Scope affirms Council of Europe Development Bank’s AAA rating with Stable Outlook

Strong capital base, excellent asset quality, very high liquidity buffers, growing strategic importance, and highly rated shareholders support the rating. High leverage is the key credit challenge.

Scope Ratings GmbH (Scope) has today affirmed the Council of Europe Development Bank’s AAA long-term issuer and senior unsecured foreign-currency ratings, and affirmed its short-term issuer rating of S-1+ in foreign currency. All Outlooks are Stable.

For the associated Rating Report, click [here](#).

**Summary and Outlook**

The Council of Europe Development Bank (CEB)’s AAA rating reflects the supranational’s ‘excellent’ intrinsic strength and ‘very high’ shareholder support. The CEB’s institutional profile benefits from a growing strategic role for its shareholder governments and excellent governance. Its social mandate has been strengthened in the context of the Covid-19 pandemic and the Ukraine crisis, underscoring the bank’s unique role among European supranational institutions. This is reflected in the large increase of paid in and callable capital approved in December 2022, alongside the bank’s new Strategic Framework for 2023-27.

The CEB’s financial profile benefits from excellent asset quality with no non-performing loans (NPLs) and high average borrower quality due to its focus on the public sector, predominantly in Europe. It also benefits from preferred creditor status (PCS) for its sovereign exposures and growing geographical diversification towards Central and Eastern Europe. The CEB’s liquidity profile is exceptionally strong. The bank’s funding profile benefits from strong market access, especially for social inclusion bond issuance, accounting for about one third of the 2022 funding requirement. Despite a sizeable decline in net profitability because of higher provisioning for credit risk, the bank has continued to strengthen its capital base with net profit allocated to general reserve of EUR 74.7m in 2022 and robust asset performance. Following an agreement by the CEB’s governing bodies in July 2022, Ukraine is expected to become the 43rd member state and eligible for direct funding in the coming months. The Strategic Framework for 2023-27 set the average annual volume of loan approvals at EUR 4.3bn over the period. This includes a cautious and gradual path of activity in Ukraine, and the strengthening of the CEB’s focus on Target Group Countries, mainly in Central and Eastern Europe. Implementation of the Strategic Framework is supported by the substantial capital increase of EUR 4.25bn approved in December 2022 of which EUR 1.2bn is to be paid in. The key rating challenge is the CEB’s ongoing high leverage, although the capital increase should improve room to manoeuvre.

Finally, the CEB benefits from highly rated leading shareholders. The governments of Europe’s largest economies – Germany (AAA/ Stable), France (AA/ Stable), Italy (BBB+/Stable), Spain (A-/ Stable), the Netherlands (AAA/ Stable), Belgium (AA-/ Stable) and Greece (BB+/Positive) – make up the CEB’s principal shareholders along with Turkey (B-/Negative), for a weighted average credit rating of A. This determines Scope’s assessment of very high shareholder support for the bank. However, at 13%, coverage of outstanding mandated assets by high-quality callable capital is moderate compared with similar institutions and has continually declined over the past decade.
Still, Scope expects this ratio to improve with the increase in callable capital provided by highly rated shareholders.

The Stable Outlook reflects Scope’s assessment of the CEB’s financial buffers against external and balance sheet-driven shocks. The rating could be downgraded if: i) the CEB recorded sustained losses, leading to a marked deterioration in the capital base; ii) its liquidity buffers were significantly reduced; and/or iii) its main shareholders were downgraded.

**Rating rationale**

The first driver of the CEB’s AAA rating is its very strong institutional profile.

This reflects the high and growing strategic importance of the bank for its shareholders. The Covid-19 pandemic, the Ukraine conflict and the 2023 earthquake in Turkey have served to underline the unique role of the CEB and its ability to rapidly adapt to crises and social challenges. These crises have demonstrated shareholder governments’ responsiveness to demand for the CEB’s financing and unique expertise. After record activity in 2020, with project approvals and disbursements up by 50% and 57% respectively from the previous year to support the bank’s response to the Covid-19 crisis, the CEB’s loan activity normalised in 2021 and 2022. The volume of loans approved last year continued to increase by more than 2% to EUR 4.2bn but loans disbursed dropped by about 12% to EUR 3.5bn. Even so, the CEB’s lending activity remains on a long-term upward trend, although the Strategic Framework for 2023-27 plans a modest increase in the volume of disbursements to EUR 3.9bn on average over the period (vs EUR 4.0bn in the Development Plan for 2020-22). Disbursements almost doubled between 2016 and 2022.

