



European Bank
for Reconstruction and Development

CAPITAL ADEQUACY POLICY AND PROCEDURES*



*This is an edited version of the 2025 Capital Adequacy Policy and the associated Capital Adequacy Policy Procedures, which form a key part of the EBRD's Capital Adequacy Framework, adjusted for external audiences. Whilst all key elements of the Policy and Procedures are included, the sections pertaining to single obligor/country exposure limits and the section of the Procedures pertaining to instrument level capital treatment for non-standard products have been omitted from this publication.

Capital Adequacy Policy

Section I: Purpose

The Capital Adequacy Policy (CAP) aims to ensure that the Bank's standalone balance sheet strength would be in high categories of capital levels as measured by rating agencies to support a triple-A rating (principally S&P). The CAP also mandates capital allocation to project level for the purposes of effective risk management, to inform investment decisions, and to facilitate calculation and management of return on capital metrics.

CAP forms a central part of the Bank's Capital Adequacy Framework, which also incorporates: (i) capital planning activities, including within the Strategy Implementation Plan (SIP) and the Strategic and Capital Framework (SCF); (ii) the risk appetite statement, which sets the level of risk that the Bank is willing to take against its key capital metrics; as well as (iii) stress testing, which tests the adherence to these levels under different forward looking scenarios.

Section II: Definitions

Terms used in this Policy have the following meanings:

Available capital	Paid in capital and reserves.
Capital utilisation ratio	The ratio of required capital to available capital.
Credit Conversion Factor (CCF)	Credit conversion factor, being the proportion of undrawn commitments estimated within the determination of exposure at default for Banking exposures.
Exposure at Default (EAD)	Exposure At Default - total value an institution is exposed to at the time of default.
LGD	Loss Given Default, being the portion of an asset that is lost if a borrower defaults.
PD rating	Probability of Default rating, denoting the likelihood of default by a borrower.
RCPs	Risk Capital Proxies, prudent long-term estimates of Banking credit risk for various exposure types. The equity risk capital proxy additionally incorporates market risk.
Required capital	Capital required to cover the risk of unexpected losses during extreme stressed economic conditions (consistent with the Bank's target 'triple-A' credit rating) to ensure that the Bank remains a going concern.
RWA	Risk weighted assets.
S&P	Standard & Poor's credit rating agency.

S&P RAC ratio

S&P's quantitative assessment of inherent balance sheet strength and capital adequacy. The ratio compares capital to the institution's risk-weighted assets with these metrics being determined by S&P.

Section III: Scope

This Policy is anchored within the overall capital adequacy framework of the Bank and additionally informed by the G20 review of capital adequacy frameworks of multilateral development banks.

The Policy applies to all financial assets of the Bank, including debt and equity exposures within the banking book as well as total gross treasury assets. Operational risk is also considered and quantified.

1. METHODOLOGY AND APPROACH**1.1. Objectives**

The different risks borne by the Bank are integrated within the Bank's capital adequacy framework. Capital adequacy is defined as the amount of capital that is required against a type of risk to support the potential losses to a specified risk level or solvency standard.

The main objectives of the Capital Adequacy Policy are to:

- ensure that the Bank's standalone balance sheet strength would be in high categories of capital levels as measured by rating agencies (principally S&P);
- facilitate capital allocation to facility level for the purposes of effective risk management and investment decisions;
- provide risk absorption capacity to withstand potential unexpected losses to a defined level of confidence; and
- ensure the Bank remains a going concern, avoiding the need to call subscribed callable capital.

In addition, the CAP aims to ensure proper capitalisation to support the business of the Bank with an adequate capital buffer maintained over the minimal level of capital requirements.

Whilst the Bank's capitalisation is an important factor in the Bank's rating, rating agencies place emphasis on a number of factors including liquidity, economic prospects in the region of operations, risk management, the perceived strength of preferred creditor treatment and the perceived strength of shareholder support, including callable capital.

