FitchRatings

RATING ACTION COMMENTARY

Fitch Upgrades CAF to 'AA-'; Outlook Stable

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Fitch Ratings - London - 13 Jan 2023: Fitch Ratings has upgraded Corporacion Andina de Fomento's (CAF) Long-Term Issuer Default Rating (IDR) to 'AA-' from 'A+'. The Outlook is Stable.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

Rating Upgrade: The upgrade of CAF's ratings reflects a strengthening in the bank's Standalone Credit Profile (SCP) to 'aa-' from 'a+'. The improvement in the SCP follows Fitch's revision of the bank's solvency risk assessment to 'aa-' from 'a+'. The recently approved very large capital increase and favourable loan portfolio dynamics, will support continued improvement in CAF's solvency profile. CAF's shareholders' capital contributions will support the bank's lending expansion and portfolio diversification in the coming years while maintaining 'excellent' capitalisation metrics.

Large Capital Increase: In December 2021, CAF's board of directors approved by consensus the resolution of the bank's 10th capital increase. The total amount approved was USD7 billion in paid-in capital, which represents CAF's largest capital increase. In March 2022, CAF's Shareholders' Assembly unanimously ratified the capital increase. Seven shareholders have already signed their subscription agreements, with Ecuador (B-/Stable) paying its first instalment in 2022. We expect further subscriptions and payments to commence in 2023.

Excellent Capitalisation: CAF's 'excellent' capitalisation metrics underpin the 'aa-' solvency assessment. Fitch's usable capital to risk-weighted assets (FRA) ratio was 48.1% as of end-September 2022, well above the threshold for an 'excellent' assessment (35%). The bank's equity/adjusted assets ratio was 30.3%, broadly in line with the pre-pandemic trend and also above the threshold for an 'excellent' assessment (25%). Capital payments from shareholders and positive internal capital generation will allow further growth in lending while supporting 'excellent' capitalisation metrics.

Shareholder Expansion Strategy: El Salvador (CC) has become CAF's 20th sovereign shareholder. This is in line with the bank's shareholding expansion strategy beyond South America. Chile (A-/Stable), Mexico (BBB-/Stable), Dominican Republic (BB-/Stable), and Costa Rica (B/Stable) are finalising their conversion to full members of the bank and are expected to make significant capital contributions as a result. These initiatives exert positive pressure on solvency metrics via increased capital contributions and loan portfolio diversification.

Moderate Risk Profile: In Fitch's view, CAF's overall risk profile is 'moderate', balancing the bank's 'excellent' record of preferred creditor status on its sovereign loans against a concentrated exposure to a number of low-rated and distressed sovereigns. Sovereign exposure to Argentina (CCC-, 12.8% of loans), Ecuador (B-/Stable, 14.0%), and Venezuela (8.9%) has declined in recent years but remains a key rating constraint. The transaction with Venezuela has led to a decline in the non-performing loan (NPL) ratio, as defined by Fitch, to 9.3% as of September 2022 from 10.1% at end-2021, but remains at a 'high' level (above 6%).

High, but Declining Venezuelan Exposure: The share repurchase programme for Venezuela, whereby CAF is using the sovereign's equity in the bank in lieu of debt service payments, has contributed to a decline in the size of the bank's loan exposure.

CAF does not consider the exposure to Venezuela as impaired or in non-accrual status, but Fitch treats the exposure as an NPL as the transaction results in a decline in CAF's equity in a way similar to a write-off. As of end-September 2022, the bank's principal exposure to Venezuela had fallen to USD2.7 billion from USD3.7 billion at end-2019. Assuming current interest rates, Venezuela's equity in the bank would be sufficient to cover debt service until mid-2024, when the principal outstanding would be USD1.9 billion (equivalent to approximately 6% of projected loans by end-2024).