The Strategic Framework for 2023-27 consolidates the bank’s core areas of operation, while introducing new sectors of operation including education, social and affordable housing, and microfinance. This is expected to result in additional financing volume to meet growing demand for social loans as inflation reached a record high in the wake of Russia’s invasion of Ukraine. Greater cooperation with the European Union (AAA/ Stable), the European Investment Bank (AAA/Stable) and the European Bank for Reconstruction and Development (AAA/ Stable) further strengthens the bank’s role in European policy-making. This includes fiduciary and grant-financing activities, such as the Instrument for Pre-Accession Assistance (IPA) for Turkey and the Western Balkans, the Facility for Refugees in Turkey (FRTT) and the Disaster Prevention and Recovery Fund set up in response to the recent earthquake in Turkey. Moreover, the CEB is an implementing partner for the social arm of the European Commission’s InvestEU Programme, which provides guarantees for eligible CEB projects, with a project pipeline of around EUR 1bn by 2027. This further enhances European cooperation and the bank’s strategic importance. Specifically, while the CEB pursues a cautious and gradual path regarding Ukraine, the bank is expected to continue playing a critical role in the European response, both in terms of crisis management and, in the longer run, the development of new social infrastructure.

While the bank’s operations primarily focus on socially oriented investment projects as per its mandate, it also links its activities to other themes including climate action, in line with a climate-social nexus approach. Consistent with its commitment to the Paris Agreement, the bank approved financing of almost EUR 900m in 2022 for climate change mitigation and adaptation, compared with about EUR 500m in 2021, EUR 800m in 2020, and EUR 1bn in 2019. As a result, Scope assesses the CEB’s potential environmental risk exposure and its environmental policies. This includes the risk of stranded assets and the reputational risk of pursuing activities, either directly or through counterparties, that are contradictory to the CEB’s mandate and environmental objectives.
Scope assesses these risks as low compared with similar institutions. This is due to: i) the comparatively low transition and physical risk scores of the CEB’s main countries of operation based on Scope’s internal assessment; and ii) the CEB’s screening efforts within project analysis and counterparty assessment regarding their alignment with sustainable development goals and their environmental impact. Projects that are not aligned with the Paris Agreement are not eligible for direct lending operations since January 2023 and this will extend to all new projects in 2024. Moreover, new sectors of operation for the bank as of January 2023 include natural or ecological disasters and environmental protection.

The second factor underpinning the CEB’s AAA rating is its excellent financial profile.

The CEB’s credit profile is supported by its excellent asset quality. Its loan book is characterised by zero NPLs, high average borrower quality, clear benefits from the PCS of its sovereign exposures, low geographical concentration and low top-10 loan book concentration (around 23%), in line with its prudent lending policies. The bank’s main lending areas are aid to refugees, migrants, displaced persons and other vulnerable groups, social housing, regional infrastructure, environmental protection, health, and supporting small- and medium-sized enterprises. The bank lends directly to sovereigns and sub-sovereigns via its Public Sector Finance Facility and via on-lending to commercial and state-owned banks. The bank may also offer guarantees in the form of securities or signed commitments (although currently none are outstanding outside of its Social Dividend Account), and it does not invest in equities.

