Research Update:

Corporacion Andina de Fomento Long-Term Rating Raised To 'AA' On Stronger Presence In The Region; Outlook Stable

May 23, 2023

Overview

- We believe that Corporacion Andina de Fomento's (CAF's) most recent capital increase of US$7 billion--with payments starting in 2023 and its increasing membership base over the past years--further consolidates its strong policy importance.
- At the same time, we expect CAF's capital position will remain resilient despite vulnerabilities in the region as balance sheet growth will be accompanied by paid-in capital.
- We therefore raised our long-term rating on CAF to 'AA' from 'AA-'.
- The stable outlook indicates our expectation that CAF will continue supporting member countries and consolidate its reach in the region while managing its capital prudently.

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Rating Action

On May 23, 2023, S&P Global Ratings raised its long-term foreign currency issuer credit rating on Corporacion Andina de Fomento (CAF) to 'AA' from 'AA-'. The outlook is stable. We also affirmed our 'A-1+' short-term issuer credit rating.

Outlook

The stable outlook reflects our expectation that over the next two years CAF will continue supporting member countries and strengthen its presence in the region following recent expanded membership and its capital increase, which will also underpin its capital adequacy. We assume that members will continue to treat CAF as a preferred creditor and that it will maintain robust shareholder support through timely capital payments, as well as maintain high levels of liquidity. We also expect that CAF will prudently manage its exposure to Venezuela once its liquidity mechanism expires in 2024 without increasing risk on its balance sheet.

Downside scenario

We could lower the ratings if CAF expands its balance sheet significantly beyond our expectation, leading to a weaker capital position. Signs of weakening support from shareholders through delays in capital payments or signs of weaker policy execution could also lead to a downgrade.

Upside scenario

We could raise the ratings if CAF incorporates highly rated shareholders, which could enhance its capital ratio and create more diversity in its governance structure. This assumes members would continue to treat CAF as a preferred creditor amid robust shareholder support as CAF continues to fulfill its countercyclical lending role in the region and maintains high liquidity. An upgrade would also depend on CAF prudently managing its exposure to Venezuela without increasing risk on its balance sheet.

Rationale

The upgrade is based on our expectation that CAF will continue to enhance its position in Latin America and the Caribbean through its most recent capital increase, with payments having started in 2023. We also expect CAF will benefit from expanded support from existing members and incorporation of new member countries in recent years.

In March 2022, the board of governors approved a $7 billion increase in paid-in capital. CAF stands out among its peers in terms of the frequency of capital increases and shareholder support given the size. This marks CAF's 10th capital increase--its largest in history--even as it continues to receive sizable capital payments from its ninth general capital increase that was approved in 2015, with $725 million to be paid in until 2025.

At the same time, a number of current members have increased their equity participation in CAF while new members have joined the institution over the past couple of years, all of which has bolstered the magnitude of capital injections. Chile became a full member of the institution in March 2023 and will contribute $1.5 billion of paid-in capital. El Salvador joined the institution as a full member in 2022, bringing total shareholders to 20. In 2021, Costa Rica and Mexico increased their participation, and Dominican Republic was incorporated as a full member.

With the increase in capital, CAF aims to focus on four areas: become the green bank of Latin America and the Caribbean, support subnational governments, promote regional integration, and strengthen the role of the non-sovereign sector. While CAF's scope is more limited than larger institutions, such as IADB or IBRD, members see CAF's value in its proximity to the region and agility in loan approval and disbursements.

We believe these are positive developments that will bolster the resilience of CAF's risk-adjusted capital (RAC) ratio. The RAC ratio was 18.3% as of December 2022, virtually unchanged from December 2021. The RAC ratio has steadily risen following a low 14.7% as of December 2019, when two key exposures, Ecuador and Argentina (that together represent 26% of the loan book), were in selective default. In 2022, continued growth in capital and the decline in Venezuela's exposure, which carries a high capital charge, offset the negative impact from the downgrades of Argentina and Bolivia. In December 2022, equity was $13.7 billion, up from $13.3 billion as of December 2021.

Beginning in 2017, recurrent payment delays from Venezuela of fewer than 180 days--amid its economic crisis--led to our decision to weaken CAF's preferred creditor treatment (PCT) status, which weighed on the rating. To redress the pressures stemming from Venezuela, in March 2020, CAF's shareholders assembly approved a support program for exceptional situations. The program effectively allowed CAF to begin repurchasing Venezuela's equity shares to pay down the debt coming due from the sovereign. In our view, this program removed the risk of a nonaccrual event materializing until 2024, limiting the risk to PCT and the rating.

