Moody's
INVESTORS SERVICE

Rating Action: Moody's affirms Corporacion Andina de Fomento's Aa3 rating; maintains stable outlook

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New York, April 20, 2021 -- Moody's Investors Service, ("Moody's") has today affirmed the long-term issuer rating and senior unsecured debt rating of Corporacion Andina de Fomento (CAF) at Aa3. The foreign-currency senior unsecured MTN program rating and the senior unsecured shelf rating have been affirmed at (P)Aa3. Other short-term rating, the commercial paper and backed commercial paper ratings have been affirmed at Prime-1 (P-1), while the foreign-currency short-term program rating has been affirmed at (P)P-1. The outlook remains stable.

The decision to affirm the rating reflects the following key factors:

1) CAF's intrinsic financial strength remains robust with solid asset quality, robust capital buffers and liquidity, despite continued challenges from high credit risk on its loan exposures.

2) Exposure to Venezuela continues to be managed using an unconventional mechanism that reduces Venezuela's shareholding and outstanding loans.

The stable outlook reflects Moody's expectation that CAF's capitalization and liquidity levels 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 outlook also reflects Moody's expectation that the institution will be able to successfully manage operating and credit risks from its exposure to Venezuela within the context of the reduction in exposure to Venezuela via its declining borrowings and shareholding vis-a-vis CAF.

RATINGS RATIONALE

RATIONALE FOR AFFIRMING THE Aa3 RATING

FIRST DRIVER: CAF'S INTRINSIC FINANCIAL STRENGTH REMAINS ROBUST WITH SOLID ASSET QUALITY, ROBUST CAPITAL BUFFERS AND LIQUIDITY, DESPITE CONTINUED CHALLENGES FROM HIGH CREDIT RISK ON ITS LOAN EXPOSURES

CAF's robust intrinsic financial strength continues to reflect strong asset performance and high levels of paid in capital that underpin solid capital adequacy. Strong liquidity coverage and ample access to capital markets support Moody's assessment of CAF's robust liquidity and funding performance.

CAF's capital position has remained relatively steady over the past five years, reflecting sustained lending activity that has grown at a compound annual rate of 5.0% in 2016-20. CAF's leverage has been stable and has improved modestly over the past five years, standing at 219.7% at the end of 2020, broadly stable from 218% in 2015 and comparable to the Aa-rated median. Additional capital will be provided by incoming shareholders Costa Rica and Mexico and CAF's continuing profitability also adds to reserves and useable equity. Overall net income decreased to $239.9 million in 2020, down from $325.6 million in 2019. The decrease was largely driven by a much lower interest rate environment and its negative impact on net interest income, as well as some base effects.

One of CAF's key credit strengths has been its good asset performance despite lending to lowly-rated sovereigns. In 2020, non-performing loans (NPLs) decreased to 0.2% from 0.3% in 2019, reflecting no new NPLs combined with continued growth in CAF's lending portfolio. Deteriorating credit quality in 2021-22, as a result of a lagged pass-through from the coronavirus shock within CAF's operating region, could push non-performing assets (NPAs) higher, but Moody's expects they will remain contained. This expectation rests on Moody's assumption that even if more of CAF's borrowers face a challenging environment, they will continue to repay CAF, as they have continuously done in previous crisis situations.

Secondly CAF's liquidity cushion is an important credit support. Although its liquidity policy requires CAF to maintain sufficient liquid assets to cover at least 12 months of net cash requirements, in practice, the institution holds 24 months of net cash requirements and has done so consistently since at least 2014. The strong liquidity buffer is confirmed in Moody's own metrics, which sizes its high-quality liquid assets relative to its net outflows from uninterrupted net loan disbursements, debt repayment and administrative costs. The Bank holds enough liquid assets to sustain operations for more than 18 months.

CAF's credit profile continues to be constrained by low borrower quality (which, by design, is consistent with the institution's mandate) including its exposure to Venezuela, and a relatively high level of portfolio concentration. Borrower quality, as measured by the weighted average borrower rating, is low at caa2. This is because the majority (69%) of outstanding loans were to non-investment grade countries in 2020, and has remained relatively steady over the last five years, despite great strides in diversifying country exposure within the lending portfolio.

SECOND DRIVER: EXPOSURE TO VENEZUELA CONTINUES TO BE MANAGED USING AN UNCONVENTIONAL MECHANISM THAT REDUCES VENEZUELA'S SHAREHOLDING AND OUTSTANDING LOANS

CAF's loan exposure to Venezuela (senior unsecured C stable) represented 11.4% of the total lending portfolio, the third largest behind Ecuador (Caa3 stable) and Argentina (Ca stable), and a decrease from 2019 when it represented 13.8% of the portfolio.

In anticipation of the potential incurrence of NPLs from Venezuela, CAF approved the so-called Support Program for Liquidity Management in Exceptional Situations. The program allows CAF to repurchase Venezuela's shares in the corporation, and apply those proceeds toward debt service owed by the sovereign to CAF. By the end of 2020 the plan had reduced Venezuela's shareholding in CAF to 11.5% from just under 16% in 2019. The Program has since been closed and as such would not be available to other borrowers in distress.

Although unconventional and despite the reduction in capital and loans related to Venezuela from implementing the plan, CAF's balance sheet did not compress. This reflects CAF's continued profitability and inflow of fresh capital from the latest general capital increase program and the expansion of the membership base. Moody's anticipates that CAF will avoid a compression of its balance sheet in the coming years until Venezuela's capital has been exhausted.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects Moody's expectation that CAF will manage its sustained increase in lending prudently, while maintaining adequate liquidity and capitalization buffers.

The stable outlook also reflects Moody's expectation that the institution will be able to successfully manage operating and credit risks from its exposure to Venezuela. Moody's expects CAF to continue to implement the Support Program for Liquidity Management in Exceptional Situations, using Venezuela's remaining shares to fund payments due.

Once Venezuela's capital will be exhausted, an accumulation of NPLs from Venezuela is likely, should there be no change in the sanctions that remain in place against the country. This is likely to exert pressure on CAF's creditworthiness.

ENVIRONMENTAL, SOCIAL AND GOVERNANCE CONSIDERATIONS

Environmental considerations are not material for CAF's rating. However, Moody's note that as part of its mission, CAF has committed to increase its lending for projects that look to address or mitigate climate change risks in the Latin America region.

Social risks are not material for CAF's rating. Moody's does not expect that social risks affecting its borrowers will affect CAF's capital adequacy or liquidity.

Governance considerations are material. CAF's governance, and in particular its risk management policies and practices, are strong and in line with similarly rated MDBs.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Upward credit pressure on CAF's rating is unlikely, save if CAF were to meaningfully reduced its exposure to its lowest rated borrowers, decreased its leverage, and if its capitalization and liquidity ratios improved significantly. The inclusion of new highly rated non-borrowing members responsible for a significant amount of callable capital, which reduced the correlation between members and assets, would also support improved creditworthiness.

Conversely, downward credit pressure would arise if the Venezuela exposure were to cause a deterioration of asset performance due to missed payments, as it would signal the potential for material pressure on the balance sheet of the bank over a 12-18 month time horizon. Negative pressure would also develop if CAF were to face a strong deterioration in asset quality due to credit events involving other borrowers, or if it were to experience an erosion of its capital and liquidity buffers due to a rapid expansion of its loan book not sufficiently compensated for by additional capital contributions.

The principal methodology used in these ratings was Multilateral Development Banks and Other Supranational Entities Methodology published in October 2020 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1232238 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1243406 .

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