The bank benefits from a loan book with high average borrower quality, which Scope estimates to be in the high ‘bbb’ category before credit enhancements (guarantees and collateral). This is based on Scope’s estimate of the geographical and sectoral distribution of aggregate loans outstanding and Scope’s sovereign ratings. The relatively stable operating environment reflects that around 30% of outstanding loans (after credit enhancements) are in France, Spain, Poland, Italy, and Germany, with a recent shift to relatively lower-rated countries. Turkey (B-/Negative) represents the riskiest near-term exposure in the CEB’s loan portfolio, accounting for around 6% of total loans, down from around 7% in 2021. In the longer run, the bank intends to strengthen its focus on Target Group Countries, mainly in Central and Eastern Europe, but also non-investment grade countries. The formalisation of Ukraine’s (CC/Negative) membership could weigh on the quality of the portfolio, although the risks are mitigated by the bank’s excellent risk management practices, strong PCS underpinned by a selective approach, lending exclusively to the sovereign, and close coordination with other development partners. The potential re introduction of inter-country transfer financing instruments developed for Central and Eastern European countries could also mitigate risks in the bank’s portfolio. Overall, public sector exposure amounts to more than 80% of the CEB’s total loan book after credit enhancements, reflecting the bank’s mandate to lend mostly to sovereigns, sub-sovereigns and state-owned financial institutions. The overall share of investment-grade exposure, as reported by the bank, stood at more than 85% after credit enhancements.

The CEB’s loan book benefits from a high degree of credit protection overall, with no defaults or late payments in 2022. The bank benefits from PCS as shown most recently during Greece’s default episode, and Scope thus expects the CEB to benefit from PCS on its high share of public sector exposure. Looking at private sector exposure, about 14% of the loan book comprises on-lending to commercial banks – with the CEB transferring in general the ultimate credit risk to the implementing bank. Furthermore, counterparties provided collateral or guarantees amounting to EUR 6.1bn at end-2022, equalling around 31% of the total loan book. In sum, Scope estimates that over 80% of the total loan book benefits from PCS or other credit enhancements.
In addition, the CEB’s loan portfolio is well diversified across member states. In 2022, the largest aggregated exposures were in Spain (around 11% of total loans), Poland (9%), France (9%), Italy (6%), Germany (6%) and Turkey (6%). In terms of sectoral concentration, the loan portfolio is concentrated among sovereigns and sub-sovereigns, and, to a lesser degree, financial institutions, in line with the nature of the CEB’s lending. The CEB actively manages large exposure risks. It has imposed a limit of 25% of prudential equity for any non-sovereign counterparty or connected group of counterparties, equalling around EUR 850m at end-2022, and a limit of 800% of prudential equity for the cumulative total of large exposures, standing around EUR 27.2bn at end-2022. No non-sovereign exposure exceeded that limit at end-2022, and the sum of large exposures to non-sovereign borrowers was EUR 3.4bn, or around 17% of gross loans. Overall, these factors improve Scope’s assessment of the CEB’s portfolio quality after credit enhancements to the highest category of ‘very strong’. The bank’s excellent portfolio quality is also reflected in a track record of recording no NPLs since 2009 and only one NPL in its entire history.

The CEB’s financial profile is further underpinned by conservative liquidity management and high liquid asset buffers. Internal liquidity guidelines stipulate, among other things, a self-sufficiency period of at least six months, while the bank stood at nine months at end-2022. This assesses the bank’s ability to cover expected net cash outflows in a severe stress scenario, given full operationality without access to funding markets and without selling or repo-ing its financial assets. In addition, the bank monitors short-term liquidity ratios over different time horizons of up to one year, for which the limit is set at 100%. All ratios were above the minimum level at end-2022. The same guidelines apply to its liquidity coverage ratio and net stable funding ratio. Finally, the bank stress-tests its contingent liquidity requirements deriving from two-way margin requirements for its derivative contracts. In addition, the CEB hedges all foreign exchange and interest rate risks stemming from its lending, treasury and funding operations.

The CEB’s prudent liquidity policies result in high and stable levels of liquid assets, providing a substantial cushion in the context of higher lending volumes resulting from the bank’s response to the Covid pandemic and the Ukraine crisis. This enables the CEB to fulfil its mandate, particularly in times of heightened activity and uncertainty. Specifically, Scope estimates total liquid assets at around EUR 9.8bn for end-2022. Conversely, total liabilities maturing in one year or less at end-2022 and disbursements in 2023, estimated at around EUR 3.8bn, amount to around EUR 9.1bn. Scope uses this as a basis to calculate the bank’s liquid asset ratio, which stood at around 107% in 2022 (on a three-year weighted average basis). This ratio implies that the bank’s available liquid assets cover all outstanding liabilities and loan disbursements within 12 months without the need to access capital markets. This is one of the strongest liquidity cushions among supranational institutions.

