

Research Update:

FONPLATA 'A-/A-2' Ratings Affirmed; Outlook Remains Positive

September 25, 2019

Overview

- We continue to view FONPLATA as making steady progress in achieving its operational and lending targets, and shareholders remain supportive of the bank with timely capital payments.
- Even though we expect capital adequacy to remain robust, recent downgrades in Argentina have increased balance-sheet risks and lowered the risk-adjusted capital ratio to 31% as of June 2019 from 37% as of December 2018.
- We are affirming our 'A-' long-term and 'A-2' short-term issuer credit ratings on FONPLATA/.
- The outlook remains positive based on our view that FONPLATA is building its operational capabilities, which will help strengthen its presence in the region and meet its targets.

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Rating Action

On Sept. 25, 2019, S&P Global Ratings affirmed its 'A-' long-term and 'A-2' short-term issuer credit ratings on FONPLATA. The outlook remains positive.

Rationale

The positive outlook reflects FONPLATA's efforts in strengthening multiple aspects of its business, such as its governance and institutional structure and its financial and risk management framework--combined with our expectation that it will continue expanding its presence in the region. This is informed by our view of FONPLATA's steady progress achieving its operational and lending targets.

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.

Historically, the bank's ability to fulfill its mandate had been constrained by gaps in governance and management as well as uneven shareholder support. However, FONPLATA has strengthened its capacity to increase the pace of lending and has bolstered shareholder support following the

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institutional overhaul and reform beginning in 2012.

Supporting its enterprise risk profile, we believe FONPLATA is well positioned for ongoing significant growth in sufficient personnel while it develops supporting systems and risk-management practices. Approval levels and disbursements grew by 30% and 14.7%, respectively, in 2018, reaching US\$425 million and US\$196 million, in line with planned targets. Although some deceleration in approvals is expected in 2019, partly due to the election cycle for three of the five founding members, loan disbursement growth seems set to continue this year. FONPLATA plans to double its approval size in 2019 vis-à-vis 2014, in line with its Institutional Strategic Plan 2018-2022, which largely focuses on expanding its lending portfolio and incorporating new members. The expansion comes from both increasing the average ticket size of the projects and expanding the number of undertakings.

Equally important, 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. As of this date, members paid capital contributions on time and in full. 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.

FONPLATA has benefited from preferred creditor treatment (PCT) from its borrowing members over the past 10 years, which is incorporated in our enterprise risk profile assessment. The calculated arrears ratio is at 0.0%, 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 partially counterbalanced by FONPLATA's ongoing 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 initial signs of a more robust risk framework are being put in place. 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. However, the participation of the founding members in the capital of FONPLATA may not be less than 51% of the authorized capital.

FONPLATA was founded in 1974 by its five member countries--Argentina, Bolivia, Brazil, Paraguay, and Uruguay--through the ratification of the River Plate Treaty. Its mission is to support the integration of member countries and achieve inclusive development within the River Plate basin area. As such, FONPLATA is particularly active in local municipalities and subregions on countries' borders, providing mainly loans for small and medium-size projects. Its niche focus favorably positions it to work with other funding organizations.

To strengthen its presence in the region and support larger ticket sizes, FONPLATA has engaged in various partnerships and co-financing arrangements with other multilateral lending institutions

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(MLIs). We have seen progress on this front as FONPLATA executed its first co-financed projects with Corporacion Andina de Fomento (CAF) and the OPEC Fund for International Development (OFID) in 2017. A memorandum of understanding for strategic cooperation was signed with the New Development Bank (NDB) in 2017 to focus on financing in Brazil.

On June 18, 2018, Mercosur signed a framework agreement with FONPLATA to negotiate the provision of technical and financial assistance to the Fund for the Structural Convergence of Mercosur (FOCEM). The goal of the agreement is to optimize and enhance aspects of FOCEM's management and establish the financing framework for infrastructure projects in smaller, less-developed countries. We believe the arrangement could further enhance FONPLATA's role in the region as the scale and size of these projects are enhanced.

The other key factor we consider in our rating on FONPLATA is its very strong financial profile, reflecting its high capitalization and liquidity.

FONPLATA's risk-adjusted capital (RAC) ratio after MLI adjustments was 31% as of June 30, 2019, down from 37% as of December 2018. The lower RAC ratio mainly reflects recent rating actions in Argentina, given that the country represents 24% of total loan exposure as of June 30, 2019. We lowered our long-term rating on Argentina to 'B-' with a negative outlook from 'B' with a stable outlook on Aug. 16, as market turbulence after the primary elections (PASO) weakened creditworthiness. On Aug. 29, we lowered the rating to 'SD' on the maturity extension of short-term debt and subsequently raised it to 'CCC-' with a negative outlook on Aug. 30, following a cured default on the short-term notes.