By December 2022, CAF had repurchased 108,693 shares, bringing Venezuela's outstanding loan balance to US$2.5 billion from US$3.5 billion in March 2020. The program essentially expires in 2024, when the paid-in capital of Venezuela used to service the debt will run down, leaving a remaining loan balance of about US$1.5 billion. At that time, a potential nonaccrual event (assuming the sovereign is unable to service its remaining debt) is assumed to have a limited impact given that Venezuela would represent a smaller proportion of CAF's balance sheet. However, we consider this unusual transaction to be a constraint on our capital adequacy assessment since the reduction in Venezuela's shares used to repay its debt was not compensated by additional capital.

During 2022, CAF grew its lending book by 4.5% (excluding fair value adjustments), reaching US$30.6 billion. At the same time, it has been strengthening its role in promoting green growth in the region. The institution's approvals for green financing are set to increase to 40% by 2026 (from 31% in 2022). CAF also demonstrated support to shareholders in response to the pandemic, with a COVID-19 response package totaling close to US$7.2 billion during 2020 and US$9.1 billion during 2021, which included:

- An emergency credit line,
- Contingent lines of credit to address public health systems,
- A regional facility for development banks, and
- A regional facility for public service companies.

This underscores our view of its important role and policy importance, sustained by exceptional support from its shareholders.

We believe CAF's administration will manage its balance sheet growth and capital prudently, especially if rating vulnerabilities emerge owing to weaker sovereign creditworthiness across region. That said, we expect members to maintain a solid track record of PCT with CAF. The institution has made efforts to diversify its portfolio and gradually increase exposure to investment-grade sovereigns. The most recent capital increase was a key condition to maintain its pace of lending growth to members.

In our view, CAF's governance is constrained by the absence of a set of nonborrowing member countries. It's a weakness relative to higher-rated multilateral lending institutions with greater shareholder diversity. On the other hand, CAF maintains robust risk management practices related to its liquidity and derivatives portfolio. We also believe CAF could withstand the loss of key personnel and significant disruptions to operations. While its headquarters are in Caracas, Venezuela, the institution has made important strides over the past few years to decentralize its workforce and has operating systems throughout Latin America.

CAF has maintained high liquidity. Our calculated 12-month liquidity ratio as of December 2022 was 1.2x, including scheduled loan disbursements, consistent with the previous year. The six-month ratio was 1.5x as of December 2022. CAF has maintained higher liquidity compared with our additional stress test that takes into account 50% of all undisbursed loans coming due in the next 12 months. As such, we expect it to accommodate unplanned disbursements.

At the same time, CAF has a conservative funding profile, with cumulative assets consistently exceeding cumulative debt for maturities up to one year and no significant gap for five years. We estimate that CAF is able to cover its scheduled short-term debt liabilities without recourse to new issuance. Its static funding gap (without loan disbursements) was 1.3x at the one-year horizon as of December 2022.

CAF's funding is also robust and diversified. The bank continues to be a regular global benchmark issuer and demonstrates exceptional access to the global markets. As of March 2023, CAF issued two benchmark bonds:

- One in January 2023 for US$1.5 billion, the largest in the history of the entity, and
- A euro-denominated bond for €1.0 billion in February 2023.

As of March 2023, total issuance in 2023 amounted to US$3.6 billion, almost the same as the full-year 2022 total of US$3.7 billion.

In May 2020, CAF issued two benchmark bonds, which demonstrates its strong access to the market during times of stress:

- One for US$800 million, and
- An inaugural social responsibility bond to manage the COVID-19 outbreak for €700 million.

Finally, in terms of shareholder support, we do not include any ratings uplift for extraordinary shareholder support because the sovereign shareholders are rated below CAF's stand-alone credit profile of 'aa'.

Ratings Score Snapshot

Issuer credit rating	**AA/Stable/A-1+**
Stand-alone credit profile	aa
Enterprise risk profile:	Strong
Policy importance	Strong
Governance and management expertise	Adequate
Financial risk profile:	Very Strong
Capital adequacy	Strong
Funding and liquidity	Very Strong
Extraordinary support	0
Callable capital:	0
Group support:	0
Holistic approach	0

Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Jan. 31, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10,

2021

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Supranationals Special Edition 2022, Oct. 11, 2022
- Introduction To Supranationals Special Edition 2022, Oct. 10, 2022
- Corporacion Andina de Fomento Upgraded To 'AA-/A-1+' On Strengthened Capital Position; Outlook Positive, June 16, 2022
- ESG Industry Report Card: Supranationals, Feb. 11, 2020

Ratings List

Ratings Affirmed		
Corporacion Andina de Fomento		
Commercial Paper	A-1+	
Upgraded		
	To	**From**
Corporacion Andina de Fomento		
Senior Unsecured	AA	AA-
Upgraded; CreditWatch/Outlook Action; Ratings Affirmed		
	To	**From**
Corporacion Andina de Fomento		
Issuer Credit Rating		
Foreign Currency	AA/Stable/A-1+	AA-/Positive/A-1+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.