1.2. Calibration of the overall capital requirements

The Policy needs to ensure that the Bank's standalone balance sheet strength would be in high categories of capital levels as measured by rating agencies (principally S&P). This provides a high-level calibration to required capital levels and recognises the Bank's private sector focus and business profile. The assessment of shareholder support, including callable capital, should act to provide a cushion against any severe market shock that could threaten the Bank's 'triple-A' rating, rather than being incorporated within the Policy and capital planning.

As such, the Policy is calibrated so that at a capital utilisation ratio (required capital to available capital) of 100% the S&P RAC ratio is estimated at 15%. Incorporating strong shareholder support, at 15% or above, the S&P RAC ratio (in isolation) represents inherent AA balance sheet strength, where other rating agency factors such as enterprise risk profile and shareholder support would be expected to support a 'triple-A' rating overall.

1.2.1 Prudential limit

The Bank's capital adequacy is managed by ensuring that the capital utilisation ratio does not exceed a 90% prudential limit. At this prudential limit, the S&P RAC ratio is estimated at 18-19%.

To allow for medium term stability and predictability, this capital utilisation threshold is managed over the medium term on the basis of the Bank's planning rate for the US dollar/ euro exchange rate.

1.2.2 Use of internal models

The Bank's Value at Risk (VaR) models directly set the Policy level of capital held for credit risk in the treasury portfolio, and for market risks related to treasury activities and Banking debt transactions. In addition, an internal economic capital model for the Banking portfolio is periodically used to independently validate the calibration of capital requirements within the CAP.

The credit risk economic capital models consider systemic (region and sector) and idiosyncratic risk factors, including expected loss parameters at counterparty level, to calculate losses on a one-year horizon at confidence levels associated with triple-A rating requirements. The internal economic capital model for the Banking portfolio applies the Bank's historical PD rates and correlation matrix calibrated to the most stressed historical periods. It estimates (through Monte Carlo simulation) the distribution of potential losses, focussing on the extreme outcomes around 1:10,000 frequency. The market risk economic capital model relies on a historical simulation VaR calculation, extending the short-term market risk measures to a longer time horizon and focussing on the extreme outcomes around 1:10,000 frequency. The magnitude of such extreme losses is directly linked to the amount of capital that the Bank should hold against its exposure under the specific assumptions and parametrisation embedded in the modelling framework.

The use of internal models in the Policy demonstrates continued effort to reflect approaches relevant to the Bank's business model, which is also in line with G20 CAF recommendations.

1.3. Required capital

The Bank's required capital covers risks arising from banking and treasury operations, as well as operational risk taken in the course of the Bank's activities, and is determined using a combination of external rating agency and regulatory standards, while also incorporating the Bank's internal risk metrics. Table 1 outlines the components of required capital.

Table 1: Required capital summary

Banking risk	<i>Required capital = Risk Capital Proxy (RCP) x Exposure at Default (EAD)</i> <i>Exposure at Default:</i> For debt and guarantees, it is based on operating assets (at cost) together with a proportion of undrawn commitments. For equity investments, it is based on equity at fair value together with a proportion of undrawn commitments. Equity: 100% RCP is applied to equity at fair value plus an element of undrawn commitments for direct equity and equity funds. 100% RCP results in matching changes of available and required capital in response to fair value fluctuations, keeping the resulting capital ratios at a stable level.¹ Debt: Debt² RCPs are set in line with the credit risk Basel formula³ for unexpected loss. Calibrating the Policy to S&P RAC ratio of 15% implies that at a capital adequacy utilisation ratio of 100%, total required capital for debt must equal: <i>Available capital – sum of capital requirements (equity, treasury, operational risk)</i> The credit risk Basel formula for unexpected loss is then multiplied by a constant ('scalar') to achieve the Policy calibration to S&P RAC of 15%. Consequently, the scalar is a function of the target minimum ratio of 15%, the capital assigned to equity, treasury and for operational risk, as well as PD, LGD and EAD parameters specific to the Bank's debt portfolio. Once these variables are set, the scalar is calculated mechanistically based on the following formula: <i>Scalar = (Available capital - sum of capital requirements (equity, treasury, operational risk)) / Debt RWAs (PD, LGD, EAD)</i> where PD and LGD rates are set in accordance with the Provisioning Policy (and reviewed by the external auditors as part of auditing the Bank's provision level). The value of the <i>scalar</i> is reviewed at least once a year, or as often as warranted to ensure compliance with the Policy calibration. Once the scalar is set, debt capital requirements at facility level are computed as follows (within the above constraint): <i>Debt requirements (RCPs) = Basel credit RWA (PD, LGD, EAD) x scalar</i>
Treasury risk	Based on a Value at Risk (VaR) computation made at a 99.99% confidence level using a one year horizon.
Operational risk	Based on Standardised Approach under the Basel III Framework (<i>Finalising post-crisis reforms, December 2017</i>)

