Council of Europe Development Bank – Aaa stable

Update following upgrade to Aaa, outlook stable

Summary
The credit profile of the Council of Europe Development Bank (CEB) reflects its strong asset quality and pristine track record of asset performance, as well as its high liquidity levels and strong access to funding. CEB’s main credit challenges are its high leverage ratio and the fact that it only has moderate levels of callable capital relative to peers, although these metrics are set to improve following the approval of a very significant increase of the bank’s paid-in and callable capital in December 2022.

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

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

Credit challenges
» A leverage ratio which is among the highest of rated MDBs
» Low levels of callable capital compared to highly-rated peers
Rating outlook
The stable outlook reflects our expectations that CEB’s Capital Adequacy will balance an excellent asset performance and a declining leverage ratio against somewhat increasing risks to its asset portfolio in coming years, while the bank’s very strong Liquidity and Funding profile will remain largely unchanged for the coming 12 to 18 months. Meanwhile, we expect that the level of shareholder support will remain strong in the wake of the recently agreed capital increase, with member states continuing to subscribe to the capital increase over the course of 2023 in line with their national ratification processes.

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

Key indicators

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<td>Callable Capital / Gross Debt</td>
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[1] Usable equity is total shareholder’s equity and excludes callable capital

Source: Moody’s Investors Service

Profile
CEB was set up in 1956 under the name of the Council of Europe Resettlement Fund for National Refugees and Over-Population in Europe. It adopted its current name in 1999 and enlarged its mandate to strengthen social cohesion in Europe and promote inclusive growth. CEB was founded by eight members – Belgium (Aa3 stable), France, Germany, Greece (Ba3 stable), Iceland (A2 stable), Italy, Luxembourg (Aaa stable) andTürkiye (B3 stable) and has since seen two waves of enlargement, bringing its current membership to 42 countries. CEB’s three overarching goals under its 2023-2027 Strategic Framework are 1. responding to evolving social development and inclusion challenges; 2. assistance and integration of refugees and migrants; 3. support for the reconstruction and rehabilitation of Ukraine’s social sectors. CEB makes loans to projects that are socially and economically viable in member states, lending directly to the sovereign or regional and local government authorities, as well as other public or private entities. It can also grant guarantees and provide technical assistance.

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

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

**FACTOR 1: Capital adequacy score: a2**

We score CEB’s capital adequacy at “a2” based on the combination of a relatively high leverage ratio set against strong asset credit quality and exceptionally strong asset performance. That said, we make a positive one-notch adjustment for the trend on leverage, in light of the decline in leverage which we expect will follow from the increase in paid-in capital approved by the CEB Governing Board on 2 December 2022.

**Lending growth was back to normal in 2021 after pandemic boost in 2020, but leverage remains high**

The leverage ratio – which we define as development-related assets and treasury assets rated A3 and lower relative to useable equity – is the key measure we use to assess an MDB’s capital position. CEB’s leverage ratio increased to 639% in 2021, up from 622% in 2020 and 527% in 2018 (see Exhibit 3). The rapid increase in leverage over the past three years contrasts with the deleveraging trend recorded in the decade leading up to 2018.

High leverage is not unusual among highly rated MDBs, which are able to carry much higher leverage because of the strength of their other core credit metrics. The [European Investment Bank](#) (EIB, Aaa stable) has higher leverage historically, averaging more than 650% over 2018-21. Nevertheless, high leverage is one of CEB’s key credit constraints.

That said, we expect that the tripling of paid-in capital agreed by CEB’s Governing Board on 2 December will significantly increase CEB’s useable equity. Despite our expectation that CEB’s loan portfolio will continue to grow in coming years, we expect that leverage will decline from its current level (see Recent Developments section).

CEB’s loan portfolio grew by 6.1% in 2021, compared to 13.4% in 2020, reflecting a slowdown in lending growth following a sharp rise in lending in response to the pandemic. Meanwhile, useable equity increased by 3.2% in 2021 compared to 1.4% in 2020, which reflected slightly higher profitability compared to previous years. Net profits for 2021 stood at €94.8 million, with the increase relative to 2020 almost wholly driven by IFRS valuation effects. Despite strong demand for CEB loans due to the refugee crisis driven by Russia’s military invasion of Ukraine, new loan approvals were broadly stable at €4.25 billion in 2022. Looking forward, [CEB’s Strategic Framework](#) published in January indicates a modest increase to €4.3 billion annually over the 2023-2027 period.

