

## RATING ACTION COMMENTARY

# Fitch Affirms Council of Europe Development Bank at 'AA+'; Outlook Positive

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Fitch Ratings - Frankfurt am Main - 22 Jul 2022: Fitch Ratings has affirmed Council of Europe Development Bank's Long-Term Issuer Default Rating (IDR) at 'AA+' with a Positive Outlook.

A full list of rating actions is detailed below.

## KEY RATING DRIVERS

**Standalone Strength Drives Ratings:** CEB's ratings are driven by its Standalone Credit Profile (SCP), assessed at 'aa+'. The SCP reflects the lower of our solvency (aa-) and liquidity (aaa) assessments, adjusted upwards by two notches as a result of the bank's low-risk business environment. The Positive Outlook reflects resilience in the bank's solvency profile, which was on a positive trend pre-pandemic. Capitalisation and asset-quality metrics have remained robust despite the Covid-19 crisis and ongoing war in Ukraine.

**Uncertain Strategic Plan:** The bank is set to approve its strategic plan for 2023-2027 in December 2022. The plan will outline annual lending targets and key priorities for the bank. Discussions surrounding the adequacy of CEB's capital to support lending targets are ongoing among the bank's key administrative bodies. The prospect of Ukraine (CCC/UCO) borrowing from the bank, coupled with its large exposure to Turkey (B/Negative/6.7% of loans at end-2021) may add pressure to capitalisation and asset-quality metrics.

A paid-in capital increase could support capitalisation metrics and potentially offset the rising credit risk resulting from negative sovereign rating trends and the prospect of Ukraine borrowing from the bank. Fitch assumes the bank would seek to have a very limited share of direct exposure to Ukraine or seek recourse to credit-risk mitigating measures in line with the bank's prudent underwriting standards and strong asset-quality metrics.

**Very Low Credit Risk:** The bank faces 'Very Low' credit risk on its loan portfolio, reflecting its lengthy record of operating with no non-performing loans (NPLs) and the high credit quality of its borrowers (average rating of 'A-' as of end-2021). The average rating of the loan book has remained unchanged since 2018, after improving from 'BBB+'. The assessment also benefits from the bank's 'Strong' preferred creditor status (PCS) given its record on sovereign repayments and the share of sovereign-guaranteed lending (53% of total loans at end-2021).

**Increased Policy Importance:** CEB received strong demand from member states in 2020 and 2021 to provide funding to governments to address the health needs and social impact resulting from the pandemic, in line with the bank's social mandate. More recently, the bank has provided financing to governments and local authorities that support resettlement and assistance to Ukrainian refugees. In a sign of solidarity, CEB's member states have approved the accession of Ukraine to the bank with zero capital cost to the sovereign. Ukraine will become the bank's 43rd member state and eligible for financing from CEB. The prospect of a capital increase and guarantees from the EU (AAA/Stable) highlight the increased relevance of CEB for member states.

**Strong Capitalisation, High Leverage:** The 'Strong' capitalisation assessment balances an 'Excellent' Fitch usable capital to risk-weighted assets (FRA) ratio (38.1% at end-2021) and a 'Moderate' equity-to-assets (e/a) ratio (11.1% at end-2021). The large increase in lending in 2020 and 2021 has led to a mild rise in leverage and adds pressure to capitalisation metrics. Downside risk to capitalisation metrics are present in the absence of a capital increase or if the bank fails to rein in lending growth. Exposure to sovereigns rated in the 'B' category or below has risen following Turkey's recent downgrades and may rise further given Ukraine's ascension to the bank, which could add pressure to capitalisation.

**Very Low Solvency Risks:** In addition to 'Very Low' credit risk, CEB's solvency assessment benefits from 'Low' concentration risk (top five obligors at 21% of the total end-2021), its 'Very Low' market and equity risk and 'Strong' risk-management policies. The risk-management framework has recently been enhanced with the addition of certain liquidity, funding and market-risk limits, in line with best banking practices.

**Excellent Liquidity:** CEB's 'aaa' liquidity assessment reflects the bank's excellent liquidity buffers, strong credit quality of its treasury portfolio (54% rated above 'AA-' at end-2021), and strong access to capital markets. We expect coverage of short-term debt by liquid assets to remain well above the 1.5x 'Excellent' threshold by 2024 (2.6x at end-2021), in line with recent years'.