¹ Given that the overall calibration of capital requirement is linked to S&P RAC approach, applying lower RCP to equity would imply higher risk charge for debt, and would therefore have no impact on the overall investment capacity of the Bank.

² Excluding debt products with non-standard features and debt/equity hybrids.

³ Excluding maturity adjustment.

1.4 Available capital

Available capital is the amount of risk-bearing capital - defined as the aggregate of paid-in share capital (including amounts due under promissory notes), reserves (including loan loss reserve and special reserve) and unrealised fair value reserves for equity investments. Impairment charges are excluded from the available capital.

2. NOMINAL POLICY

In addition to the risk-based policy outlined above, the EBRD also adheres to the following nominal constraint on its operational activity.

Nominal capital ratio =

$$\frac{\text{development related exposure} - \text{impairment}}{\text{members' equity} - \text{paid in capital subscribed but not yet received}}$$

The development related exposure includes loans at cost, equity investments (at fair value) and guarantees. Members' equity does not include callable capital.

The nominal capital ratio should not exceed a limit of 4 times.

Capital Adequacy Procedures

Section I: Purpose

These Procedures set out the methodology and provide detail for the computation of required capital for each of the risks that the Bank bears.

These Procedures implement the Capital Adequacy Policy and Capital Adequacy Directive.

Section II: Definitions

Terms used in these Procedures have the following meanings:

Available capital	Paid in capital and reserves
BI	Business indicator, a financial statement based proxy for operational risk.
BIC	Business indicator component
Capital utilisation ratio	The ratio of required capital to available capital.
CCF	Credit conversion factor, being the proportion of undrawn commitments estimated within the determination of exposure at default for Banking exposures.
EAD	Exposure At Default - total value an institution is exposed to at the time of default.
ILM	Internal loss multiplier
LGD	Loss Given Default, being the portion of an asset that is lost if a borrower defaults.
PD rating	Probability of Default rating, denoting the likelihood of default by a borrower.
Required capital	Capital required to cover the risk of unexpected losses during extreme stressed economic conditions (consistent with the Bank's target triple-A credit rating) to ensure that the Bank remains a going concern.
RCPs	Risk Capital Proxies, prudent long term estimates of Banking credit risk for various exposure types. The equity risk capital proxy additionally incorporates market risk.
RWA	Risk weighted assets
S&P	Standard & Poor's credit rating agency

S&P RAC ratio	S&P's quantitative assessment of inherent balance sheet strength and capital adequacy. The ratio compares capital to the institution's risk-weighted assets with these metrics being determined by S&P.
TALP	Treasury Authority and Liquidity Policy
TFP	Trade Finance Programme
Value at Risk (VaR)	Measure of the maximum loss on a portfolio of assets for a given probability and time horizon. VaR is the threshold value for the loss on the portfolio that will not be exceeded over the given time horizon and with the given probability level.
VP CFO	Vice President, Chief Financial Officer

Section III: Legal Basis

Capital Adequacy Policy (BDS23-078 (F)) and Capital Adequacy Directive

Section IV: Scope

1. OVERVIEW

The Bank manages the ratio of required capital to available capital – the capital utilisation ratio – against a prudential limit of 90%.

