S&P Global
Ratings

# RatingsDirect®

**Research Update:**

# Corporacion Andina de Fomento Downgraded To 'A+' On Increasing Likelihood Of Venezuela Arrears; Outlook Is Negative

**Primary Credit Analyst:**
Alexis Smith-juvelis, New York + 1 (212) 438 0639; alexis.smith-juvelis@spglobal.com

**Secondary Contacts:**
Constanza M Perez Aquino, Buenos Aires (54) 544-891-2167; constanza.perez.aquino@spglobal.com
Alexander Ekbom, Stockholm (46) 8-440-5911; alexander.ekbom@spglobal.com

## Table Of Contents

Research Update:

# Corporacion Andina de Fomento Downgraded To 'A+' On Increasing Likelihood Of Venezuela Arrears; Outlook Is Negative

## Overview

- Following a review of Corporacion Andina de Fomento (CAF) under our revised criteria for multilateral lending institutions (MLIs), we are lowering our foreign currency long- and short-term issuer credit ratings on CAF to 'A+/A-1' from 'AA-/A-1+' and removing them from under criteria observation.
- The recent political and economic dynamics in Venezuela, in our view, increase the likelihood of a nonaccrual event to CAF. This, combined with significant exposure to Venezuela and CAF's current capitalization, weighs on our financial risk profile assessment.
- The stand-alone credit profile for CAF is 'a+', reflecting our assessment of its strong enterprise risk profile and strong financial risk profile.
- The negative outlook reflects our view that there is at least a one-in-three likelihood of Venezuela entering in nonaccrual with CAF, which would affect our view of the bank's preferred creditor treatment (PCT) and weaken the enterprise risk profile and capital ratio.

## Rating Action

On Feb. 21, 2019, S&P Global Ratings lowered its foreign currency long- and short-term issuer credit ratings on Corporacion Andina de Fomento (CAF) to 'A+/A-1' from 'AA-/A-1+'. The outlook is negative.

At the same time, we removed the ratings from under criteria observation, where we placed them on Dec. 14, 2018, after publishing our revised multilateral lending institution (MLI) criteria.

## Rationale

The downgrade reflects the adoption of our revised criteria for rating multilaterals, combined with our expectation of weakened preferred creditor treatment (PCT) as conditions in Venezuela--one of CAF's largest borrowers--continue to deteriorate. The ratings on CAF are based on its strong enterprise risk profile and strong financial risk profile. We do not give any ratings uplift for extraordinary shareholder support because we rate CAF's sovereign shareholders equal to or higher than the stand-alone credit profile of 'a+'--insufficient to support a higher assessment. We outline these factors in our revised criteria, "Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology," published Dec. 14, 2018.

We believe the recurrent payment delays from Venezuela, combined with the complex and deteriorating economic and political situation in the country, exacerbated by the recent U.S. imposed oil sanctions on Petróleos de Venezuela S.A. (PDVSA), increase the likelihood of future nonpayment to CAF. While payment delays have not yet exceeded 180 days, the sovereign has already entered into nonaccrual status with the Inter-American Development Bank and on all its commercial debt.

Our capital adequacy assessment incorporates the heightened risk of Venezuela arrears exceeding 180 days, coupled with the marginal build-up in CAF's loan exposure to the sovereign, which weighs on CAF's risk-adjusted capital (RAC) ratio of 16% as of December 2017. CAF's nominal exposure to Venezuela increased to US$3.4 billion as of September 2018 from US$3.3 billion as of December 2017, mostly because of the approval of a US$400 million liquidity facility to the Central Bank of Venezuelan (CBV) in December 2017 and disbursed throughout 2018 during periods in which Venezuela was current with the bank. In December 2018, CAF approved a second liquidity loan for US$500 million to the CBV.

The decision to continue extending loans to Venezuela, despite persistent and deteriorating credit quality, in our view, reflects a higher risk tolerance, which, combined with CAF's current capitalization levels, further constrain our capital assessment.

Our outlook is negative based on our expectation that Venezuela has a one-and three chance of going into nonaccrual--defined as arrears that exceed 180 days--over the next 24 months. Venezuela comprises 16% of the sovereign outstanding portfolio, which would weigh heavily on our PCT assessment and translate into a lower enterprise risk profile.

On the other hand, CAF has maintained its high liquidity levels, and we view its funding profile as robust, which supports the financial risk profile.