**No Support Uplift:** Fitch assesses extraordinary support from shareholders at 'a-'. The shareholders' capacity to support is based on the average rating of key shareholders assessed at 'A+'. Fitch applies a two-notch negative adjustment to the capacity to support to 'a+', to reflect a 'Weak' propensity of shareholders to support. The 'Weak' propensity accounts for callable capital not fully covering net debt and lack of paid-in capital increases throughout the bank's history.

## **RATING SENSITIVITIES**

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

**Solvency (Risks):** Continued excellent performance of the bank's loan book that leads to maintenance of the bank's 'Very Low' NPL ratio (below 1%). Reduced downward risks to the credit quality of the bank's borrowers, preventing deterioration in the average rating of the loan portfolio to below the 'A-' level as of end-2021.

**Solvency (Capitalisation):** Stabilisation or improvement in the bank's capitalisation metrics as evident by maintenance of the FRA ratio above the 35% threshold for an 'Excellent' assessment and an e/a ratio within the range recorded in recent years (11%-13%).

**Business Environment (Business Profile):** Increased policy importance as reflected in the approval of a capital increase or increased support from member states in the form of guarantees extended to cover credit risk

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

**Solvency (Capitalisation):** An increase in leverage or increased exposure to borrowers with weak credit quality, potentially caused by faster-than-expected loan growth, that reduces the bank's capital buffers, including deterioration in the FRA ratio to below 35%, and affects our 'Strong' capitalisation assessment

**Solvency (Risks):** Increased credit risk resulting from multiple negative sovereign rating actions, rising exposure to sovereign borrowers with weak credit ratings, or from an increase in NPLs

## **BEST/WORST CASE RATING SCENARIO**

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

## **Sources of Information**

The sources of information used to assess these ratings were CEB's financial statements, and other information provided by CEB.

## **REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING**

The principal sources of information used in the analysis are described in the Applicable Criteria.

## **ESG CONSIDERATIONS**

CEB has an ESG Relevance Score of '4[+]' for human rights, community relations, access & affordability. The CEB provides grants funded by donors to support projects in favour of migrants and refugees. It also subsidises certain loans to its most vulnerable borrowers to support social development, including social housing, education, and healthcare. This supports the policy importance of the bank. This has a positive impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

CEB has an ESG Relevance Score of '4' for rule of law, institutional & regulatory quality. All supranationals attract a score of '4'. Supranationals are neither subject to bank regulation nor supervised by an external authority. Instead, supranationals comply with their own set of rules. Fitch pays particular attention to internal prudential policies, including compliance with these policies. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

The ESG Relevance Score for labour relations and practices (SLB) has been changed to '2' from '3', given that restrictions on recruitment based on nationality or quotas is no longer considered to be relevant to multilateral development banks' ratings.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg)

RATING ACTIONS

ENTITY / DEBT ⚡	RATING ⚡			PRIOR ⚡
Council of Europe Development Bank	LT IDR	AA+ Rating Outlook Positive		AA+ Rating Outlook Positive
	Affirmed			
	ST IDR	F1+	Affirmed	F1+
senior unsecured	LT	AA+	Affirmed	AA+
senior unsecured	ST	F1+	Affirmed	F1+

[VIEW ADDITIONAL RATING DETAILS](#)

FITCH RATINGS ANALYSTS

Malgorzata Glowacka

Director

Primary Rating Analyst

+49 69 768076 279

malgorzata.wegner@fitchratings.com

Fitch Ratings – a branch of Fitch Ratings Ireland Limited

Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

Enrique Bernardez, CFA

Director

Secondary Rating Analyst

+44 20 3530 1964

enrique.bernardez@fitchratings.com

**Michele Napolitano**

Senior Director

Committee Chairperson

+44 20 3530 1882

michele.napolitano@fitchratings.com

**MEDIA CONTACTS****Peter Fitzpatrick**

London

+44 20 3530 1103

peter.fitzpatrick@thefitchgroup.com

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

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**APPLICABLE CRITERIA**

[Supranationals Rating Criteria \(pub. 11 Apr 2022\) \(including rating assumption sensitivity\)](#)

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Council of Europe Development Bank

EU Issued, UK Endorsed

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