# CEB Strategic Review:
## Contributing to a socially cohesive and sustainable Europe in the 21st century

Report of the Committee of Eminent Persons to the Governing Board of the Council of Europe Development Bank (CEB)

October 2008

*Paris, October 2008*

**Letter from the Committee of Eminent Persons for the Strategic Review to the Governing Board of the Council of Europe Development Bank, CEB**

Dear Chairman Kolte,

It is our pleasure to submit to you herewith the report of the Committee of Eminent Persons, entitled "CEB Strategic Review – Contributing to a socially cohesive and sustainable Europe in the 21st century". It is our hope that the Committee has accomplished the task set out for it in its terms of reference.

The Committee of Eminent Persons (CEP) was formally appointed in its final composition in March 2008 to provide views on the Strategic Review of the CEB, which the Governing Board, on a proposal by the Governor, had begun in the summer of 2007. The Committee made a careful study of CEB's development since its inception more than half a century ago and considered the key driving forces for its future activities. It then formulated a number of recommendations for consideration in defining the medium- to longer-term strategy of the institution. This report represents the Committee's consensus views.

We would like to express our great appreciation for the valuable contribution of the Committee's Special Advisor, Mr. Jacques de Larosière.

The Committee met five times between January 2008 and October 2008: three times in Paris and once each in Bucharest and Madrid. During its deliberations, the Committee was briefed extensively by Governor Raphaël Alomar and his staff on all aspects of the Bank's activities. In addition, it benefited from meetings with Mr. Terry Davis, the Secretary General of the Council of Europe, and his staff; with Mr. Rainer Steckhan, the Chairman of the Administrative Council; and with yourself. The Committee also had the privilege of exchanging views with the Governing Board and the Administrative Council on three occasions, in Strasbourg and Paris on 10 and 11 March and in Bucharest on 13 June 2008.

We should like to thank you, Mr. Chairman, and through you, the Governing Board for having entrusted us with this important task. In our work, we have benefited from having access to records of the extensive discussions that have taken place in the Governing Board and the Administrative Council during the course of the Strategic Review process.

The work of the Committee would not have been possible without the unflagging support we have received from the Management and Staff of the Bank throughout the process. The Committee was also assisted in its work by two consultants: Mr. Magnús Ágústsson, our consultant in the field of financial risk analysis, and Mr. Waldemar Wirsig, our operational performance advisor.

We are happy to have been given this opportunity to contribute to the future development of this important European institution and to do our part to enable it to fulfil its mandate more effectively.

Yours sincerely,

| | |
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| Enrique Iglesias | Jón Sigurdsson |
| Member of the CEP | Member of the CEP |

## The Committee of Eminent Persons

Enrique Iglesias, Ibero-american General Secretary, former President of the Interamerican Development Bank, IDB

Jón Sigurðsson, Chairman of the Board of the Financial Supervisory Authority, FME, Iceland, former President of the Nordic Investment Bank, NIB

**Special Advisor to the Committee:**

Jacques de Larosière, former President of the European Bank for Reconstruction and Development, EBRD, former Managing Director of the International Monetary Fund, IMF

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# Acronyms and Abbreviations

**BSTDB:** Black Sea Trade and Development Bank
**CEB:** Council of Europe Development Bank
**CEO:** Chief executive officer
**CEP:** Committee of Eminent Persons
**EBRD:** European Bank for Reconstruction and Development
**EIB:** European Investment Bank
**ECOFIN Council:** EU meeting of the Economic and Financial Affairs Council
**EU:** European Union
**Eur:** euro
**€:** euro
**GDP:** Gross Domestic Product
**IBRD:** International Bank for Reconstruction and Development
**IDB:** Interamerican Development Bank
**IFI:** international financial institution
**IPA:** Instrument for Pre-Accession Assistance
**IOM:** International Organization for Migration
**IMF:** International Monetary Fund
**JESSICA:** Joint European Support for Sustainable Investment in City Areas
**KfW:** Kreditanstalt für Wiederaufbau
**MDB:** Multilateral Development Bank
**MoU:** Memorandum of Understanding
**NIB:** Nordic Investment Bank
**PPP:** Purchasing Power Parity
**SME:** small and medium size enterprise
**UN:** United Nations
**UNDP:** United Nations Development Program
**UNHCR:** United Nations High Commissioner for Refugees
**UNICEF:** United Nations Children's Fund
**USD:** American dollar
**VaR:** Value-at-Risk
**WB:** World Bank
**WHO:** World Health Organization

# Introduction

The strategic review of the Council of Europe Development Bank (CEB) was launched in June 2007. The primary objective of the review was to make further improvements to CEB's overall functioning, governance, and performance so as to enhance its value for the membership, adapt it to the demands of the 21st century, and enable it to continue to play a valuable role in promoting social cohesion and sustainable development in Europe.

In the course of the review process, the Governing Board of the CEB decided to appoint a Committee of Eminent Persons who have served as leaders of international financial institutions and to entrust them with the task of reflecting on "the CEB's social mandate, its governance and its international positioning."

The terms of reference given to the Committee of Eminent Persons (CEP) by the Bank's Governing Board covered four main topics: CEB's mandate, its relations with the Council of Europe, its relations with other international organisations, and its governance. The terms of reference specified very clearly that the Bank should endeavour to serve its mandate in the years ahead without a general capital increase from shareholders while maintaining its triple-A credit rating. In effect, this twofold condition defines the financial constraint – the financial framework – for the Bank's operations. It was also clear that, in order to do justice to the tasks outlined in the terms of reference, it was necessary to look into the Bank's operational methods. For this reason, the CEP added two topics to the four mentioned earlier: financial framework and operational performance. Consequently, the report is divided into the following six chapters:

1. Mandate
2. Relations with the Council of Europe
3. Financial framework – capitalisation
4. Co-operation with other IFIs and international organisations
5. Operational performance
6. Governance

In its work, the CEP has drawn extensively on both the excellent background material provided by the Bank's management and the written and oral contributions made by members of the Governing Board and the Administrative Council during the review process.

The bulk of this report was drafted in the spring and summer of 2008, when there was still some hope that the worst of the financial crisis that began with the sub-prime loan problems originating in the US, was over. Unfortunately, that financial crisis has deepened in the past few weeks. The whole of Europe and North America are engulfed in the worst financial and banking crisis since 1930-31. This turn of events is particularly worrisome for the newest members of the CEB among the Bank's target countries. The economic difficulties caused by the international banking crisis accentuate many social problems in these member countries at a time when their access to long-term financing in the international financial markets has become even more limited and more expensive than before. Thus there is an increased need for CEB financing for projects that can cushion the negative social impact of the financial crisis on the populations of member states. The need for investments in social infrastructure, human capital development, and small and medium-sized enterprises in the target countries may actually have increased as a consequence of the crisis.

This is indeed a global concern requiring a swift and decisive response from the international community. CEB should play its part in this action on behalf of its membership.

It is heartening that, in September and in the first half of October 2008, in the middle of the turmoil currently plaguing the financial markets, all three major international rating agencies have decided to affirm their triple-A rating with a stable outlook for CEB. This is a welcome recognition of the prudential and cautious financial policies followed by the CEB for a long time and recommended by the Committee. The triple-A rating makes CEB a particularly valuable partner for the financing of social infrastructure in member countries. The challenge for the Bank in the years ahead is to maintain this outstanding credit rating while fulfilling its social cohesion mandate effectively.

The aim of this report is to identify improvements that can be made in order to strengthen the Bank's overall functioning, governance and performance. An important recommendation made by the Committee is that the Governing Board should ask the Governor and his management team to prepare a plan of action to modernise CEB's governance structure so as to enable the Bank to fulfil its mandate more effectively. Recent events in the world economy and financial markets have increased general awareness of the need for social development financing for the benefit of member states. The Committee therefore recommends that the Governing Board ask Management to propose, as quickly as possible, a two-pronged plan of action aimed at **reforming** the Bank's governance and operations along the lines drawn up in this report, and at **responding** effectively to the new challenges resulting from the financial crisis, inter alia by providing additional financing for social development.

# Executive Summary

Since the inception of CEB's predecessor, the Council of Europe Resettlement Fund, more than half a century ago, the geo-political landscape of Europe has undergone a fundamental change. This change has been particularly dramatic during the last two decades. In many ways, the year 1989 marks the beginning of the opening of Europe from east to west, symbolised by the fall of the Berlin Wall. Since then, former communist countries in Central and Eastern Europe have, one after the other, joined the family of European democracies in the Council of Europe. Most of them have subsequently joined the CEB. CEB's membership has increased from 8 founding members in 1956 to 20 in 1990 and then to 40 countries in 2007. The doubling of the membership from 1990 took mainly place from 1994 onwards, when so many Eastern European countries joined the Bank.[1] This development is an interesting measure of the geo-political transformation of the continent in recent years.

The establishment of the CEB in the mid-1950s was a reponse to an urgent need at that time to mobilise resources to help solve the problems of displaced populations in the aftermath of the Second World War. In addition to fulfilling its original purpose, CEB has evolved since 1994 into a fully fledged development bank with a unique social vocation. The eastward opening of Europe since the beginning of the 1990s has brought with it new tasks for the CEB, with special emphasis on supporting the transformation of the former communist countries into democratically governed market economies aiming at socially and environmentally sustainable, inclusive growth.

The CEB has demonstrated its ability to adapt to the changing circumstances in its surroundings, as well as in the global financial markets, which have changed fundamentally in recent decades with the liberalisation of capital movements across borders. The Bank has performed very well in the financial markets and has been able to provide financing at favourable terms for important social and environmental investments in its member countries. This has been particularly important for the new members of the Bank.

In the turmoil currently reigning in the world's financial markets, access to capital for the emerging economies of Europe has become very limited and very expensive. This has made CEB, with its top-notch credit rating, even more valuable as a source of finance for these countries, which are the Bank's target countries. In this way, CEB is an important instrument for the priorities and values of the Council of Europe.

The task of the strategic review is to identify improvements that can be made in order to strengthen the Bank's overall functioning, governance and performance and adapt it to the demands of the 21st century so as to enhance its value for the entire membership.

[1] See Figure-table 1 in the Statistical Appendix.

## CEB's mandate

After careful study of the development of the Bank's mandate and based on the policy guidance of the Bank's owners at the highest level, reflecting the priorities and values of the Council of Europe, the Committee recommends that CEB should focus its activities on four core areas:

- Promoting social cohesion and inclusive economic growth and helping to deal with the consequences of migration.

- Supporting environmentally sustainable growth through investment in infrastructure for clean energy and projects that can prevent environmental despoliation and natural catastrophes, as well as helping to deal with the consequences of ecological disasters.

- Promoting the development of human capital through investment in infrastructure for health and education services, particularly in disadvantaged areas.

- Strengthening democracy, human rights, and the rule of law through investment in judicial and civil service training institutions and judicial infrastructure. This should also help to create a sound business environment. Furthermore, it will enhance the role of the Bank in promoting the development of human capital.

The value added by the Bank's financing of these four core areas is greatest when the Bank assists its newest members in developing their social and environmental infrastructure with long term financial resources.

## Relations with the Council of Europe

Relations with the Council of Europe are at the core of the Bank's identity. The Committee points to certain aspects of these relations that could be further improved.

- As regards governance, it seems important to make a clear distinction between the role of the Bank's owners, on the one hand, and the roles of the executive and administrative organs, on the other, in order to clarify the lines of responsibility and accountability.

- Greater ministerial interest in the affairs of the Bank should be encouraged. Annual meetings of the Governing Board at the ministerial level would be useful for the visibility of the institution and its contribution to the promotion of the Council of Europe's priorities and values.

- The Bank and the Council of Europe must continue to make efforts to identify bankable pilot and template projects so as to demonstrate in a concrete way the value added by the Bank's financing.

- The responsibility for the secretariat function for the Bank, except for the preparation of "admissibility statements" for loan proposals, should be transferred to the Bank, thereby relieving the Council of Europe of the cost of these tasks.

- The Governor should hold meetings once a year with the Committee of Ministers, the Parliamentary Assembly and the Secretary General of the Council of Europe, in order to keep them informed about the Bank's activities. This is important for the visibility and recognition of the Bank among its stakeholders and the general public.

## Financial framework

CEB's financial performance has been excellent during the last decade and a half. It has achieved and continuously maintained the highest credit ratings from the major international rating agencies. The Bank's triple-A rating is essential for its usefulness to the entire membership.

- Because of CEB's financial strength, there is still some limited scope for an increase in lending to its target countries (or eligible projects of similar creditworthiness) over the next five to seven years without a capital increase and without impairing its triple-A rating, provided that the current level of outstanding loans to other member countries is maintained and the Bank continues to follow cautious lending and prudential policies.

- CEB's present prudential framework is commendably cautious in its approach to credit risk. It has garnered approval by the rating agencies as being in line with Basel II and has even been regarded as being more cautious than required by the Basel Recommendations and the EU Capital Requirements Directive. But it could be strengthened and made more comparable to other financial institutions' by implementing, in the next few years, an explicit assessment of all types of financial and operational risk, using risk assessment methods in line with best practice in the financial services industry, and a change in presentation.

- A broadening of CEB's membership to include all eligible Council of Europe member countries would strengthen the basis for the Bank's operations in the years ahead but would require additional resources in order to deal with the challenges this brings.

## Relations with other IFIs and international organisations

Over the last decade and a half, the CEB has significantly strengthened its co-operation with other IFIs and international organisations. This has brought positive results. The co-operation strategy, set forth in the Bank's Development Plan 2005-2009, should be continued. The objective of co-operation with other institutions is to enhance CEB's capacity to fulfil its mandate to promote social cohesion and sustainable development in its member countries. The basic objectives are the same for co-financed projects and projects financed by CEB alone. This is the guiding light for all CEB operations.

- CEB should continue to seek complementary rather than competitive relations with other IFIs and international organisations. In particular, increased co-ordination with the European Union helps the Bank carry out its specific task of supporting social development and enables it to promote the priorities of the Council of Europe more effectively.

- CEB should co-operate closely with the various EU regional development programmes for the easterly neighbours of the Union, as well as with the EIB and EBRD and other development banks active in the target countries. Co-operation with NIB on programmes promoting women's entrepreneurship, micro-finance, and energy efficiency is a niche of considerable interest for CEB from the standpoint of social cohesion as well as economic development.

- CEB should continue to develop its co-operation with UN agencies, with the aim of developing projects that support populations of CEB member states through their humanitarian and development assistance programmes.

- CEB should place greater emphasis on migration as a central focus of its operations, in keeping with the Bank's original purpose. It should actively seek co-operation with the international agencies that deal with the consequences of international migration in a humane and just manner. CEB should finance projects addressing the causes and consequences of migration, both in the countries of origin and in the countries of destination within its membership.

- CEB's co-operation with other IFIs and international organisations has yielded positive results for the target countries and increased the Bank's visibility and leverage, particularly through its partnership with the EU and other European institutions in the field of development co-operation.

## Operational performance

Operational performance can be measured by the number of operations or the volume of financial resources processed by a given institutional capacity, but by the same token, the value added to the flow of financing provided, expressed through more effective developmental impact of operations, also constitutes a crucial factor for the evaluation of good performance. The goal of CEB is to continue to improve its performance on both these scores.

