MOODY'S
INVESTORS SERVICE

CREDIT OPINION
9 September 2020

Update

Rate this Research

Contacts

Renzo Merino +1.212.553.0330
VP-Senior Analyst
renzo.merino@moodys.com

Gabriel Agostini +1.212.553.8882
Associate Analyst
gabriel.agostini@moodys.com

Mauro Leos +1.212.553.1947
Associate Managing Director
mauro.leos@moodys.com

Yves Lemay +44.20.7772.5512
MD-Sovereign/Sub Sovereign
yves.lemay@moodys.com

Corporacion Andina de Fomento – Aa3 stable

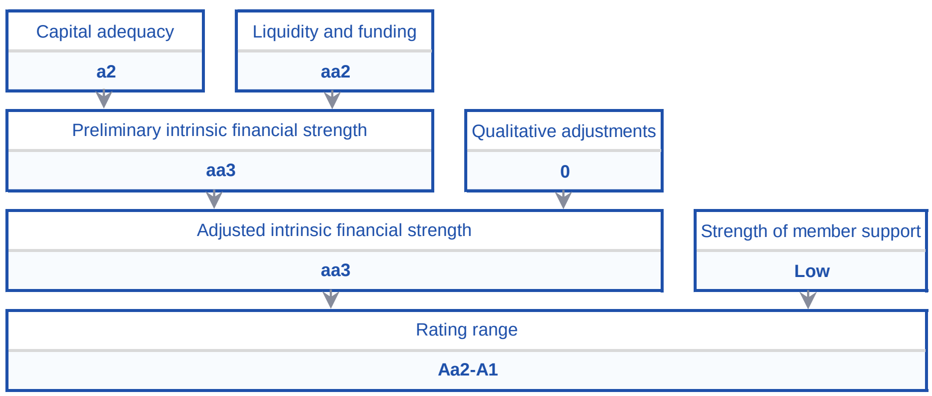
Regular update

Summary

The credit profile of Corporacion Andina de Fomento (CAF) reflects the development bank's history of strong asset performance and healthy growth with a portfolio that is exposed to low borrower credit quality and higher-than-peer leverage. CAF's credit profile also incorporates its healthy liquidity, underpinned by a robust liquidity risk management policy and prudent financial management. While CAF's loan book is subject to concentration risk, it continues to diversify its lending portfolio and shareholder base.

Exhibit 1

CAF's credit profile is determined by three factors



Source: Moody's Investors Service

Credit strengths

» Strong availability of liquid resources underpinned by a conservative liquidity policy

» Prudent financial management reflected in diversified funding sources

» Record of strong asset performance and very low nonperforming loans (NPLs)

Credit challenges

» Significant, although declining, credit exposure to low-rated countries

» Very limited presence of highly rated shareholders

» High leverage compared with that of its Aa-rated peers

Rating outlook

The stable rating outlook reflects our expectation that CAF's capitalization and liquidity will remain consistent with its Aa3 rating, as CAF continues to expand its operations, balancing loan growth with adequate liquidity and capitalization buffers. The stable rating outlook also reflects our expectation that the institution will be able to successfully manage operating and credit risks from its exposure to Venezuela (issuer rating withdrawn, senior unsecured C stable) and that the sovereign will remain current on its obligations to CAF.

Factors that could lead to an upgrade

Although unlikely in the near future, upward credit pressure would develop if CAF significantly reduces its exposure to its lowest-rated borrowers and decreases its leverage, and its capitalization and liquidity ratios improve significantly. The inclusion of new non-borrowing highly rated members responsible for a significant amount of callable capital, which would reduce the correlation between members and assets, would also support improved creditworthiness.

Factors that could lead to a downgrade

We would change the rating outlook to negative if Venezuela were to be placed on nonaccrual status because of missed payments, as it would indicate potential significant pressure on the bank's balance sheet and profitability over a 12-18-month time horizon.

A subsequent rating downgrade would result if CAF and Venezuela were unable to quickly resolve the missed payments to limit the negative impact on CAF's capital adequacy and liquidity metrics. Downward pressure on CAF's credit profile would also develop if it were to face a strong deterioration in asset quality because of credit events involving other borrowers, or if it were to experience an erosion in its capital and liquidity buffers because of a rapid expansion of its loan book that is not sufficiently compensated by additional capital contributions.