![Exhibit 3](image1.png) **Leverage was high but broadly stable in 2021 after jump in 2020**

Leverage ratio, %

- Development-related assets
- Useable equity

Source: CEB, Moody’s Investors Service

![Exhibit 4](image2.png) **CEB has maintained a solid, underlying profitability**

- Net income, € million
- Return On Average Assets, % (rhs)

Source: CEB, Moody’s Investors Service
Underlying profitability has remained relatively solid despite challenge of low-yield environment
CEB has recorded steady profits over the past decade, averaging €108 million over 2011-21. The bank has remained profitable throughout past episodes of turbulence, including the global financial and euro area debt crises. Following a dip in profitability in 2020, the bank recorded net profit of €94.8 million in 2021, up from €74.8 million the previous year (see Exhibit 4). CEB’s average return on assets stood at 0.3% in 2021, maintaining the previous year’s level. Since the most recent capital increase in 2012, the expansion of useable equity has been driven by the sustained increase in reserves, to which almost all its profits are added.

Asset quality is enhanced by CEB’s preferred creditor status
We assess CEB’s development asset credit quality (DACQ) at “aa”. The starting point is the weighted average borrower rating (WABR) that stood at Baa3 at end-2021, which has also been stable since 2015. At the end of 2021, 24.5% of the development asset portfolio was rated Aaa-Aa, with another 28% in the A category. 20% of the portfolio was non-investment grade. CEB’S Strategic Framework for 2023-2027, which among other things aims to support the reconstruction and rehabilitation needs of Ukraine’s social sectors, will entail an increase of credit risk for CEB’s loan portfolio with a higher share of non-investment grade lending in its portfolio.

The bank’s lending portfolio is relatively diversified geographically within Europe. The top recipients of loans are France, which accounts for 11% of the loan portfolio, followed by Spain (10%), Germany (7%) and Turkiye (7%). The bank’s exposure to Turkiye largely relates to the SME sector. The bank also launched its programme Strengthening Healthcare Infrastructure for All (SHIFA) in March 2021 under its Facility for Refugees in Turkiye in cooperation with the European Union (EU, Aaa stable).

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

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

The pandemic shock did not lead to the materialisation of any new non-performing loans for CEB. Although the increasingly challenging macroeconomic environment in Europe and the impact of the military invasion in Ukraine poses risks for asset performance, the bank’s pristine track record of asset performance even in times of crisis supports our expectation that asset performance will remain robust over the coming 12 to 18 months.

FACTOR 2: Liquidity and funding score: aa2
We consider CEB’s liquidity and funding position to be very strong with a score of “a1” for its availability of liquid resources and a score of “aa” for the quality of its funding, which results in an overall score for liquidity and funding of “aa2”.

CEB maintains a strong liquidity position
CEB has a large liquid assets portfolio, standing at €9.4 billion at the end of 2021 (including assets available for sale and assets held to maturity, as well as bank deposits). This marks a 12% increase from the €8.4 billion recorded in 2020. For the purpose of calculating our liquid resources ratio, we consider only highly liquid assets such as cash and short-term bank deposits as well as securities rated A2 or higher, as we believe only those would be available in a stress scenario at short notice and with minimal loss.

CEB’s treasury assets must have a minimum rating at purchase of Baa. At the end of 2021, 62% of CEB’s treasury assets were rated Aaa-Aa. The rest of CEB’s treasury portfolio is exclusively investment grade.

We consider the size of the available liquid assets relative to cash outflows in a stressed scenario over the coming 18 months, in which the MDB has no access to markets but continues its normal business operations. CEB’s availability of liquid resources ratio stood at 113% in 2021, resulting in a score of “a1”. This is somewhat above the Aaa median of 105% and slightly below the Aaa-Aa2 median of 137%.
This provides CEB with a buffer to withstand a severe tail-risk scenario of limited or no market access. Its liquidity would also be more than sufficient to meet cash requirements until callable capital could be paid in. Based upon the most recent CEB stress tests, as of March 2022, the self-sufficiency period stood at 13 months (up from 11 months in December 2021 and 9 months in December 2020), which is above the bank’s minimum “self-sufficiency period” fixed at six months. Based on the same stress tests, CEB would be able to survive 18 months without access to capital markets.