CEB has made a commitment to more effective action, greater efficiency of management, and quality of service. Value addition and effective development are at the core of its effort. The prospect of strengthening CEB's response, over the coming years, to the demand of social sector actors and its own constituencies is favorable and could be based on the following recommendations.

- The correct understanding of the countries' needs, the client focus, is fundamental to a long lasting relationship. Dialogue and strategy work at the country level can provide new investment opportunities and better coordination with donors. However, more permanent dialogue with the Bank's clients, including in some cases with a permanent local presence on the ground to level-up with other IFIs, will generate higher operational costs.

- Thematic specialization and new lending instruments, paired with mobilization of technical assistance, can further increase efficiency and better complement in some cases other institutions' work. CEB's processing capacity and technical human resource base will have to be strengthened. Institutional learning has to be intensified.

- Technical Assistance is a strategic instrument which supports the achievement of development objectives and provides a fundamental competitive advantage in terms of pipeline development, project preparation and capacity building. A Grant Management Facility would have to be created in order to increase the number and volume of trust funds for this purpose.

These challenges will have to be adapted in substance and pace, to fit CEB's size and budget constraint. Shareholders could envisage increasing CEB's resources to meet these operational objectives in the next Development Plan 2010-2014.

## Governance

The present structure and distribution of functions of CEB governance differs noticeably from generally accepted governance principles and from the governance arrangements of other multilateral development banks (MBDs). Systematic clarification of the roles and responsibilities of the various supervisory, executive and management bodies could lead to significant institutional improvements and increased efficiency. A reform of CEB's governance structure would enable the Bank to fulfil its mandate more effectively.

- Attendance to the Governing Board's Annual Meeting should be elevated to the ministerial level. This would improve the Bank's image vis-à-vis other stakeholders and the international financial community.

- Establishing a process of annual selection of the chairman of the Governing Board among his/her ministerial peers, in order to emphasise the governmental, political and honorary nature of the position, is likely to facilitate the relationship with the other organs/bodies of governance of the institution and with the Council of Europe.

- For the executive functions entrusted to the Administrative Council, including the Executive Committee, a new and more efficient non-resident body – a Board of Directors – should be established, aligning it with the arrangements prevalent among other MDBs. The issues that require primary attention in this connection are: reducing the number of directors on the Board to a "manageable" number while securing balanced composition of the Board, representing the entire membership; making the President/Governor the chairman of the Board of Directors; eliminating dual representation on governing and executive bodies; and securing a stable distribution of responsibilities and functions among the governing, supervisory and executive organs so as to enhance accountability and avoid conflicts of interest.

- The role and functions of the Governor (it is proposed that the title be changed to President) should be enhanced, both externally – within the international financial community, as the official representative of the institution – and internally, by reinforcing the President's/Governor's role as the CEO of the Bank. This implies that the President/Governor is the chairman of the Board of Directors and will, as chief of staff, participate in all senior appointments. The President's management capacity could be reinforced by establishing an operational headquarters secretariat and a team of Vice-Presidents (one of them as Executive Vice-President) accountable to the President, each with direct-line supervisory responsibility for specified business areas. These responsibilities should be reflected in the professional selection criteria for appointments of Vice-Presidents.

- A plan of action setting out the different stages of implementation is required to modernise CEB's governance arrangements and bring them into line with best practice in a systematic way.

## Concluding remarks

The report suggests a number of modifications in CEB's operations and governance. In the Committee's opinion, these modifications would improve the Bank's overall functioning and performance and enable it to fulfil its mandate more effectively. The implementation of these changes is an important task that would make a good institution even better. This requires the wholehearted participation of all elements of the Bank's governance structure, always keeping in mind that much can be achieved without – or in advance of – formal changes in the Bank's Articles of Agreement.

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# Chapter 1: CEB's Mandate

CEB's social development mandate – its social vocation – remains as relevant to European society today as it was more than half a century ago, when the Bank's predecessor, the Council of Europe Resettlement Fund, was established in 1956. Like all institutions, CEB bears the imprint of the values, ideas and circumstances prevailing at the time of its creation. However, for an institution to be of lasting value, it must continually reformulate its existence and adapt to changing circumstances. CEB has been successful in this endeavour over the years, and this is the challenge it will continue to face in the years ahead. The purpose of the strategic review is to organise the thinking about how best to respond to this challenge.

## 1.1 Original and present mandate

When the Resettlement Fund, the forerunner to CEB, was established, the dominant need was to channel investment funds to help solve the problems European countries faced as a result of population movement in the aftermath of World War II. Article II of the original Articles of Agreement, the *Purpose* article, was wisely structured so as to enable the Fund also to provide capital to address social problems stemming from population movement due to natural disasters or other causes.

This more general social mandate gained in importance with the passage of time. The evolution of the Bank's mandate was codified in 1993, when the current wording of the *Purpose* article was formally adopted by a resolution of the Committee of Ministers of the Council of Europe. This resolution aligned the Bank's formal mandate with the practice that had evolved over the years, directing its financing also towards projects involving job creation in disadvantaged regions, housing for low-income groups, and investment in social infrastructure, in addition to focusing on resettlement and dealing with the consequences of natural disasters. The resolution of 1993 defined clearly the general social vocation of CEB, which had in effect been approved by the Governing Body of the Resettlement Fund when it decided in 1989 to adopt, without amendment to the Articles of Agreement, the title *Council of Europe Social Development Fund* as a common name for the Fund. When the current name of the CEB was formally adopted by the Governing Board in 1999, it was stressed that the name change did not affect the social vocation of the institution.

It is noteworthy that the three summits of Heads of State and Government of the Member States of the Council of Europe (in 1993, 1997 and 2005) have had a major influence on the development of the CEB mandate:

The **Vienna Summit** of 1993, through its emphasis on promoting the democratic transition and economic integration of the new member states that joined the Council of Europe after the end of division of Europe;

The **Strasbourg Summit** of 1997, which decided to reinforce the activities of the Bank and invited it to participate actively in the action for social cohesion and urged it to increase its investment effort in the social field and in job creation, with focus on Central and Eastern European countries;
And finally, the **Warsaw Summit** of 2005, which requested that, in addition to its traditional role, the CEB direct its resources towards projects promoting the consolidation of democracy, the rule of law, and respect for human rights.

These decisions, which are taken at the highest level by the Bank's owners, should continue to guide its activities.

## 1.2 Migration

From the very beginning, addressing the social consequences of population movement within and between countries has been prominent on CEB's agenda. The increase in international migration in recent years, which can be described as a global trend, has re-emphasised the importance of this original element of the Bank's mandate.
The reasons for population movement may be different from those prevailing in the aftermath of World War II, but the social consequences are the same; indeed, they are often just as difficult to deal with now as they were then. The background of increasing international migration is complex. People move across borders in the hope of finding better living conditions or in flight from persecution, terror, poverty, armed conflict, and regional wars.
The process of globalisation itself is generating unbalanced outcomes, both between and within countries. Wealth is being created, but it is distributed unevenly. Even in economically successful countries, some communities and groups in society are adversely affected by globalisation. The revolution in global communications heightens the awareness of social disparities. These are some of the root causes of international migration. Within the membership of CEB are both countries of origin and countries of destination for international migration. For this reason, CEB should sharpen its focus on migration as a central objective for the Bank's operations. In keeping with its original purpose, CEB should endeavour to be of use in addressing the social consequences of migration in a humane and just manner. For this reason, CEB should emphasise co-operation with international institutions that deal with migration, such as UNHCR and IOM, as well as WHO and UNICEF.

## 1.3 Environmental protection

Since the early years of CEB's operations, investment in projects addressing the consequences of natural or ecological disasters has been an integral part of the CEB mandate. Increasing emphasis on environmentally sustainable development has sharpened this focus. This has been manifest in the increasing share of preventive rather than reactive environmental investment, particularly to include investment in infrastructure that can prevent environmental damage and natural catastrophes, as well as projects dealing with the consequences of ecological disasters. Many of the low-income countries among CEB's membership are exposed to the risk of environmental damage. This should be given particular attention in CEB's operations and co-operation with the EU and other IFIs, with particular focus on southeastern Europe and the Balkans. It appears that regional focus combined with joint programmes with other financiers is advisable if CEB is to make strides toward environmental improvement. In this context, it is noteworthy that a recent report by a high-level task force on social cohesion appointed by the Council of Europe emphasised the importance of sound environmental policies. The report states as follows: "(I)n any 21st century social cohesion strategy sustainability must be of the essence. …(A)ttention must be given to the relationship between economic, social and environmental sustainability as a condition for social cohesion."[2]

The current debate about climate change and global warming has highlighted the importance of carefully husbanding natural resources, stopping further environmental damage, and reversing it if possible. It is therefore proposed that the promotion of environmentally sustainable growth should remain one of CEB's primary strategic objectives. Climate change management, efficient use of energy resources, and increased reliance on clean and renewable energy sources are topics that deserve particular attention in the lower-income countries of the Bank's membership.

Extreme climate events are a source of mounting concern all over the world. While it may not be possible to demonstrate a direct cause-and-effect relationship, current evidence indicates strongly that climate change will increase the risk of exposure to climate disasters. This view speaks in favour of CEB's participation in financing investments in both **adaptation** and **mitigation** projects aimed at dealing with the negative effects of climate change in the lower-income countries of the membership, and **mitigation** projects aimed at reducing emissions of greenhouse gases into the atmosphere throughout the entire membership. The earth's atmosphere is a truly global common good that needs protection by all countries in the common interest of mankind. The CEB should participate in this effort in all its member countries. In particular, it should act to protect vulnerable population groups that are exposed to the vagaries of extreme climate events.

## 1.4 Social Cohesion

For more than a decade, social cohesion has been a guiding idea for the social goals and achievements of Europe. The concept was a central element in the political strategy defined by the 2nd Summit of Heads of State and Government of the Council of Europe in 1997. Since then, the importance of social cohesion as a common element of the policy of Council of Europe members has been emphasised repeatedly at the highest levels of government. The European Union (EU), for its part, has long used social cohesion as a frame of reference for its Structural Funds and other measures to support economic and social development. Social cohesion underlines the importance of shared values and commitment to a unifying community. It requires that all individuals be able to participate in economic life and enjoy its advantages. It requires tolerance and recognition of persons from different cultures and ethnicity. A recent report from the Council of Europe task force on social cohesion lists six core elements of a policy framework for social cohesion in today's Europe. "These are: employment and labour, social protection, education and training, health and social care, housing, planning and environment, activation and integration in society."[3]

CEB has been active in supporting investment conducive to social cohesion, not least in the newer member countries of the Council of Europe and the Bank. Investing in job creation in disadvantaged regions, social housing, and social infrastructure is an integral part of the CEB mandate and has been given clear support at the highest level by its owners. The policy declarations of all Council of Europe Summits held to date have emphasised the goal of social cohesion throughout Europe. This goal should continue to guide the activities of the Bank.

[2] "Towards an active, fair and socially cohesive Europe", p. 15.
Council of Europe, TFSC (2007) 31E, Strasbourg, 28 January 2008.
[3] "Towards an active, fair and socially cohesive Europe", p. 51.
Council of Europe, TFSC (2007) 31E, Strasbourg, 28 January 2008.

Both the financing of small and medium-sized enterprises in the new member countries and loan facilities promoting women's entrepreneurship can be useful instruments for this purpose. The preservation of historic and cultural heritage could also promote job creation in the tourism industry in several new member countries. Co-operation with the EU is particularly important because of the shared view of the need for social cohesion in Europe reaching beyond the present borders of the EU. Co-operation with other IFIs – the EIB, EBRD and NIB – is also useful in this endeavour.

## 1.5 Development of human capital

Investment in educational and health service infrastructure in disadvantaged regions, with the aim of improving future prospects, is an important objective for CEB. Health and education play a vital role in creating the conditions for sustainable and socially inclusive growth. For this reason, these areas should be given greater weight in CEB's strategic direction. This policy implies a need for co-operation with international organisations such as WHO, UNICEF and UNDP, as well as other IFIs, to gain momentum for investment in these vitally import areas of activity, particularly for the newest members of the Bank.

## 1.6 Democracy, human rights, and the rule of law

As is mentioned earlier in this report, in 2005 the CEB was mandated by the Council of Europe Summit in Warsaw to direct its financing towards judicial infrastructure and education of magistrates and civil servants so as to consolidate democracy and to strengthen the rule of law and respect for human rights. This should also help to create a sound business environment. All of these are worthy objectives that deserve particular attention. Sectoral programming carried out jointly with the national authorities in selected member countries might be a useful means of finding bankable projects that fit into this category of investment.

## 1.7 Four core areas of activity

The above review of the historical development of the CEB mandate gives the background to the three broad lines of action describing the Bank's mission, which have been presented in the following way in its recent publications:

**Strengthening social integration**
**Managing the environment**
**Developing human capital**

Reflecting the policy guidance given in recent years by the Bank's owners at the highest level, a fourth explicit strategic direction could be added:

**Strengthening democracy, human rights, and the rule of law**

This is a laudably brief description of CEB's mandate but very general in nature. Perhaps the concepts **social cohesion**, **migration** and **environmental protection** should be brought out more clearly, even in the briefest of presentations of the Bank's mandate. This is attempted in the main points concluding this chapter.

## Main points:

Based on the policy guidance of the Bank's owners at the highest level, and reflecting the priorities and values of the Council of Europe, CEB should focus on four core activities:

■ Promoting social cohesion and inclusive economic growth and helping to deal with the consequences of migration.

■ Supporting environmentally sustainable growth through investment in infrastructure for clean energy and projects that can prevent environmental despoliation and natural catastrophes, as well as helping to deal with the consequences of ecological disasters.

■ Promoting the development of human capital through investment in infrastructure for health and education services in particular in disadvantaged areas.

■ Strengthening democracy, human rights, and the rule of law through investment in judicial and civil service training institutions and judicial infrastructure. This should also help to create a sound business environment. Furthermore, it will enhance the role of the Bank in promoting the development of human capital.

The value added by the Bank's financing of these four core areas is greatest when the Bank assists its newest members in developing their social and environmental infrastructure with long term financial resources.

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# Chapter 2: Relations with the Council of Europe

Relations with the Council of Europe are at the core of the Bank's identity. In a very real sense, they constitute the "brand" of the Bank within the IFI community. The basic strength of CEB – its raison d'être – lies in its close relationship with the Council of Europe and the fundamental values it represents. The closeness of the relationship between the Bank and the Council of Europe is clear from the Bank's Articles of Agreement. Article I states that "The Bank shall be attached to the Council of Europe and administered under its supreme authority", and in no fewer than nine of the 17 articles making up the Articles of Agreement is a reference to the Council of Europe. This is understandable in view of the history of CEB and its roots in the Resettlement Fund of the Council of Europe, which was established in 1956, presumably as a temporary financial instrument to deal with the pressing problem of resettling fugitives in the aftermath of World War II. In effect, the basic structure of the Articles of Agreement is unchanged since 1956, even if the Bank has developed as a fully fledged international financial institution with its own identity. Therefore, it might prove necessary to realign some of the formal provisions on the distribution of tasks and roles of various decision-making bodies to conform to today's views on what constitutes good governance in international financial institutions. As far as the institutional relationship between CEB and the Council of Europe is concerned, the most important principle is to make a clear distinction between the Council of Europe as CEB's owner, on the one hand, and the organs responsible for the executive and administrative management of the Bank, on the other. This does not detract in any way from the importance of the relationship from the standpoint of Council of Europe policy. The Bank should be viewed as a financial instrument to promote the priorities and values of the Council of Europe while respecting in its operations the principles of sound financial management. Clarifying the separation of responsibilities between owners, on the one hand, and executives and administrators, on the other, enhances accountability and ensures greater responsibility in the operations of the Bank. This question is also addressed in the chapter on governance (Chapter 6).

