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Research Update:

Caribbean Development Bank Long-Term Rating Raised To 'AA+' On Strengthening Business Profile; Outlook Is Stable

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Overview

- In our view, CDB's business profile has been strengthening recently, mainly through its enhanced public policy mandate and improving track record of preferred creditor treatment by CDB's sovereign borrowers.
- We are therefore raising our long-term issuer credit rating on CDB to 'AA+' from 'AA'.
- The stable outlook reflects our view that CDB will retain its high capital adequacy levels and sufficient liquidity, and that the bank's business profile will remain strong as we expect sovereign borrowers to treat the bank as a preferred creditor.

Rating Action

On May 9, 2017, S&P Global Ratings raised its long-term issuer credit rating on the Caribbean Development Bank (CDB) to 'AA+' from 'AA'. The outlook is stable. At the same time, we affirmed our 'A-1+' short-term issuer credit rating on CDB.

Rationale

The upgrade reflects our view that CDB has improved its business profile while maintaining extremely strong capital. In addition, one of the largest members that was late on capital subscriptions started to become current and is expected to fully comply with remaining installments before year-end 2017, which we think is a demonstration that CDB's public policy mandate is strengthening. Moreover, delays in subscriptions payments have not been meaningful--representing 3% of the total 2010 general capital increase (GCI). After 2017, the capital installment arrears would be below 1% of total approved GCI.

Also, other initiatives not directly linked to the balance sheet, such as the U.K. giving CDB the mandate to administer a £300 million fund ("U.K. Caribbean Infrastructure Partnership Fund"), speak to the role and mandate of the institution.

Regarding preferred creditor treatment (PCT), over the past five years, some of CDB's member country borrowers defaulted to their commercial creditors but stayed current to CDB. In our opinion, CDB has proven its status as a preferred creditor. For instance, the selective default by Belize (a borrowing member country) in February 2017 did not result in arrears or missing payments on CDB's outstanding loans. The same happened following Jamaica's selective default in 2010. The only instance since CDB's inception in 1969 that it was not treated as a preferred creditor occurred in 2012, when a member country defaulted on a very small loan. The amount in arrears was subsequently cured before year-end 2012, so the bank did not report any impairment in the full-year accounts. CDB continues to report very low impaired and past-due loans, totaling $5.1 million as of Dec. 31, 2016, and all come from two private-sector loans.

The bank's loan concentration has been gradually reducing but remains high, in our view. As of December 2016, the top three borrowers represented 42% of the total loan portfolio (Jamaica 18%, Barbados 14%, and Belize 10%), compared with a peak of 50% in 2013. To offset large concentrations and exposures to several sovereigns with relatively high default risk, CDB maintains high capitalization, even considering our adjustments to its RAC ratio.

CDB was established in 1969 and remains one of the most prominent lenders in the Caribbean. It provides long-term financing with grace periods and below-market rates of interest, as well as guarantees, a role that, in our view, cannot be fulfilled by another private or domestic public institution in the Caribbean. Its role was reaffirmed in the 2015-2019 strategic plan, in which the bank's board of directors endorsed the goal of reducing inequality and halving the incidence of extreme poverty in its borrowing member countries by 2025.

The ratings on CDB, which pertain only to CDB's ordinary capital resources (OCR), reflect its strong business profile and extremely strong financial profile. Although CDB benefits from $205 million in eligible callable capital from its 'AAA' rated shareholders (Canada and Germany), CDB's capital adequacy is extremely strong, which is why we do not incorporate any uplift above the 'aa+' stand-alone credit profile in deriving the 'AA+' long-term issuer credit rating.

CDB's members have demonstrated their support to the bank. In May 2010, CDB's board of governors approved a $217 million (138% increase over the bank's capital) GCI in paid-in capital. The payment occurred in six annual and equal installments from 2011 to 2016.

The bank also has a robust shareholder relationship. Brazil became a member in 2015 and has paid its subscription on time and in cash--unlike other MLIs, to which Brazil has capital installment delays. Significant support from nonregional members also materializes in the funding of CDB's special funds resources (SFR; not rated), which provide grants and concessional loans to the bank's lower-income borrowing member countries. This has helped sustain the credit quality of the OCR.

