CREDIT OPINION
2 November 2023

Update

RATINGS
Council of Europe Development Bank

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<td>Short-term Issuer</td>
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Contacts
Petter Bryman  +33.1.5330.3394
VP-Senior Analyst petter.bryman@moodys.com

Will Dallas  +33 153 303 428
Ratings Associates will.dallas@moodys.com

Dietmar Hornung  +49.69.70730.790
Associate Managing Director dietmar.hornung@moodys.com

Marie Diron  +44.20.7772.1968
MD-Global Sovereign Risk marie.diron@moodys.com

Council of Europe Development Bank – Aaa stable
Regular update

Summary
The credit profile of the Council of Europe Development Bank (CEB) reflects its strong asset quality and pristine track record of asset performance, as well as its high liquidity levels and strong access to funding. CEB’s main credit challenges are its high leverage ratio and the fact that it only has moderate levels of callable capital relative to peers, although these metrics are set to improve due to a very significant increase of the bank’s paid-in and callable capital which we expect will become effective at the beginning of 2024.

Exhibit 1
CEB’s credit profile is determined by three factors

Credit strengths
» A pristine asset performance track record and high asset quality
» A consistently strong liquidity profile and access to funding

Credit challenges
» A leverage ratio which is among the highest of rated MDBs
» Low levels of callable capital compared to highly-rated peers

Source: Moody’s Investors Service
Rating outlook
The stable outlook reflects our expectations that CEB's capital adequacy will balance an excellent asset performance and a declining leverage ratio against somewhat increasing risks to its asset portfolio in coming years, while the bank's very strong liquidity and funding profile will remain largely unchanged. Meanwhile, we expect that the level of shareholder support will remain strong in the wake of capital increase agreed at the end of 2022, with member states continuing to subscribe to the capital increase over the course of 2023 in line with their national ratification processes.

Factors that could lead to a downgrade
Downward pressure on the Aaa rating would build if CEB’s asset quality deteriorates materially beyond our current expectations or if there is a material deterioration of its asset performance, most likely as a result of its increasing exposure to Ukraine (Ca stable). Downward pressure could also build if the growth of CEB’s loan portfolio in coming years significantly exceeds the plans laid out in its strategic framework, leading to a smaller than expected decline in the bank’s leverage ratio. A failure by member states to provide significant amounts of the recently approved funding would also put negative pressure on the ratings, as would any emerging weaknesses in its liquidity and funding profile. A downgrade of major shareholders such as Germany (Aaa stable), France (Aa2 stable), Italy (Baa3 negative) and Spain (Baa1 stable) would also add to negative credit pressures.

Key indicators

Exhibit 2

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<th>Council of Europe Development Bank</th>
<th>2017</th>
<th>2018</th>
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<th>2020</th>
<th>2021</th>
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[1] Usable equity is total shareholder's equity and excludes callable capital

Source: Moody’s Investors Service

Profile
CEB was set up in 1956 under the name of the Council of Europe Resettlement Fund for National Refugees and Over-Population in Europe. It adopted its current name in 1999 and enlarged its mandate to strengthen social cohesion in Europe and promote inclusive growth. CEB was founded by eight members – Belgium (Aa3 stable), France, Germany, Greece (Ba1 stable), Iceland (A2 positive), Italy, Luxembourg (Aaa stable) and Turkiye (B3 stable) and has since seen two waves of enlargement, bringing its current membership to 43 countries.

CEB’s three overarching goals under its 2023-2027 Strategic Framework are 1. responding to evolving social development and inclusion challenges; 2. assistance and integration of refugees and migrants; 3. support for the reconstruction and rehabilitation of Ukraine's social sectors. CEB makes loans to projects that are socially and economically viable in member states, lending directly to the sovereign or regional and local government authorities, as well as other public or private entities. It can also grant guarantees and provide technical assistance.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on https://ratings.moodys.com for the most updated credit rating action information and rating history.
Detailed credit considerations

Our determination of a supranational’s rating is based on three rating factors: capital adequacy, liquidity and funding and strength of member support. For Multilateral Development Banks, the first two factors combine to form the assessment of intrinsic financial strength, as shown on the cover page graphic. Additional factors can affect the intrinsic financial strength, such as risks stemming from the operating environment or the quality of management. The strength of member support is then incorporated to yield a rating range. For more information please see our Supranational Rating Methodology.

