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Research Update:

Development Bank IDB Invest Outlook To Positive On Expanded Role; 'AA/A-1+' Ratings Affirmed

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Overview

- IDB Invest is strengthening its organization to fulfill its expanded mandate to manage all private-sector lending within the Inter-American Development Bank (IADB) group.
- Progress in 2017 includes increased lending and strengthened operations and risk management.
- We are thus revising our outlook on IDB Invest to positive from stable and affirming our 'AA/A-1+' long- and short-term issuer credit ratings.
- The positive outlook reflects prospects for an upgrade over the next two years if IDB Invest's transformation into the private sector arm of the IADB group is successful.

Rating Action

On April 30, 2018, S&P Global Ratings revised to positive from stable its outlook on IDB Invest (legal name: Inter-American Investment Corporation). At the same time, we affirmed our 'AA/A-1+' long- and short-term issuer credit ratings. We also affirmed the 'mxAAA' national scale rating.

Rationale

The positive outlook reflects the progress IDB Invest has made in expanding its mandate, specifically the increase in lending in 2017, but also establishing policies and procedures for its operations. IDB Invest provides financing directly or indirectly without a sovereign guarantee primarily to the private sector, and to date, mostly small and midsize enterprises in Latin America and the Caribbean. IDB Invest increased approvals to $3.2 billion in 2017, slightly above its target of $3 billion and a significant improvement compared with the $2.2 billion in approvals in 2016. In line with its focus, loans for energy and infrastructure projects increased by about 3x compared with 2016. In addition, the mobilized amount from the private sector increased meaningfully and core mobilization, a measure of fee-generating syndications, reached $2.1 billion. We believe there is a conducive business climate in Latin America where the growth outlook is improving and infrastructure needs are high. This presents opportunities for further business growth.

Since its adoption of the new mandate, IDB Invest has been working toward improving its operational capabilities, risk practices, and systems, and increasing its presence in the regional member countries. To that end, in 2017, it expanded the number of offices in regional member countries to 23 from 16 and set up dedicated customer teams that resulted in higher loan volumes and a stronger private sector mobilization. In addition, the institution increased significantly its share of direct corporate lending, which we believe has a stronger developmental impact than providing funds via financial institutions. The share of lending to financial

institutions decreased to 56% as of end-2017, from 69% the previous year, and we expect this to continue.

IDB Invest is also enhancing its risk framework policies and its Financial Risk Management Framework was approved in December 2017. It is also in the process of defining a clear risk appetite for the institution. In due course, we expect IDB Invest to operationalize its internal economic capital model to improve the allocation of capital and the pricing of its loan book. While the business IDB Invest underwrites is clearly changing, we believe that the institution is strengthening its risk management for the new environment. We expect the share of nonperforming loans to increase from its earlier low levels, but to remain in line with or even better than peers such as International Finance Corp. and The European Bank for Reconstruction and Development.

Although IDB Invest received capital contributions of $426 million in 2017, leading to a 41% increase in its capital, some 9% of the contributions from the first and second installments are still overdue. The majority of the countries in arrears are experiencing significant financial stress and we do not expect arrears to be cleared in the near future. Counterbalancing this, is in our view, prepayments from other countries and the first transfer from the IADB as envisaged by the merge-out plan, which took place during 2017. We believe that a risk adjusted capital (RAC) ratio of 80% as of end-2017, puts IDB Invest in a comfortable position to significantly increase lending in its target countries, even though some members are delaying contributions. We expect IDB Invest's role and public mandate to strengthen over time, should it successfully expand its footprint in the region following a consistent increase and diversification of its lending activities. This would likely enhance its business profile.

We base our ratings on IDB Invest's adequate business profile and extremely strong financial profile. The institution does not have callable capital, and we do not factor any uplift from potential extraordinary shareholder support into the long-term rating. In our view, IDB Invest does not benefit from a preferred creditor status, given that its role is to lend to the private sector. However, there is a track record of member governments affording preferential treatment by not restricting borrowers' access to foreign exchange for debt service or dividend payments to IDB Invest.

Over the past year, given its new role, we have observed improvements in the operational setup within the organization. IDB Invest is strengthening the majority of its various functions, such as risk management, sales, operations, and executive management, to be able to fulfill its new role as the private-sector lender in the IADB group. We see these advances as positive, though necessary given its revitalized role.

IDB Invest's ability to deliver under the new mandate depends on increased capital provided by its shareholders. The second general capital increase approved in 2015 is underway: A total of $2.03 billion to be provided over 10 years. While three countries are still in arrears, we expect all other members to stay current, which is an important factor in our assessment of IDB Invest's relationship with its

shareholders. These increased capital contributions will underpin the institution's expanded role and balance-sheet growth.

