

Research Update:

FONPLATA Upgraded To 'A/A-1' On Stronger Presence In Latin America And Improving Risk And Operational Capabilities

September 27, 2021

Overview

- FONPLATA is steadily strengthening its presence in Latin America and has continued to achieve its operational and lending targets, while shareholders remain supportive of the bank with timely capital payments.
- We expect capital adequacy and liquidity to remain robust, and the risk-adjusted capital ratio to remain above 23% as the bank balances continued lending growth with committed capital from members.
- We raised our issuer credit ratings on FONPLATA to 'A/A-1' from 'A-/A-2'.
- The stable outlook reflects our expectation that, over the next two years, FONPLATA's shareholders will remain supportive, the bank will continue benefiting from preferred creditor treatment, and it will prudently manage capital levels while maintaining high-quality liquid assets.

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Rating Action

On Sept. 27, 2021, S&P Global Ratings raised its issuer credit ratings on FONPLATA to 'A/A-1' from 'A-/A-2'. The outlook on the long-term rating is stable.

Rationale

The upgrade of FONPLATA is based on our view that the institution has shown progress in shaping its policies and building operational capabilities over the past five years, while reaching its lending targets. Amid the pandemic, FONPLATA virtually doubled approvals and disbursements, which we believe reflects its capacity to respond to member countries' needs, as well as the gradual strengthening of its presence in the Latin American region. The bank maintains ample liquidity and robust capitalization, and a pristine preferred creditor treatment (PCT) track record.

We assess FONPLATA's stand-alone credit profile at 'a', the same as the long-term issuer credit rating of 'A', given that it does not benefit from extraordinary support in the form of callable capital.

FONPLATA has a limited geographic scope and smaller size compared with other MLIs. However, the bank has strengthened its capacity to increase the pace of lending and has bolstered shareholder support following the institutional overhaul and reform beginning in 2012. Following the opening of its office in Brazil, the bank currently has presence in all five member countries (Argentina, Bolivia, Brazil, Paraguay, and Uruguay).

We believe FONPLATA is well positioned for growth while it continues to strengthen supporting systems and risk management practices, which buttresses its enterprise risk. Loan portfolio growth has been 23% on average over the past five years (2016-2020) (or 14% in the case of loan approvals), more than doubling the bank's balance sheet in the period, currently at \$2 billion. The expansion comes from both increasing the average ticket size of the projects and expanding the number of undertakings. In 2020, amid the COVID-19 pandemic, loan disbursements increased 78%. FONPLATA's response to COVID-19 included the approval of an emergency line for \$60 million as well as an emergency clause that allows borrowers to use up to 5% of the approved financing through expedited procedures. It also allowed for reassignment of resources.

In September 2020, FONPLATA approved the Economic Recovery Line for \$1 billion (\$200 million for each member country)--to provide more beneficial financial conditions for certain projects--to help spur economic recovery. Approvals and disbursements are expected to slow in 2021 from 2020 high levels, and as the institution matures. The outstanding loan portfolio will continue increasing, mostly explained by previous approvals.

FONPLATA recently approved nonsovereign lending to public entities as a new product (until 2019, all lending was to sovereigns or with sovereign guarantee). As of June 2021, the nonsovereign risk (NSR) portfolio consisted of loans with Minas Gerais development bank BDMG and Paraguayan Banco Fomento. The NSR portfolio represented 5.5% of outstanding loans (the limit is 10%).

Importantly, shareholders have increased their support for the bank following FONPLATA's 2012 reform, with a first general capital increase approved in 2013 for US\$1.15 billion, of which 30.4% is paid-in capital. Governors approved a second general capital increase in 2016, for US\$1.375 billion, including US\$550 million of capital paid in over seven yearly installments beginning in 2018. As of September, members' paid capital contributions for 2021 are on time and in full. FONPLATA's earnings are exempt from corporate income tax, which contributes to higher net income.

At the same time, FONPLATA has benefited from PCT from its borrowing members over the past 10 years. The calculated arrears ratio is zero, and no country has gone into arrears with the institution for over 180 days.

Constraining our assessment of FONPLATA's enterprise risk profile is its shareholder concentration and, on average, lower ranking in governance from its five borrowing members. We believe that this presents an agency problem, which, in an extreme scenario, could pose governance risks. Argentina and Brazil are FONPLATA's two largest shareholders (holding 66% of the capital participation combined). However, each member country has equal voting rights, with all approvals and policies requiring four out of five votes in favor.

This is partly counterbalanced by FONPLATA's efforts to enhance accountability and transparency in decision-making and strengthen its financial and risk management framework. This includes conservative limits to manage the growth in lending set at 3x equity, as well as exposure limits by country aiming at a more balanced loan portfolio composition. In mid-2018, the bank hired a chief risk officer to separate the planning and risk functions, and it has put in place a more robust risk

framework since then. Moreover, the first executive president of FONPLATA, Juan Notaro, took office in September 2012 and was reelected for a second term from 2017-2022.