Key indicators

Exhibit 2

Corporacion Andina de Fomento (CAF)	2014	2015	2016	2017	2018	2019
Total Assets (USD million)	30,458.2	32,469.7	35,669.0	38,111.6	40,014.2	42,293.6
Development-related Assets (DRA) / Usable Equity [1]	221.8	218.0	213.5	216.3	215.5	210.9
Non-Performing Assets / DRA	0.1	0.0	0.6	0.6	0.5	0.3
Return on Average Assets	0.5	0.2	0.4	0.2	0.6	0.8
Liquid Assets / ST Debt + CMLTD	301.7	233.0	288.9	277.0	418.5	266.1
Liquid Assets / Total Assets	33.3	33.2	33.6	33.4	32.6	32.8
Callable Capital / Gross Debt	9.0	8.1	7.7	6.9	6.8	6.2

[1] Usable equity is total shareholder's equity and excludes callable capital.
Source: Moody's Investors Service

Detailed credit considerations

CAF's "a2" **capital adequacy** score reflects its comparatively modest (but weaker than that of Aa-rated peers) leverage and robust asset performance, both of which are counterbalanced by relatively low development asset credit quality (DACQ).

The bank's capital position is sound and benefits from regular, paid-in capital contributions from its membership. Despite regular, market-based funding of its development-related-assets (DRA), its leverage ratio has fallen steadily over the last five years, with DRA reaching 211% of usable equity last year, down from 233% in 2013. We expect leverage to remain steady, with the market funding of its DRA partially matched by small, regular increases in capital contributions from regional members.

DACQ is low relative to its peers that we rate similarly, reflecting a high level of portfolio concentration in low-credit quality borrowers, consistent with the institution's development mandate and regional role. CAF's top five borrowers account for more than half of the lending portfolio. However, CAF has made progress in diversifying its operations, particularly in reducing exposure to founding members and single borrower exposure, with the latter representing 13.5% of the total loan portfolio in 2019, down from 25% in

2005. Portfolio concentration and relatively low borrower quality reflect CAF's development mandate and as a result are unlikely to change significantly over the next few years. Nevertheless, prudent financial and strong risk management have resulted in strong asset performance and a long track record of very low nonperforming assets (NPA).

CAF's "aa2" **liquidity and funding** score reflects the bank's well-established presence in international bond markets and strong liquidity position.

CAF funds its borrowing needs through frequent bond issuances in multiple international markets; its outstanding debt as of year-end 2019 was denominated in 17 different currencies, a reflection of the reach and diversification of its market access.

The bank also benefits from a conservative liquidity risk management policy that mandates it to hold at least 12 months of net cash requirements (defined as debt service and committed disbursements less repayments). In practice, however, the institution holds 24 months of net cash requirements. As a result, CAF's availability of liquid resources over an 18-month period is just above that of the Aa-rated median and in line with peers such as North American Development Bank (Aa1 stable) and Fondo Latinoamericano de Reservas (FLAR, Aa2 stable).

Finally, we assess CAF's **strength of member support** as "Low." At "b3," the ability of the bank's membership to provide support — as proxied by the weighted average shareholder rating — is low, reflecting the relatively low credit quality and limited fiscal space of the bank's largest shareholders. At the same time, because most of CAF's capital is paid-in, it has limited callable capital, further constraining member support; only 19.9% of CAF's capital was callable in 2019.

Shareholders' limited ability to provide extraordinary support is partially offset by a strong and demonstrated willingness to support the institution. This is primarily illustrated by regular capital increases that support its strong capital buffer and expanded lending operations. This strong willingness would at least partially offset shareholders' relatively constrained ability to support the bank in times of stress.

Recent developments

CAF ramps up lending and liquidity support to borrowing members during the pandemic

On 23 March, CAF introduced a $2.5 billion rapid emergency credit facility for its shareholders in an effort to support their emergency policy measures to combat the coronavirus pandemic. The new facility complements the $50 million contingent credit line that the bank made available to its shareholders on 3 March, and reflects the region's increased need and desire for multilateral financial support during the pandemic.

