

Research Update:

FONPLATA 'A/A-1' Ratings Affirmed; Outlook Remains Stable

September 15, 2022

Overview

- FONPLATA has been strengthening its presence in Latin America by supporting member countries' development and integration, while it continues enhancing its risk management and operational capabilities.
- We believe commitments and lending growth could weigh on the risk-adjusted capital ratio, currently 23%, although capital adequacy will continue to be supported by paid-in capital from members.
- We affirmed our issuer credit ratings on FONPLATA at 'A/A-1'.
- 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. 15, 2022, S&P Global Ratings affirmed its foreign currency long-term and short-term issuer credit ratings of 'A/A-1' on FONPLATA. The outlook remains stable.

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 preferred creditor treatment (PCT) is upheld. We expect it will maintain its stronger presence in Latin America, balanced by capital levels that will be managed prudently and remain broadly high, and liquid assets will continue to be ample and high-quality.

Downside scenario

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

Upside scenario

We could raise the ratings on FONPLATA if further consolidation of management practices and potential membership expansion support our view of the institution's overall governance, while the bank consistently maintains ample liquidity. If FONPLATA sustainably manages capitalization above 23%, this could also lead to an upgrade.

Rationale

FONPLATA 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 strong capitalization, and a pristine 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 multilateral lending institutions (MLIs). However, it has strengthened its capacity to increase the pace of lending and has bolstered shareholder support following the institutional overhaul and reform beginning in 2012. The bank's main objective is to reduce socioeconomic differences in member countries, mainly through small and midsize infrastructure projects. FONPLATA views its value-added role as being an agile bank that is close to member countries and their needs, and aims at maintaining its niche focus. It currently has presence in all five member countries: Argentina, Bolivia, Brazil, Paraguay, and Uruguay.

Approvals and disbursements are likely to slow as the institution matures, although the outstanding loan portfolio will continue increasing, mostly explained by previous approvals.

Loan portfolio growth has been 23% on average over the past six years (2016-2021), more than doubling the bank's balance sheet in the period, currently at \$2 billion. The expansion comes in part from increasing the average ticket size of the projects, but mostly by 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. It subsequently 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.

As part of a goal to expand its toolkit, FONPLATA approved nonsovereign lending to public entities as a new product in 2019 (until that year, all lending was to sovereigns or with a sovereign guarantee). As of June 2022, the nonsovereign risk (NSR) portfolio consisted of loans with public banks in Brazil and Paraguay. A loan to a public-sector corporation in Uruguay for \$29.5 million was also signed in July 2022 under the scheme. The NSR portfolio represented 4.6% of outstanding loans in June 2022. In 2022, flexible financial conditions facilities (FFC) were also introduced, similar to those available in other development banks.

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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 2022, members' paid capital contributions for 2022 are on time and in full except Brazil, which has also delayed payments with other multilateral institutions. 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 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 66.67% 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 continuous 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.

The first executive president of FONPLATA, Juan Notaro, who took office in September 2012 and was reelected, recently completed his second term. Luciana Botafogo--chief operations officer of FONPLATA--has been assigned as interim president. Elections have been set for March 21, 2023. Shareholders expressed the intention to maintain continuity in FONPLATA's growth strategy, and we believe the transition will be an important indication of the bank's institutional depth and operational resilience.

If FONPLATA can further increase its membership, this may also support our view of the institution's governance.

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

FONPLATA's risk-adjusted capital (RAC) ratio after MLI adjustments was 23% as of June 30, 2022, below 26% from June 2021. Our base case assumes planned capital increases in the bank until 2024 (with Brazil completing payments until 2026) will remain supportive of capital adequacy. However, we believe there will be challenges and the RAC could fall below 23% as capital space narrows following several years of ramp up in approvals and lending, and as the institution continues to consolidate its presence in the region. As of June 2022, loan distribution was 27% Argentina, 22% Bolivia, 19% Paraguay, 18% Uruguay, and 9% Brazil (4.6% nonsovereign), reflecting a high concentration due to the limited number of borrowers.

We have removed the constraint on capital adequacy that we had applied in light of the loss on FONPLATA's holdings of Argentine bonds (\$2.03 million). We think this event indicated a somewhat higher risk tolerance due to the maintenance of the bonds in the institution's portfolio and not an unwillingness of the Argentine government to treat FONPLATA as preferred. FONPLATA did not receive special treatment on these bonds during the restructuring but will receive indirect compensation from Argentina. Moreover, we believe a similar situation is unlikely to occur in the future. Current investment policies do not allow FONPLATA to hold speculative-grade bonds (rated

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'BB+' or lower).

FONPLATA is mostly equity funded. Total adjusted equity to adjusted total assets was 58% as of June 2022. FONPLATA's static funding gap with loan disbursements at one year increased to 1.3x as of June 2022 from 1.2x as of June 2021. 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 and CHF150 million in February and December 2021, respectively. Aside from debt issuances, FONPLATA's main funding source in past years has been credit lines from multilaterals, particularly with the Inter-American Development Bank, Corporación Andina de Fomento, and European Investment Bank. FONPLATA also contracted its first loan with commercial bank--Banco Bilbao Vizcaya Argentaria (BBVA)--for \$100 million in 2021, which was part of its funding diversification strategy.

The bank has indicated a goal to diversify as much as possible and, in the process, obtain better borrowing conditions. In addition, it approved its Sustainable Debt Framework in December 2021 to guide future issuances of green and social bonds, as well as loans and other financial instruments.

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 2022 data, our 12-month liquidity ratio considering the netted derivatives position was 1.2x with scheduled loans disbursements, while the six-month ratio was 2.1x. However, we estimate the bank would need to slow its planned disbursements under a stress scenario.

Rating Score Snapshot

Issuer Credit Rating: A/Stable/A-1

SACP: a

Enterprise risk profile: Moderate

- Policy importance: Strong
- Governance and management expertise: 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, Jan. 31, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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 27, 2022
- Supranationals Special Edition 2021, Oct. 27, 2021
- 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

FONPLATA

Sovereign Credit Rating

Foreign Currency A/Stable/A-1

FONPLATA

Senior Unsecured 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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