FITCH AFFIRMS COUNCIL OF EUROPE DEVELOPMENT BANK AT 'AA+'; OUTLOOK STABLE

Fitch Ratings-Paris/London-05 September 2018: Fitch Ratings has affirmed Council of Europe Development Bank's (CEB) Long-Term Issuer Default Rating (IDR) at 'AA+' with a Stable Outlook. The Short-Term IDR has been affirmed at 'F1+'.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS
CEB's ratings are driven by its intrinsic credit quality and reflect its strong solvency (assessed at 'aa-'), its excellent liquidity (assessed at 'aaa') and its low-risk business environment, which provides an uplift of two notches to the lower of its solvency and liquidity assessments ('aa-'), resulting in an intrinsic rating of 'aa+'.

The solvency assessment of 'aa-' is driven by CEB's 'very low' risk profile, notably the excellent performance of its loan book, with no loan impairments in recent years. Fitch has revised the assessment of the bank's preferred creditor status (PCS) to 'strong' from 'moderate', in part reflecting the strong asset quality track record.

CEB's risk profile also benefits from the high credit quality of its borrowers with an average rating of 'BBB+' ('A' after the two-notch upward PCS adjustment), among the highest in the multilateral development bank universe. The Long-Term Foreign-Currency IDR of Turkey, CEB's single largest exposure (9.8% of the banking book at FYE17), was downgraded in August 2018 to 'BB'/Negative' from 'BB+'. This has largely offset the improvements elsewhere in the portfolio relative to the last review (Spain: upgraded to 'A-' from 'BBB+'; Cyprus to 'BB+' from 'BB-'). Overall 'low' concentration risk, 'very low' market and equity risks and 'strong' risk management policies further contribute to CEB's 'very low' risk profile.

Fitch's solvency assessment also reflects CEB's 'moderate' capitalisation. The equity-to-adjusted assets ratio improved to 13.1% at FYE17 (2016: 11.4%). Fitch expects this ratio to remain broadly stable over the forecast horizon. Growth in equity will continue to be driven by internal capital generation. Leverage, as measured by debt to equity, has materially decreased from its peak of 10x at FYE 2011 to 6.4x at FYE17. However, it remains higher than peers, ultimately constraining the capitalisation assessment.

Liquidity remains a key rating strength, with the bank's coverage of short-term liabilities by liquid assets at 1.64x as of FYE17 (2016: 2.65x), with the reduction largely reflecting maturing debt that has since been refinanced. This metric is expected to remain above the 'excellent' threshold (1.5x) over the medium term. The quality of liquid assets is 'strong' with 56% of liquid assets rated above 'AA-', in line with recent years.

CEB's 'low'-risk business environment translates into a two-notch uplift over its solvency assessment. The business environment assessment balances the 'low' risks of its operating environment, including the high credit quality and low political risk in the countries of operations, and CEB's 'medium risk' business profile. The latter benefits from the high quality of CEB's governance and management standards. The active role of the bank in the European migrant and refugee crisis has also increased its visibility. However, in Fitch's view, the importance of CEB's public mandate is a relative weakness, as evidenced by the absence of paid-in capital increases and the limited role CEB plays in the financing of the countries in which it operates.

CEB's ratings do not benefit from credit uplift from shareholders' support. The average rating of key shareholders remains unchanged at 'AA-', which is below the intrinsic rating.

RATING SENSITIVITIES
The Outlook on the IDR is Stable. However, future developments that could, individually or collectively, result in positive rating action include:
- An increase in the capitalisation ratio towards the 15% threshold that is consistent with a 'strong' capitalisation assessment, either from internal capital generation or a capital injection from shareholders that strengthens the bank's solvency.
- An improvement in the bank's risk profile as a result of a continued increase in exposure to highly-rated counterparties.

Conversely, future developments that could, individually or collectively, result in negative rating action include:
- A deterioration in the bank's capitalisation metrics, resulting from either losses or marked acceleration in the growth of lending.
- A substantial deterioration in CEB's asset quality.

KEY ASSUMPTIONS
The ratings and Outlooks are sensitive to a number of assumptions:
- CEB maintains a conservative risk management framework.
- CEB maintains an excellent liquidity buffer throughout the ratings horizon.

The full list of rating actions is as follows:

Long-Term Foreign-Currency IDR affirmed at 'AA+'; Stable Outlook
Short-Term Foreign-Currency IDR affirmed at 'F1+'
Senior unsecured debt affirmed at 'AA+'/'F1+'
Commercial paper affirmed at 'F1+'

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Additional information is available on www.fitchratings.com

Applicable Criteria

Supranationals Rating Criteria (pub. 24 May 2018)

https://www.fitchratings.com/site/re/10031448