Another credit strength is the CEB’s strong market access. The bank’s bond issuance is designated as Level 1 high-quality liquid assets, which are granted a 0% risk weight under the Basel Framework and are eligible for the ECB’s asset purchase programmes. This preferential regulatory treatment, along with an established track record on capital markets and a strong shareholder and capital base, underpins the CEB’s market access for its annual issuance volumes of EUR 5.3bn on average between 2020-22. Furthermore, the bank’s prudent funding strategy is reflected in the roughly six-year average maturity of its issuance, which limits refinancing and maturity mismatch risks. Its diversification in terms of instruments and currencies is shown by bond issues in six different currencies during 2022, down from eight in 2021. Since 2017, the CEB has issued multiple social bonds that follow the bank’s social inclusion bond framework and align with the ICMA’s social bond.
principles. These include bonds issued to fund the bank’s pandemic response after it added the health sector to its social bond framework, further underscoring its unique social mandate\(^4\). Despite being a relatively small issuer on capital markets compared to other development banks with AAA ratings, the CEB operates under equally favourable funding conditions.

The third driver of the CEB’s AAA rating is its high level of shareholder support.

The CEB’s key shareholder group comprises some of Europe’s largest economies – Germany (AAA/Stable), France (AA/Stable), Italy (BBB+/Stable), Spain (A-/Stable), the Netherlands (AAA/Stable), Belgium (AA-/Stable) and Greece (BB+/Positive) – as well as Turkey (B-/Negative). This results in a weighted average credit rating of A based on Scope’s sovereign ratings, signalling deep shareholder capacity to support the CEB. However, exceptional support in the form of the bank’s callable capital, if ever needed, is assessed as relatively moderate compared with similar institutions. High-quality callable capital of shareholders rated AA- or higher amounts to around EUR 2.5bn, or around 13% of outstanding mandated assets. Still, this ratio is expected to improve following the large capital increase approved in December 2022.

Despite these credit strengths, the CEB also faces the following credit challenges:

The CEB’s capitalisation relative to its outstanding assets is low compared with similar institutions. Scope expects marginal change in the coming years given the high stock of approved projects to be financed, worth EUR 9.0bn at the end of 2022, although the ongoing capital increase could provide additional room to manoeuvre. Scope estimates the CEB’s equity and reserves at around EUR 3.4bn. The CEB’s operational gearing ratio – which limits total loans after swaps and guarantees to 2.5 times its own funds (subscribed capital, reserves and net profits) – acts as an operational target that is credibly enforced. This limit stood at around EUR 20.7bn in 2022. The bank has a capitalisation ratio of about 17%, below that of peers, but still higher than the 10% observed for the European Investment Bank (AAA/Stable), assuming maximum operations under the gearing ratio limit and the CEB’s current capitalisation. The CEB’s actual capitalisation ratio, based on disbursed gross loans, is slightly higher at around 19%, signalling that the bank was operating close (2.41) to the gearing ratio limit (2.50) at end-2022.

At the same time, Scope acknowledges several factors that compensate for the CEB’s low capitalisation. First, the capital base is strengthened by the capital increase approved in December 2022, driving Scope’s one-notch positive adjustment under the trend adjustment. The capital increase of EUR 4.25bn, of which up to EUR 1.2bn will be paid in, is conditional upon the subscription of at least 67% of the participating certificates by end-2023. Scope expects a vast majority of member states to subscribe the capital over the course of the year given the growing importance of the bank for its shareholders. At the end of the four-year payment period, in 2026, the CEB’s paid-in capital would be multiplied by around three, increasing from EUR 0.6bn currently to EUR 1.8bn, while the bank’s callable capital is expected to rise by more than EUR 3.0bn, from EUR 4.8bn to EUR 7.9bn. Overall, Scope expects the CEB’s leverage ratio to improve thanks to the gradual rise in paid-in capital that is likely to exceed that of mandated assets. This is because the average annual volume of loan approvals, set at EUR 4.3bn on average between 2023 and 2027, is moderately above the three-year average of EUR 3.7bn.