The Bank's internal capital requirements are calibrated to ensure certain minimum levels of the S&P RAC ratio, with a capital adequacy utilisation ratio of 100% representing the estimated point where the Bank would be at material risk of losing its triple-A credit rating.

2. REQUIRED CAPITAL

The Bank's required capital covers risks arising from banking and treasury operations, as well as operational risk taken in the course of the Bank's activities.

2.1 Banking risk

For Banking risk, required capital is calculated for each facility based on the following:

$$\text{Required capital} = \text{Risk Capital Proxy (RCP)} \times \text{Exposure at Default (EAD)}$$

Debt and guarantees

Calibrating the policy to S&P RAC ratio of 15% implies that at 100% capital adequacy utilisation ratio, total required capital for debt must equal:

$$\text{Available capital} - \text{sum of capital requirements (equity, treasury, operational risk)}$$

The credit risk Basel formula for unexpected loss is then used to compute debt capital requirements at facility level, within the above constraint. Given that the Basel formula is a function of PD and LGD means that derived RCPs are directly responsive to counterparty risk ratings. This ensures the link between risk parameters and capital requirements always holds and allows appropriate capital allocation for any type of product, also recognising risk mitigating factors such as first loss cover.

Methodology

The credit risk Basel formula⁴ is applied to compute debt RWAs, which are then multiplied by a constant (‘*scalar*’) to establish the intended calibration to S&P RAC ratio of 15%. The capital requirements for all facilities are computed as follows:

$$\text{Debt requirements} = \text{Basel credit RWA} (PD, LGD^5, EAD) \times \text{scalar}$$

Based on the Banking portfolio exposure as at the end of third quarter 2021, and subsequently validated by most recent PD and LGD rates as outlined in the Provisioning Procedures⁶, the ‘*scalar*’ has been updated to 23.5%. Note that the scalar is reviewed and updated annually⁷.

For illustration, risk capital proxies for non-sovereign debt representing senior debt and subordinated debt are presented in table 1.1.

Table 1.1: Average RCPs for non-sovereign debt PD rating

PD rating	FI		Corporate		SIG	
	36%	46%	37%	46%	28%	46%
1.0	1.0%	1.2%	1.9%	2.4%	1.2%	1.9%
1.7	1.0%	1.2%	1.9%	2.4%	1.2%	1.9%
2.0	1.4%	1.8%	2.9%	3.6%	1.8%	2.9%
2.3	1.7%	2.2%	3.7%	4.6%	2.2%	3.7%
2.7	2.1%	2.6%	4.4%	5.5%	2.7%	4.4%
3.0	2.4%	3.0%	5.1%	6.3%	3.0%	5.0%
3.3	2.6%	3.4%	5.6%	7.0%	3.4%	5.6%
3.7	3.4%	4.3%	7.1%	8.9%	4.3%	7.1%
4.0	4.0%	5.1%	8.4%	10.4%	5.1%	8.4%
4.3	6.0%	7.7%	12.1%	15.0%	7.5%	12.3%
4.7	7.4%	9.4%	14.3%	17.7%	9.0%	14.7%
5.0	10.3%	13.2%	18.4%	22.8%	11.9%	19.6%
5.3	11.1%	14.2%	19.4%	24.1%	12.7%	20.8%
5.7	11.8%	15.1%	20.2%	25.2%	13.3%	21.9%
6.0	12.6%	16.1%	21.1%	26.3%	14.0%	23.0%
6.3	16.7%	21.3%	25.3%	31.5%	17.2%	28.3%
6.7	19.9%	25.4%	29.1%	36.2%	19.7%	32.4%
7.0	22.8%	29.1%	34.1%	42.4%	22.5%	37.0%
7.3	25.9%	33.1%	40.5%	50.4%	26.6%	43.6%

⁴ Excludes maturity adjustment.