FACTOR 1: Capital adequacy score: a2

We score CEB’s capital adequacy at “a2” based on the combination of a relatively high leverage ratio set against strong asset credit quality and exceptionally strong asset performance. That said, we make a positive one-notch adjustment for the trend on leverage, in light of the decline in leverage which we expect will follow from the increase in paid-in capital approved by the CEB Governing Board in December 2022.

CEB’s loan book contracted in 2022, contributing to a reduction in the leverage ratio

The leverage ratio – which we define as development-related assets and treasury assets rated A3 and lower relative to useable equity – is the key measure we use to assess an MDB’s capital position. CEB’s leverage ratio decreased to 573% in 2022, down from 639% in 2021 (see Exhibit 3). The reduction in leverage in 2022 brings the ratio back to around its pre-pandemic level following a rapid increase in leverage over the previous two years.

High leverage is not unusual among highly rated MDBs, which are able to carry much higher leverage because of the strength of their other core credit metrics. The European Investment Bank (EIB, Aaa stable) has higher leverage historically, averaging more than 638% over 2019-22. Nevertheless, high leverage is one of CEB’s key credit constraints.

That said, we expect that the tripling of paid-in capital agreed by CEB’s Governing Board in December 2022, and currently in the process of national ratification, will significantly increase CEB’s usable equity. Despite our expectation that CEB’s loan portfolio will continue to grow in coming years, we expect that leverage will decline from its current level as member countries provide their paid-in capital contributions over the coming years, up until the 2026 deadline (see also Recent Developments section).

CEB’s loan portfolio contracted by 4.2% in 2022 after growing 6.1% in 2021 and 13.4% in 2020, when lending sharply increased in response to the pandemic. Meanwhile, useable equity increased by 6.4% in 2022 compared to 3.3% in 2021. Despite strong demand for CEB loans due to the refugee crisis driven by Russia’s military invasion of Ukraine, new loan approvals were broadly stable at €4.24 billion in 2022, while loan disbursements declined to €3.5 billion from €4 billion in 2021. CEB’s Strategic Framework published in January 2023 indicates a modest increase of loan approvals to €4.3 billion annually over the 2023-2027 period.

Exhibit 3
Leverage fell back towards its pre-pandemic level in 2022

Exhibit 4
CEB has maintained a solid, underlying profitability

Source: CEB, Moody’s Investors Service
Underlying profitability has remained relatively solid despite challenge of low-yield environment
CEB has recorded steady profits over the past decade, averaging €106 per year million over 2012-22. The bank has remained profitable throughout past episodes of turbulence, including the global financial and euro area debt crises. Following a rebound profitability in 2021, the bank recorded net profit of €80 million in 2022, down from €95 million the previous year mainly due to IFRS valuation effects (see Exhibit 4). CEB’s average return on assets stood at 0.3% in 2022, maintaining the previous year’s level. Since the most recent capital increase in 2012, the expansion of useable equity has been driven by the sustained increase in reserves, to which almost all the banks profits are added.

Asset quality is enhanced by CEB’s preferred creditor status
We assess CEB’s development asset credit quality (DACQ) at “aa”. The starting point is the weighted average borrower rating (WABR) that stood at Baa3 at end-2022, which has also been stable since 2015. At the end of 2022, 23.1% of the development asset portfolio was rated Aaa-Aa, with another 29.1% in the A category. 15.2% of the portfolio was non-investment grade. CEB’S Strategic Framework for 2023-2027, which among other things aims to support the reconstruction and rehabilitation needs of Ukraine’s social sectors, will entail an increase of credit risk for CEB’s loan portfolio with a higher share of non-investment grade lending in its portfolio.

The bank’s lending portfolio is relatively diversified geographically within Europe. The top recipients of loans are France, which accounts for 11% of the loan portfolio, followed by Spain (11%), Poland (A2 stable) (8%) and Italy (7%). The bank also has significant, but declining, exposure to Turkiye (6% in 2022), largely relating to the SME sector. The bank also launched its programme Strengthening Healthcare Infrastructure for All (SHIFA) in March 2021 under its Facility for Refugees in Turkiye in cooperation with the European Union (EU, Aaa stable).

The “aa” score for asset quality also reflects the bank’s preferred creditor status (PCS), which reduces the expected loss on loans in the event of a default by a sovereign counterparty. CEB also uses credit-enhancement instruments (guarantees and collateral) to transfer all or part of the risk of the initial borrower.