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

The bank has an opportunistic and dynamic approach to debt issuance, and has traditionally issued debt in US dollars and euros. In 2021, 46% of funds raised were in euros, followed by 27% in US dollar and 17% in sterling. At the end of 2021, CEB’s stock of debt was primarily denominated in euros (57%), followed by dollars (27%). However, after accounting for currency swaps, the CEB’s overall debt exposure is euro-denominated.

As of December 2021, outstanding debt reached in €24.7 billion in 2021, up from €22.7 billion in 2020. In 2021, CEB made full use of its €5.5 billion funding authorisation for the year, including €0.9 billion issued in October 2020 under the 2021 pre-funding borrowing authorisation. In total, the bank issued €4.6 billion over the course of 2021. The average funding maturity was 5.7 years in 2021, broadly in line with 2020 levels (see Exhibit 6).

CEB issued a €500 million Social Inclusion Bond (SIB) in April and a $500 million SIB in June 2021, a level similar to that of the previous year. The SIB proceeds can be used to support longer-term needs of refugees in the current context, since the bank updated its Social Inclusion Bond Framework in April 2020 to include social housing, education and vocational training, health and social care and support to MSMEs as sectors that can be financed with the proceeds of SIBs.

Qualitative adjustments to intrinsic financial strength
Operating environment
We do not apply any adjustment for CEB’s operating environment. CEB has maintained solid profitability in the years leading up to the pandemic and we expect the bank’s operations to remain resilient to heightened geopolitical tensions in Europe.
Quality of management
Our “+1” adjustment for quality of management reflects our long-standing view that CEB’s management (including risk management) is among the best in class. The results of this can be seen in its unusually strong asset quality, with the bank only ever recording one NPL in its history. CEB also has a stringent capital monitoring framework. Under the bank’s own guidelines, the capital adequacy ratio in its prudential framework (prudential equity as a % of risk-weighted assets) has a lower limit of 10.5%. However, the bank’s capital is always multiples of this limit. In 2021, it stood at 29.1% from 27.6% in 2020.

FACTOR 3: Strength of member support score: High
The strength of CEB’s member support is assessed at “High”, which combines a “baa1” ability to support, “ba3” contractual willingness to support and “Very High” non-contractual willingness to support the institution.

Moderate average weighted shareholder rating and low levels of callable capital are relative weaknesses
We use the weighted average shareholder rating (WASR) to assess shareholders’ ability to support an MDB. In the case of CEB, the WASR stood at “baa1” in 2021, unchanged from previous years. This is in line with the Aaa-Aa2 median of “baa1” but below the Aaa median of “a3” (see Exhibit 7). CEB currently has 42 member-states, following Andorra’s (Baa2 stable) accession in May 2020, and we expect Ukraine will shortly be confirmed as its the 43rd member. France, Germany and Italy are the largest shareholders, each accounting for 17% of subscribed capital. They are followed by Spain (11%) and Turkiye (7%). The credit profiles of most shareholders, especially highly rated European sovereigns, have been resilient to the pandemic shock.

We use callable capital relative to the debt stock to assess the strength of contractual support. With a ratio of 19.7% in 2021, CEB scores moderately on this measure. Among Aaa-Aa2 rated peers, only Eurofima has a lower ratio of callable capital to total debt (see Exhibit 8). A number of Aaa-Aa2 rated MDBs do not have callable capital, including International Development Association (IDA, Aaa stable), International Finance Corporation (IFC, Aaa stable) and Inter-American Investment Corporation (IDB Invest, Aa1 stable). Despite having relatively high callable capital relative to subscribed capital (89%), CEB’s high debt stock explains the weak performance on this metric. That said, in light of the substantial capital increase with an addition to €3 billion in callable capital agreed on 2 December 2022, we expect callable capital relative to debt to increase leading to an improvement of contractual support (see recent developments section.)

