Research Update:

Corporacion Andina de Fomento Upgraded To 'AA-/A-1+' On Strengthened Capital Position; Outlook Positive

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Overview

- We believe Corporacion Andina de Fomento (CAF) will maintain its capital position, particularly following the recent approval of its 10th capital increase of US$7 billion--the largest in its history--which will be fully paid-in capital.
- CAF's capital benefited from key borrowers coming out of default, combined with the gradual reduction in Venezuela's outstanding balance via a share repurchase mechanism.
- At the same time, CAF's policy importance remains strong, with an attractive value proposition evidenced by current shareholders increasing their participation and new members joining the institution.
- We therefore raised our ratings on CAF to 'AA-/A-1+' from 'A+/A-1'. The positive outlook reflects our view that CAF's role, policy importance, and capital can strengthen partly based on significant capital support from shareholders, which could more than offset vulnerabilities in the region.

Rating Action

On June 16, 2022, S&P Global Ratings raised its foreign currency long-term and short-term issuer credit ratings on Corporación Andina de Fomento (CAF) to 'AA-/A-1+' from 'A+/A-1'. The outlook is positive.

Outlook

The positive outlook reflects our expectation that over the next two years, there is a greater than one-in-three likelihood that CAF's policy importance will strengthen. Our view is based on CAF expanding its reach geographically with current members increasing participation and new members joining, along with capital payments underpinning stronger capital. In addition, an upgrade could follow if CAF incorporates highly rated nonborrowing shareholders, which, in our view, would create more diversity in its governance structure. 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 maintain high levels of liquidity. It also assumes that CAF will manage its exposure to Venezuela once its liquidity mechanism expires in 2024 without increasing risk on its balance sheet.

We could revise the outlook to stable if there are signs of weakening support from shareholders through delays in capital payments or if there are signs of weaker policy execution.

We could lower the ratings on CAF if, contrary to our expectations, any of CAF's shareholders fail to treat CAF as preferred. Rapid balance sheet growth amid worsening credit conditions in the region, reflected in significant downgrades of CAF's largest borrowers, and weakening liquidity ratios could also pressure the rating.

Rationale

In December 2021, CAF shareholders approved a capital increase of US$7 billion. We view this as positive compared with peers in terms of shareholder support given the size and frequency of capital payments. This marks CAF's 10th capital increase--its largest in history--even as it continues to receive sizable capital payments from its ninth general capital increase, with approximately US$608 million paid in during 2021.

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. The board of directors approved the incorporation of the Dominican Republic as a full member shareholder, and El Salvador recently joined CAF as new member, bringing total shareholders to 20.

We believe these are positive developments that will translate to increased capital resiliency and lead to further improvements to CAF's risk-adjusted capital (RAC) ratio. The RAC ratio improved to 18.3% as of December 2021, from 17.7% as of December 2020 and 14.7% as of December 2019. While two key members, Argentina and Ecuador, coming out of default supported the large improvement during 2021, the gradual reduction in Venezuela's outstanding loan balance and a steady flow of capital continue to benefit CAF's capital. In December 2021, equity grew to $13.3 billion from $13 billion as of December 2020.

Historically, recurrent payment delays from Venezuela, beginning in 2017, reflected a weakening in preferred creditor treatment (PCT) status, which had 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 and limited the risk to PCT and the rating.

As of December 2021, CAF repurchased 75,657 shares for a total of US$1.1 billion, bringing Venezuela's outstanding balance to US$2.9 billion from US$3.6 billion in March 2020. Once this mechanism expires, because the paid-in capital of Venezuela is being used to service the debt, a remaining balance of close to US$1.5 billion will remain. However, the overall impact to the rating of an arrears event, assuming the sovereign is unable to service its remaining debt, will be limited given the lower concentration it will represent on the balance sheet. At the same time, we consider this unusual transaction as a constraint on our capital adequacy assessment given the reduction in Venezuela's shares to repay its debt was not compensated by additional capital.

CAF continued to grow its lending book during 2021 by 5%, reaching US$30.2 billion, at the same time it strengthened its role in promoting green growth in the region. The institution's green financings are set to increase to 40% by 2026. CAF also demonstrated support to shareholders in response to the pandemic with a COVID-19 response package totaling close to US$7.2 billion during 2020 and US$9.1 billion during 2021, which included 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. This underscores our view of its important role and policy importance, sustained by exceptional support from its shareholders.

We believe management will manage its 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 region is expected to recover this year, the recovery paths across different countries are uneven, and some rating vulnerabilities could emerge. That said, we expect members to maintain PCT to the institution.

Our view 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 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, because it has made important strides over the past few years to decentralize its workforce throughout Latin America.

On Sept. 1, 2021, Sergio Diaz-Granados assumed the executive presidency of CAF for a five-year term, following the resignation of Luis Carranza in April 2021, before the end of his five-year term. The smooth and prompt election process, combined with the strong support of shareholders and the recently approved capital increase, points to, in our view, an institution that can withstand changes in key roles without affecting operations.

CAF has maintained its high liquidity levels, and we view its funding as robust--supporting our view of its financial risk. The 12-month liquidity ratio as of December 2021 was 1.3x with scheduled loan disbursements, consistent with the previous year. The six-month ratio was 1.4x as of December 2021. 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) was 1.8x at the one-year horizon as of December 2021.

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, which demonstrates its strong access to the market during times of stress. CAF continued issuing other benchmark issues during 2021 and 2022 at competitive rates.

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

Ratings Score Snapshot

Issuer Credit Rating: AA-/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: 0

Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Jan. 31, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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 2022: Comparative Data For Multilateral Lending, May 26, 2022
- Introduction To Supranationals Special Edition 2021, Oct. 27, 2021
- Supranationals Special Edition 2021 Says Boost In Multilateral Lending Support May Not Last, Oct. 27, 2021
- ESG Industry Report Card: Supranationals, Feb. 11, 2020

Ratings List

Upgraded

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

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