## 2.1 Ownership

The ownership of the Bank is defined by the Partial Agreement of the Council of Europe, which established it. The Bank promotes the principles and interests of its owners in accordance with its Articles of Agreement under the ultimate authority of the Council of Europe. The action plans decided by the three Council of Europe Summits demonstrate the interest in and support for the Bank at the highest level of the member states' governments. This is valuable for CEB and its international standing, including its standing in the financial markets. Greater ministerial interest in the Bank's activities should be encouraged. One way of doing this might be to elevate the Governing Board to the ministerial level so as to attract greater attention to programmes and projects that are of particular interest to the Council of Europe at the Bank's annual meetings.

## 2.2 Close contacts

Close contacts must be maintained between the bank and the Council of Europe secretariat in order to identify projects and programmes that are of particular interest to the Council of Europe and can be made bankable.

## 2.3 Pilot projects and template projects

Pilot projects and template projects demonstrating explicitly, and in a concrete way, the Bank's ability to promote the Council of Europe's objectives can be a valuable tool for the Bank's operations and should be identified with the help of the Council of Europe subject to final approval by the Administrative Council.

## 2.4 Institutional links

Institutional links and the division of tasks between the Bank and the Secretariat of the Council of Europe should be reviewed with an eye to simplification.
Examples of tasks that could be examined more closely are the secretariat functions for the Governing Board and the Administrative Council and the preparation of "Admissibility Opinions" for projects and programmes under consideration for CEB financing. The division of labour and costs for these functions may no longer be practical or functional. It would seem better in line with a clear demarcation of responsibility and accountability to transfer responsibility for these functions to CEB.

## 2.5 Reporting to the Council of Europe

Reporting to the Council of Europe on CEB activities should be the responsibility of the Governor, who should meet once a year with the Committee of Ministers and the Parliamentary assembly (instead of every three years at present for the latter) in order to keep them informed about the Bank's business. This contact with the representatives of the Bank's owners is important for the visibility and recognition of the Bank among its stakeholders and the general public.

**Main points:**

- As regards governance, it seems important to make a clear distinction between the role of the Bank's owners, on the one hand, and the roles of the executive and administrative organs, on the other, in order to clarify the lines of responsibility and accountability.

- Greater ministerial interest in the affairs of the Bank should be encouraged. Annual meetings of the Governing Board at ministerial level would be useful for the visibility of the institution and its contribution to the promotion of the Council of Europe's priorities and values.

- The Bank and the Council of Europe must continue to make efforts to identify bankable pilot and template projects to demonstrate in a concrete way the value added by the Bank's financing.

- The responsibility for the secretariat function for the Bank, except for the preparation of "admissibility statements" for loan proposals, should be transferred to the Bank, thereby relieving the Council of Europe of the cost of these tasks.

- The Governor should hold meetings once a year with the Committee of Ministers, the Parliamentary Assembly and the Secretary General in order to inform them about the Bank's activities. This is important for the visibility and recognition of the Bank among its stakeholders and the general public.

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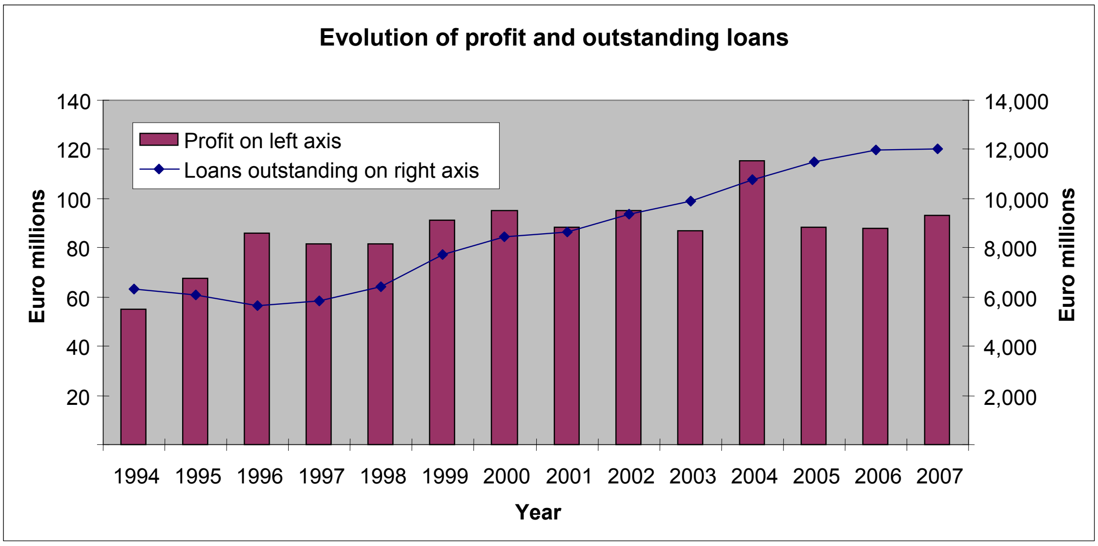
## Chapter 3: Financial framework - Capitalisation

The CEP's terms of reference state clearly that the policy of the Bank's owners is that the Bank should aim to fulfil its mission to promote socially and environmentally sustainable development in member countries, while maintaining its triple-A credit rating without recourse to a capital increase from shareholders. This twofold condition defines in effect the financial framework for the strategic review of the Bank's activities.

### 3.1 The basis of CEB's triple-A rating

CEB's triple A-credit rating from the international rating agencies is based on four elements:

- Its strong capital base
- Its cautious liquidity management policy
- Its status as an international financial institution supported by a strong group of countries as shareholders
- Its consistently prudential and successful economic performance over a long period of time, which is reflected in the key financial figures for the years 1994 to 2007 (Table 1 and Graph 1) and the Bank's excellent and stable credit ratings (Table 2).




**Graph 1**

Table 1 lists key economic indicators for the Bank for the period 1994 – 2007. It highlights very clearly the Bank's stable and positive results over this whole period. The Bank's results for 2007 and the indications of its economic performance during the first half of 2008 show that, in spite of the recent financial market turbulence, CEB has been able to continue its good performance, which makes it a valuable partner for the financing of social infrastructure in member countries, particularly those without easy access to the international financial markets.

| In M€ | Net interest income | Operating income | Profit | Loans outstanding | Debts evidenced by certificates | Total assets | Subscribed capital | General reserves after profit allocation | Equity | Return on equity ratio | Cost to income ratio |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **1994** | 77 | 68 | 55 | 6,337 | 7,775 | 9,805 | 1,241 | 465 | 762 | 7.2% | 13.7% |
| **1995** | 90 | 84 | 68 | 6,076 | 8,489 | 9,784 | 1,297 | 515 | 813 | 8.3% | 14.4% |
| **1996** | 91 | 94 | 86 | 5,629 | 8,044 | 9,183 | 1,318 | 591 | 891 | 9.6% | 13.0% |
| **1997** | 90 | 94 | 82 | 5,843 | 8,331 | 9,539 | 1,326 | 668 | 969 | 8.4% | 14.9% |
| **1998** | 95 | 95 | 81 | 6,403 | 9,729 | 11,096 | 1,386 | 747 | 1,055 | 7.7% | 16.7% |
| **1999** | 106 | 106 | 91 | 7,743 | 11,050 | 12,659 | 1,401 | 831 | 1,140 | 8.0% | 16.1% |
| **2000** | 108 | 107 | 95 | 8,442 | 12,526 | 14,434 | 1,401 | 906 | 1,225 | 7.8% | 16.7% |
| **2001** | 105 | 105 | 88 | 8,630 | 12,023 | 13,926 | 3,004 | 814 | 1,294 | 6.8% | 18.2% |
| **2002** | 113 | 112 | 95 | 9,350 | 11,506 | 14,217 | 3,231 | 879 | 1,384 | 6.9% | 18.6% |
| **2003** | 106 | 105 | 87 | 9,903 | 10,883 | 14,786 | 3,249 | 965 | 1,473 | 5.9% | 22.4% |
| **2004** | 115 | 115 | 115 | 10,765 | 11,777 | 16,390 | 3,294 | 1,236 | 1,604 | 7.2% | 21.3% |
| **2005** | 114 | 116 | 89 | 11,483 | 13,725 | 17,675 | 3,294 | 1,316 | 1,685 | 5.3% | 23.6% |
| **2006** | 115 | 118 | 88 | 11,965 | 13,620 | 18,232 | 3,294 | 1,398 | 1,767 | 5.0% | 25.0% |
| **2007** | 117 | 123 | 93 | 12,007 | 13,264 | 18,509 | 3,303 | 1,490 | 1,821 | 5.1% | 24.1% |

**Table 1**

Table 2 shows the stability of CEB's outstanding ratings from all major rating agencies over the same period. This excellent ratings performance is of great value to the whole membership and makes CEB an effective tool to fulfil its social mandate.

| Rating | Standard & Poor's | Moody's | Fitch Ratings |
|---|---|---|---|
| **1994** | AAA | Aa1 | |
| **1995** | AAA | Aa1 | |
| **1996** | AAA | Aa1 | AAA |
| **1997** | AAA | Aa1 | AAA |
| **1998** | AAA | Aa1 | AAA |
| **1999** | AAA | Aa1 | AAA |
| **2000** | AAA | AAA | AAA |
| **2001** | AAA | AAA | AAA |
| **2002** | AAA | AAA | AAA |
| **2003** | AAA | AAA | AAA |
| **2004** | AAA | AAA | AAA |
| **2005** | AAA | AAA | AAA |
| **2006** | AAA | AAA | AAA |
| **2007** | AAA | AAA | AAA |

**Table 2**

## 3.2 Capacity to increase lending to priority areas

CEB's Development Plan 2005-2009 set forth a policy to increase significantly the Bank's lending to social projects in those Central and Southeastern European countries defined as target countries. A list of these countries is shown in Table 3. In the Development Plan, the Bank declared its intention to devote 50% of its loans to social projects in this geographical area. Furthermore, the Bank's stated goal is to increase the target countries' share in its outstanding loans to 43% by year-end 2009.[4] In comparison, this percentage was 35% at the end of 2007.

In the extensive discussions that have taken place in the Bank's Governing Board and Administrative Council since September 2007, strong support has been expressed for a continued shift in lending towards the target countries and towards projects of high social value in general. This implies a shift of lending to less highly rated borrowers – i.e., riskier investments – which calls for an assessment of the

[4] CEB: Development Plan 2005-2009, pp 9 and 10.

Bank's capacity to sustain such a shift in lending over the medium to longer term, given the financial framework defined by the requirement to maintain the Bank's triple-A rating without a capital increase from shareholders. For this purpose, a review of the Bank's capital base and prudential system has been undertaken under the auspices of the Committee.

A broad assessment was made of the risk capital base required to maintain the Bank's triple-A credit rating given the composition of its loan portfolio at year-end 2007, covering also its exposure to credit, market risk, operational and business risk.

- The overall risk capital requirement was estimated based on an Economic Capital, approach, i.e. the capital required to cover unforeseen credit losses.
- Credit risk was assessed with a simplified yet conservative credit portfolio model.
- Market risk was measured through a Value-at-Risk (VaR) type measure.
- Operational risk was quantified using the standardised approach of Basel II.
- Business risk was quantified based on a factor approach.

All four risk types were aggregated using a correlation approach.

The same type of approach was used to obtain a broad assessment of whether CEB's capital base was sufficient to accommodate a shift in lending such as that presented in the Development Plan 2005-2009, if similar policies were to be followed from 2009 to 2014. Simply put, this would imply that the share of the target countries in the Bank's loan portfolio would approach 50% by the end of 2014. Various scenarios were studied for the development of CEB's loan portfolio over the seven-year period 2008-2014.

The result of these simulations was that a moderate growth in lending to target countries could be sustained for the next 5 -7 years without jeopardising the Bank's triple-A rating, provided that the total amount of loans outstanding to the group of other countries was maintained, broadly speaking, at its current level and that the general prudential lending and financial policies of CEB were continued throughout. We emphasise in particular that the stability of the amount of loans outstanding to the group of other countries is key to maintaining a sufficient and significant size of the CEB bond issuance program every year in order to keep the benefit of the best available interest rates on the financial markets. This is indeed one of the elements of attractiveness of the Bank for target group countries that should be maintained in the coming years in order for the Bank to effectively fulfil its social role for its membership.

The methods used for these tentative assessments of CEB's capital requirements are in line with the financial industry's best practice as applied by well-run financial organisations, supervisory authorities, and the international rating agencies.

Risk management methods based on VaR and Economic Capital have gained currency in recent years in the financial industry and have been included in the prudential methods recommended by the Basel Committee and the EU Capital Requirements Directive[5] as well as forming the basis for new approaches of the rating agencies. But they have weaknesses that have become apparent in the recent financial market turmoil and the unexpected losses suffered by financial firms previously regarded as solid.

[5] EU Capital Requirements Directive for credit institutions and investment firms (2006/48/EC and 2006/49/EC)

These statistical measures of risk and capital adequacy while sound in theory rely in practice mostly on historical data from the rating agencies concerning credit losses, mainly in securities markets, and primarily in the US, on the one hand, and on historical statistics on volatility in securities markets, on the other, as inputs. These historical observations- even looking back a decade or more - are fairly benign in character, which reduces their predictive usefulness. Consequently, these methods are fairly untested in situations of severe market dislocations- so lessons have still to be learned. These models also rely heavily on ratings from the international rating agencies as inputs, and these, as experience has shown, are far from being infallible. Weaknesses in these technical elements of financial risk management have contributed to the recent turmoil in financial markets, but the root cause of these troubles is undoubtedly to be found in deficient credit processes in the first instance and poor documentation of widely traded financial instruments that have recklessly been distributed throughout the financial markets, both locally and globally.

For these reasons and considering the complex and somewhat uncertain assumptions underlying the Economic Capital and VaR models, it is prudent to have sizeable headroom on top of the calculated capital requirement in order to meet extraordinary events that could affect the Bank's credit exposures in a negative way. This has been taken into account in the scenario analysis undertaken for the Committee. It is also advisable, not least in view of recent developments in the financial markets, to combine statistical risk management methods – which have shown their flaws recently, and have often been misleading- with gross leverage ratios and limits on large exposures in the "old-fashioned way". Stress tests should also be conducted on a regular basis.

## 3.3 CEB's target countries

Table 3 lists CEB's 21 "target countries", a concept that the Bank has used in recent years to focus its efforts on areas where its contribution is most needed. This classification of member countries into target countries and other countries has a direct influence on the allocation of the Bank's resources. It was given a particularly important operational role in the Development Plan 2005-2009, and its roots lie in the 1997 decision of the Strasbourg Summit of Heads of State and Government of the Member States of the Council of Europe to give priority to Central and Eastern European countries in the Bank's lending. Since then, the socio-economic landscape of Europe has changed significantly. Luckily, many of the original target countries have developed strongly.