For year-end 2017 data and incorporating our updated liquidity haircuts, our 12-month liquidity ratio, considering the netted derivatives position, was 1.4x with scheduled loans disbursements, while the six-month ratio stood at 1.8x. CAF has kept higher stocks of liquidity compared with the additional stress we factor into our liquidity ratio, which takes into account 50% of all undisbursed loans coming due in the next 12 months. We expect liquidity won't be affected substantially by a nonpayment of Venezuela, because we believe CAF has strong market access and will continue to target high liquidity levels. In February 2019, CAF issued a $1.25 billion benchmark bond, which was oversubscribed by investors. Therefore, we expect CAF to accommodate unplanned disbursements.

At the same time, CAF has a conservative funding profile, with cumulative assets exceeding consistently cumulative debt for maturities up to one year without a significant gap for five years. We estimate that CAF is structurally able to cover its scheduled short-term debt liabilities without recourse to new issuance. Its static funding gap (without loan disbursements) was 2.2x at the one-year horizon as of December 2017, compared with 2.0x at year-end 2016. Its static funding gap (without loan disbursements) was 1.4x for five years.

The assessment of CAF's policy importance is supported by our view of its role as a key lender for infrastructure and energy projects in the region, which its proven track-record of lending through the credit cycle and continued growth in its portfolio demonstrate. CAF's loan book grew by 4.6%, reaching US$24.1 billion as of September 2018, and we expect CAF to maintain this growth momentum sustained by exceptional support from its shareholders.

Over the past 10 years, CAF has made more frequent and larger general capital increases. In 2015, the Board of Directors approved the largest general capital increase in its history, equivalent to US$4.5 billion. In 2017, paid-in capital contributions totaled US$570 million, and US$478 million through September 2018. Shareholders continue to pay on time and in full--except for Venezuela, which has made marginal capital contributions during 2018.

We expect management will continue to diversify its portfolio and gradually increase exposure to investment-grade sovereigns. The top three countries that account for the largest proportion of the portfolio are Ecuador, Venezuela, and Argentina, accounting for 41% in 2017, down from 42% in 2016. Similarly, 36% of CAF's loan book is investment grade, up from 35% in 2016. We expect this trend to continue, which could, over time, support CAF's capital ratio.

Our appraisal of CAF's governance is constrained by the absence of a set of nonborrowing member countries, a weakness relative to higher-rated MLIs with greater shareholder diversity. Three members (Peru, Venezuela, and Colombia) account for 52% of total shares, followed by Argentina and Brazil, accounting for 9.0% each.

On the other hand, CAF maintains robust risk management practices related to its liquidity and derivatives portfolio. We also believe CAF has the ability to withstand loss of key personnel and significant disruptions to operations (given its headquarters are in Caracas, Venezuela), because CAF has made important strides over the past few years to decentralize its workforce throughout Latin America.

We factor extraordinary support in the form of callable capital from Chile (to which we assign a foreign currency long-term rating of 'A+'), although this is insufficient to provide additional uplift to our RAC ratio. We do not incorporate callable capital from other shareholders, because we rate them below CAF's stand-alone credit profile.

## Outlook

The negative outlook on the long-term rating reflects our view that within the next 24 months there is a greater than one-in-three likelihood that Venezuela arrears will exceed 180 days, which would trigger a deterioration in our assessment of CAF's enterprise risk profile and further stress the bank's capital ratio.

If, contrary to our expectations, any of CAF's shareholders fail to treat CAF as preferred, that could also lead to a downgrade.

We could revise outlook to stable if CAF builds sufficient capital buffers and maintains its high levels of liquidity to counterbalance the increased risk in its loan portfolio.

## Ratings Score Snapshot

| | |
|---|---|
| Issuer credit rating | A+/Negative/A-1 |
| SACP | a+ |
| Enterprise risk profile | Strong |
| Policy importance | Strong |
| Governance and management | Adequate |
| Financial risk profile | Strong |
| Capital adequacy | Adequate |
| 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, Dec. 14, 2018
- 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Related Research

- Criteria Guidance: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- Supranationals Special Edition, Oct. 11, 2018

## Ratings List

Downgraded

| | To | From |
|---|---|---|
| Corporacion Andina de Fomento | | |
| Issuer Credit Rating | | |
| Foreign Currency | A+/Negative/A-1 | AA-/Negative/A-1+ |
| Senior Unsecured | A+ | AA- |
| Commercial Paper | A-1 | 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.