If FONPLATA can further increase its membership, this may support our view of the institution's governance. Notably, in November 2018, the board of governors approved the modification of its charter to promote the transition from financial fund to development bank and allow the incorporation of new shareholding members.

The other key factors we consider in our rating on FONPLATA are its high capitalization and liquidity.

Our base case assumes capital adequacy will remain extremely strong, as management balances prudent loan growth, in line with its conservative financial limits, to maintain its capital adequacy. FONPLATA's risk-adjusted capital (RAC) ratio after MLI adjustments was 26% as of June 30, 2021, unchanged from June 2020. The recent ramp-up of FONPLATA's lending activity was counterbalanced by increases in paid-in capital. As of June 2021, the loan distribution was 27% Argentina, 26% Bolivia, 19% Uruguay, 15% Paraguay, and 9% Brazil, reflecting a high concentration due to the limited number of borrowers.

At the same time, the capital assessment is limited by our view of risk management shortcomings compared with peers, in light of the recent loss on FONPLATA's holdings of Argentine bonds. Within its investment portfolio, FONPLATA held Argentine par and discount bonds issued under local law for a small amount (\$2.03 million) as of June 2020, which were included in the most recent sovereign debt restructuring completed in September 2020. These holdings were received by the institution in exchange for holdings of bonds BONTE-04 in 2005 (under the previous debt exchange).

Current investment policies do not allow the institution to hold speculative-grade bonds (rated 'BB+' or lower), and due to the credit rating, these Argentine bonds are not considered liquid assets. Nonetheless, they have remained on the institution's balance sheet. FONPLATA did not receive special treatment on these bonds, but since FONPLATA is a multilateral lending institution, we expect the Argentine government will offer additional support to FONPLATA, as it has done in the past. We think this event indicates a somewhat higher risk tolerance due to the maintenance of the bonds in the institution's portfolio. And, in our view, this does not indicate an unwillingness of the Argentine government to treat FONPLATA as preferred. Argentina has continued to repay its loans and capital installments normally. We could remove this adjustment once there is a definitive resolution, if our belief is that a similar situation is unlikely to occur in the future.

FONPLATA is mostly equity funded. Total adjusted equity to adjusted total assets was 57% as of June 2021. FONPLATA's static funding gap with loan disbursements at one year increased to 1.19x as of June 2021 from 0.77x as of June 2020. We expect no significant funding gaps over the next two years.

Because the bank has no significant debt liabilities, by definition its funding is undiversified. However, we have seen several positive developments in funding sources. In March 2019, FONPLATA issued its first bond in the international capital markets for Swiss franc (CHF) 150 million, and issued another bond for CHF200 million in February 2021. Aside from its recent debt issuance, FONPLATA's main funding source in the past years has been credit lines from multilaterals, and particularly with the IADB, CAF, and EIB.

Funding increased almost 50% to \$927 million in June 2021 from \$629 million in 2020, mainly explained by the new notes, as well as a loan with commercial bank BBVA for \$100 million. This is the first time FONPLATA received funding from a commercial bank, which is part of its funding diversification strategy.

FONPLATA could also diversify funding sources with other MLIs, central banks, new bond issuances, and commercial bank loans. The bank has indicated a goal to diversify as much as possible and, in the process, obtain better borrowing conditions.

FONPLATA follows a conservative liquidity policy, under which it is required to maintain a minimum level of liquidity sufficient to cover all liability payments and disbursements over the next 12 months. It holds high-quality liquid assets, in compliance with its investment guidelines.

Our calculations of FONPLATA's liquidity incorporate stressed market conditions and assume no market access. For June 2021 data, our 12-month liquidity ratio considering the netted derivatives position was 1.3x with scheduled loans disbursements, while the six-month ratio was 1.9x. However, we estimate the bank would need to slow its planned disbursements under a stress scenario.

Outlook

The stable outlook reflects our expectation that, over the next two years, FONPLATA's member countries will remain supportive of the institution and continue to make timely capital payments, while PCT is upheld. We also expect capital levels will be managed prudently and remain at high levels, and liquid assets will continue to be ample and high-quality.

Downside scenario

We could lower our ratings if we observe signs of weakening support, including signs of weakening PCT from borrowing members, or if capital and liquidity ratios markedly deteriorate.

Upside scenario

We could raise the ratings on FONPLATA if further management enhancements and membership expansion support our view of the institution's overall governance, while the bank maintains ample liquidity and robust capitalization levels.

Ratings Score Snapshot

Issuer credit rating: A/Stable/A-1

SACP: a

Enterprise risk profile: Moderate

- Policy importance: Strong
- Governance and management: Weak

Financial risk profile: Very strong

- Capital adequacy: Very strong
- Funding and liquidity: 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, Dec. 14, 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
- S&P Global Ratings Definitions, Jan. 5, 2021
- Supranationals Special Edition, October 2020, Oct. 20, 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

Upgraded; CreditWatch/Outlook Action

	To	From
FONPLATA		
Sovereign Credit Rating		
Foreign Currency	A/Stable/A-1	A-/Positive/A-2

Upgraded

	To	From
FONPLATA		
Senior Unsecured	A	A-

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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