Asset performance remains superior to most peers
We assess CEB’s asset performance as “aaa”. CEB’s asset quality track record is among the strongest of all the MDBs we rate. Since its inception in 1956, the bank has recorded only one nonperforming loan (NPL): in 2009, an Icelandic counterparty failed to meet its commitment on capital and interest, for which CEB had provisioned the total outstanding loan amount of €1.8 million. In the Aaa-Aa2 European MDB space, only Eurofima (Aa2 stable), the European Stability Mechanism (Aaa stable) and the European Financial Stability Facility (EFSF, Aaa stable) have a similar asset quality track record.

The pandemic shock did not lead to the materialisation of any new non-performing loans for CEB. Although the increasingly challenging macroeconomic environment in Europe and the impact of the military invasion in Ukraine poses risks for asset performance, the bank’s pristine track record of asset performance even in times of crisis supports our expectation that asset performance will remain robust for the foreseeable future.

FACTOR 2: Liquidity and funding score: aa2
We consider CEB’s liquidity and funding position to be very strong with a score of “aa2” for its availability of liquid resources and a score of “aa” for the quality of its funding, which results in an overall score for liquidity and funding of “aa2”.

CEB maintains a strong liquidity position
CEB has a large liquid assets portfolio, standing at €9.7 billion at the end of 2022 (including assets available for sale and assets held to maturity, as well as bank deposits). This marks a 3.5% increase from the €9.4 billion recorded in 2021. For the purpose of calculating our liquid resources ratio, we consider only highly liquid assets such as cash and short-term bank deposits as well as securities rated A2 or higher, as we believe only those would be available in a stress scenario at short notice and with minimal loss.

CEB’s treasury assets must have a minimum rating at purchase of Baa. At the end of 2022, 60% of CEB’s treasury assets were rated Aaa-Aa. The rest of CEB’s treasury portfolio is exclusively investment grade.

We consider the size of the available liquid assets relative to cash outflows in a stressed scenario over the coming 18 months, in which the MDB has no access to markets but continues its normal business operations. CEB’s availability of liquid resources ratio stood at 164% in 2022, resulting in a score of “aa2”. This is somewhat above the Aaa median of 136%.
This provides CEB with a buffer to withstand a severe tail-risk scenario of limited or no market access. Its liquidity buffers would also be more than sufficient to meet cash requirements until callable capital could be paid in. As of March 2023, the self-sufficiency period stood at 13 months (up from 9 months in December 2022), which is above the bank’s minimum “self-sufficiency period” fixed at six months.

CEB has a strong track record of stable access to market funding at competitive rates

CEB has a “aa” score for our assessment of quality of funding and market access. Having demonstrated the strength of its market access during the pandemic, CEB has again been able to regularly tap debt markets at competitive rates in a context of rising interest rates globally and market turbulence sparked by the Russian invasion of Ukraine. CEB’s investor base is diversified, both in terms of institution type and geography, and the bank’s bonds were also included in the ECB’s asset purchase programmes.

The bank has an opportunistic and dynamic approach to debt issuance, and has traditionally issued debt in US dollars and euros. In 2022, 65% of funds raised were in euros, followed by 16% in US dollars and 14% in sterling. At the end of 2022, CEB’s stock of debt was primarily denominated in euros (61%), followed by dollars (25%). However, after accounting for currency swaps, the CEB’s overall debt exposure is euro-denominated.

As of December 2022, outstanding debt fell to €24.1 billion, down from €24.7 billion in 2021. In 2022, CEB used €6 billion of its €6.5 billion funding authorisation for the year. The average funding maturity was 5.7 years in 2022, remaining at the same level as in 2021 (see Exhibit 6).

CEB issued a €2 billion equivalent of Social Inclusion Bonds (SIB) in 2022, up from €1 billion the previous year. The SIB proceeds covered 34% of CEB’s funding needs in 2021 and can be used to support longer-term needs of refugees in the current context. The bank updated its Social Inclusion Bond Framework in April 2020 to include social housing, education and vocational training, health and social care and support to MSMEs as sectors that can be financed with the proceeds of SIBs.

Qualitative adjustments to intrinsic financial strength

Operating environment

We do not apply any adjustment for CEB’s operating environment. CEB has maintained solid profitability in the years leading up to the pandemic and we expect the bank’s operations to remain resilient to heightened geopolitical tensions in Europe.