In fulfilling its broader mandate, supported by the expanding capital base, IDB Invest is now targeting a lending strategy to a larger degree focused on larger transactions in Latin America and the Caribbean, and the average size of new approved loans has increased markedly. This major shift requires significant investments in staff and systems, but we believe the institution is taking appropriate steps to accommodate its new larger target transactions. After a slow start, the expansion process seems to be progressing in line with expectations. During 2017, IDB Invest received approvals of $3.2 billion, which is in line with the target of $3 billion. We expect the loan book will continue to increase significantly in the years to come, with increasing disbursements being booked on IDB Invest's balance sheet.

IDB Invest now manages the IADB's entire private-sector lending portfolio, although this portfolio will remain on the IADB's balance sheet. IDB Invest will originate and manage new private-sector loans, thereby generating fee income. New loans will continue to be co-financed between IDB Invest and IADB over the next six years until 2024 with IDB Invest progressively assuming a larger share. As such, the assets under management have boosted the institution's profitability in 2017 and non-interest revenues now account for 53% of total revenues, but that share is likely to decrease as loans recorded on IDB Invest's books increase.

Although recent changes and performance are, in our view, positive, we are cautious of IDB Invest's history of a contracting loan book and minimal profitability. Furthermore, historically, IDB Invest's shareholder support has been weaker than that for larger regional and global peers. These factors will continue to inform our business profile assessment relative to larger peers' until IDB Invest establishes a track record under its new mandate.

However, if successfully executed, the new mandate would likely enhance the institution's business profile following consistent increased lending and diversification of activities, thereby strengthening its public policy role and mandate. At the same time, we expect the RAC ratio will decline gradually over the next few years, but remain extremely strong at above 23% following more rapid growth of the lending portfolio. The RAC ratio after adjustments was 80%, reflecting the institution's financial position as of Dec. 31, 2017, and our ratings parameters as of April 17, 2018. (The criteria correction explained in "Criteria For Assessing Bank Capital Corrected," published on July 11, 2017, is not factored into the RAC ratio after diversification. The impact of the correction on the ratio is not material to the rating). We consider private-sector lending riskier than sovereign exposure and therefore apply higher risk weights in our capital calculation, but IDB Invest's RAC ratio is among the highest in its peer group.

IDB Invest retains high levels of liquid assets, which reflect conservative capitalization policies but also the slow pace and capacity at which it has historically expanded its loan portfolio. These assets act as a buffer against its limited capital market presence and the unevenness of its debt amortization profile.

Our funding and liquidity ratios indicate that the institution would be able to finance its expansion mandate, disburse scheduled loans, and service its debt obligations without capital market access for at least one year. The static one-year funding gap was 29.0x at year-end 2017, significantly up from 2.0x in 2016, excluding loan disbursements. The sharp jump reflects the redemption of its $400 million bond in October 2017, which was replaced by paid-in capital. Using year-end 2017 data, the liquidity ratio for the one-year horizon including scheduled loan/equity disbursements was 12.6x.

Outlook

The positive outlook reflects a one-in-three chance that we could raise our ratings on IDB Invest over the next two years. Progress on executing its expanded mandate in 2017 includes loan approvals that grew at a double-digit pace and increased mobilization that contrasts with the institution's performance before its relaunch in 2015. It also reflects operational improvements. A shift to more direct corporate lending, which in our view has a stronger developmental impact, could also strengthen the institution's role. While these transformational changes occur, we also believe that IDB Invest is enhancing its risk framework and operational structure to better manage new, increased business volumes, something we believe is essential to reduce the execution risk in this period of change.

We could raise the ratings over the coming two years if IDB Invest continues expanding its operational mandate while sustaining appropriate capitalization levels and implementing prudent risk-management policies. The business profile could improve following a track record of increased lending, private sector mobilization, and business diversification, all of which could strengthen the institution's role and public policy mandate.

Conversely, we could revise the outlook back to stable should IDB Invest's business expansion lose significant momentum, the financial profile deteriorate markedly, for example as a result of insufficient capitalization to absorb new exposures, or should it experience a rapid build-up of significant nonperforming assets. Should operations expansion outpace the build-up of risk-management capacity or shareholder support appear to weaken, we could also take a negative rating action.

Related Criteria And Research

Related Criteria

- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables - August 14, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017
- General Criteria: National And Regional Scale Credit Ratings - September 22, 2014
- Criteria - Governments - General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology - November 26, 2012
- Criteria - Financial Institutions - Banks: Multilateral Lending Institutions Capital Methodology And Assumptions - December 06, 2010
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

- IDB Invest - December 8, 2017
- Supranationals Special Edition 2017: Comparative Data For Multilateral Lending Institutions - October 20, 2017

Ratings List

	Rating	
	To	From
IDB Invest		
Issuer Credit Rating		
Foreign Currency	AA/Positive/A-1+	AA/Stable/A-1+
CaVal (Mexico) National Scale	mxAAA/Stable/--	mxAAA/Stable/--
Senior Unsecured		
Foreign Currency	AA	AA
CaVal (Mexico) National Scale	mxAAA	mxAAA

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. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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