Relevance of CEB’s mandate is increasing in the context of the post-war reconstruction of Ukraine
We assess CEB’s non-contractual support as “Very High” given the track record of support the bank has received from shareholders but also peers and the EU since its creation. In particular, the approval on 2 December 2022 of a very substantial increase of CEB’s paid-in and callable capital by the bank’s Governing Board is testament to sharing member states’ very strong support for CEB as well as the bank’s enhanced relevance in tackling key social challenges stemming from the conflict in Ukraine as well as in Europe more broadly.
CEB’s role as the social-development bank in Europe has been strengthened by its response to the 2015 migrant crisis and the coronavirus pandemic. The Ukrainian crisis makes CEB’s mandate increasingly important to its members in a context of renewed geopolitical instability in Europe with far-reaching economic and social consequences causing a large influx of refugees in Ukraine’s neighboring countries.

ESG considerations

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

Exhibit 9
ESG Credit Impact Score

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

Source: Moody’s Investors Service

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

Exhibit 10
ESG Issuer Profile Scores

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<th>Environmental</th>
<th>Social</th>
<th>Governance</th>
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<tr>
<td>E-2 Neutral-to-Low</td>
<td>S-1 Positive</td>
<td>G-1 Positive</td>
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</table>

Source: Moody’s Investors Service

Environmental

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

Social

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

CEB’s governance issuer profile score is positive (G-1). CEB adheres to very strong risk management processes, which has resulted in a pristine track record of asset performance. The bank’s management is highly credible and has a strong track record in implementing CEB’s strategy. CEB’s strong governance profile will be a key factor in helping the bank to manage the increase in risk of its loan portfolio which Moody’s expects will occur over coming years.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

All of these considerations are further discussed in the “Detailed credit considerations” section above. Our approach to ESG is explained in our cross-sector methodology General Principles for Assessing ESG Risks. Additional information about our rating approach is provided in our Supranational Rating Methodology.

Recent developments

Large capital increase will reduce leverage and is evidence of the strength of member support

On 2 December 2022, CEB’s Governing Board (composed of representatives of the shareholding member states) approved a €4.25 billion increase of the bank’s subscribed capital, a 78% increase from its current level. Of the total capital increase, €1.2 billion is to be provided in the form of paid-in capital with the remainder made available as callable capital. Once fully provided, CEB’s total paid-in capital will roughly triple to €1.8 billion from €600 million today, while we estimate that its total equity (including retained earnings added to reserves) will increase by close to 40% compared to end-2021 levels. Moreover, the €3.05 billion addition of callable capital will lead to a total increase of the bank’s callable capital of 60%.

The very substantial increase of both paid-in and callable capital marks a step change for CEB. This is the first increase of paid-in capital in the more than 65-year history of CEB, which so far has exclusively relied on retained earnings and the accession of new shareholders to boost its useable equity. CEB’s elevated leverage ratio has long been a key weakness of the credit profile and we expect that the increase in paid-in capital will gradually lower CEB’s leverage until 2026 when all the new shareholder contributions have to be paid in.

The capital increase becomes effective once 67% of the offered shares have been subscribed. We expect member states to complete their respective national approval processes for signing off on the capital increase over the course of 2023, although the payment of funds to CEB will materialise over up to four years. However, the majority of CEB’s shareholders are highly rated European sovereigns and we consider the risk of these governments not fully providing the funds approved by the Governing Board to be very low.

Moreover, the magnitude of the capital increase is testament to shareholding member states’ very strong support for CEB as well as the bank’s enhanced relevance in tackling key social challenges in Europe. This, in turn, has a direct and marked positive impact on our assessment of the strength of member support, both in its contractual and non-contractual forms.

New Strategic Framework sets out lending plans and signals a “cautious” approach to operations in Ukraine

CEB’s Strategic Framework for 2023-2027 was published at the end of January, setting out the bank’s operational plans for the coming five year period. The Framework sets CEB’s three overarching objectives for the coming five years as responding to evolving social development and inclusion challenges; assistance and integration of refugees and migrants; and support for the reconstruction and rehabilitation of Ukraine’s social sectors. Sectors receiving particular focus in the Framework include health and social care; education and vocational training; social and affordable housing; and micro, small and medium-sized enterprise financing. The average annual volume of loan approvals over the period is set at €4.3 billion, roughly in line with 2020-2021 volumes.