Quality of management

Our “+1” adjustment for quality of management reflects our long-standing view that CEB’s management (including risk management) is among the best in class. The results of this can be seen in its unusually strong asset quality, with the bank only ever recording one NPL in its history. CEB also has a stringent capital monitoring framework. Under the bank’s own guidelines, the capital adequacy ratio
in its prudential framework (prudential equity as a % of risk-weighted assets) has a lower limit of 10.5%. However, the bank’s capital is always multiples of this limit. In 2022, it stood at 30.4%, up from 29.1% in 2021.

**FACTOR 3: Strength of member support score: High**

The strength of CEB’s member support is assessed at “High”, which combines a “baa1” ability to support, “ba3” contractual willingness to support and “Very High” non-contractual willingness to support the institution.

**Moderate average weighted shareholder rating and low levels of callable capital are relative weaknesses**

We use the weighted average shareholder rating (WASR) to assess shareholders’ ability to support an MDB. In the case of CEB, the WASR stood at “baa1” in 2022, unchanged from previous years and somewhat below the Aaa median of “a3” (see Exhibit 7). CEB currently has 43 member-states, following Ukraine’s accession in June 2023. France, Germany and Italy are the largest shareholders, each accounting for 17% of subscribed capital. They are followed by Spain (11%) and Turkiye (7%). The credit profiles of most shareholders, especially highly rated European sovereigns, have been resilient to the pandemic shock.

We use callable capital relative to the debt stock to assess the strength of contractual support. With a ratio of 20.2% in 2022, only Eurofima has a lower ratio of callable capital to total debt among Aaa-Aa2 rated peers (see Exhibit 8), although number of Aaa-Aa2 rated MDBs do not have callable capital, including International Development Association (IDA, Aaa stable), International Finance Corporation (IFC, Aaa stable) and Inter-American Investment Corporation (IDB Invest, Aa1 stable). Despite having a relatively high level of callable capital relative to subscribed capital (89%), CEB’s high debt stock explains the weak performance on this metric. That said, in light of the substantial capital increase with an addition to €3 billion in callable capital agreed in December, we expect callable capital relative to debt to increase leading to an improvement of our measure of contractual support in 2024 at the latest.

**Relevance of CEB’s mandate is increasing in the context of support for Ukraine**

We assess CEB’s non-contractual support as “Very High” given the track record of support the bank has received from shareholders but also peers and the EU since its creation. In particular, the approval in December 2022 of a very substantial increase of CEB’s paid-in and callable capital by the bank’s Governing Board is testament to sharing member states’ very strong support for CEB as well as the bank’s enhanced relevance in tackling key social challenges stemming from the conflict in Ukraine as well as in Europe more broadly.

CEB’s role as the social development bank in Europe has also been strengthened by its response to the 2015 migrant crisis and the coronavirus pandemic. The Ukrainian crisis makes CEB’s mandate increasingly important to its members in a context of renewed geopolitical instability in Europe with far-reaching economic and social consequences causing a large influx of refugees in Ukraine’s neighboring countries.
ESG considerations

Council of Europe Development Bank’s ESG Credit Impact Score is Positive CIS-1

Exhibit 9
ESG Credit Impact Score

CIS-1
Positive

For an issuer scored CIS-1 (Positive), its ESG attributes are overall considered as having a positive impact on the rating. The overall positive influence from its ESG attributes on the rating is material.

Source: Moody’s Investors Service

CEB’s credit impact score is positive (CIS-1). On the one hand, this reflects the positive impact on its credit profile of the bank’s very strong governance profile, a feature shared with most other Aaa-rated supranationals. More uniquely, CEB’s role as a dedicated development bank for social policy objectives enhances its role and relevance in addressing common social challenges for instance related to demographic change. Furthermore, CEB’s exposure to environmental risks is generally low.

Exhibit 10
ESG Issuer Profile Scores

Environmental
CEB’s environmental issuer profile score is neutral to low (E-2), reflecting neutral-to-low exposure across all five environmental risk categories. CEB tracks the carbon footprint of projects approved, and since 2017 the emission savings from mitigation projects approved have mostly exceeded the emission levels from all other projects. In line with other MDBs, CEB is in the process of aligning its project portfolio with the Paris Agreement on Climate Change.

Social
CEB’s social issuer profile score is positive (S-1). CEB’s explicit mandate is to be a social bank, and social policy objectives are central to its mission which positions it well to benefit from demographic and societal trends and supports our assessment of responsible production. CEB has been an early adopter of Social Inclusion Bond issuance. Given its policy role and reputation, it has a strong relationship with its customers.

