

Research Update:

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

September 11, 2024

Overview

- FONPLATA has been working to strengthen its presence among its shareholders, as evidenced by a recently approved general capital increase (GCI) of US\$3.5 billion, while enhancing its risk management and operational capabilities.
- Some recent rebalancing of its loan portfolio and certain members' improved creditworthiness support its very strong capital adequacy ratio, while the issuance of two sustainable bonds in 2024 adds diversification and expands its funding base.
- We affirmed our ratings on FONPLATA at 'A/A-1'.
- The stable outlook indicates our expectations that FONPLATA's members will remain supportive and current on their obligations and that the institution will maintain its preferred creditor treatment (PCT) while liquidity remains ample.

Rating Action

On Sept. 11, 2024, S&P Global Ratings affirmed its 'A/A-1' long- and short-term issuer credit ratings on FONPLATA. The outlook remains stable.

Outlook

The stable outlook reflects our expectations that member countries will remain supportive of FONPLATA and continue to make timely capital payments, while the institution will maintain its PCT status. We expect the entity will maintain its strong presence in Latin America, prudently managing its high capital levels along with ample and high-quality liquid assets.

Downside scenario

We could lower our ratings on FONPLATA if its liquidity ratios deteriorate, pressuring its financial metrics. In addition, weaker shareholder support, whether in the form of delayed capital payments

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or a hit to PCT, could affect capital adequacy or enterprise risk and also lead to a lower rating.

Upside scenario

We could raise the ratings if FONPLATA further consolidates its management practices and expands its membership, prompting us to revise our view of its enterprise risk to a stronger category, while the bank maintains ample liquidity. In addition, sustaining capitalization above 23% could lead to an upgrade.

Rationale

Now that Bolivia formally joined MERCOSUR in July 2024, all of FONPLATA's members correspond to the customs union, which enhances the institution's role as the financial arm of the group. One step toward the goal of promoting MERCOSUR projects for regional integration was launching a US\$500 million compensation line for the operating rate applied in financing members in July 2024. The instrument encompasses projects for enhancing logistics, communications, trade, and energy cooperation between members.

FONPLATA is rebalancing its loan portfolio across its small shareholder base by adjusting new loan operations. The governors agreed on the strategy in 2023, and the new president intends to strengthen all members' representation to align with correspondent capital and the organizational structure.

To that end, FONPLATA plans to begin disbursing more to Brazil and Uruguay than to other members, considering the current volume of lending to Brazil and higher execution of projects in Uruguay. In Brazil, the focus will be on municipalities, following the 2020 sanitation framework reform. And for Uruguay, FONPLATA recently approved a \$325 million 19-year loan aimed at the universalization of water utilities services.

We expect lending to somewhat stabilize after years of strong growth. Disbursements in 2023 decreased due to the suspension of approvals and disbursements to Argentina while its potential withdrawal was pending; they normalized in 2024 after confirmation that Argentina would remain a member. Record amounts of approvals and disbursements, at around US\$750 million and US\$700 million, respectively, are slated for 2024, but we expect them to remain at those levels until the end of 2026, while capital injections decrease.

FONPLATA's directors are discussing the terms of the GCI announced in February 2024, which underpins the institution's policy relevance. While it's still early in the process, they agreed to increase authorized capital by \$3.5 billion, raising the total amount to \$6.5 billion, with the distribution of subscribed capital to be defined in 2025. Around half of the capital increase will take the form of paid-in capital, and the first installments should reach FONPLATA by the second half of 2026 or early 2027.

The institution last approved a GCI in 2016, with final installments scheduled for 2024 (except for Brazil, which will make scheduled payments up to 2026). Combined with the constitutive agreement, which all members' legislatures approved, the third GCI will allow the possibility of incorporating new shareholders at a maximum share of 20% of FONPLATA's total capital. In our view, this could strengthen shareholders' support and FONPLATA's governance.

The third GCI should support a pickup in FONPLATA's lending and deepen its presence in the region. Meanwhile, we expect the institution to maintain a very strong risk-adjusted capital (RAC) ratio (25.1% with financial information as of June 2024 and rating parameters as of September 2024). The recent improvement in the RAC ratio mainly stems from:

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- The rebalancing of the lending portfolio;
- Some borrowers' improved creditworthiness (Argentina upgraded to 'CCC' from 'CCC-' and Paraguay upgraded to 'BB+' from 'BB');
- Capital payments under the 2016 GCI (including Argentina's US\$31.2 million capital payment for 2023); and
- Retained earnings.

FONPLATA's liquidity ratio as of June 2024 reached 1.59x for all scheduled loans in the next six months and 0.94x for all scheduled loans in the next 12 months, following the normalization of operations with Argentina. We expect that the ratio will remain above 0.90x and that the bank will continue to follow its robust liquidity policy, which targets one-year coverage.

FONPLATA has been active in expanding and diversifying funding sources to reduce its borrowing costs. The bank's funding strategy has shifted from credit lines, mainly from other multilateral lending institutions, to debt issuance. Its first bond, issued in March 2019, matured in March 2024, and the bank returned to capital markets in May 2024 after other issuances in March 2021, December 2021, and March 2023. The bank performed sustainable issuances in Swiss and Japanese markets this year, at US\$159 million and US\$47 million, respectively. It plans to make additional issuances in coming years and is exploring the possibility of tapping new jurisdictions.

Ratings Score Snapshot

| | |
|-------------------------------------|--------------|
| Issuer credit rating | A/Stable/A-1 |
| Stand-alone credit profile | 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 | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- 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

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- 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

- Research Update: FONPLATA Outlook Revised To Stable From Negative On Argentina's Membership Confirmation; 'A/A-1' Ratings Affirmed, Jan. 30, 2024
- FONPLATA, Oct. 20, 2023
- S&P Global Ratings Definitions, June 9, 2023

Ratings List

| Ratings Affirmed | | |
|-------------------------|--------------|--|
| FONPLATA | | |
| Sovereign Credit Rating | | |
| Foreign Currency | A/Stable/A-1 | |
| FONPLATA | | |
| Senior Unsecured | A | |

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