Today the group of 21 target countries is very heterogeneous. In Table 3, the 21 target countries are ranked by GDP per capita. On the basis of this measure, they can be divided into three groups. There are seven target countries with GDP per capita between USD 3 and 10 thousand, seven with GDP per capita between USD 10 and 20 thousand, and seven with GDP per capita between USD 20 and 30 thousand. Their international credit ratings – and consequently, their ease of access to finance in the international capital markets – follow basically the same ranking. Almost all seven countries with the highest incomes are rated A or better. In the middle group of seven countries, almost all are rated triple B; that is, investment grade. But the bottom seven by per capita income all have ratings below investment grade, and some of them are not rated at all, which makes them much more dependent upon IFI financing than the other two groups are.

It is undoubtedly the case that the seven countries in the lowest income group have more limited capacity to develop bankable projects to absorb loan finance than the other fourteen. Therefore, greater support from IFI lenders such as CEB is desirable. This should be reflected in CEB's lending and technical assistance policies in the years ahead. Careful development of projects in the low-income countries, combined with cautious lending policies, is necessary to achieve the owners' goals for the Bank's operations. Realistically, however, it is likely that the limited absorptive capacity of the target countries most in need of IFI financing will slow down the increase in lending to these countries.

**CEB's 21 Target Countries ranked by GDP per capita 2007[6]**

| | | GDP per capita | Population 2006 |
|---|---|---|---|
| | | PPP USD | Millions |
| 1 | Cyprus | 31 522 | 0.8 |
| 2 | Slovenia | 26 576 | 2 |
| 3 | Czech Republic | 25 346 | 10.2 |
| 4 | Malta | 23 454 | 0.4 |
| 5 | Estonia | 21 860 | 1.3 |
| 6 | Hungary | 21 040 | 10.1 |
| 7 | Slovakia | 20 002 | 5.4 |
| | | | |
| 8 | Latvia | 18 005 | 2.3 |
| 9 | Lithuania | 17 749 | 3.4 |
| 10 | Poland | 16 599 | 38.2 |
| 11 | Croatia | 15 733 | 4.4 |
| 12 | Romania | 11 079 | 21.6 |
| 13 | Bulgaria | 10 973 | 7.7 |
| 14 | Bosnia-Herzegovina | 9 964 | 3.9 |
| | | | |
| 15 | Turkey | 9 816 | 72.1 |
| 16 | FYR Macedonia | 8 215 | 2 |
| 17 | Serbia | 7 265 | 7.5 |
| 18 | Montenegro | 7 150 | 0.6 |
| 19 | Albania | 6 197 | 3.1 |
| 20 | Georgia | 4 176 | 4.5 |
| 21 | Moldova | 3 090 | 4.2 |

**Table 3**

## 3.4 CEB's Prudential framework

Careful study of the risk and capital requirement implications of a continued prudent shift of lending towards the target group of countries – or similar priority areas of activity along the lines defined in the Development Plan 2005-2009, in a sense extending this trend to 2014 – indicates that there is probably scope for such a shift in lending without impairing the Bank's triple-A rating. Here we should keep in mind that CEB's rating is not only based on its excellent capitalisation but also on its reputation as a supranational institution with a record of strong financial performance.

[6] Sources: IMF estimates for GDP, WB for population.

It is noteworthy that CEB follows a very cautious liquidity management policy, keeping a pool of liquid assets covering at least 50% of projected cash requirements over the coming three years. This policy has stood the Bank in good stead and is appreciated by the rating agencies.

To recapitulate, the key factors underpinning CEB's triple-A rating – in addition to its strong capitalisation and cautious liquidity management– are its excellent asset quality, prudent lending policies and strong membership support. Provided that all these factors remain, there is no reason to doubt CEB's ability to sustain a continued cautious shift in lending as described above, while preserving its triple-A rating, which is its stock in trade.

In this connection, CEB's prudential framework, presented in the Development Plan 2005-2009, is important. The prudential framework garnered approval by the rating agencies as being in line with Basel II, and was even regarded as being more conservative than required by the Basel Recommendations and the EU Capital Requirement Directive.

This is positive, of course, but the prudential framework should be developed further. The risk assessment methods and gross leverage ratios used by CEB to manage its risk-taking, while being prudently cautious, have the disadvantage of making comparisons with other financial institutions difficult, as has been pointed out by the rating agencies. Furthermore, they do not easily provide frequent quantitative feedback to management for guidance in its ongoing risk management. We therefore recommend that CEB's risk management methods and processes be developed to make it comparable with the Basel II Recommendations, both Pillar I and Pillar II –not only in substance, but also in form and, above all, in continuing disclosure to shareholders and the financial community. We know from the information provided for our work by the Bank's management and staff that the necessary material and human resources are already available at CEB for this purpose. We believe that such a change in presentation and risk management governance would enhance CEB's excellent reputation in the financial markets and support its triple-A rating, which is essential for the Bank's role of promoting the goals and priorities of its owners. Therefore, such a change should be cautiously considered by Management in the next few years without impairing the well functioning routines of the Bank.

## 3.5 Assumptions on ratings and membership

Two important assumptions lie behind our reflections about CEB's capacity to increase its lending to target countries and other priority areas over the medium to longer term. First, we have assumed that the credit ratings of both target countries and other member countries will remain unchanged. Second, we have assumed that CEB's membership will remain unchanged as well.

The first of these assumptions can be regarded as cautiously conservative, as it might be reasonable to expect that, on average, the ratings of the target countries should be more likely to improve than deteriorate over the medium to longer term, while, on balance, the ratings of the other member countries should most likely be maintained. The strengthening of the economies of several of the target countries over the past five to ten years appears to support this view. But as experience has shown, sudden country financial crises do tend to occur in unexpected conditions. This should also be kept in mind.

As regards the assumption on membership, we can safely say that it would certainly strengthen the basis for CEB's operations if the Western European member countries of the Council of Europe that are currently not members of CEB – mainly Austria and the United Kingdom – were to join the Bank. A broadening of the Bank's membership would also bring with it a capital increase. Furthermore, should some of the Eastern European members of the Council of Europe that presently are not members of CEB– for example, Armenia, Azerbaijan, the Russian Federation, or the Ukraine – join the Bank in the years ahead, this would bring new and interesting perspectives to CEB. Further eastward expansion of the Bank's membership would entail new and challenging tasks. In particular, this addition to membership could bring with it an interesting opportunity for the Bank to become an active participant in a much-needed co-ordinated effort to increase investment in environmental projects and to promote socially inclusive economic growth projects in Eastern Europe. In this part of Europe, there are many environmental challenges that must be tackled on a regional as well as a national basis. It appears as though CEB is well placed to participate in regional partnership solutions in this area, together with other international financial institutions, national authorities, and the European Union. Such a move, however, would require a significant strengthening in CEB staff and capital in order to tackle effectively the great challenges in this part of the continent.

## Main points:

- CEB's financial performance has been excellent during the last decade and a half. It has achieved and continuously maintained the highest credit ratings from the major international rating agencies. The Bank's triple-A rating is essential for its usefulness to the entire membership.

- Because of CEB's financial strength, there is still some limited scope for an increase in lending to its target countries (or eligible projects of similar creditworthiness) over the next five to seven years without a capital increase and without impairing its triple-A rating, provided that the current level of outstanding loans to other member countries is maintained and the Bank continues to follow cautious lending and prudential policies.

- CEB's present prudential framework is commendably cautious in its approach to credit risk. It has garnered approval by the rating agencies as being in line with Base II and has even been regarded as being more cautious than required by the the Basel Recommendations and the EU Capital Requirements Directive. Yet, it could be strengthened and made more comparable to other financial institutions by including, in the next few years, an explicit assessment of all types of financial and operational risk, using risk assessment methods in line with best practice in the financial services industry and by implementing a change in presentation.

- A broadening of CEB's membership to include all eligible Council of Europe member countries would strengthen the basis for the Bank's operations in the years ahead but would of course require additional resources in order to deal with the challenges this brings.

4

# Chapter 4: Co-operation with other IFIs and international organisations

The basic purpose of the policy of co-operation must be to increase the value of CEB activities within the framework of its institutional mandate, sectoral approach and operational pipeline. To this end, CEB should continue to seek complementary rather than competitive relationships with other IFIs and international organisations. In particular CEB should endeavour to complement the EU's various programmes of support for the Union's Eastern European neighbours aimed at promoting their transition to open democratic societies and socially, environmentally and economically sustainable market economies.

A review of the last two decades of CEB's co-operation with other IFIs and international organisations reveals a significant evolution from a limited approach (until 2005) to a more determined search for new opportunities for co-operation within the framework of the Development Plan 2005-2009, which is still in force.

## 4.1 First period until 2005

Several co-operation agreements (MoUs and other types) signed in the period 1999 to 2004, with a specified group of IFIs, are listed below:

- With the European Union and KFW, on co-operation on Central and Eastern European countries, including Turkey, signed in 2000.
- With the World Bank Group, signed in 2000.
- With EBRD, signed in 1999.
- With NIB, signed in 2002.
- As a general observation, except for the tripartite agreement with the European Union and KFW, the other agreements did not yield many results in terms of co-financed projects, although there were a number of projects for which both institutions provided financing in parallel.
- During the period from 2000 until 2005, the Tripartite Agreement with the European Union and KFW allocated a total of € 280 million in CEB financing, mostly towards SMEs and municipal infrastructure investments in Central and Southeastern Europe, as well as Turkey.

Even if the quantitative results stemming from these agreements are noticeable, CEB's actions were limited in scope (channelling requests for funds, etc).

In general, other CEB co-operation projects during this period consisted of parallel financing (NIB, World Bank, EIB, EBRD) with a wide geographical and sectoral distribution, which benefited the borrowers principally by providing additional financial resources.

## 4.2 Second period: 2005 to the present, within the framework of the Development Plan 2005-2009

While Europe, CEB's field of activity, was being transformed by the EU's successive steps of enlargement, the Bank's management focused on the impact that these steps – and the changes that could take place in EU policies in the social field – would have on the implementation of the Bank's mandate. As is mentioned above, this was reflected in the 2005-2009 Development Plan.

Therefore, one of the operational implications of these developments was to dedicate a growing effort towards establishing a network of regular contacts with those EU General Directorates within the Commission that have a bearing on the Bank's mandate.

At the same time, the Bank's closer attention to EU policies produced a more active dialogue with the IFIs and bilateral financial institutions that have been developing partnerships in relation to EU policies. The same is true of the co-operation with UN institutions active in Europe.

As a result of this new co-operation, CEB could consolidate its sectoral and geographical activities by signing new agreements (MoUs or other types of agreement) within the framework of EU policies, and by implementing them effectively.

Four new MoUs were signed under the aegis of EU policies, and in which one or more IFIs in addition to CEB participate:

- Urban Renewal and Development, with the Commission and EI (2007).
- Neighbourhood, with the Commission, EIB, EBRD, IBRD, NIB, BSTDB (2006).
- Enlargement, with the Commission, EIB, EBRD, IBRD, NIB, BSTDB (2006).
- Environment, with the Commission, EIB, EBRD, NIB (2006).

Three new MoUs were concluded with UNHCR, UNICEF and UNDP, in 2005, 2006 and 2007 respectively.

A concerted strategy has been set forth in order to secure other sources of technical assistance and co-financing for CEB's projects: Norway Trust Account, Human Rights Trust Fund, and contact with several potential bilateral donors.

All the agreements mentioned above are being implemented effectively:

- The MoU on Urban Renewal and Development has crystallized in the DG REGIO-EIB-CEB Partnership to develop the JESSICA programme, which has enhanced the visibility of the Bank and its role in social housing and integrated urban development.

- The MoUs on Neighbourhood and Enlargement have secured financing from EU funds for technical assistance and grants to several CEB projects in the Western Balkans and neighbouring countries.

- New co-operation on environmental principles is being developed, as are new co-financing proposals under the inter-IFI dialogue set up for the implementation of these MoUs.

- A co-ordinated approach is being secured, as is CEB's leading role, in certain projects involving EU facilities, IPA (EU's Instrument for Pre-Accession Assistance) funds, and bilateral donors' funds (for instance a state prison project in Bosnia-Herzegovina).

- Use of Norway's Trust Account has accelerated in recent years, with € 2 million already allocated out of € 3 million received and a pipeline of € 1.4 million.

- Contacts have been developed with other potential donors: Germany, Finland, Italy, Spain and Sweden.

These results have had and will have a significant impact, both quantitatively and qualitatively, on the value added by CEB financing and therefore the value gained by the recipient borrower.

## 4.3 Revised co-operation strategy

Clearly, the strengthening of the relationship between CEB and EU General Directorates can be beneficial to both parties, particularly if common projects lead to the effective execution of common policies. Therefore, CEB should pursue its present strategy of co-operation with the EU while maintaining its independence and reinforcing its strong ties with the Council of Europe.

The reinforcement of EU-CEB co-operation implies selective collaboration with other IFIs. In the case of EIB, the right track for CEB to follow is through the tripartite relationship CEB-Commission-EIB within the context of the EU programme. In the case of EBRD, the fact that Turkey has now become a country of operations for EBRD makes for interesting additional co-operation possibilities.

It is also very encouraging to note that the ECOFIN Council conclusions dated 14 May 2008 underlined that "closer coordination is vital to ensure complementarity, coherence, effectiveness, and efficiency of assistance in the Western Balkans." The Council in this regard welcomed "the initiative by the Commission in its Communication of 5 March 2008, together with the European Investment Bank, the European Bank for Reconstruction and Development and the Council of Europe Development Bank to establish a comprehensive Western Balkans Investment Framework". This certainly bodes well for the future of the cooperation between the CEB, the European Commission, the EIB and the EBRD in this part of Europe.

Co-operation with EBRD has slowed down due to differences in two institutions policies, such as on pricing and operational approach. There seems to be some scope for continued co-operation in the Western Balkans; in any case, environment and municipal infrastructure appear to be potential areas for joint activities with EBRD over a wider geographic area.

NIB-CEB: The two institutions different mandates do not exclude further co-operation in specific areas such as promotion of women's entrepreneurship, micro-financing, and energy efficiency.

Relations with the World Bank would require a high degree of co-ordination before they could engender common sector strategies in certain target countries.

CEB should place greater emphasis on migration as a central focus for the Bank's operations. This is not only in keeping with the Bank's original purpose, but it could also help make it more visible and more relevant to today's pressing problems. For this reason, CEB's co-operation with international institutions such as UNHCR, IOM, WHO, and UNICEF, which address the consequences of migration in a humane and just manner, should be emphasised.

Finally, regarding UN agencies in general, CEB should consider a dual role for them: not merely the traditional implementation role, but also a new role as developers of loan financed projects.

## 4.4 Results of co-operation

In several respects, it appears that the new co-operation strategy pursued within the framework of the Development Plan 2005-2009 has produced positive results in a number of dimensions beyond financing: for example, increased visibility of the Bank, additional leverage because of co-ordination with other European players in the field of development co-operation, etc.

The combined effect of co-operation between CEB and other IFIs and international institutions is significantly positive and would not have materialised without a parallel adaptation of the internal culture of the institution. In particular, this positive effect could not have been achieved had the operational and support teams' unavoidable reluctance not been overcome. Fortunately, these teams now perceive the benefits of the new resources and policies that follow from the participation of new partners, even if they have had to stretch available human resources.