Governance
CEB’s governance issuer profile score is positive (G-1). CEB adheres to very strong risk management processes, which has resulted in a pristine track record of asset performance. The bank’s management is highly credible and has a strong track record in implementing CEB’s strategy. CEB’s strong governance profile will be a key factor in helping the bank to manage the increase in risk of its loan portfolio which Moody’s expects will occur over coming years.
All of these considerations are further discussed in the "Detailed credit considerations" section above. Our approach to ESG is explained in our cross-sector methodology General Principles for Assessing ESG Risks. Additional information about our rating approach is provided in our Supranational Rating Methodology.

Recent developments

**CEB capital increase on track to become effective by 2024**

Following the approval of a €4.25 billion increase in CEB's subscribed capital by its board in December 2022 (of which €1.2 billion is to be paid in and the rest provided as callable capital), 43% of offered shares have been subscribed by member countries as of 2 November 2023. We expect that by the end of 2023, CEB will reach the 67% threshold at which the capital increase would become effective although we expect 100% of shares to eventually be subscribed.

Once the subscription to the capital increase becomes effective, the full amount of callable capital will be available to CEB, which will notably lead to an improvement in our score for member states' contractual willingness to support the institution. Paid-in capital will increase more gradually over the following years as members make their contributions up until the 2026 deadline.

The first instalment of 25% of the capital to be paid in will be due once the subscription becomes active, with an additional 25% due in the following year. Assuming that the capital increase becomes effective at the end of 2023 or early 2024, half of the additional paid-in capital could thus have been provided to CEB by the end of 2024, notably leading to an improvement in our measure of the bank's leverage for the 2024 financial year.

**Ukraine is confirmed as CEB shareholder - operations in the country set to begin in 2023**

A significant motivating factor behind the capital increase is member states desire to see CEB play an active role in supporting Ukraine both during and after the war. In June, Ukraine was also confirmed as CEB's 43rd shareholding member state, with the country being exonerated of any payment requirement for accession.

CEB’s first operations in Ukraine, with an initial focus on restoring housing damaged by the war, will be rolled out already in 2023. Under the 2023-2027 Strategic Framework published in January 2023, CEB plans a "cautious and gradual" path of operations in Ukraine, aiming to start at €200 million in 2023 and reach €390 million in 2027.

However, contingent on the course of the war in Ukraine and conditions in the country, the roll-out may be slower than expected and not reach the planned total €1.5 billion in lending by 2027. CEB is cooperating with other MDBs and with Ukrainian authorities to navigate operating in the new and challenging environment, aiming to flexibly meet the current social needs in Ukraine while maintaining a focus on social housing, its area of particular expertise.

**Half-year 2023 results points to pick-up in profitability from higher interest rate environment**

CEB in October published the bank’s unaudited mid-year results for 2023. The total volume of loans outstanding increased only marginally on the end of 2022, while €2.2 billion in new projects had been approved and €935 million in funding actually disbursed in the first half of the year, a decline relative to €2.6 billion approved and €1.6 billion in disbursed loans in the first half of 2022.

Following a dip in profits in 2022, net profits in the first half of 2023 increased by 13.2% compared to the first half of 2022. The positive development was driven by an increase in the net interest margin by €9.7 million over the period as the treasury portfolio benefits from the high interest rate environment. We expect that net interest income will continue to increase in coming years both as the bank’s treasury portfolio increases due to the provision of additional equity under the capital increase and as the higher global interest rate environment increases returns on the treasury portfolio overall.
Rating methodology and scorecard factors: Council of Europe Development Bank - Aaa stable

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**Scorecard-Indicated Outcome Range**

Aaa-Aa2

**Rating Assigned**

Aaa

**Note:** Our ratings are forward-looking and reflect our expectations for future financial and operating performance. However, historical results are helpful in understanding patterns and trends of an issuer's performance as well as for peer comparisons. Additional considerations that may not be captured when historical metrics are used in the scorecard may be reflected in differences between the adjusted and assigned factor scores. Furthermore, in our ratings we often incorporate directional views of risks and mitigants in a qualitative way. For more information please see our Multilateral Development Banks and Other Supranational Entities rating methodology.

*Source: Moody's Investors Service*
Related websites and information sources

» Moody's Supranational web page

» Moody's Sovereign and supranational rating list

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