France's departure from CDB more than a decade ago--although a remarkable event in that it's the only major G20 country to have withdrawn from a multilateral bank, to our knowledge--does not weigh on the ratings on CDB, in our view, because it did not occur in the recent past.

CDB has continued to take actions to strengthen its governance and risk management. In late 2015, CDB's new strategic framework for integrity, compliance, and accountability began operations. CDB has also strengthened its internal audit and oversight procedures, as well as created a code of conduct for the board of directors. Offsetting these factors is the potential agency risk that stems from the majority of voting shares (55% as of 2016) coming from borrowing-eligible members. We believe that such a structure could create problems in stressed environments, but we also recognize CDB's track record of operating under this model in difficult times in the past. We believe, especially in the case of CDB, that the similar economic structures of the regional members make it important to maintain a close relationship to nonborrowing members for financial and other forms of support in case they're needed.

The accounting treatment of CDB's derivative positions generates volatility in CDB's comprehensive income, which factored heavily in the $15.7 million comprehensive loss the bank reported in 2016. CDB's derivatives are not traded and are being held until maturity; accordingly, this volatility remains unrealized and is not included in the operating income, which is used in the calculations of its key ratios.

CDB's extremely strong financial profile is based mainly on a risk-adjusted capital (RAC) ratio after adjustments of 30%, well above our 23% threshold for extremely strong capital adequacy. Additionally, CDB's eligible 'AAA' callable capital of $205 million provides a buffer if CDB's own balance sheet RAC after adjustments were to fall below the extremely strong threshold.

CDB's static funding gap in December 2016, with all scheduled loan disbursements at one year, was 2.16x. The static funding gap is calculated as maturing assets divided by maturing liabilities; the ratio is cumulative and based on scheduled receipts and payments.

On the other hand, liquid assets as a percentage of adjusted total assets increased to 28% in December 2016 from 19% a year earlier, mainly because of the CHF145 million bond issued in July 2016. CDB's liquidity ratio at one year with all scheduled loan disbursements was 1.11x as of Dec. 31, 2016. Under our extreme capital markets and economic conditions stress test, CDB's liquid assets are sufficient to service its debt and maintain operations for one year without capital market access.

Outlook

The stable outlook is mainly based on our view that in 2017 and 2018 CDB will maintain its extremely strong financial profile backed by a high level of capitalization. We expect its RAC ratio after diversification to remain well above the extremely strong capital adequacy threshold, even if the asset quality of the loan book continues to weaken. In addition, the stable outlook is based on our expectation that PCT status will not deteriorate. We also factor in continued strong support from shareholders underpinning CDB's business profile and its role and mandate.

We currently consider the likelihood of an upgrade remote. We could consider raising the ratings on CDB if the bank consistently strengthens its governance and management expertise by effectively removing potential agency risk and strengthening its risk-management framework.

We could lower the ratings on CDB if the relationship with shareholders deteriorates or if doubts about the PCT arise. We consider these events unlikely in the medium term.

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Governments - General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Nov. 26, 2012
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions, Dec. 6, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Sovereign Ratings History, May 5, 2017
- How Brexit Could Impact Ratings On Supranational Institutions, April 10, 2017
- 2016 Annual Sovereign Default Study And Rating Transitions, April 3, 2017
- Introduction To Supranationals Special Edition 2016, Sept. 29, 2016
- How Much Can Multilateral Lending Institutions Up The Ante?, April 12, 2016
- The Heat Is On: How Climate Change Can Impact Sovereign Ratings, Nov. 25, 2015
- How An Erosion Of Preferred Creditor Treatment Could Lead To Lower Ratings On Multilateral Lending Institutions, Aug. 26, 2013

Ratings List

Upgraded; Ratings Affirmed		
	To	From
Caribbean Development Bank		
Issuer Credit Rating		
Foreign Currency	AA+/Stable/A-1+	AA/Stable/A-1+
Senior Unsecured	AA+	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.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.