CEB has shown a capacity of resolute adaptation to the evolving new framework of European relations by strengthening its ties with the EU Commission directly and by complementing EU policies of support for its new members and neighbouring countries with full compatibility with the Bank's Council of Europe mandate, for instance as regards migration issues. It is advisable for CEB to continue to develop its multilateral co-operation activities with other IFIs which partly base their European operations on common EU policies. This approach brings gains in visibility and effectiveness which facilitate the Bank's negotiations on additional sources of co-operations and technical assistance with multilateral as well as bilateral donors.

## Main points:

- CEB should continue to seek complementary rather than competitive relations with other IFIs and international organisations. In particular, increased co-ordination with the European Union helps the Bank in its specific task of supporting social development and enables it to promote the priorities of the Council of Europe more effectively.

- CEB should co-operate closely with the various regional development programmes of the EU for the easterly neighbours of the Union, as well as with the EIB and EBRD and other development banks active in the target countries. Co-operation with NIB on programmes promoting women's entrepreneurship, micro-finance, and energy efficiency is a niche of considerable interest for CEB from the standpoint of social cohesion as well as economic development.

- CEB should continue to develop its co-operation with UN agencies, with the aim of developing projects that support populations of CEB Member States through their humanitarian and development assistance programmes.

- CEB should place greater emphasis on migration as a central focus of its operations, in keeping with the Bank's original purpose. It should actively seek co-operation with the international agencies that deal with the consequences of international migration in a humane and just manner. CEB should finance projects addressing the causes and consequences of migration, both in the countries of origin and in the countries of destination within its membership.

- CEB's co-operation with other IFIs and international organizations has yielded positive results for the target countries and increased the Bank's visibility and leverage, particularly through its partnership with the EU and other European institutions in the field of development co-operation.

5

# Chapter 5: Operational performance

Operational performance can be measured by the number of operations or the volume of financial resources processed by a given institutional capacity, but by the same token, the value added to the flow of financing, expressed through more effective developmental impact of operations, also constitutes a crucial factor for the evaluation of good performance. The goal of CEB is to continue to improve its performance on both these scores.

## 5.1 CEB's current performance and challenges

CEB has proven to be very efficient regarding the first yardstick of performance mentioned above. Its operational units are small compared to the size of the lending programme. Three factors helped to maintain streamlined operating capacity:

- Concentration of most loans in a few areas: Urban social infrastructure and services and the support for job creation (SMEs) combined represent 75% of approvals in 2007;
- Strong emphasis on work with financial intermediaries. Over the 2001-2007 period, approximately two-thirds of the approved lending volume and three–fourths of the number of operations have been approved for first- or second-tier lending institutions; and
- CEB's reliance on joint-venture financing, which represents an efficient and cost-effective way to serve diverse borrowers, reduce risk, and learn about demand. These operations accomplish the Bank's principle of "complementarity".

CEB's project performance quality rating is similar to that of other development banks; overall, they show satisfactory results. An examination of the reasons why barely satisfactory and unsatisfactory projects[7] underperform reveals two recurrent weaknesses: a lack of accomplished physical objectives (43%), and a minimal guarantee of objective sustainability of the project (36%).

Both causes can be attributed in part to the absence of a thorough analysis of the borrowers' capacity to implement the project and a lack of institutional strengthening components in project design.

The recognised efficient use of CEB's processing capacity has a downside: it is too stretched to ensure effective quality enhancement. The Bank's technical capacity is devoted primarily to good project monitoring (83%). In 2007, only 13% of the

[7] According to information from CEB staff, roughly 5% of projects during the period 2001-2007, and 3% during the last three years, were rated as "unsatisfactory" in the Monitoring Reports on Projects sent annually to the Administrative Council.

Technical Advisory Directorate's (DCT) installed technical capacity, equivalent to less than one professional/year, participated in project preparation or appraisal.

As a consequence, the institution has to allocate its resources based on the quality of clients' loan applications, which varies.

## 5.2 Principles and lessons to follow

CEB's institutional commitments and recent developments establish some guidance for improvements:

- The **Paris Declaration on Development Aid Effectiveness** (2005) sets a benchmark in this respect by calling for better management of results and by directing country-led development processes toward clearly defined goals and measured terms of outcomes. It also calls on the banks to take steps to improve the quality of operations, and emphasises the need for enhanced country strategies and programming, sector strategies, project preparation and execution. CEB signed the Paris Declaration and is committed to its spirit.
- A shift in borrower demand from requests for pure financing to technical and sector-related advice is occurring. **Transfer of knowledge** is perceived as more important than attractive financial conditions. Evidence shows that in a variety of development banks, borrowers are now requesting clear, specified knowledge from institutions as part of the development financing.
- A new **demand for technical support** with a further shift of CEB's attention to target group countries in Central and Southeastern Europe is taking place. This originated in the low quality of project applications from countries without experience in project design and international financing. These operations will be smaller in lending amounts and more complex because of low absorptive capacity, and they will increase in number.

These challenges must be adapted in substance and pace in order to fit with CEB's size and budget constraints.

## 5.3 Building on own strengths - recommended actions

CEB is well positioned to face these challenges. Borrowers perceive the Bank as having close ties with the region, and they have confidence in it. This broad acceptance from its clients is an asset and a positive precondition for CEB's action in the region, as well as for the strengthening of its business model. CEB should aim to be an institution that introduces additional skills with significant social impact, thus becoming a **social cohesion bank**.

The prospect of strengthening CEB's response, over the coming years, to the demands of social sector actors and its own constituencies is favourable. One key to achieving this is to place more focus on the client's demands and a certain degree of specialisation, following the natural vocation of the institution. New lending instruments, paired with mobilisation of technical assistance, and co-operation with other institutions can complement CEB own expertise. Institutional presence at selected locations and dialogue at the country level can provide new investment opportunities and improve co-ordination with donors. Other important elements are measures to enhance project quality, strengthen the human resource base, and increase institutional learning.

Several groups of recommendations are proposed. They build on CEB's strengths and comparative advantages and would be selectively introduced over the next three years, implementing a long-term vision. They constitute a full menu of options and ideas, rather than an obligatory set of actions. Prioritisation is indispensable; furthermore, individual actions must be selected in accordance with the institutions' absorptive capacity for change and must respect the tradition of CEB as a cost-effective institution. The following is a summary of the CEP's main recommendations.

## 5.4 Continue efforts to understand and serve clients better

An accurate understanding of the countries' needs – the client focus – is central to a long-lasting relationship. This calls for more systematic and updated information on each country and its opportunities and challenges.

- An informal **country strategy** and ongoing sector dialogue form the basis for future co-operation. As CEB's operational frameworks for Turkey and Hungary show, an informal country strategy – not to be approved by the Administrative Council and with no formal commitment – can serve both as the focal point for the identification of specific development priorities and objectives on a multi-annual basis and as the platform for the allocation of the Bank's financial and human resources according to its comparative and competitive advantages. The existence of a country strategy can also allow for deeper co-ordination with other multilateral institutions. The preparation of such a strategy can be based on other institutions' research and analytical knowledge of the countries involved. This will tend to prevent duplication, promote better use of scarce resources, and allow for sharing of lessons learned.

  Complete country strategy documents should only be prepared for borrowing countries where the lending volume, or the complexity of CEB's programme, justifies this effort (as in the case of Turkey) and where periodic programming exercises will take place. It would be possible to prepare a **strategy for all target group countries together**, or a sub-group of them, highlighting shared characteristics or circumstances and CEB's response to them.

- Nearly all regional development banks establish **a local presence** through country offices. Among other advantages, an institutional local presence will help facilitate dialogue, solve upcoming problems quickly, accumulate knowledge on local constraints and idiosyncrasies, and foster a deeper understanding of local capabilities.
  CEB's size may not justify a field office in any of the borrowing member countries; however, sub-regional coverage might produce economies of scale, especially when employing local staff. The suggestion for CEB is **to consider** creating one **hub, which could serve several target group countries.**

- Client focus entails institutional flexibility and offering a **menu of options for the Borrower**. Within the category of investment loans, other IFIs developed new vehicles for lending, which are tested and might be attractive to CEB because they offer more flexibility in project design and implementation:
  - o The Conditional Credit Line for Investment Projects **(CCLIP)** expedites the loan preparation and approval process, while reducing loan processing costs for both the Bank and its borrowers. Because of its longer-term projection, this option might be attractive for target group countries with a proven track record in project management.

- The **Time Slice**, whereby the Bank's loan would finance a percentage of the investment plan for a period, can be used effectively in countries with solid budget management and good implementation capabilities.
- The **SWAp** (Sector Wide Approach) is an investment lending mechanism by which development agencies collaborate to support government-led programmes for a sector in a comprehensive and coordinated manner; therefore, it is suitable for countries with weaker structures. CEB has already taken part in one such operation.
- The **Project Preparation and Start Facility** would strengthen the Bank's pipeline and facilitate conditions necessary for initial steps for the preparation of baseline data and design of indicators. It is believed to shorten the time required for borrowers to prepare projects. Such a facility would be of particular interest within the framework of cooperation with the European Union and is currently considered in this framework in Western Balkan countries.

It would be necessary, however, to conduct testing to determine the usefulness of these instruments for CEB and their acceptance by borrowers.

## 5.5 Further improve project quality

The introduction of some proven practices into the project identification and preparation phase can greatly improve project quality and add value.

- Using the **institutional capacity assessment** method will draw attention to weak conditions of executing agencies *ex ante* and can help to identify bottlenecks or impediments during project execution.

- The systematic use of the **Logical Framework Method,** which has proven over decades to be a simple and effective tool for project design, would be useful. The "Log Frame" or more recently developed equivalent methods are a good tool for result monitoring and evaluation. They are also extremely useful in identifying external risks. Of course, they both require additional resources.

- CEB should use the opportunity of financing projects in social sectors to **supplement** infrastructure investment. Using CEB's investments as a vehicle for the improvement of public spending patterns in countries with weak technical and budgetary structures adds to the value of CEB's operations.

- **Environmental safeguards** could include a social impact review. During project design, CEB would require beneficiary participation from borrowers. This would enhance project design features, relevance, and effectiveness. Indeed, borrowers' participation in project design could link borrowers more closely to their projects and increase their willingness to pay for or contribute to project maintenance. The creation of an internal technical review group is recommended.

- **Fiduciary systems** are a key element in the assurance of effective development. Good fiduciary systems ensure that budgetary allocations and public expenditures--including procurement processes--are transparent, effective, efficient, and open to public scrutiny. Projects financed through CEB's resources must be designed to take full advantage of country fiduciary systems, thus avoiding unnecessary duplication of controls and reporting/auditing requirements. A certification procedure would be applied in some cases.

## 5.6 Strengthen knowledge transfer and technical capacity

Transfer of knowledge occurs through sector work, application of adequate methodologies, and training, but especially through joint project design on the spot. Lasting results depend largely on the resources that can be devoted to this kind of work.

The use of staff time would become more transparent and its allocation more realistic if a simple **time budget** figure were given for each project in preparation/monitoring. The same rule should apply to knowledge management and risk-control activities.

## 5.7 Verify developmental impact and systematise knowledge base and institutional learning

An institution learns from its own successes and failures. Evaluation units play an important role in translating findings into lessons learned in a way that the institution can absorb. In its short institutional history, the Ex-post Evaluation Department (DEP) has done an excellent job and produced clear and precise recommendations, which have also been a rich source of information for this report. Recommendations are:

- Due to the size of the institution and the scarcity of resources, the role of DEP could have to be interpreted in a broader sense and could include learning and training activities.
- In the learning function, DEP should pursue its dialogue with other MDBs in order to share knowledge, experiences, and lessons learned; harmonise approaches as appropriate; and explore the scope for co-ordination of staff training activities.
- DEP should suggest improvements in Project Completion Reports' format to enhance their value for institutional learning.

## 5.8 Climate for change and implementation

CEB's management has initiated several internal steps geared towards accomplish institutional improvements along the lines of this report's recommendations. Three examples can be highlighted: (1) The Bank's **internal performance assessment,** which aimed to facilitate the conduct and steering of the institution and enhance planning and resource allocation; (2) The publication of a **Handbook on environmental methodology** together with other development banks (EIB, EBRD, etc.); and (3) The production of an operational framework for Turkey, which can be used as an example of a complete **country strategy** document.

- ### Impact through a package

While the implementation of each of the individual recommendations has its own intrinsic merits and positive effects, a real step-up requires a consolidated effort of several actions, with a concrete work programme proposed by management to the shareholders (action plan).

## ● Cost implications

It would be an illusion to think that the improvements suggested do not involve additional costs. CEB will have to invest in upgrading technical capacity, as well as in knowledge transfer and local presence, in order to become more competitive.

There is a direct relation between added value and investment in technical capacity. More intensive technical support of borrowers, the employment of quality-ensuring methodologies, and a closer and more permanent dialogue with the Bank's clients generate higher operational costs.

In human resources, there is no doubt that the above recommendations, even extended over the coming years, will require additional technical and processing capacity. Attracting additional human resources through **outsourcing** could be the best and most economic way to proceed. The implication is that technical advisors and country managers will have to be prepared and must acquire the necessary skills to deal with knowledge management. That means that their activity profile would shift from direct execution of tasks to partial steering of outsourced capacities. The flexible use of consultants would allow the creation of a critical mass of knowledge needed, especially for possible flagship areas.

Very rough cost estimates indicate that, depending on the intensity and depth of the implementation, a one-time investment of EUR 0.8 – 1.2 million (divided over two years) and an additional yearly amount of EUR 0.6 – 0.8 million for maintenance of the achieved level will be needed.

## ● Sources of funding

The sources of direct financing of the above-mentioned improvements are:

- CEB's administrative budget, and
- Thematic trust funds.

With regard to additional Bank staff, sector and country strategy development, studies for internal purposes, and costs for eventual decentralisation, CEB should be prepared for **budget allocations.** The necessary resources must be clearly designated for the purpose of strengthening the operational capacity and technical support of clients.

Trust funds are already in use with CEB and have achieved effective results in support of target group countries. If the institution should decide to increase the number and volume of trust funds, as is common practice in other IFIs, a **grant management** facility must be created. This mechanism would establish a strategic link between technical assistance and CEB's lending portfolio and country strategies, as well as standardising approval and execution procedures so as to reduce transaction costs.

## Main points:

CEB has made a commitment to more effective action, greater efficiency of management, and quality of service. Value addition and effective development are at the core of its efforts. The prospect of strengthening CEB's response, over the coming years, to the demands of social sector actors and its own constituencies is favourable and could be based on the following recommendations.

- The correct understanding of the countries' needs, the client focus, is fundamental to a lasting relationship. Dialogue and strategy work at the country level can provide new investment opportunities and better co-ordination with donors. However, more permanent dialogue with the Bank's clients, including in some cases with a permanent local presence on the ground to level-up with other IFIs, will generate higher operational costs.

- Thematic specialisation and new lending instruments, paired with mobilisation of technical assistance, can further increase efficiency and, in some cases, better complement other institutions' work. CEB's processing capacity and technical human resource base will have to be strengthened. Institutional learning should be intensified.

