FitchRatings

Fitch Revises Outlook on Council of Europe Development Bank to Positive; Affirms at 'AA+'

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Fitch Ratings has revised the Outlook on the Council of Europe Development Bank's (CEB) Long-Term Issuer Default Rating (IDR) to Positive from Stable and affirmed the IDR at 'AA+'.

Key Rating Drivers

The revision of the Outlook on CEB's Long-Term IDR to Positive reflects continued improvement in the bank's solvency metrics. CEB's leverage, which has historically been a rating weakness, decreased to 6.5x at end-2018 compared with its peak of 10.0x at end-2011 (when Fitch downgraded CEB to 'AA+' from 'AAA'). In line with Fitch's new approach for assessing capitalisation for multilateral development banks, CEB's capitalisation has been revised to 'strong' from 'moderate. Concurrently, the bank has maintained an 'excellent' performing loan book with no non-performing loans (NPL).

CEB's ratings are driven by its intrinsic credit features and reflect its solvency (assessed at 'aa-'), its 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 'strong' capitalisation and 'very low' risk profile.

Fitch has revised CEB's capitalisation assessment upwards to 'strong' from 'moderate' following the introduction of Fitch's usable capital to risk-weighted assets ratio (FRAR) as per the latest Supranationals Rating Criteria. Under Fitch's projections, CEB's highly rated callable capital (EUR2.4 billion rated AAA-AA) and high quality assets result in a FRAR above 40%, well above the threshold for 'excellent' (35%). Combined with the bank's 'moderate' equity to adjusted assets ratio (12.9% at end-2018), and the 'excellent' FRAR, this leads to an overall 'strong' capitalisation assessment. Fitch expects capitalisation metrics to decline slightly, as loan growth is expected to reach 5% per year by 2021, but to remain consistent with a 'strong' assessment.

CEB's 'very low' risk profile benefits from the high credit quality of its borrowers and its preferred creditor status (PCS), which Fitch assesses as 'strong'. The bank's average rating of loans improved to 'A-' at end-2018 (from 'BBB+'). The PCS adjustment translates into a two-notch uplift over the average rating of loans to 'A+', the highest in Fitch's MDB rating coverage.

The improvement in the average rating of loans since the last rating review reflects upgrades across some large countries of exposure such as Hungary (BBB from BBB-; 4.1% of total loans is to the sovereign), Cyprus (BBB from BB+;3.3%), and Croatia (BBB- from BB+; 2.3%), as well as increased exposure to highly rated northern European sub-sovereigns. Exposure to the Turkish sovereign (9.8% of loans at end-2018) weighs on the bank's risk profile. In July 2019, Fitch downgraded Turkey's Long-Term Foreign Currency IDR to 'BB-'/Negative. This is the third downgrade since 2016, when the Long-Term IDR was 'BBB-'. Further downgrades without offsetting improvements elsewhere in the loan book would put pressure on the average rating of loans and in turn, the bank's risk profile.

Overall 'low' concentration risk, 'very low' market and equity risks and 'strong' risk management policies further contribute to CEB's 'very low' risk profile.

CEB's 'aaa' liquidity assessment reflects the bank's excellent liquidity buffers and strong credit quality of its treasury portfolio (average rating of AA- at end-2018). The coverage of short-term debt by liquid assets is expected to remain well above the 1.5x 'excellent' threshold by 2021 (2.3x at end-2018), in line with recent years. The share of 'AA' to 'AAA' rated assets in the bank's treasury portfolio is expected to remain within the 'strong' range (40%-70%).

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. In Fitch's view, CEB has gained greater visibility as a development institution as the recent migrant crisis in Europe has renewed its relevance. In the context of EU budgetary framework for the 2021-2027 cycle, the bank has been listed as a potential recipient of the European Commission's InvestEU guarantee scheme.

CEB's ratings do not benefit from credit uplift from shareholders' support. The average rating of key shareholders is unchanged at 'AA-', which is below the intrinsic rating. The lack of paid-in capital injections from shareholders in the last two decades and no coverage of net debt by callable capital translate into a 'weak' assessment of the propensity of shareholders to provide support.

RATING SENSITIVITIES

The main factor that could trigger positive rating action is stabilisation or further improvement in Fitch's assessment of the bank's risk profile and capitalisation metrics. Conversely, future developments that could, individually or collectively, result in a stabilisation of the Outlook or other negative rating action include:

- Deterioration in the bank's capitalisation metrics, resulting from either losses or greater than anticipated acceleration in the growth of lending.

- Significant deterioration in CEB's asset quality metrics, either via rising non-performing loans or a marked decrease in the average credit quality of its loan book.

Key Assumptions

CEB maintains a conservative risk management framework.

Sources of Information

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

VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

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Applicable Criteria

Supranationals Rating Criteria (pub. 23 May 2019)

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