Furthermore, the CEB’s record of ensuring high asset quality protects its capital base and stable levels of profitability – averaging EUR 103m over the past 10 years in a low-yield environment – enable the bank to continuously retain earnings and build up reserves and its capital base. The
CEB’s net income of EUR 79.7m in 2022, or 2.3% of equity, was significantly down from 2021 (by negative 15.9%) because of a significant rise in the cost of risk. Despite a challenging macroeconomic environment in Europe resulting from Russia’s invasion of Ukraine, Scope expects profitability to be supported by net interest income amid higher interest rates.

In addition, the bank’s prudential framework ensures strong capital adequacy. The bank’s reported capital adequacy ratio, which measures its prudential equity (paid-in capital, reserves and net profit) versus risk-weighted assets, stood at 30.4% at end-2022. This is significantly above the internal floor of 10.5% and above the CEB’s comfort zone of over 25%, which is intended to ensure a sufficient buffer. In addition, the bank set the prudential framework floor for the leverage ratio (i.e., prudential equity as a share of the value of all exposures, including off-balance sheet items) at 7%, against 10.3% as of end-2022.

Finally, Turkey (B-/Negative) is the sixth largest exposure, and the steady deterioration of its macroeconomic environment, as highlighted by Scope’s Negative Outlook on the country, signals heightened credit risks. The CEB’s contribution to tackle the consequences of the recent earthquake amount to EUR 500m in loans and an additional EUR 3m in grants. However, these risks are mitigated by Turkey’s declining share of total loans (from around 10% in 2018 to 6% in 2022), the PCS on the direct sovereign exposures, the public guarantees granted to state-owned banks that comprise the remaining exposure in Turkey and the absence of any impairments during previous Turkish financial crises. Overall, Scope thus assesses this exposure as manageable.

**Factoring of environment, social and governance (ESG)**

Scope considers ESG sustainability issues during the rating process as reflected in its supranational methodology. ESG factors are explicitly captured in Scope’s assessment of the institutional profile, which Scope assesses as ‘very strong’ for the CEB.

**Scope’s supranational scorecard**

Scope’s supranational scorecard, which is based on clearly defined quantitative parameters, provides an indicative AAA rating for the CEB. This indicative rating includes a one-notch positive adjustment under the trend adjustment for the capitalisation assessment based on the capital increase approved in December 2022.

Additional considerations allow Scope to incorporate idiosyncratic characteristics that cannot be assessed in a consistent and comprehensive manner across all supranationals, but which may still affect an issuer’s creditworthiness. For the CEB, no additional considerations have been identified.

A rating committee has discussed and confirmed these results.

For further details, please see the Rating Report.

**Rating committee**

The main points discussed were: i) institutional profile; ii) financial profile, including capitalisation, asset quality, liquidity and funding; iii) shareholder support; iv) additional considerations; and v) consideration of peers.

**Rating-driver references**

1. [CEB, Financial Report 2022](#)
2. [CEB, Strategic Framework 2023-27](#)
3. [CEB, Sustainability Report 2022](#)
4. CEB, Report of the Governor 2022

Methodology
The methodology used for these Credit Ratings and/or Outlooks, (Supranational Rating Methodology, 11 August 2022), is available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies. Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in ‘Rating Definitions – Credit Ratings, Ancillary and Other Services’, published on https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at https://scoperatings.com/governance-and-policies/regulatory/eu-regulation. Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope Ratings’ definitions of default and Credit Rating notations can be found at https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.

The Outlook indicates the most likely direction of the Credit Ratings if the Credit Ratings were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information
The Credit Ratings were not requested by the Rated Entity or its Related Third Parties. The Credit Rating process was conducted:

With Rated Entity or Related Third Party Participation YES
With Access to Internal Documents YES
With Access to Management YES

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Regulatory disclosures
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The Credit Ratings and/or Outlooks are UK-endorsed.

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The Credit Ratings/Outlooks were first released by Scope Ratings on 2 October 2020. The Credit Ratings/Outlooks were last updated on 24 June 2022.

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