

Research Update:

Corporacion Andina de Fomento Outlook Revised To Positive On Strengthened Capital Position; 'A+/A-1' Ratings Affirmed

June 14, 2021

Overview

- Corporacion Andina de Fomento's (CAF's) capital position has strengthened following Argentina's and Ecuador's emergence from default and a gradual reduction in Venezuela's outstanding balance via a share repurchase mechanism, which removes the sovereign's risk of an arrears event until 2024.
- At the same time, CAF's policy importance remains strong given the robust response to COVID-19 and membership expansion following Mexico's and Costa Rica's increased participation.
- We therefore revised our outlook to positive from stable and affirmed our 'A+/A-1' ratings on CAF.
- The positive outlook reflects our view that CAF will sustain the improvement in its capital position, supported by capital payments from existing and new members that will counterbalance increases in lending and sovereign rating vulnerabilities in the region.

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Rating Action

On June 14, 2021, S&P Global Ratings revised its outlook on Corporacion Andina de Fomento to positive from stable. We also affirmed our 'A+/A-1' foreign currency long- and short-term issuer credit ratings on CAF.

Rationale

CAF's risk-adjusted capital (RAC) ratio improved to 17.7% as of December 2020 from 14.7% as of December 2019 following key members Argentina's and Ecuador's emergence from selective default, as well as a gradual reduction in Venezuela's outstanding loan balance. This led to an improvement in CAF's financial risk, which we believe could lead to an upgrade if CAF sustainably

manages its capital at this higher level over the next 12 months and if no new rating vulnerabilities emerge.

The institution's capital adequacy has historically experienced volatility because of sovereign rating vulnerabilities, combined with a concentrated loan portfolio. As of December 2020, Argentina, Ecuador, and Venezuela accounted for 44% of the total sovereign loan book. In addition, recurrent payment delays from Venezuela that began in 2017, reflecting weakening preferred creditor treatment (PCT), weighed on the rating. In March 2020, CAF's shareholders assembly approved a support program for liquidity management in exceptional situations. This effectively allowed CAF to begin repurchasing Venezuela's shares to pay down its debt coming due from the sovereign and, in our view, removed the risk of a nonaccrual event materializing until 2024, as well as limited the downside risk to its PCT and the rating.

As of March 2021, CAF had repurchased 50,079 shares for a total of US\$711.1 million, bringing Venezuela's outstanding balance to US\$3.16 billion, from US\$3.6 billion in March 2020. Once this mechanism expires as the paid-in capital of Venezuela is used to service the debt, a balance of close to \$1.1 billion will remain, although the overall impact to the rating of an arrears event, assuming the sovereign is unable to service its remaining debt, would be marginal given the lower concentration it would represent on the balance sheet. At the same time, our capital adequacy assessment considers this unusual transaction to be a constraint, given the reduction in Venezuela's shares to repay its debt was not compensated by additional capital.

CAF's exceptional shareholder support bolsters its capital position over our outlook horizon. CAF continues to receive sizable capital payments from its 10th general capital increase--with approximately \$600 million paid in during 2020. This is in addition to the capital from members that are increasing their participation in the institution. In March 2021, CAF approved the incorporation of Costa Rica and Mexico as full members, which will translate to \$1.6 billion in additional subscribed capital payments paid in through 2035. Equity grew to \$13 billion in December 2020 from \$12.8 billion in 2019.

In 2020, CAF introduced a COVID-19 response package totaling close to \$7.2 billion, including 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. CAF's lending portfolio grew to \$28.1 billion in 2020 from \$26.5 billion in 2019. This reinforces our view of its policy importance, sustained by exceptional support from its shareholders.

We believe CAF will manage balance-sheet growth and capital prudently. The institution has made efforts to diversify its portfolio and gradually increase exposure to investment-grade sovereigns. While the Latin American region is expected to recover this year, the recovery path across different countries is uneven, and some rating vulnerabilities could emerge. That said, we expect members to maintain PCT with the institution.

Our view of CAF's governance is constrained by the absence of nonborrowing member countries--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 has the ability to withstand loss of key personnel and significant disruptions to operations, given its headquarters are in Caracas, Venezuela, and it has made important strides over the past few years to decentralize its workforce throughout Latin America. Former CAF President Luis Carranza resigned in April 2021, before the end of his five-year term, and the board is expected to designate a new president over the coming months.

CAF has maintained high liquidity, and we view its funding as robust and supportive of its financial risk. The December 2020 12-month liquidity ratio was 1.5x with scheduled loan disbursements,

consistent with the previous year. The six-month ratio was 1.95x as of December 2020. CAF has kept higher stocks of liquidity compared with our stress test, which 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 conservative funding, with cumulative assets consistently exceeding cumulative debt for maturities up to one year and no significant gap for five years. We estimate 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 2.1x at the one-year horizon as of December 2020.

CAF's funding program is also robust and diversified. 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, which demonstrates its strong access to the market during times of stress.

We do not give any ratings uplift to CAF for extraordinary shareholder support because the sovereign shareholders are rated below CAF's 'aa-' stand-alone credit profile.

Outlook

The positive outlook reflects our expectation that over the next two years, there is a greater than 1-in-3 likelihood that CAF will sustain its RAC ratio to maintain its stronger capital position, supported by expected capital payments from existing and new members, which will more than offset credit risk in the region. This presupposes that members will continue to treat CAF as a preferred creditor and maintain robust shareholder support through timely capital payments, as well as presupposes that CAF will maintain high liquidity.

We could revise the outlook to stable if CAF's capital position weakens. If, contrary to our expectations, any of CAF's shareholders fail to treat CAF as preferred, this could lead to a downgrade.

Ratings Score Snapshot

Issuer Credit Rating: A+/Positive/A-1

SACP: aa-

Enterprise Risk Profile: Strong

- Policy Importance: Strong
- Governance and Management: 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: -1

Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 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: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Abridged Supranationals Interim Edition 2021: Comparative Data For Multilateral Lending Institutions, May 11, 2021
- Supranationals Special Edition 2020, Oct. 20, 2020
- Argentina Upgraded To 'CCC+' From 'SD' On Settlement Of Restructuring Of Foreign And Local Law Debt; Outlook Stable, Sept. 7, 2020
- Ecuador Long-Term Ratings Raised To 'B-' From 'SD' On Completed Debt Exchange; Outlook Stable, Sept. 1, 2020
- Can Multilateral Lenders' Capital Bases Hold Up Against COVID-19?, June 9, 2020
- How Multilateral Lending Institutions Are Responding To The COVID-19 Pandemic, June 9, 2020
- ESG Industry Report Card: Supranationals, Feb. 11, 2020

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Corporacion Andina de Fomento		
Issuer Credit Rating		
Foreign Currency	A+/Positive/A-1	A+/Stable/A-1

Ratings Affirmed

Corporacion Andina de Fomento		
Senior Unsecured	A+	
Senior Unsecured	mxAAA	
Commercial Paper	A-1	

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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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