S&P Global Ratings

(/en_US/web/guest/home) Corporacion Andina de Fomento Outlook Revised To Stable From Negative; 'A+/A-1' Ratings Affirmed

16-Jun-2020 16:55 EDT

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Corporacion Andina de Fomento (CAF) introduced a mechanism to support Venezuela's debt service payments using its paid-in capital, which has removed the near-term risk of a protracted nonaccrual event and stabilized its enterprise risk profile. Although it removed the risk of Venezuela entering into arrears until 2024, this mechanism has not been compensated by additional capital, which remains a constraint in our capital assessment. On the other hand, CAF's policy importance remains strong, supported by its robust response to COVID-19 and membership expansion of both regional and non-regional sovereigns.

We are revising our outlook to stable from negative and are affirming our 'A+/A-1' ratings on CAF.

The stable outlook reflects our view that member countries will remain supportive of the institution and that an increase in lending volumes combined with rising risks in the region will be compensated by timely capital payments.

On June 16, 2020, S&P Global Ratings revised its outlook on Corporación Andina de Fomento (CAF) to stable from negative. We also affirmed our 'A+' foreign currency long-term and 'A-1' short-term issuer credit ratings on CAF.

In March 2020, CAF's shareholders assembly approved a support program for liquidity management in exceptional situations. This effectively allows CAF to repurchase a specific member country's shares and apply the proceeds to the country's debt service in the event that a country shows three consecutive years of two of the following conditions: a decrease of more than 15% per year in GDP, international reserves at six months of imports or less, or three years of inflation above 100%.

This has allowed CAF to begin repurchasing Venezuela's shares to pay down its debt coming due from the sovereign and, in our view, removes the risk of a nonaccrual event materializing until 2024 and limits the downside risk to its preferred creditor treatment (PCT) and the rating.

CAF experienced recurrent payment delays from Venezuela since 2017 given the complex and deteriorating economic and political situation in the country. Although payment delays never exceeded 180 days, we maintain a view that the share repurchasing mechanism does not reflect an improvement in payment capacity nor credit fundamentals. With an exposure of $3.5 billion as of March 2020, this program will only cover the sovereign's debt service until 2024, though we may positively adjust our view of the country's PCT if there is evidence that Venezuela can begin repurchasing its shares or repays the remaining balance after this program expires.

Furthermore, our capital adequacy assessment considers this unusual transaction as a constraint given that the reduction in Venezuela's shares to repay its debt is not compensated by additional capital.

CAF's risk-adjusted capital (RAC) ratio was 14.7% as of December 2019, down from 16.2% as of June 2019. This already reflects the significant credit stresses experienced in the region--with two key members, Argentina and Ecuador, entering selective default, although we continue to assume they will uphold PCT with CAF.

CAF continues to receive sizable capital payments from its 10th general capital increase--with approximately $600 million expected to be paid in during 2020. This is in addition to the capital from members that are increasing their participation in the institution. Costa Rica is expected to join as a full member in 2020, and the Dominican Republic is expected to join as a full member in 2022. We also expect other non-regional countries to incorporate as CAF's members within the next 24 months.

We believe capital payments will compensate the additional deployment of resources expected during 2020 given COVID-19, although capital could rise with the incorporation of new members. While CAF's lending portfolio grew 5% in 2019 to $26.7 billion, it is likely that growth will double given its important relief package. CAF allocated $2.5 billion toward an emergency credit line for rapid disbursements to mitigate the effects of COVID-19. Earlier in March, the board had announced a contingent credit line of up to $50 million per country, made available to shareholders to provide direct attention to public health systems. This underscores and reinforces our view of its important role and policy importance, sustained by exceptional support from its shareholders.

In fact, the past 10 years have been characterized by 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 2019, paid-in capital contributions totaled $610 million, compared with US$520 million in 2018. Shareholders continue to pay on time and in full--except for Venezuela.

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 42% as of December 2019, slightly lower than the 43% as of December 2018. Additionally, 38% of its loan book is investment-grade as of year-end 2019, up from 37% in 2018. We expect this trend to continue, which can, over time, support the bank'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 multilateral lending institutions (MLIs) 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 has the ability to withstand loss of key personnel and significant disruptions to operations, given its headquarters are in Caracas, Venezuela, as it has made important strides over the past few years to decentralize its workforce throughout Latin America.

CAF has maintained its high liquidity levels, and we view its funding profile as robust--supportive of the financial risk profile. 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 the callable capital from CAF's sovereign shareholders that are rated equal or higher than CAF's stand-alone credit profile of 'a+' is insufficient to support a higher assessment.

The December 2019 12-month liquidity ratio was 1.5x with scheduled loan disbursements, compared with 1.4x as of year-end 2017. The six-month ratio was 2.5x as of December 2019. CAF has kept higher stocks of 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 structurally able to cover its scheduled short-term debt liabilities without recourse to new issuance. Its static funding gap (without loan disbursements) improved substantially to 2.3x at the one-year horizon as of December 2019.

CAF has a robust and diversified funding program. In May 2020, CAF issued two benchmark bonds, one for US$800 million and an inaugural social responsibility bond to manage the COVID-19 outbreak for €700 million.

We factor extraordinary support in the form of callable capital from Chile (long-term foreign currency rating 'A+'), although it is insufficient to provide additional uplift to our RAC ratio.

The stable outlook reflects our expectation that, over the next two years, CAF's shareholders will remain supportive and continue to make timely capital payments, which will stabilize its capital position in light of higher lending volumes in response to COVID-19. We also expect CAF will maintain high levels of liquidity. At the same time, members will continue to treat CAF as a preferred creditor.

We could raise the ratings within the next 24 months if CAF sustainably improves its capital position to more than offset risks in its portfolio.

If, contrary to our expectations, any of CAF's shareholders fail to treat CAF as preferred or if we believe shareholder support for member countries has weakened, this could lead to a downgrade.

Related Criteria

Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology (/en_US/web/guest/article/-/view/sourceId/10614770), Dec. 14, 2018
General Criteria: Methodology For National And Regional Scale Credit Ratings (/en_US/web/guest/article/-/view/sourceId/10575669), June 25, 2018
Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology (/en_US/web/guest/article/-/view/sourceId/10170016), July 20, 2017
General Criteria: Methodology For Linking Long-Term And Short-Term Ratings (/en_US/web/guest/article/-/view/sourceId/10011703), April 7, 2017
General Criteria: Use Of CreditWatch And Outlooks (/en_US/web/guest/article/-/view/sourceId/5612636), Sept. 14, 2009

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Abridged Supranationals Interim Edition 2020: Comparative Data For Multilateral Lending Institutions (/en_US/web/guest/article/-/view/sourceId/11480828), May 8, 2020
Supranationals Special Edition 2019 (/en_US/web/guest/article/-/view/sourceId/11200126), Oct. 16, 2019
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.

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