- Technical assistance is a strategic instrument that supports the achievement of development objectives and provides a fundamental competitive advantage in terms of pipeline development, project preparation and capacity building. A grant management facility would have to be created in order to increase the number and volume of trust funds for this purpose.

These challenges must be adapted in substance and pace to fit with CEB's size and budget constraints. Shareholders could envisage increasing CEB resources to meet these operational objectives in the next Development Plan 2010-2014.

6

# Chapter 6: Governance

Sound corporate governance is essential for the proper functioning of CEB, as it is for any well-run financial institution. It is clear that CEB's present governance arrangements are greatly influenced by the fact that at its inception, more than half a century ago, its member countries were only eight in number. Today CEB has five times as many members, yet the governance provisions of the Articles of Agreement remain basically unchanged.

In the beginning, it may have seemed natural that all eight member countries should be directly represented not only on the Governing Board but also on the Administrative Council, which, broadly speaking, corresponds to the board of directors of other IFIs. However, most observers would agree that a 40-member board of directors runs the risk of being unwieldy and inefficient. Furthermore, since CEB was established, the financial markets have changed dramatically, as have the prevailing attitudes towards corporate governance for financial organisations. In particular, the importance of establishing clear lines of accountability and responsibility and avoiding potential conflicts of interest has emerged during this period. Against this background, it is necessary to review the governance arrangements of CEB.

One of the goals of the strategic review is to improve CEB's governance to bring it into line with best practice. For this purpose the Committee of Eminent Persons (CEP) has looked for guidance in two directions. On the one hand, it consulted the most recent guidelines on best practice in the governance of financial institutions, issued by the recognised international authorities in this field: the OECD and the Basel Committee.[8] On the other hand, the CEP considered the practice that has evolved in the governance of other MDBs and IFIs in recent years.

## 6.1 Bank corporate governance

The Bank's corporate governance arrangements determine the manner in which the Board of Governors (Governing Board), the Board of Directors (Administrative Council), and senior management govern the affairs and business of the Bank, thereby affecting how they:

- Set the Bank's objectives and overall policies
- Operate the Bank's business on a day-to-day basis
- Meet the obligation of accountability to their shareholders
- Take into account the interests of other recognised stakeholders
- Protect the interests of all shareholders in an equitable manner
- Organise the operations of the Bank in a safe manner in accordance with the principles of sound financial management.

[8] OECD: Principles of Corporate Governance, 2004; BIS: Basel Committee: Enhancing corporate governance for banking organisations, 2006.

There are four important forms of oversight that should be included in the Bank's organisational structure so as to ensure appropriate checks and balances:

- Oversight by the Board of Directors, which is accountable to the Board of Governors
- Oversight by individuals not involved in the day-to-day operation of the various business areas
- Independent risk management, compliance and audit functions
- Direct-line supervision by managers of the different business areas

Furthermore, it is important that key personnel be well qualified to carry out the tasks entrusted to them.

## 6.2 Governance of CEB

The governance of CEB is complicated. It reflects neither the typical Continental European structure nor the Anglo-Saxon pattern found in most IFIs. The Governing Board – with 40 members and a chairman chosen from outside the group of owners' representatives – is unusual. The Governing Board of CEB, which is essentially the "annual shareholders' meeting" or the board of governors' annual meeting of MDBs, has assumed some features of a "supervisory board" in the Continental European tradition, and even some features and decision-making powers of a "board of directors". The existence of CEB's Administrative Council, also with 40 members, and within it an Executive Committee of 13 members, both led by a chairman chosen from outside in a personal capacity, complicates the situation further. The areas of responsibility for each of the decision-making "organs" of CEB are not clearly demarcated. This pattern is not conducive to clarity of responsibility and accountability. For instance, there are examples of individuals who sit simultaneously on the Governing Board and the Administrative Council. In addition, the Governing Board can fairly simply reassume powers that it had previously delegated to the Administrative Council, and on occasion, it has done so. The allocation of functions and responsibilities between the chairman of the Governing Board and the Governor, and to some extent the chairman of the Administrative Council, is not clear in all respects. There is obviously good reason to simplify and clarify the formal structure of governance, but much can be done without – or in advance of – formal amendments to the Articles of Agreement. Most important is that the parties involved come to an agreement on codes of conduct and work patterns that clarify lines of accountability and responsibility and avoid the potential conflicts of interest that are to some extent inherent in the legal structure set forth in the present Articles of Agreement.

## 6.3 Principles of good governance

A fundamental premise of the generally accepted principles of sound corporate governance is the separation of ownership and day-to-day administration. This is particularly important in ensuring accountability in a financial institution. This separation may be particularly important in an international institution with nation states as owners. From this premise flows the need to create the foundation for an effective governance framework, which protects the rights of all shareholders, ensures their equitable treatment, and defines the responsibilities of the Board of Directors and its duty to present reliable financial statements and to respect the need for clear disclosure and transparency in its information about the Bank's business.

While there may be general agreement on these very general principles of sound governance, there are significant differences between or even within jurisdictions as regards some of the key structural elements of governance. Most Continental European countries prefer a two-tier board structure, with a management board essentially consisting of top executives of the company and, above that, a supervisory board usually comprising non-executives. While such a structure establishes a division of accountability and responsibility, it may also be unwieldy and inefficient. Furthermore, the supervisory boards tend to be chaired by previous chairmen or other former members of the company's top management, inviting opportunities for second guessing the firm's executive management. A single board of directors avoids these risks. But there are other risks, notably of an excessive concentration of power where the chairman is also the CEO. The advantages of combining the two roles is clarity in management and accountability and establishing clearly the identity of the institution. For an overly dominant individual it may also remove a potential source of restraint, weakening the checks and balances of the governance arrangement. This can, however, be overcome by establishing proper internal control mechanisms of compliance and internal audit, based also on codes of conduct.[9] Structures for collective decision making within top management on important matters can also be helpful in this regard.

The unitary board structure with a combined CEO and chairmanship role and both executive and non-executive board members has long been preferred in the US and the UK. This pattern has undoubtedly had considerable influence on the governance structure of the majority of international financial institutions, as is mentioned below.

There are also differing points of view concerning the size of the board of directors, the role of non-executives on the board, and the value of a supervisory board ranking above the board of directors. While there can be no universal answer to these questions, no one size that fits all firms, it is beyond doubt that a board of directors with more than 15 to 20 members is destined to be either inefficient with a risk of micromanagement or simply inert. A balance must be struck.

## 6.4 Guidance from other MDBs' governance

Practically all MDBs (from the largest to the smallest) organise their governance structure along similar lines.

### ● Board of governors

MDBs' shareholders are institutionally represented at the ministerial level in a collective body that is generally called the board of governors. The board of governors is recognised as wielding the decision-making powers on major policy and institutional issues, requiring special voting majorities in certain instances and requiring unanimity in exceptional cases. The distribution of voting power is allocated according to the shares of the membership, following certain criteria.

Boards of governors typically convene once a year at an annual meeting and elect a chairman for that purpose, on a yearly rotation basis. The chairmanship is of a political, governmental nature and regarded as an honorary post without pay.

The World Bank and IMF also hold a regular governors' meeting each spring (Development Committee and the IFMC-Committee). Those meetings follow a different format but are also convened at the ministerial level.

[9] Davies and Green, 2008. Global Financial Regulation – The Essential Guide, pp. 94-99. Polity Press, Cambridge, UK.

Most of the other MDBs hold also special meetings of committees of governors, but their frequency and dates are not as regular as those mentioned above. The committees of governors incorporate important policy and institutional issues into their agendas.

Among the most important decisions taken by the governors is the election of the president/CEO (exceptionally delegated to the board of directors in one or two cases) as well as the election of directors that are grouped in constituencies following certain criteria for the distribution of the voting power they represent.

## ● Board of directors

As is mentioned above, directors of almost all MDBs are grouped in constituencies, colloquially called ”seats”, and the number varies from one institution to another, from 24 (WB and IMF) to eight (NIB). While there are single country constituencies in all MDBs, the general rule is that each director represents more than one country. (EIB, NIB and CEB are special cases.)

Directors are normally supported by a team that includes one alternate and a few technical advisors or assistants.

The institutions with headquarters outside Europe generally have a resident board, while in Europe, with the exception of EBRD, the board of directors is non-resident (EIB, NIB, CEB).

The board holds those powers delegated to it by the governors and is accountable to them, as well as being responsible for supervising, in all respects, the conduct of business executed by management.

There is a critical point that directors must keep in mind while carrying out their responsibilities: they must, at all cost, avoid micro-managing; that is, interfering with the day-to-day activities of management.

Directors and senior management must work as a team and they must generate a climate of trust among themselves that is compatible with open and frank discussion of the institutional, policy, or operational issues that are the ultimate responsibility of the directors.

## ● Control structure

The control function has been reinforced in most MDBs during the last decade, in its concept, execution and organisation.

Although MDBs follow different models, they do not differ significantly in substance.

- They have an internal audit office that reports either to the president /CEO or to the board.
- Their external auditor(s) are generally appointed by the board, based on a qualified proposal by senior management. They produce an annual report that must be approved by the governors at the annual meeting. The principle of rotation after a certain number of years (generally 3 or 4) has become common practice.
- Some MDBs also have an audit committee of no more than three professionals who review all of the work previously performed by the internal and external auditors.
- Furthermore, some institutions have created special positions – for instance, a compliance officer – in order to complement the activities performed by the above groups.

It seems that there are two key issues:

- to have a list of candidates that include qualified names from all member countries;
- professional expertise in the auditing function should be the main requirement, if not the only criterion.

### ● Management

As in any public or private organisation, the senior management team – i.e., president/CEO, managing directors/vice-presidents, top-line managers – are the engine of any MDB.

President/CEO. The title of president is the normal pattern. His/her selection is based on complex criteria and the traditions of each institution. He/she is appointed either by the governors or by the directors, if they have received this type of delegation. Normally, certain voting majorities are required. The president/CEO is typically appointed for a renewable term of four to five years.

The president/CEO is the legal and official representative of the institution, the chief of staff, and in practically all cases, the chair of the board of directors. The position of president is incompatible with any other activity, as is explicitly reflected in the typical contractual agreement. The president also represents the institution in all other fora and on official visits to member states or institutions.

The president/CEO is charged with negotiating bilateral or multilateral Trust Funds without prejudice to their formal approval by the board(s). He/she keeps the board of governors informed on all pertinent institutional matters, in addition to reporting regularly to the directors. Because the president is mainly responsible for the proper functioning of the organisation in its day-to-day activities, he/she is supported by a close team that includes managing directors and/or vice-presidents, a secretariat unit with high-ranking status, line managers, and independent advisors (internal auditor, legal advisor and, in some cases, ex post evaluation officer).

## 6.5 Reform of CEB's governance

The current Articles of Agreement establish four "organs" to structure the governance system:

The Governing Board, the Administrative Council (and within it the Executive Committee), the Governor, and the Audit Committee.

Examining their composition and interrelationships could prove useful in identifying areas for possible improvement:

### ● The Governing Board

As is mentioned above, the present governance arrangement reflects a mixture of functions. To improve governance, it appears advisable to move towards the governance pattern found most frequently among MDBs.

The Governing Board is the forum for major policy and institutional decisions concerning the institution as a whole and its strategic direction. It seems advisable to enhance the level of its Annual Meeting by convening it at the ministerial level, in line with the practice of other MDBs. In our opinion, the general rule should be to convene the Governing Board only once a year to the main shareholders' meeting, the Annual Meeting, which could be complemented by another meeting, held at a different time of the year at a suitable level, to discuss specific institutional and policy issues of current interest for the institution. The ministerial-level Annual Meeting, attended also by stakeholders of all areas, particularly from the international financial community, is the appropriate forum to select a chairman of the Board of Governors from among his/her peers, on yearly rotating basis. The position of the chairman of the Board of Governors would be held for one year by a minister from one of the member countries. His/her identity as the highest-ranking authority of CEB could help to make the institution more visible at the political level, particularly vis-à-vis the Council of Europe and the international community. The representative function of the chairman for the institution should be complemented by the President/CEO on the basis of an agreed code of conduct.

The present powers vested in the Governing Board regarding key appointments could be maintained (the case of the Administrative Council is treated separately), with strong emphasis placed on applying the highest professional selection criteria to the election of the Governor (President/CEO), the auditing board members, and the Vice-Governors.

### ● The Administrative Council

Several features of this body deserve special consideration.

First, the large number of Council members – 40 (one representative per member country) – is striking. In this respect and several others, it differs substantially from the usual model of an MDB's board of directors.

Another unusual characteristic is the appointment of a subordinate body within the Administrative Council: the 13-member Executive Committee. The distribution of executive functions between the two bodies is somewhat unclear. The Administrative Council and the Executive Committee are chaired by the same chairman, who is elected by the Governing Board from outside in a personal capacity. On the other hand, while the CEO (the Governor) attends the Administrative Council's meetings, he/she is neither its chairman nor even a member of it.

Furthermore, the secretariat function for the meetings of both the Governing Board and the Administrative Council is placed outside the "headquarters for operational services", in fact, with the Council of Europe Secretariat, as is mentioned in Chapter 2.

Finally, it is worthwhile to note a very special situation that could affect the relations between the Governing Board and the Administrative Council because, under special circumstances, the former can temporarily reassume powers previously delegated to the latter.

Another departure from good governance practice is that, on occasion, the same person sits simultaneously on the Governing Board and the Administrative Council. This should not be allowed, as it clearly breaches the principles of separation of powers and gives rise to potential conflicts of interest.

There is no doubt that the key body of executive supervision and direction of the institution, the Administrative Council, differs substantially from the usual model of most MDBs and does not appear to fit the pattern of best practice for the governance of financial institutions.

The function of the Administrative Council, or Board of Directors of CEB, would benefit by adopting the general model of grouping the members into "constituencies," selecting a director for each and limiting the number of "seats" to 10 to 15 non-resident directors. The fear of inadequate representation of smaller shareholders appears to have been dealt with satisfactorily in all other MDBs, regardless of whether they have resident or non-resident boards. Care must be taken to secure the access and representation of all member countries - large and small - in the decision making processes of the institution in an orderly manner. Constituencies usually organise themselves their internal procedures such as an orderly rotation of Board of Directors posts among members.

Furthermore, the shift towards a smaller but more efficient Board of Directors would automatically eliminate the need for an Executive Committee within it, with consequent gains in efficiency.

Moreover, the perception of the Bank's external representation is confusing, and sometimes even misleading, due to the fact that three different officials seem to present themselves in this capacity on international missions: the Chairman of the Governing Board, the Governor and the Chairman of the Administrative Council. This should be simplified. According to good international practice, the external representation of the institution is the responsibility of the Governor/ President; in the case of the CEB, of course in close co-operation with the Chairman of the Governing Board.

Furthermore, in our opinion, the chairmanship of the Administrative Council (Board of Directors) should follow the regular model of other MDBs with the President/Governor as chairman, as chairing the board of directors represents one of the major functions of the CEO. A change of title from Governor to President should be considered in the interest of clarity and comparability.

We believe that, if this advice is followed, the meetings of the board of directors will become more efficient, particularly if the secretariat function for the meetings – and for the meetings of the Governing Board – is also moved to the "operational headquarters".