⁵ LGDs are floored at 5% for the purposes of the required capital calculations.

⁶ Effective from December 2024.

⁷ Or following a material change to the Bank’s risk parameters as outlined in the Provisioning Procedures.

Sovereign debt

LGDs for sovereign exposures are as set out in the Bank's Provisioning Procedures: EU, non-EU and highly indebted countries. In computing required capital for sovereign debt, LGD is increased by 10% (e.g. 5% becomes 15%) given that the S&P RAC ratio methodology considers a single name concentration adjustment for sovereign exposures. This 10% LGD adjustment is also applied to sub-sovereign exposures.

Illustrative RCPs for sovereign LGDs are presented in table 1.2.

Table 1.2: Average RCPs for sovereign debt by PD rating

PD rating	FI			Corporate			SIG		
	EU	Non-EU	Highly indebted	EU	Non-EU	Highly indebted	EU	Non-EU	Highly indebted
1.0	0.4%	0.5%	0.8%	0.8%	1.0%	1.6%	0.6%	0.8%	1.3%
1.7	0.4%	0.5%	0.8%	0.8%	1.0%	1.6%	0.6%	0.8%	1.3%
2.0	0.6%	0.8%	1.2%	1.2%	1.6%	2.4%	0.9%	1.3%	1.9%
2.3	0.7%	1.0%	1.5%	1.5%	2.0%	3.0%	1.2%	1.6%	2.4%
2.7	0.9%	1.1%	1.7%	1.8%	2.4%	3.6%	1.4%	1.9%	2.9%
3.0	1.0%	1.3%	2.0%	2.1%	2.7%	4.1%	1.6%	2.2%	3.3%
3.3	1.1%	1.5%	2.2%	2.3%	3.1%	4.6%	1.8%	2.4%	3.6%
3.7	1.4%	1.9%	2.8%	2.9%	3.9%	5.8%	2.3%	3.1%	4.6%
4.0	1.7%	2.2%	3.3%	3.4%	4.5%	6.8%	2.7%	3.6%	5.5%
4.3	2.5%	3.4%	5.0%	4.9%	6.5%	9.8%	4.0%	5.4%	8.0%
4.7	3.1%	4.1%	6.1%	5.8%	7.7%	11.6%	4.8%	6.4%	9.6%
5.0	4.3%	5.7%	8.6%	7.5%	9.9%	14.9%	6.4%	8.5%	12.8%
5.3	4.6%	6.2%	9.3%	7.9%	10.5%	15.7%	6.8%	9.1%	13.6%
5.7	4.9%	6.6%	9.9%	8.2%	10.9%	16.4%	7.1%	9.5%	14.3%
6.0	5.3%	7.0%	10.5%	8.6%	11.4%	17.1%	7.5%	10.0%	15.0%
6.3	6.9%	9.3%	13.9%	10.3%	13.7%	20.5%	9.2%	12.3%	18.4%
6.7	8.3%	11.0%	16.6%	11.8%	15.8%	23.6%	10.6%	14.1%	21.1%
7.0	9.5%	12.7%	19.0%	13.8%	18.4%	27.6%	12.1%	16.1%	24.2%
7.3	10.8%	14.4%	21.6%	16.4%	21.9%	32.9%	14.2%	19.0%	28.4%

Impaired assets

For impaired assets, specific impairment provisions reduce available capital. The required capital is applied for the part of debt exposure not covered by specific provisions. This treatment ensures that in medium term capital planning, the capital requirements are the same for modelled impaired assets held in the balance sheet compared with assumed write off of impaired assets/ return to performing status (on the basis of loss given default assumptions).

Equity

For equity investments, including direct equity and equity funds, a **100% RCP** is applied to equity at fair value plus an element of undrawn commitments (with the exception of determinable return equity – see products with non-standard features below).