Negative Revision to Liquidity: Large debt maturities and an increase in short-term funding (deposits and commercial paper) have led to a reduction in CAF's liquidity buffers as measured by Fitch. This is reflected in the coverage of short-term debt by liquid assets, which had reduced to 106% at end-September 2022, from 160% a year prior, and the historical trend of the ratio being well above the 'excellent' threshold of 150%. Fitch has revised its assessment of CAF's liquidity to 'aa' from 'aa+' in light of this deterioration. Access to capital markets has also been revised to 'strong' from 'excellent' as challenging market conditions in 2022 contributed to the shift in the funding mix. CAF's liquidity assessment is supported by the 'moderate' credit quality of treasury assets (34% rated above 'AA-').

Medium Risk Business Environment: Our medium risk business environment assessment for CAF balances the importance of its public mandate, as evidenced by the large capital increase approved and the credit and political risk related to its countries of operations. Initially focused on the Andean region, CAF has expanded its scope of operations to include most Latin American countries, with outstanding loan operations in 16 countries. The bank's headquarters remain in Caracas, but operationally the bank has moved the majority of its staff and operations to other capitals in the region, such as Bogota and Lima.

Shareholders' Support: Consistent with Fitch's Supranationals Rating Criteria, potential support from shareholders is not currently a driving factor of the overall rating. The weighted average rating of CAF's shareholders is 'BB-'. Although callable capital does not cover net debt, Fitch views propensity to support as 'strong', which is evidenced by recurring capital increases from shareholders.

National Scale Rating: CAF's Long-Term IDR is materially above Mexico's sovereign rating, therefore the bank's issue rating on the Mexican national rating scale is 'AAA(mex)'.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

Solvency (Capitalisation): Decline in capitalisation ratios that could affect our 'excellent' capitalisation assessment. This could be the case if delays on capital payments led either the equity/assets or FRA ratios to fall close to or below their 25% and 35% respective 'excellent' thresholds.

Solvency (Risks): Weakening in the assessment of the 'moderate' risk profile, which could stem from deterioration in credit or concentration risk. For example, additional sovereign downgrades and/or higher exposure to the bank's top borrowers.

Liquidity: Track record of operating with reduced liquidity buffers, potentially stemming from an increase in short-term funding and/or a reduction in the size and credit quality of the treasury portfolio.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Solvency (Risks): A significant improvement in CAF's 'credit risk' profile, reflected in a higher average credit quality of the loan book and a material reduction in the NPL ratio, sustained well below the 'high' risk level (defined as above 6%).

Solvency (Risks): Continued improvement in the bank's concentration risk metrics, as reflected in lower exposure to distressed sovereigns and greater diversification in the loan book. A decline in the ratio of the top five largest exposures as a percentage of total banking exposure closer to the 'low' risk threshold of 40%, from 58% currently, would be positive for the rating.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

Sources of Information

The sources of information used to assess these ratings were CAF's financial statements and other information provided by CAF.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

CAF has an ESG Relevance Score of '4' for 'Governance Structure'. High share of capital ownership by borrowing countries (above 90%) have influenced the bank's lending strategy towards large shareholders with weak credit fundamentals at the expense of diversification and prudent lending growth.

CAF has an ESG Relevance Score of '4' for 'Rule of Law, Institutional and Regulatory Quality'. All supranationals attract a score of '4' as they are neither subject to bank regulation nor supervised by an external authority. Instead, supranationals comply with their own set of prudential limits. Fitch pays particular attention to these internal prudential policies, including the bank's compliance with them. This has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Corporacion Andina de Fomento (CAF)	LT IDR	AA- Rating Outlook Stable	Upgrade	A+ Rating Outlook Positive
	ST IDR	F1+	Affirmed	F1+
senior unsecured	LT	AA-	Upgrade	A+
senior unsecured	ST	F1+	Affirmed	F1+
senior unsecured	Natl LT	AAA(mex)	Affirmed	AAA(mex)

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

National Scale Rating Criteria (pub. 22 Dec 2020)

Metodología de Calificaciones en Escala Nacional (pub. 22 Dec 2020)

Supranationals Rating Criteria (pub. 11 Apr 2022) (including rating assumption sensitivity)

Metodología de Calificación de Supranacionales (pub. 13 Jun 2022)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Corporacion Andina de Fomento (CAF)	UK Issued, EU Endorsed

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Sovereigns Banks Supranationals, Subnationals, and Agencies Latin America

Venezuela