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Research Update:

Council of Europe Development Bank Upgraded To 'AAA' On Criteria Revision; Outlook Stable

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Overview

- Following a review of the Council of Europe Development Bank (CEB) under our revised criteria for multilateral lending institutions (MLIs), we are raising our long-term issuer credit rating on CEB to 'AAA' from 'AA+ and removing the ratings from under criteria observation (UCO).
- We believe that CEB has increased its relevance as a funding contributor in its niche market over the past three years, which together with the bank's pristine track record of preferred creditor treatment, underpins its improved extremely strong enterprise risk profile.
- The outlook is stable since we expect CEB's strengths will remain unchanged in the next two years, particularly its newfound positive disbursement dynamics and corresponding funding relevance, together with its very solid liquidity position.

Rating Action

On Feb. 15, 2019, S&P Global Ratings raised its long-term issuer credit rating on Council of Europe Development Bank (CEB) to 'AAA' from 'AA+'. At the same time we affirmed our 'A-1+' short-term issuer credit rating on CEB. The outlook is stable.

We removed the ratings from UCO, where we placed them on Dec. 14, 2018, after publishing the revised MLI criteria.

Rationale

The ratings are based on CEB's extremely strong enterprise risk profile and its very strong stand-alone financial risk profile. These assessments underpin our view of the bank's stand-alone credit profile (SACP), which we now assess at 'aa+'. Our assessment of CEB's financial risk profile is further lifted by extraordinary support in the form of callable capital from 'AAA' and 'AA+' rated members resulting in an issuer credit rating of 'AAA'. We outline these factors in our revised criteria, "Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology," published Dec. 14, 2018, on RatingsDirect.

CEB's history of demonstrated preferred creditor treatment (PCT) underlines its overall enterprise risk profile. Specifically, the CEB has, since its creation, benefited from an excellent track record of PCT by the countries in which it operates, and we expect this to remain the case. Though the CEB has a concentrated loan portfolio, its loan loss experience has been minimal. Since its inception in 1956, it has experienced only one sovereign default, which was a debt owed by the former Yugoslavia, and fully recovered including back arrears as of July 2004, representing a net present value loss to the CEB of 0%. We consider this a confirmation of the PCT afforded to CEB.

We believe that CEB is on track to increase and widen its activities. In sharp contrast with its lackluster activity levels after the 2007 financial crisis, the bank is now responding swiftly to high demand for investments in social infrastructure. Partly by re-inventing and modernizing its lending mandate, CEB has increased its efforts to broaden its activities over the past three years.

With its broadening mandate and increasingly tangible role as a social investor in member countries' budgets, CEB has managed to scale-up its operations. In particular, in 2017 and 2018, we observed strong momentum in CEB's disbursements and project approvals. Both have achieved record highs, and could increase further, in our view. Specifically, approvals of €3.9 billion in both 2017 and 2018 have outperformed the bank's aim of €3.5 billion annually. Although the higher disbursements in 2017 were offset by almost equally high scheduled reimbursements, leaving the overall loan book rather flat, we observe an ongoing positive trend in the bank's activity levels. This is even more apparent in the preliminary 2018 non-audited figures, which depict a 6% increase in outstanding loans.

We believe this robust momentum will continue as the bank's more dynamic approach to its lending mandate will allow it to improve its lending footprint through the pent-up demand for social investments throughout Europe. In addition, we observe that the EU is contemplating inclusion of a specific social investment window in its structural funds deployment in the upcoming EU 2021-2027 budget, which we believe could help CEB further improve its mandate fulfillment and lending footprint and sustain its policy relevance. While relevance is clearly increasing, we consider CEB's role and mandate slightly inferior in comparison with peers that we consider have similar policy importance.

Reflecting CEB's stronger engagement outside its target group of countries, the bank's asset quality has strengthened over the past two years. Moreover, we have revised our treatment of factoring PCT into our capital adequacy calculation. Together with an improvement in the single name charge, where we now include only the purpose-related exposures, and improving credit quality of some key borrowing countries, this has boosted CEB's risk-adjusted capital (RAC) ratio. We now position it at 25.2%, incorporating all the new parameters as of Feb. 4, 2019, based on input data from 2017. That said, we believe that CEB's increasing lending activity, if sustained, may consume capital over the coming years. In this context, we observe an ongoing deleveraging initiative at the bank, which in combination with fairly contained profitability and no expectation of an imminent capital increase from the shareholders, leads us to maintain our view of very strong capital adequacy on a stand-alone basis.