Finally, the provision authorising the potential reassumption, in exceptional circumstances, of powers previously delegated by the Governing Board to the Board of Directors (Administrative Council), and the occasional exercise of this authorisation, weakens the standing of the Board of Directors and should be subject to stringent consensus requirements.

Taken together, all of the above suggestions – i.e., a single executive body, the Board of Directors, comprising 10 to 15 members, each representing a constituency of countries, its meetings chaired by a president/CEO and supported by an internal secretariat – would represent important institutional improvements for all concerned: shareholders, clients, directors and management. Establishing a direct working relationship between the CEO and the Board of Directors would be beneficial in most respects: it would enhance efficiency, effectiveness, dialogue, consensus building, team approach, trust, and respect for each other's roles within a structure of governance without overlapping functions or micro-management.

### ● The Bank's secretariat

At present the secretariat functions for the Governing Board and the Administrative Council and the preparation of "Admissibility Opinions" for projects under consideration for CEB financing are the responsibility of the Partial Agreement Secretariat of the Council of Europe. As pointed out in Chapter 2 above, it would seem in keeping with a clear demarcation of responsibility and accountability to transfer part of these duties and the cost attached to them to the Bank. Once the issue of the composition of the Board of Directors and its chairmanship has been resolved it would seem advisable to create a secretariat at operational headquarters that takes care of the secretariat functions for the Governing Board/Board of Governors and the Administrative Council/Board of Directors and specialises in all issues that are important for the operational headquarters of the Bank. This Bank secretariat that would be attached to the Governor's/President's office would work in close co-operation with the Partial Agreement Secretariat on all pertinent matters, the Partial Agreement Secretariat remaining in charge of preparing the "admissibility opinions" issued by the Secretary General of the Council of Europe concerning the political and social aspects of proposed projects.

### ● The auditing board and external auditor

The Governing Board appoints CEB's auditing board and external auditor. This procedure is important because it gives independent status to these functions, which must always meet the highest professional standards. As a practical matter, the CEO should play an active and collaborative role in the preparatory selection process for the appointment of the members of the auditing board. In our view, it would be advisable to:

- require a significant previous professional experience in the auditing field;
- provide for the proposal of more than one candidate by the member states;
- provide for a system of rotation between all member states.

The same approach could be followed regarding the appointment of the external auditor by the Governing Board.

### ● The Governor/President and the Vice-Governors/Vice-Presidents

The previous comments touch on the somewhat ambiguous relations between the Governor/CEO, as chief of staff and legal representative of the institution, and the other governance "organs".

As regards the Governing Board, it is proposed above that the external representative function, shared under the present governance arrangements by the Chairman of the Governing Board and the Governor/CEO, could and should be clarified by emphasising the ministerial status of the Governing Board and by internal consensus so as to avoid mistaken perceptions and overlapping functions and to confirm the standing of the President as the official head of the Bank among his colleagues in the international community.

Regarding the appointment of Vice-Governors, the CEO should continue to be entitled to propose the number of positions of Vice-Governors. In addition, he should be entitled to propose the professional selection criteria, as well as participating in the selection. The option of delegating the appointment of Vice-Governors to the Board of Directors, on the basis of a proposal from the President (Governor), should be considered.

The role of the three Vice-Governors of CEB is only vaguely described in the present Articles of Agreement as that of "assisting" the Governor, with one of them "replacing" the Governor if necessary. Following the example of other MDBs, it appears sensible to define the roles of the three Vice-Governors more clearly, giving each direct-line supervision responsibility for certain business areas, with the title Vice-President, and appointing one as the Executive Vice-President, who replaces the Governor/ President when necessary. This type of structure, with the Bank's top management led by the Governor/ President, seems more in line with best practice in corporate governance than the present arrangement, from the standpoint of both efficiency and accountability. Therefore, subject to the previously mentioned qualifications, it should be possible to give each of the Vice-Governors direct-line supervision responsibility for certain business areas; these direct-line supervision responsibilities also mean that each of the Vice-Governors would be accountable to the Governor in carrying out his/ her duties. One of the most important functions of the Governor/ President is to instil a sense of common purpose and enhance motivation at all levels of staff, including senior management.

## Main points:

- The present structure and distribution of functions of CEB governance differs noticeably from generally accepted governance principles and from the governance arrangements of other multilateral development banks (MDBs). A decision to launch a process of clarification of the roles and responsibilities of the various supervisory, executive and management bodies could lead to significant institutional improvements and increased efficiency. A reform of CEB's governance structure could enable the Bank to fulfill its mandate more effectively.

- In the case of the Governing Board, elevating attendance to its Annual Meeting to the ministerial level would improve the Bank's image vis-à-vis other stakeholders and the international financial community.
  Establishing a process of annual selection of the chairman of the Governing Board among his/her ministerial peers, in order to emphasise the governmental, political and honorary nature of the position, is likely to facilitate the relationship with the other organs/bodies of governance of the institution and with the Council of Europe.

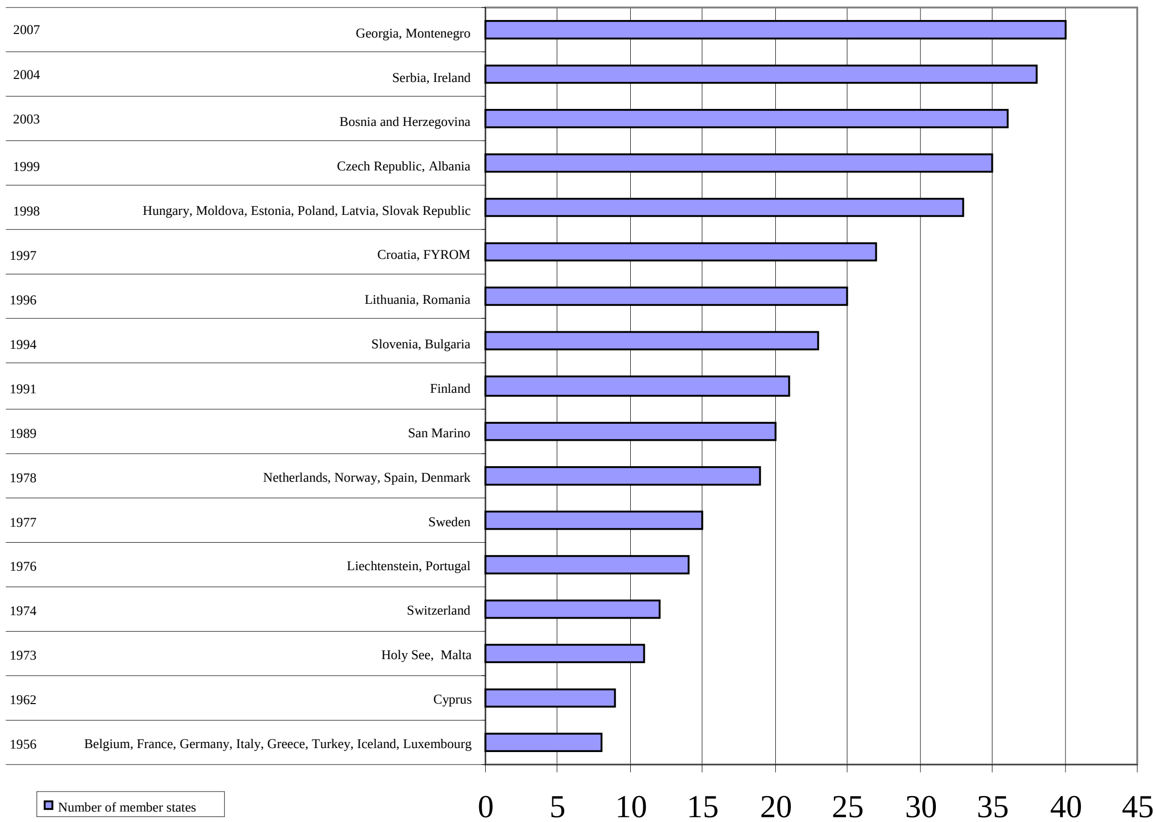
- For the executive functions entrusted to the Administrative Council, including the Executive Committee, a new non-resident, more efficient structure – a Board of Directors – should be defined, aligning it with the arrangements prevalent among other MDBs. The issues that require primary attention are: reducing the number of directors on the Board to a "manageable" number while securing balanced composition of the Board, representative of the entire membership; making the President/Governor the chairman of the Board of Directors; eliminating dual representation on governing and executive bodies; and securing a stable distribution of responsibilities and functions among the governing, supervisory and executive organs so as to enhance accountability and avoid conflicts of interest.

- The role and functions of the Governor (it is proposed that the title be changed to President) should be enhanced, both externally – within the international financial community and as the official representative of the institution, and internally, by reinforcing the President's/Governor's role as the CEO of the Bank. This implies that the President/Governor is the chairman of the Board of Directors and will, as chief of staff, participate in all senior appointments. The President's management capacity could be reinforced by an operational headquarters secretariat and by a team of Vice-Presidents (one of them as Executive Vice-President) accountable to the President, each with direct-line supervisory responsibility for specified business areas. These responsibilities should be reflected in the professional selection criteria for appointments of Vice-Presidents.

- A plan of action setting out the different stages of implementation is required to modernise CEB's governance arrangements and bring them into line with best practice in a systematic way.

# Statistical Appendix

## Figure-table 1. CEB member states and year of accession.




Source: CEB

## Table 2. CEB key economic indicators for the period 1994 – 2007.

| In M€ | Net interest income | Operating income | Profit | Loans outstanding | Debts evidenced by certificates | Total assets | Subscribed capital | General reserves after profit allocation | Equity | Return on equity ratio | Cost to income ratio |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **1994** | 77 | 68 | 55 | 6,337 | 7,775 | 9,805 | 1,241 | 465 | 762 | 7.2% | 13.7% |
| **1995** | 90 | 84 | 68 | 6,076 | 8,489 | 9,784 | 1,297 | 515 | 813 | 8.3% | 14.4% |
| **1996** | 91 | 94 | 86 | 5,629 | 8,044 | 9,183 | 1,318 | 591 | 891 | 9.6% | 13.0% |
| **1997** | 90 | 94 | 82 | 5,843 | 8,331 | 9,539 | 1,326 | 668 | 969 | 8.4% | 14.9% |
| **1998** | 95 | 95 | 81 | 6,403 | 9,729 | 11,096 | 1,386 | 747 | 1,055 | 7.7% | 16.7% |
| **1999** | 106 | 106 | 91 | 7,743 | 11,050 | 12,659 | 1,401 | 831 | 1,140 | 8.0% | 16.1% |
| **2000** | 108 | 107 | 95 | 8,442 | 12,526 | 14,434 | 1,401 | 906 | 1,225 | 7.8% | 16.7% |
| **2001** | 105 | 105 | 88 | 8,630 | 12,023 | 13,926 | 3,004 | 814 | 1,294 | 6.8% | 18.2% |
| **2002** | 113 | 112 | 95 | 9,350 | 11,506 | 14,217 | 3,231 | 879 | 1,384 | 6.9% | 18.6% |
| **2003** | 106 | 105 | 87 | 9,903 | 10,883 | 14,786 | 3,249 | 965 | 1,473 | 5.9% | 22.4% |
| **2004** | 115 | 115 | 115 | 10,765 | 11,777 | 16,390 | 3,294 | 1,236 | 1,604 | 7.2% | 21.3% |
| **2005** | 114 | 116 | 89 | 11,483 | 13,725 | 17,675 | 3,294 | 1,316 | 1,685 | 5.3% | 23.6% |
| **2006** | 115 | 118 | 88 | 11,965 | 13,620 | 18,232 | 3,294 | 1,398 | 1,767 | 5.0% | 25.0% |
| **2007** | 117 | 123 | 93 | 12,007 | 13,264 | 18,509 | 3,303 | 1,490 | 1,821 | 5.1% | 24.1% |

Source: CEB

## Table 3. CEB Ratings history for the period 1994 – 2007.

| Rating | Standard & Poor's | Moody's | Fitch Ratings |
|---|---|---|---|
| **1994** | AAA | Aa1 | |
| **1995** | AAA | Aa1 | |
| **1996** | AAA | Aa1 | AAA |
| **1997** | AAA | Aa1 | AAA |
| **1998** | AAA | Aa1 | AAA |
| **1999** | AAA | Aa1 | AAA |
| **2000** | AAA | AAA | AAA |
| **2001** | AAA | AAA | AAA |
| **2002** | AAA | AAA | AAA |
| **2003** | AAA | AAA | AAA |
| **2004** | AAA | AAA | AAA |
| **2005** | AAA | AAA | AAA |
| **2006** | AAA | AAA | AAA |
| **2007** | AAA | AAA | AAA |

Source: The rating agencies

## Table 4. CEB Operations and lending 2001-2007.

| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|---|---|
| **Number of borrowers (all projects)** | 27 | 20 | 30 | 27 | 31 | 26 | 33 |
| **Number of projects approved** | 35 | 21 | 42 | 33 | 42 | 37 | 37 |
| **Amount approved (€ millions)** | 1.664 | 1.605 | 2.149 | 1.751 | 2.517 | 2.460 | 2.414 |
| **Amount Intermediated Loans (€ millions)** | 747 | 1.093 | 1.095 | 1.274 | 1.771 | 1.519 | 1.611 |
| **Percentage of total amount** | 45% | 68% | 51% | 73% | 70% | 62% | 67% |
| **Number of Intermediated Loans** | 15 | 13 | 23 | 24 | 27 | 22 | 27 |
| **Percentage of total operations** | 43% | 62% | 55% | 73% | 64% | 59% | 73% |