Products with non-standard features

Non-standard products include investments that generally combine both debt and equity characteristics (e.g. convertible bond that has features of an ordinary bond, but is influenced by the price movements of the stock into which it is convertible etc.). Similarly, equity investments with debt-like return features would also fall into this category; determinable return equity for example, is treated as debt for capital adequacy purposes, and as such reduces the Bank's overall required capital. The capital treatment of the Bank's non-standard products is decided on an instrument by instrument basis.

2.2 Exposure at default

Exposure at default (EAD) for:

- **Debt and guarantees** is based on operating assets (at cost) together with a proportion of undrawn commitments.

Part of the Bank's debt book where there are performance-related returns or convertible features is accounted for at fair value in accordance with IFRS9 and therefore not subject to impairment. For this debt accounted for at fair value, the relevant risk capital proxy for debt is applied to fair value together with a proportion of undrawn commitments to determine required capital.

- **Equity investments** is based on equity at fair value together with a proportion of undrawn commitments.

The CCF represents the proportion applied to undrawn commitments to derive exposure at default.

- 50% CCF is applied to undrawn debt commitments.
- 100% CCF is applied to undrawn direct equity commitments, reflecting that these instruments are disbursed rapidly once signed;
- 25% CCF is applied to equity funds, reflecting the slower disbursement rate; and
- 50% CCF is applied to guarantees with maturity <1 year and 100% CCF is applied to other guarantee commitments - signed commitments in the portfolio at any one time represent the Bank's actual credit exposure, albeit that there has been no disbursement.

2.3 Treasury risk

Credit risk is the largest component of overall Treasury risk and represents the total loss to the portfolio that could result from either the default of a counterparty or the deterioration of its creditworthiness. Market risk is the risk of loss in any financial position arising from changes in the term structure of interest rates or from changes in foreign exchange rates.

The Bank models capital requirements for Treasury based on a Value at Risk (VaR) computation made at a 99.99% confidence level using a one year horizon.

For medium term planning, required capital for Treasury (credit and market risk) is based on 5% of gross Treasury assets. It is important to set aside sufficient capital in the medium term to allow the Bank to hold sufficient liquidity compatible with the TALP, but not to incorporate additional buffers into Treasury capital requirements.

2.4 Operational risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk, but excludes strategic and reputational risk.

The Bank computes the operational risk component of the overall required capital based on Standardised Approach under the Basel III Framework⁸.

The standardised approach methodology incorporates the following components:

- (i) BI - a financial-statement-based proxy for operational risk;
- (ii) BIC - calculated by multiplying the BI by a set of regulatory determined marginal coefficients which increase with the size of BI; and
- (iii) ILM - a scaling factor that is based on a bank's average historical losses and the BIC.

Operational risk is calculated by multiplying the BIC and the ILM. For those banks that do not have 5 years of high-quality loss data, the capital requirements are based solely on BI components.

Therefore, for EBRD, operational risk charge equals BIC.

3. AVAILABLE CAPITAL

As outlined in the Policy, the Bank's available capital base is defined as the aggregate of:

- Share capital excluding callable capital, i.e. paid-in share capital, including amounts due under promissory notes; and
- Reserves, including EBRD specific reserves treated as restricted but which are available to absorb losses (loan loss reserve and special reserve) and unrealised fair value reserves for equity investments.

This capital base is equal to the total members' equity in the Bank's financial statements⁹.

Callable capital is not included in the available capital base, as its presence is already incorporated in a lower calibration (than would have otherwise been possible) of the capital utilisation limit.

⁸ Basel III: Finalising post-crisis reforms, December 2017

⁹ Note that net income allocations approved by the Board of Governors which remain contingent are only reflected in the Bank's financial accounts as a contingent liability. For prudence, AC is additionally adjusted (reduced) for these contingent amounts, as appropriate.