We expect a gradually declining trend in the RAC ratio as FONPLATA continues to ramp up its lending activities to its five borrowing member countries, but we expect the ratio to remain above 23% even if asset quality in the loan book weakens further. As of June 2019, the loan distribution was Bolivia (29%), Argentina (24%), Uruguay (23%), Paraguay (17%), and Brazil (8%), reflecting a high level of concentration due to limited number of borrowers. However, we assume that management will manage the loan book prudently, in line with its conservative financial limits to maintain its capital adequacy at strong levels.

At the same time, we view FONPLATA's track record of nonperforming loans as somewhat weaker than peers in the region given its focus on local and regional governments in Brazil that are prone to debt servicing strains. While all of FONPLATA's subnational loans are guaranteed by the respective sovereign, we have seen some arrears with Brazilian municipalities over the past three years, even though these were paid within the 90-day period.

FONPLATA is mainly equity funded, with total adjusted equity to adjusted total assets at 80% as of June 2019. We estimate that FONPLATA is structurally able to cover its scheduled loan disbursements without recourse to debt issuance.

Since the bank has no significant debt liabilities, by definition its funding profile is undiversified. However, we have seen some positive developments in terms of funding sources. In March 2019, FONPLATA issued its first bond in the international capital markets for 150 million Swiss francs (CHF). Funding sources in 2018 were primarily development bank financing, such as CAF with a contingent line for US\$75 million, followed by a line of credit for US\$100 million with the Inter-American Development Bank (IADB), as well as with the European Investment Bank (EIB) for US\$60 million and the French Development Agency for US\$20 million, among others.

FONPLATA could also further diversify funding sources with other MLIs (Asian Infrastructure Investment Bank and KfW Development Bank), central banks, and new bond issuances. The bank has indicated a goal to diversify as much as possible and, in the process, obtain better borrowing conditions.

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FONPLATA follows a conservative liquidity policy, under which it's 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, which complies with its investment guidelines.

Our calculations of FONPLATA's liquidity incorporate stressed market conditions and assume no market access. For June 2019 data, our 12-month liquidity ratio considering the netted derivatives position was 1.6x with scheduled loans disbursements, while the six-month ratio was 2.5x. However, we estimate that the bank would need to slow down planned disbursements under a stress scenario.

Outlook

The positive outlook is based on our view that FONPLATA has shown progress in shaping its policies and building up its operational capabilities, which will help it to strengthen its presence in the region and to meet its set targets. This could lead to an improvement in the enterprise risk profile over the next 24 months. The positive outlook also incorporates our expectation that over the next two years, FONPLATA will maintain its high level of capitalization. We expect its RAC ratio after MLI adjustments to remain well above 23%, even if the asset quality of the loan book weakens. It also incorporates our expectation that FONPLATA will continue increasing its lending activity, maintain solid support from shareholders, and remain a preferred creditor among its borrowers.

We could raise the ratings in the next two years if the bank maintains ample liquidity and robust capitalization levels while enhancing multiple aspects of its enterprise risk profile. This includes evidence of a stronger presence in the region; sustained shareholder support, including full and timely payment of capital installments due under its approved general capital increase and the incorporation of new members potentially; and growing lending and disbursements in line with its targets. We could also raise the ratings if we see better loss experience as well as a cemented improvement in credit and risk monitoring.

We could revise the outlook to stable if, in the next two years, FONPLATA loses its positive momentum and there is evidence of weakening capital support from shareholders, or if the institution struggles to comply with its set targets, reflecting limited risk management capabilities or operational bottlenecks.

Ratings Score Snapshot

Issuer credit rating: A-/Positive/A-2

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

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- 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Abridged Supranationals Interim Edition 2019: Comparative Data For Multilateral Lending Institutions, July 15, 2019
- Argentina Sovereign Ratings Raised To 'CCC-/C' From 'SD' Following Cured Default On Short-Term Notes; Outlook Negative, Aug. 30, 2019
- Argentina Downgraded To 'SD' On Maturity Extension Of Short-Term Debt; Long-Term Issue Ratings Lowered To 'CCC-', Aug. 29, 2019
- Argentina Long-Term Sovereign Ratings Lowered To 'B-' As Market Turbulence Weakens Creditworthiness; Outlook Negative, Aug. 16, 2019
- Supranationals Special Edition, Oct. 11, 2018

Ratings List

Ratings Affirmed

FONPLATA

Sovereign Credit Rating	
Foreign Currency	A-/Positive/A-2
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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