Given CAF's large, important and countercyclical role as a regional development partner, we expect the bank's lending operations to increase in tandem with the borrowing members' need for financial relief as the region weathers a severe, pandemic-induced recession in 2020. Nonetheless, we expect CAF's asset performance to remain strong and in line with historical conduct; as of 30 June 2020, NPLs were just 0.3% of the loan portfolio, down from 0.4% as of year-end 2019.

CAF's new liquidity management program prudently manages lending exposure to the Venezuelan sovereign

On 3 March, CAF's Board of Governors approved the "Support Program for Liquidity Management in Exceptional Situations," a plan which allows CAF to repurchase a specific member country's shares and apply the proceeds to the country's debt service as it comes due. Member countries that undergo an economic contraction of more than 15% for three consecutive years, go through a three-year inflationary process with a more than 100% annual inflation, and/or record a reduction in official international reserves to less than six months of import cover, can become eligible for the program if they meet any two of those conditions. The introduction of the program follows last year's tightening of the US sanctions on Venezuela, which posed further challenges in transferring funds in and out of the country, resulting in a late-2019 default to the only other multilateral with which Venezuela remained current — FLAR.

Venezuela meets all three conditions and is CAF's third-largest shareholder, owning 15.8% of the institution's capital. As of March 2020, Venezuela had accumulated debt service arrears of around $200 million, but remained below CAF's 180-day NPL threshold, while approaching our 90-day NPA threshold. CAF has now implemented the new policy toward Venezuela's arrears, which will reduce Venezuela's capital position and its outstanding loan balance. As more debt service comes due, CAF will likely continue to apply the policy until Venezuela is able to make debt service payments, or until all of its shares have been bought and applied against debt service payments. In the event this happens, Venezuela will still retain its participation in the board as a founding member, but will be ineligible to access new loans until the shares bought by CAF are reacquired.

The program reflects the long-standing prudent approach to dealing with challenges arising from exposure to Venezuela. The strategy will prevent CAF from incurring an NPL from Venezuela until 2024, rapidly reducing the size of the exposure and granting the sovereign time to resolve its ongoing crises.

Rating methodology and scorecard factors

Exhibit 3

Rating factor grid - Corporacion Andina de Fomento	Initial score	Adjusted score	Assigned score
Factor 1: Capital adequacy (50%)		a2	a2
Capital position (20%)		a3	
Leverage ratio	a3		
Trend	0		
Impact of profit and loss on leverage	0		
Development asset credit quality (10%)		ba	
DACQ assessment	ba		
Trend	0		
Asset performance (20%)		aaa	
Non-performing assets	aaa		
Trend	0		
Excessive development asset growth	0		
Factor 2: Liquidity and funding (50%)		aa2	aa2
Liquid resources (10%)		aaa	
Availability of liquid resources	aaa		
Trend in coverage outflow	0		
Access to extraordinary liquidity	0		
Quality of funding (40%)		aa	
Preliminary intrinsic financial strength			aa3
Other adjustments			0
Operating environment	0		
Quality of management	0		
Adjusted intrinsic financial strength			aa3
Factor 3: Strength of member support (+3,+2,+1,0)		Low	Low
Ability to support - weighted average shareholder rating (50%)		b3	
Willingness to support (50%)			
Contractual support (25%)	caa3	caa3	
Strong enforcement mechanism	0		
Payment enhancements	0		
Non-contractual support (25%)		Very High	
Scorecard-Indicated Outcome Range			Aa2-A1
Rating Assigned			Aa3

Note: Our ratings are forward-looking and reflect our expectations for future financial and operating performance. However, historical results are helpful in understanding patterns and trends of an issuer's performance as well as for peer comparisons. Additional considerations that may not be captured when historical metrics are used in the scorecard may be reflected in differences between the adjusted and assigned factor scores. Furthermore, in our ratings we often incorporate directional views of risks and mitigants in a qualitative way. For more information please see our Multilateral Development Banks and Other Supranational Entities rating methodology.

Source: Moody's Investors Service

Moody's related publications

» **Credit Analysis**: Corporacion Andina de Fomento - Aa3 stable: Annual credit analysis, 14 May 2020

» **Sector In-Depth**: Supranationals - Americas: Exposure risks to Venezuela vary, but strong buffers contain negative credit pressures, 7 June 2018

» **Rating Methodology**: Multilateral Development Banks and Other Supranational Entities, 25 June 2019

REPORT NUMBER 1244116

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454