Our funding ratios indicate that CEB is structurally able to cover its scheduled short-term debt repayments and loan disbursements without recourse to new issuance. Owing to a deleveraging initiative, which has reduced the amount of treasury assets, as well as more pronounced loan disbursement commitments, CEB's liquidity ratios have been declining, but even so remain solid. Under our liquidity stress scenario at all horizons up to one year, CEB would fully cover its balance-sheet liabilities without market access. For year-end 2017 data and incorporating our updated liquidity haircuts, our 12-month liquidity ratio was 1.16x including scheduled loan disbursements while the six-month ratio stood at 2.1x. In terms of committed disbursements, CEB's projects tend to have a shorter time horizon for disbursements compared with its project-finance heavy peers. Therefore, CEB holds a lower level of committed disbursements outside the 12-month horizon compared with most peers.

On a strategic note, CEB has largely completed a shift to two-way credit support annexes (CSA) positions on the majority of its derivative counterparts in 2018, which has resulted in a build-up of liquidity buffers to cater for potential collateral posting needs. When it settles, we expect this shift will be managed prudently, supported by our view of the bank's competent and sophisticated financial management.

CEB was founded in 1956 as the Council of Europe Resettlement Fund for National Refugees and Over-Population in Europe, with a mandate to help refugees and other displaced persons after World War II. Its current role of supporting social infrastructure investment in Europe involves loans to support job creation in small and midsize enterprises, vocational training, social housing, health care, environmental projects, correctional facilities, natural catastrophe relief, and educational reform. Even though parts of CEB's lending activity could be performed by other MLIs, we believe CEB holds a key position because of its established history, role, and the core essence of its mandate. The institution holds an important role for its smaller member countries, even though the bank's expansion is partly through relaxation of the stipulation that favored its traditional target countries. In particular, for social projects in some of the bank's smaller member countries, alternative financing solutions are scarce. A significant portion of CEB's lending focuses on projects in target countries where the associated project costs, loan sizes, and business expertise deter many other institutions (both commercial and other government-owned). CEB's average loan size is significantly smaller than those of highly rated peers that are more project-finance heavy. Moreover, CEB offers additional expertise in a number of social domains (such as housing and education), technical design support, and technical assistance through the project cycle.

Shareholders have been supportive since inception. We view the bank's policy of not paying dividends as a sign of ongoing shareholder support, and we expect this to continue. In this vein, in 2012, CEB benefited from member countries' additional capital subscriptions linked to its capital increase approved on Feb. 4, 2011. This increase required no disbursement of cash from member countries and had no effect on adjusted shareholders' equity. While windfall capital improvements, from stronger credit quality of exposures and dynamics surrounding the high scheduled repayments, have reduced the imminent need for a capital increase from shareholders, we believe sustained longer-term growth would likely prompt a medium-term build-up in financial capacity.

Incorporating CEB's callable capital from shareholders rated 'AAA' and 'AA+' into its equity base leads us to revise up our enhanced financial risk profile assessment to extremely strong. Accordingly, we add one notch of uplift to the issuer credit rating from the stand-alone credit profile. Currently, CEB has eight 'AAA' shareholders and one 'AA+' shareholder.

Outlook

The stable outlook reflects our expectation that CEB will be able to maintain its newfound positive lending dynamics over the coming two years, such that its policy relevance and funding importance remain unquestioned. We also assume CEB will continue to enjoy excellent PCT and to adequately cater for increased liquidity needs following its move to two-way CSAs, so that its liquidity will remain independent from the markets for 12 months.

We could downgrade CEB if its policy relevance for shareholders significantly deteriorated, as seen, for example, through lack of shareholder engagement or support for the current activities of the bank. If we observed that CEB's financing contribution was not sufficiently unique or meaningful for its shareholders, illustrated by declining lending activity, momentum for a downgrade could build. A significant deterioration in CEB's funding and liquidity assessment could also have a negative impact on the ratings. A significantly deteriorating capital ratio would most likely be mitigated by the existing callable capital provided by highly rated sovereigns.

Ratings Score Snapshot

Issuer Credit Rating	AAA/Stable/A-1+
SACP	aa+
Enterprise Risk Profile	Extremely Strong
Policy Importance	Very strong
Governance and management	Strong
Financial Risk Profile	Very Strong
Capital Adequacy	Very Strong
Funding and Liquidity	Strong
Extraordinary Support	1

Callable capital	1
Group Support	0
Holistic Approach	0

Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Ratings On 32 Multilateral Lending Institutions And Supranationals Placed Under Criteria Observation On Criteria Update, Dec. 14, 2018
- Criteria Guidance: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- Supranationals Special Edition, Oct. 11, 2018

Ratings List

Upgraded; Ratings Affirmed

	To	From
Council of Europe Development Bank		
Issuer Credit Rating		
Foreign Currency	AAA/Stable/A-1+	AA+/Positive/A-1+
Senior Unsecured	AAA	AA+

Ratings Affirmed

Council of Europe Development Bank		
Commercial Paper	A-1+	

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.