Source: CEB

## Table 5. CEB Disbursements 2002-2007.

| | Countries | GDP per capita | Population | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|---|---|---|---|
| 1 | **Cyprus** | 31.522 | 0,8 | 141,4 | 91,6 | 37,6 | 15,0 | 85,7 | 41,7 |
| 2 | **Slovenia** | 26.576 | 2,0 | 5,5 | 0,0 | 0,0 | 20,0 | 15,0 | 9,1 |
| 3 | **Czech Republic** | 25.346 | 10,2 | 0,0 | 0,0 | 0,0 | 12,0 | 16,0 | 7,0 |
| 4 | **Malta** | 23.454 | 0,4 | 25,5 | 75,5 | 0,0 | 0,0 | 0,0 | 0,0 |
| 5 | **Estonia** | 21.860 | 1,3 | 3,6 | 3,0 | 0,0 | 0,0 | 0,0 | 0,0 |
| 6 | **Hungary** | 21.040 | 10,1 | 17,8 | 122,2 | 174,3 | 144,7 | 164,0 | 95,0 |
| 7 | **Slovak Republic** | 20.002 | 5,4 | 7,8 | 2,3 | 6,5 | 7,3 | 0,6 | 0,0 |
| 8 | **Latvia** | 18.005 | 2,3 | 5,3 | 7,1 | 4,5 | 0,5 | 38,5 | 61,5 |
| 9 | **Lithuania** | 17.749 | 3,4 | 3,3 | 4,1 | 3,0 | 4,2 | 4,2 | 11,4 |
| 10 | **Poland** | 16.599 | 38,2 | 151,1 | 103,9 | 23,3 | 132,2 | 103,4 | 51,9 |
| 11 | **Croatia** | 15.733 | 4,4 | 22,4 | 33,3 | 23,2 | 41,6 | 34,8 | 19,1 |
| 12 | **Romania** | 11.079 | 21,6 | 63,1 | 6,2 | 88,7 | 37,4 | 51,6 | 74,7 |
| 13 | **Bulgaria** | 10.973 | 7,7 | 4,6 | 10,0 | 28,1 | 5,3 | 33,4 | 3,8 |
| 14 | **Bosnia and Herzegovina** | 9.964 | 3,9 | 0,0 | 0,0 | 0,0 | 0,0 | 2,4 | 26,9 |
| 15 | **Turkey** | 9.816 | 72,1 | 54,0 | 22,6 | 63,9 | 160,6 | 33,5 | 84,9 |
| 16 | **FYROM** | 8.215 | 2,0 | 8,6 | 0,0 | 3,0 | 0,0 | 6,7 | 0,0 |
| 17 | **Serbia** | 7.265 | 7,5 | 0,0 | 0,0 | 0,0 | 0,0 | 9,6 | 8,0 |
| 18 | **Montenegro** | 7.150 | 0,6 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 |
| 19 | **Albania** | 6.197 | 3,1 | 0,0 | 0,7 | 2,3 | 6,2 | 0,5 | 8,4 |
| 20 | **Georgia** | 4.176 | 4,5 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 |
| 21 | **Moldova** | 3.090 | 4,2 | 0,0 | 0,0 | 0,0 | 0,0 | 2,0 | 1,0 |
| | **Target group countries (without transit loans)** | | | **514,0** | **482,4** | **458,4** | **587,0** | **601,9** | **504,3** |
| | *+ Transit loans* | | | *30,0* | *85,0* | *127,5* | *211,3* | *208,8* | *166,3* |
| | **Total Target group countries (including transit loans)** | | | **544,0** | **567,4** | **585,9** | **798,3** | **810,7** | **670,6** |
| | **Total Other countries (excluding transit loans)** | | | **992,7** | **1 022,1** | **944,0** | **760,2** | **829,5** | **919,1** |
| | **TOTAL ALL COUNTRIES** | | | **1.536,7** | **1.589,5** | **1.529,9** | **1.558,5** | **1.640,2** | **1.589,7** |

Notes:
- Transit loans: non-target countries' operations for the final benefit of target countries)
- GDP per capita in PPP USD 2007
- population in millions (2006)
- disbursements in million euros
- Serbia & Montenegro until 2004

Sources: IMF estimates for GDP; WB for population; CEB for lending

## Table 6. CEB Outstanding 2002-2007.

| | Countries | GDP per capita | Population | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|---|---|---|---|
| 1 | **Cyprus** | 31.522 | 0,8 | 445,3 | 473,3 | 464,0 | 447,7 | 457,6 | 459,0 |
| 2 | **Slovenia** | 26.576 | 2,0 | 38,6 | 33,7 | 31,8 | 54,5 | 64,1 | 63,7 |
| 3 | **Czech Republic** | 25.346 | 10,2 | 0,0 | 0,0 | 0,0 | 11,4 | 23,5 | 25,0 |
| 4 | **Malta** | 23.454 | 0,4 | 84,0 | 133,3 | 120,8 | 120,2 | 102,0 | 101,0 |
| 5 | **Estonia** | 21.860 | 1,3 | 5,6 | 8,5 | 8,3 | 8,1 | 7,9 | 7,4 |
| 6 | **Hungary** | 21.040 | 10,1 | 101,3 | 223,5 | 390,6 | 523,8 | 667,8 | 676,6 |
| 7 | **Slovak Republic** | 20.002 | 5,4 | 24,0 | 26,2 | 32,4 | 39,1 | 37,9 | 34,3 |
| 8 | **Latvia** | 18.005 | 2,3 | 5,3 | 11,6 | 15,6 | 17,1 | 53,8 | 114,5 |
| 9 | **Lithuania** | 17.749 | 3,4 | 9,9 | 13,1 | 15,3 | 19,1 | 22,2 | 30,4 |
| 10 | **Poland** | 16.599 | 38,2 | 351,0 | 444,9 | 481,3 | 613,7 | 705,9 | 747,1 |
| 11 | **Croatia** | 15.733 | 4,4 | 61,9 | 94,0 | 116,6 | 155,9 | 184,8 | 195,3 |
| 12 | **Romania** | 11.079 | 21,6 | 109,2 | 102,4 | 186,2 | 234,8 | 271,1 | 329,5 |
| 13 | **Bulgaria** | 10.973 | 7,7 | 14,0 | 22,0 | 48,9 | 55,1 | 85,6 | 82,4 |
| 14 | **Bosnia and Herzegovina** | 9.964 | 3,9 | 4,7 | 3,9 | 5,7 | 4,2 | 6,1 | 31,9 |
| 15 | **Turkey** | 9.816 | 72,1 | 883,0 | 681,2 | 635,9 | 791,4 | 689,5 | 653,2 |
| 16 | **FYROM** | 8.215 | 2,0 | 13,9 | 13,9 | 16,9 | 16,8 | 22,9 | 20,9 |
| 17 | **Serbia** | 7.265 | 7,5 | 0,0 | 0,0 | 24,6 | 21,1 | 27,2 | 31,6 |
| 18 | **Montenegro** | 7.150 | 0,6 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 |
| 19 | **Albania** | 6.197 | 3,1 | 0,0 | 0,7 | 3,0 | 9,6 | 9,6 | 17,6 |
| 20 | **Georgia** | 4.176 | 4,5 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 | 0,0 |
| 21 | **Moldova** | 3.090 | 4,2 | 0,0 | 0,0 | 0,0 | 0,0 | 2,0 | 3,0 |

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|---|
| **Target group countries** | **2.151,6** | **2.286,2** | **2.597,9** | **3.143,6** | **3.441,7** | **3.624,4** |
| *+ Transit loans* | *60,6* | *145,6* | *273,1* | *403,1* | *491,0* | *619,8* |
| **Total Target group countries (including transit loans)** | **2.212,2** | **2.431,8** | **2.871,0** | **3.546,7** | **3.932,7** | **4.244,2** |
| **Total Other countries (excluding transit loans)** | **7.137,3** | **7.470,8** | **7.893,8** | **7.936,1** | **8.032,6** | **7.763,1** |
| **TOTAL ALL COUNTRIES** | **9.349,5** | **9.902,6** | **10.764,8** | **11.482,8** | **11.965,2** | **12.007,3** |

Notes:
- Transit loans: non-target countries' operations for the final benefit of target countries)
- GDP per capita in PPP USD 2007
- population in millions (2006)
- outstanding in million euros
- Serbia & Montenegro until 2004

Sources: IMF estimates for GDP; WB for population; CEB for lending

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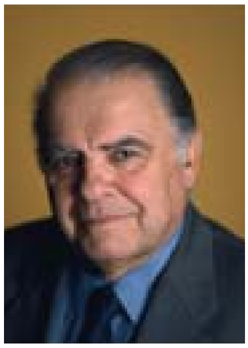
# Curricula vitae of the members of the Committee and its Special Advisor

# Enrique V. Iglesias

**Former President of the Interamerican Development Bank**
**Ibero-american General Secretary**



Enrique V. Iglesias served more than 17 years as president of the IDB, presiding over a period of strong growth of the institution's resources and an expansion of its activities. Under his leadership the Bank became the leading source of multilateral development financing for Latin America and the Caribbean.

After his successive election by the Board of Governors to four five-year terms, Iglesias resigned on Sept. 30, 2005, in the middle of his fourth term. He subsequently became the first secretary general of the Ibero-American Secretariat, an office based in Madrid, Spain, that provides technical assistance and coordinates the annual Ibero-American conferences and summits.

Born in Asturias, Spain, Iglesias became a naturalized Uruguayan citizen. He graduated from Uruguay's Universidad de la República in Economics and Business Administration in 1953 and pursued specialized studies in the United States and France.

Prior to his election as president of the IDB, Iglesias served as Uruguay's Minister of Foreign Relations (1985-1988); Executive Secretary of the U.N. Economic Commission for Latin America and the Caribbean (1972-1985); Secretary General of the U.N. Conference on New and Renewable Sources of Energy, held in Kenya in 1981; and chairman of the conference that launched the Uruguay Round of international trade negotiations in Punta del Este, Uruguay, in 1986. These negotiations led to the creation of the World Trade Organization, the successor to the General Agreements on Tariffs and Trade. Iglesias served as President of Uruguay's Central Bank from 1966 to 1968.

Iglesias taught economic development at Uruguay's Universidad de la República and served as director of its Institute of Economics. He has written numerous articles and papers on Latin American and Uruguayan economic issues, capital markets, external financing and multilateralism. Iglesias has received many honorary academic degrees and professional awards.

## Jón Sigurdsson

**Former President & CEO of NIB**
**Chairman of the Board of the Financial Supervisory Authority, FME, of Iceland**

Jón Sigurdsson was President and Chief Executive Officer of the Nordic Investment Bank (NIB) in Helsinki 1994-2005. Before his appointment as head of NIB, Mr. Sigurdsson was Governor of the Central Bank of Iceland and Chairman of the Central Bank´s Board of Governors. Prior to heading the Central Bank Mr.Sigurdsson was a member of the Icelandic Government for six years, 1987-1993, as Minister of Trade, Banking, Industry and Energy. He also served as Minister of Justice and Nordic Co-operation. During this six year period he was a member of the Althing, the Parliament of Iceland.

Mr. Sigurdsson was Managing Director of the Icelandic National Economic Institute in 1974-1980 and 1983-1987. He was Executive Director representing the Nordic countries on the Executive Board of the International Monetary Fund in Washington D.C. 1980-1983.

Mr. Sigurdsson was Chairman of the Board of Directors of the Nordic Investment Bank 1984-1986, Chairman of the Council of Ministers of the OECD 1989 and Chairman of the Northern Dimension Environmental Partnership, NDEP, 2001-2002 and 2004-2005.

Mr. Sigurdsson earned a M.Sc.(Econ.) degree from LSE, the London School of Economics, in 1967 and a fil.kand. degree in economics and statistics from the University of Stockholm in 1964.

He has published a number of books and articles on economics and international relations and is currently active as an independent consultant on economic and financial affairs. He is Vice-Chairman of the Supervisory Board of the Central Bank of Iceland and Chairman of the Financial Supervisory Authority, FME, of Iceland.

# Jacques de Larosière de Champfeu

**Former President of EBRD**
**Former Managing Director of IMF**

After gaining degrees in arts and law and graduating from the Institut d'études politiques (IEP) in Paris, Jacques de Larosière attended the Ecole nationale d'administration (1954-1958), o“inspecteur” (1960) in the finance ministry. He went on to serve as project officer in the finance ministry's “general inspection” department (1961), then subsequently in the external finance division (1963) and the Treasury division (1965). He became unit leader (“sous-directeur”) (in the Treasury division) (1967), then deputy director (“directeur adjoint”), and then section head (“chef de service”) in the Ministry of Economics and Finance (1971).

After being private secretary to Valéry Giscard d'Estaing, when he was Minister of Economics and Finance (January to May 1974), Jacques de Larosière became Director of the Treasury (1974-1978), General Manager of the International Monetary Fund (IMF) (1978-1987), and “Inspecteur général des finances” (1981). In 1987, he was appointed Governor of the Banque de France, a job he held until 1993. On leaving that position, he was appointed President of the European Bank for Reconstruction and Development (EBRD) (1993-1998).

Concurrently, Jacques de Larosière held the following positions: Chairman of the Economic and Development Review Committee (EDRC) of the Organisation for Economic Cooperation and Development (OECD) (1967-1971), director of Renault when it was a state-owned company (1971-1974), of the Banque nationale de Paris (BNP) (1973-1978), of Air France and the SNCF (1974-1978), and of the Société nationale industrielle aérospatiale (SNIA) (1976-1978), chairman of the “Group of Ten” (G-10) (1976-1978), Chairman of the governors of central banks of the G-10 countries (1990). Jacques de Larosière is a director of France Télécom, Alstom and Power Corporation.

Jacques de Larosière is a member of the Institut de France.

Since 1998, he has been advisor to the Chairman of the bank BNP Paribas.

# Terms of reference for the Committee of Eminent Persons

**adopted by the Governing Board of CEB on 28 March 2008**
**(Cf. CD PV/188/2008- Appendix 2)**

The Committee's objectives will be to reflect on "**the CEB's social mandate, its governance and its international positioning"** (including its visibility).
It is expected that the Committee's opinion will therefore enrich the debate on the first four themes identified by the shareholders in September last:

- **theme 1: mandate;**
- **theme 2: relations with the Council of Europe;**
- **theme 3: relations with the other institutions** given CEB's specific role within the IFI community;
- **theme 4: governance.**

The resulting comments will have to contribute to the debate concerning **the role that a social development bank can and should play in Europe today.**

- The Committee will have to propose potential ways that would enable the CEB to fully play its **social role in respect of "target groups" in each member state**, in particular and in priority *yet* not exclusively, in the target group countries, while still preserving its AAA rating and avoiding any call for capital.

- The work of this Committee could also usefully address different **ways of further increasing the added value of the Bank,** if necessary by conducting studies on the social actions that could have the best functional effects on an environmental improvement of each project: areas in which the social added value of financings for SMEs is clearly defined; areas enjoying a healthy banking sector but having needs to facilitate access to credit or to improve the efficiency of social services (housing, health, education, water treatment, etc.); areas in which significant poverty situations continue to exist despite a high economic level, etc.

- Regarding **Governance**, the work of the Committee should imply a preparation of an inventory of the existing governance principles and of the respective roles of the Managing Committees, the Governor and the Auditing Board taking into account an appropriate international comparison to equivalent organisations as well as an analysis of their practical application of the Governance principles.

- Lastly, for each project the systematic role of the **long-term technical monitoring provided by the Bank** (country manager missions; technical advisor missions leading to regular monitoring reports and a completion report; periodic borrower follow up reports monitored internally; ex-post evaluation missions), that could be usefully complemented in the future by **increased activities of technical assistance** at the beginning of and during the life-time of a project, could become the object of special attention for the Committee in its objective to contribute considerably to define **the long-term social added value provided by the CEB's teams.** The results of this study will enable the Bank to achieve clearer and better-argued communication on its comparative advantages.

After having drawn up an inventory of the way in which the CEB positions itself today and fulfils its mandate within the framework of a clear set of governance principles, the Committee will formulate **recommendations for improvement that will be submitted to the shareholders** at meetings of the Administrative Council and Governing Board.

- The subjects of the **added value provided to the member states,** the **structuring of the CEB's logical geographical and sector engagements,** the **existing margins to manoeuvre in the field of grants** should be addressed and then become part of the recommendations as precise as possible.

- The question of **reinforced cooperation with the Council of Europe** will come within the Committee's mandate; it includes the issue of coherence of the action of the Bank with the **priority project programs of the Council of Europe**.

- **Concerning governance,** proposals for improvement are expected if deemed necessary, with or without implied changes to the Articles of Agreement, so that, thanks to a strong and comprehensive set of governance principles, the CEB be in line with best international business standards and practices.

- Lastly, an improvement in **the Institution's communication both internally and with its Business partners and interested parties** (beneficiaries, NGOs, press, general public, etc.) via, for example, a more systematic organisation of seminars providing an opportunity for exchanges of experiences on CEB's principal tasks and its main projects, could also give rise to concrete recommendations.