Facility (ECF), and will have a dedicated chapter in the Handbook for the Preparation and Implementation of Projects[16].

Keeping the three-year duration for the next Development Plan

92. As the current high level of uncertainty is set to continue, a new Development Plan with a duration of three years is therefore proposed. The Bank would thus be able to concentrate on the most appropriate response, adapt its instruments and show the same responsiveness in a continuously changing environment as under the current Development Plan 2014 – 2016.

Acceptable balance between credit risk and volume

93. In consideration of the current challenges concerning both the socio-economic situation and the evolution of credit risk in Europe, enhanced attention must be given to balancing the Bank's future volume of activity with its risk profile. Hence, as under the current Plan, the major determinants of the

[16] Handbook for the Preparation and Implementation of Projects is available on www.coebank.org

new Plan will be related to the challenge of achieving greater integration between high social content and affordable credit risk.

94. The CEB will increase its role by fostering the development of socially oriented projects with a pro-active business oriented approach. For this, it will combine all the institutional mechanisms at its disposal for the selection, monitoring and enforcement of social added value with the provision of loans at attractive interest rates in both Target and Non-Target Groups of countries. In particular, the Bank will continue to effectively exploit the potential complementarities between public and private sector financing operations.

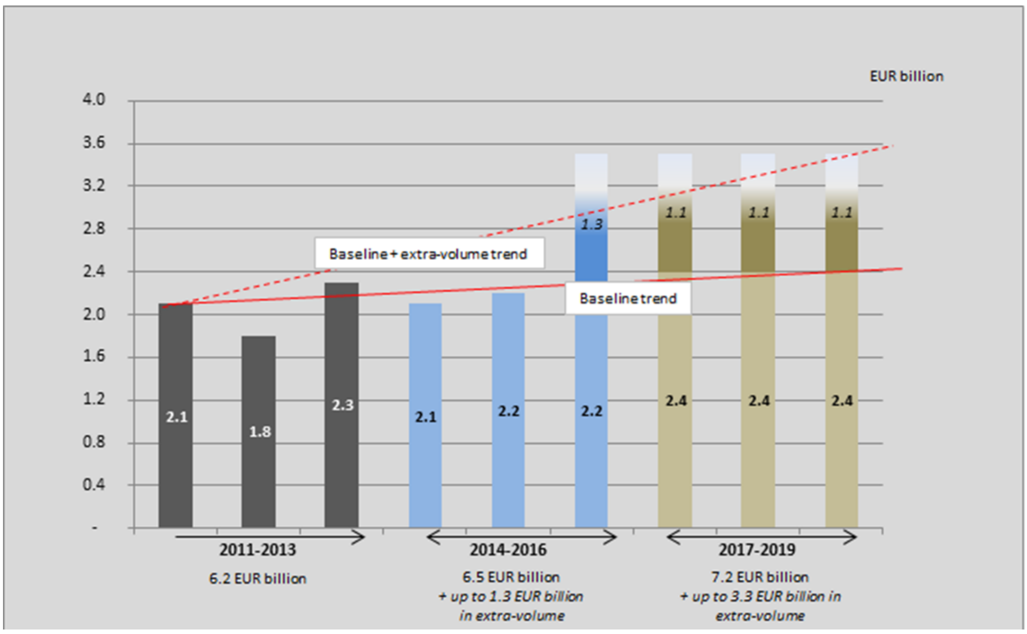
95. In a context of strong demand coming from communities hosting refugees and migrants, 2016 is emerging as an extraordinary year in terms of expected total volumes of up to € 3½ billion including around € 1.3 billion in approvals above and beyond the 2014 and 2015 baseline of € 2.2 billion.

96. Were the surges in financing demand coming from communities hosting refugees and migrants to persist and spill-over into 2017, then the apparently exceptional nature of 2016 would have to be put into perspective. Planning based on expected 2016 volumes means considering a possible new trend of extra volumes which, if confirmed, would mean the CEB taking into account an annual increase in approvals of up to 50% of the baseline for the coming three years, as presented in Diagram 4 below.

97. In this context, the Bank will strive to keep approval and disbursement volumes in the Target Group of countries within this trend and record disbursements of above € 1 billion in Target Groups of countries each year of the new Plan; this, however, will depend on the loan demand emanating from borrowers in those countries and the absorption capacity.

98. The baseline operational objectives allow the Bank to steadily increase its contribution to Target and Non-target Groups of countries, in continuity with the operational orientations of previous Development Plans. Nevertheless, an increase in the volume of approvals, even if substantial, may not lead immediately to a comparable increase in the volume of disbursements due to (i) the current low interest rate environment and resulting competitive pressures and high volatility on the market, and (ii) the specificity of the CEB's newly created lending instruments, mainly the EU Co-financing Facility and the Public Sector Finance Facility, which provide borrowers with long disbursement periods, adapted to the EU Programmes and budgetary needs.

Diagram 4: CEB Project Approvals (previous development plans and forecasts)



99. All the numbers are set with +/- 10% flexibility due to the considerable level of uncertainty, as detailed in Chapter IV above. The variations could be more important, if some of the risks listed in the current document materialise or the interest for investments in social sectors is higher.

Prudential Framework – close monitoring of parameters

100. The Bank is implementing a new Financial and Risk Policy. The aim of the CEB's new Policy is to maintain the solid financial standing of the Bank so as to allow it to pursue and achieve its social mandate with success. Against the background of current developments that stress the importance of the Bank's mission and call for redoubled efforts and commitments, the new policy is well-suited to accompany implementation of the new Development Plan. Coupled with the careful introduction of elements of flexibility in financial management to respond to changes in market and regulatory environments, the new policy preserves the CEB's prudent approach to its financial strategy and ensures the financial solidity of the Bank in the changing circumstances.

101. Meanwhile, it should be noted that the operational objectives of the new Development Plan assume a stabilisation of the CEB's risk profile and do not consider either the accession of new member states with considerable impact on the CEB's capital nor the Bank receiving additional paid-in capital.

102. Based on the current context assumptions, the CEB will strive to maintain and even improve the current Capital Adequacy Ratio levels and bring the Indebtedness Ratio to levels below 6.

103. In order to ensure the Bank's healthy financial position, as other IFIs are also doing, regular reviews of the capital adequacy will be carried out, especially taking into account the constrained profitability. The first exercise is planned for the first half of 2018.

Balance Sheet – increased efficiency

104. If the assumptions in terms of volumes are confirmed, the new Plan will allow the Bank to increase the efficiency of its capital by increasing lending without substantially increasing risks, through optimisation of the use of its financial resources. Depending on the trends in volumes mentioned above, the CEB's loan portfolio might go above € 14.5 billion during the period, thus potentially increasing its share in the Bank's total balance sheet. This would allow CEB member states to take full advantage of the CEB's balance sheet potential without putting its financial position at undue risk.

105. The new Development Plan aims to further strengthen the CEB's social label through the consolidation of the Bank's mandate and greater impact on projects within a context of increased allocation of the Bank's resources to its core business.

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