The Framework identifies operations in Ukraine as a key priority but notes the need to take a “cautious” approach given the high degree of uncertainty and operational risk. Over the coming five years, CEB intends to lend to Ukraine exclusively at the sovereign level and to develop its activities gradually, applying enhanced appraisal and monitoring processes. In the short term, following the formalisation of Ukraine’s membership which we expect will occur in the coming months, CEB expects to extend emergency loans to finance support for internally displaced persons, before focussing on the reconstruction of social infrastructure, including housing, in the longer term.
Aside from lending to Ukraine, the Framework also commits to a “strengthened focus” on CEB’s 22 Target Group countries. This includes many highly rated Central and Eastern European countries but also lower rated sovereigns such as Albania (B1 stable), Bosnia and Herzegovina (B3 stable), Georgia (Ba2 negative), Kosovo, Moldova (B3 negative), Montenegro (B1 stable), North Macedonia, Serbia (Ba2 stable) and Turkiye.

Lending to Ca-rated Ukraine will naturally entail a higher level of credit risk for CEB’s loan portfolio. However, we expect that the size and nature of the exposure to Ukraine as well as the high quality of CEB’s management and its long track record of prudently and successfully managing the risks of its loan portfolio will limit overall risks from the exposure in a way that it does not offset the many benefits to CEB’s credit profile stemming from the capital increase.

**Preliminary 2022 results point to no major changes to CEB’s key financial metrics**

We expect that CEB’s full, audited 2022 results will be published in April 2023. However, the bank late January published its preliminary results for last year. On the whole, these point to no major changes to the key financial metrics that we use for our rating scorecard. CEB’s total loan portfolio continued to grow by about 5%, although the level of disbursements declined by 12% compared to 2021. Net profit was down by 16%, due IFRS valuation effects, while core earnings was relatively stable at EUR 84 million. The bank recorded no defaults or other new problem loans in 2022.
### Rating methodology and scorecard factors: Council of Europe Development Bank - Aaa stable

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<th>Adjusted score</th>
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<td>Trend</td>
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<td>Impact of profit and loss on leverage</td>
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<td>Development asset credit quality (10%)</td>
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<td></td>
<td></td>
<td>aa3</td>
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<tr>
<td><strong>Factor 3: Strength of member support (+3,+2,+1,0)</strong></td>
<td></td>
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<tr>
<td>Ability to support (50%)</td>
<td></td>
<td></td>
<td></td>
<td>baa1</td>
</tr>
<tr>
<td>Weighted average shareholder rating</td>
<td></td>
<td>baa1</td>
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<tr>
<td>Willingness to support (50%)</td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>Contractual support (25%)</td>
<td></td>
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<td>ba3</td>
</tr>
<tr>
<td>Strong enforcement mechanism</td>
<td></td>
<td></td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>Payment enhancements</td>
<td></td>
<td></td>
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<td>0</td>
</tr>
<tr>
<td>Non-contractual support (25%)</td>
<td></td>
<td></td>
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<td>Very High</td>
</tr>
<tr>
<td><strong>Scorecard-Indicated Outcome Range</strong></td>
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<td></td>
<td>Aaa-Aa2</td>
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<tr>
<td><strong>Rating Assigned</strong></td>
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<td>Aaa</td>
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**Note:** Our ratings are forward-looking and reflect our expectations for future financial and operating performance. However, historical results are helpful in understanding patterns and trends of an issuer’s performance as well as for peer comparisons. Additional considerations that may not be captured when historical metrics are used in the scorecard may be reflected in differences between the adjusted and assigned factor scores. Furthermore, in our ratings we often incorporate directional views of risks and mitigants in a qualitative way. For more information please see our Multilateral Development Banks and Other Supranational Entities rating methodology.

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

» Moody's Supranational web page

» Moody's Sovereign and supranational rating list

» CEB web page

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