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Research Update:

Development Bank IDB Invest 'AA/A-1+' Ratings Affirmed Under Revised Criteria; Outlook Remains Positive

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Research Update:

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Overview

- Following a review under our revised criteria for multilateral lending institutions, we are affirming our 'AA/A-1+' ratings on IDB Invest and removing them from under criteria observation (UCO).
- We assess IDB Invest's stand-alone credit profile at 'aa', owing to its adequate enterprise risk profile and extremely strong financial risk profile.
- 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.
- 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 Feb. 21, 2019, S&P Global Ratings affirmed its 'AA' long-term and 'A-1+' short-term issuer credit ratings on IDB Invest (legal name: Inter-American Investment Corporation). The outlook remains positive.

At the same time, we removed the ratings from UCO, where we placed them on Dec. 14, 2018, after publishing the revised criteria.

Rationale

We base our ratings on IDB Invest's adequate enterprise risk profile and extremely strong financial risk profile under our revised criteria " Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology" published Dec. 14, 2018. We assess IDB Invest's stand-alone credit profile at 'aa', the same level as the long-term issuer credit rating, given that the IDB Invest does not benefit from extraordinary support in the form of callable capital.

IDB Invest has made progress in expanding its mandate, as demonstrated in the increase in lending in 2017 and 2018, as well as in establishing policies and procedures for its operations. IDB Invest provides financing directly or indirectly, without a sovereign guarantee primarily to the private sector, so far mostly small and midsize enterprises in Latin America and the Caribbean. IDB Invest's approvals increased to $3.2 billion in 2017, which is slightly above its target of $3 billion annually and a significant improvement compared with its $2.2 billion in approvals in 2016. Moreover, as of Sept. 30, 2018, IDB Invest's loan book had increased by 24% to $1.19 billion from year-end 2017. In line with its focus, loans for energy and infrastructure projects increased about 3x compared with the total in 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.

Since the adoption of its 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 stronger private-sector mobilization. In addition, it significantly increased 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 48% as of Sept. 30, 2018, from 67% at year-end 2016, and we expect this trend will continue.

IDB Invest is enhancing its risk framework policies, and its financial risk management framework was approved in December 2017. In due course, we expect IDB Invest to adapt its internal economic capital model to improve the allocation of capital and the pricing of its loan book. Although 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 low levels but remain in line with or lower than those of 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, about 9% of the contributions from the first and second installments are still overdue. The majority of countries in arrears are experiencing significant financial stress, and we do not expect arrears to be cleared in the near future. Counterbalancing this, in our view, are prepayments from other countries and the first transfer from the IADB as envisaged by the merge-out plan that took place during 2017. We believe that IDB Invest's risk-adjusted capital (RAC) ratio of 109% as of year-end 2017 under the new criteria puts it in a comfortable position to significantly increase lending in 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 enterprise risk profile.

As a fully specialized private-sector lender, IDB Invest does not benefit from preferred creditor treatment (PCT), which we only apply to sovereign exposures. Consequently, we don't incorporate PCT in our assessment of IDB Invest's enterprise risk profile. 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.

In fulfilling its broader mandate, supported by the expanding capital base, IDB Invest is now targeting a lending strategy that, to a greater extent, focuses 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 enlarged target transactions.

IDB Invest now manages the IADB's entire private-sector lending portfolio, although that 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 cofinanced with IADB over the next six years until 2024, with IDB Invest progressively assuming a larger share. As such, IDB Invest's assets under management boosted its profitability in 2017 and until Sept. 30, 2018, and noninterest revenues accounted for 42% of total revenues in the first nine months of 2018. However, that share is likely to decrease as the loans 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, shareholder support has been weaker for IDB Invest than for larger regional and global peers. These factors will continue to weigh on our business profile assessment until IDB Invest establishes a better track record under its new mandate. However, if successfully executed, the new mandate would likely enhance the institution's enterprise risk profile following consistent increased lending and diversification of activities, thereby strengthening its public policy role and mandate.

IDB Invest retains high levels of liquid assets, which reflect conservative capitalization policies and the slow pace at which it previously 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 IDB Invest 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. Using year-end 2017 data and incorporating our updated liquidity haircuts, our 12-month liquidity coverage ratio is 12.9x, including scheduled loan disbursements, while the six-month ratio is 22.9x. In addition, we believe that IDB Invest would have room to accelerate disbursements as measured by our stressed scenario, which takes into account 50% of all undisbursed loans, regardless of planned disbursement date, as if they were coming due in the next 12 months.

Outlook

The positive outlook indicates a one-in-three chance that we could raise our ratings over the next two years if IDB Invest makes further progress on executing its expanded mandate. We believe the continued expansion of loan approvals, increasing mobilization of private capital, and a shift to more direct corporate lending, which in our view has a stronger developmental impact, could also strengthen the institution's role. We also believe IDB Invest's efforts to enhance its risk framework and operational structure should help reduce the execution risk during this period of transformational change.

Conversely, we could revise the outlook to stable if IDB Invest's business expansion loses significant momentum; its financial profile deteriorates markedly, for example due to insufficient capitalization to absorb new exposures; or it experiences a rapid buildup of large nonperforming assets. If IDB Invest's expansion outpace the increase of risk-management capacity or shareholder support appears to weaken, we could also take a negative rating action.

Ratings Score Snapshot

Issuer credit rating	AA/Positive/A-1+
SACP	aa
Enterprise risk profile	Adequate
Policy importance	Adequate
Governance and management	Adequate
Financial risk profile	Extremely strong
Capital adequacy	Extremely 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Criteria Guidance: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- Ratings On 32 Multilateral Lending Institutions And Supranationals Placed Under Criteria Observation On Criteria Update, Dec. 14, 2018
- Supranationals Special Edition 2018, Oct. 11, 2018

Ratings List

Ratings Affirmed

IDB Invest	
Issuer Credit Rating	
Foreign Currency	AA/Positive/A-1+
IDB Invest	
Senior Unsecured	AA

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.