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Caribbean Development Bank

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Caribbean Development Bank

Major Rating Factors

Counterparty Credit Rating
Foreign Currency
AA/Negative/A-1+

Strengths:

- Robust capitalization in support of the Caribbean region lending mandate
- Improved balance sheet liquidity at year-end 2012 versus the previous year-end

Weaknesses:

- Correlation risk among sovereign borrowers
- Prolonged economic weakness and high debt burdens of several borrowing member countries that could impede preferred creditor treatment from borrowing members

Rationale

The foreign currency ratings on Caribbean Development Bank (CDB) reflect its 'aa-' stand-alone credit profile (SACP) and one notch of extraordinary shareholder support based on our expectation that the bank's three highest-rated shareholders would provide the bank callable capital in the event of a capital call. The bank's "strong" business profile and its "very strong" financial profile (as our criteria describe the terms) combine to support its 'aa-' SACP. Standard & Poor's credit ratings pertain only to the Caribbean Development Bank Ordinary Capital Resources (OCR), the bank's primary operations. All references to CDB and financial ratios in this report refer to the OCR, unless otherwise noted.

CDB, a subregional multilateral lending institution (MLI), has 26 member countries and 18 eligible Caribbean borrowing member countries. Akin to other multilateral development banks, CDB provides loans and guarantees principally to sovereign governments and public-sector companies (95% of loans) and to a small portfolio of private enterprises. CDB had $984 million in net loan and guarantee exposure in the Caribbean as of Dec. 31, 2012.

The bank continues to have a "strong" business profile. CDB is a prominent lender to Caribbean sovereigns, and it lends countercyclically in periods of economic stress. (It increased net loans by 21% in 2010, and net loan growth slowed subsequently.) Shareholders demonstrated their support to CDB by approving a 38% increase in its paid-in capital in May 2010 (payable during 2011-2016), although some shareholders have had parliamentary or administrative delays paying their capital installments. Members collectively had paid 90% of capital installments ($36 million per year) envisioned under the last strategic plan as of Dec. 31, 2012. (This includes $11 million in arrears and $4 million in advance payments.)

CDB's business profile incorporates our expectation of how its borrowers will treat CDB vis-à-vis their commercial lenders (the bank's preferred creditor treatment, or PCT), which became more constrained in 2012. A sovereign borrower went into arrears more than 180 days to CDB while it serviced commercial debt during 2012. Although the borrower cleared its arrears by Dec. 31, 2012, and remained current on its obligations to CDB as of July 2013, these events and the continuing economic risks for the region temper our expectation that borrowers will treat the bank as a preferred creditor.

We assess CDB's financial profile as "very strong" before consideration of callable capital. The bank retained a 20% risk-adjusted capital (RAC) ratio--its adjusted common equity divided by Standard & Poor's risk-weighted assets--after MLI-specific adjustments, reflecting the bank's financial data as of Dec. 31, 2012, and Standard & Poor's credit rating risk weights as of July 19, 2013. This ratio was similar to 21% as of year-end 2011. To calculate the RAC after adjustments, we adjust CDB's 38% RAC before MLI adjustments primarily for sovereign single-name concentration risk, which is partly compensated by our expectation for some PCT.

CDB's liquidity portfolio strengthened to 30% of total assets as of Dec. 31, 2012, from the previous year-end. The bank maintained, as of year-end 2012, sufficient liquidity on a cumulative basis to meet all its scheduled loan disbursements, debt service, and payable derivatives during 2013. As a small and infrequent issuer in the capital markets, the bank's borrowing costs tend to be higher than large MLIs', and its debt maturity schedule may be uneven. To smooth this rollover risk, the bank built a feature into its latest $300 million bond issue in November 2012 that amortizes the principal over the last five years to maturity. Steps to maintain sufficient liquidity and prudent funding will be important for the bank's creditworthiness over the next five years. The bank has increased its leverage (to 1.4x adjusted common equity at year-end 2012 from 1.0x at year-end 2007) to finance greater lending in recent years. This has increased the bank's debt service expense, and a greater 22% share of debt comes due in 2013 (lower than 26% in 2012) than during 2005-2010 (when the bank's refinancing needs fluctuated between 1% and 15% of total debt). We expect that CDB will continue to use similar leverage and that its refinancing requirements will remain higher than they were prior to 2010.

The issuer credit rating incorporates one notch of uplift based on our expectation for extraordinary shareholder support. This assumes that shareholders rated the same as CDB or higher (Canada, Germany, and the U.K.) collectively would provide up to $328 million in callable capital to CDB in the event of a capital call. This raises CDB's financial profile with callable capital to "extremely strong."

Outlook

The negative outlook reflects the risk that the embedded credit risk in CDB's portfolio could rise. With many of its borrowing members experiencing prolonged low economic growth, high public debt burdens, and limited monetary flexibility, their own creditworthiness may diminish as well as their ability to treat CDB as a preferred creditor. Our rating on CDB could stabilize if we judge that downside risks to regional creditworthiness have eased, if no further borrowing arrears emerge, and if shareholders become current with their capital subscriptions. Conversely, we could lower the rating most likely if sovereign borrowers do not treat the bank as a preferred creditor, or if its financial profile otherwise weakens.

Business Profile: Strong

Our assessment of CDB's business profile reflects its policy importance relative to other MLIs, including the record of support from borrowers and other shareholders, and the bank's governance and management expertise.

Policy importance assessment

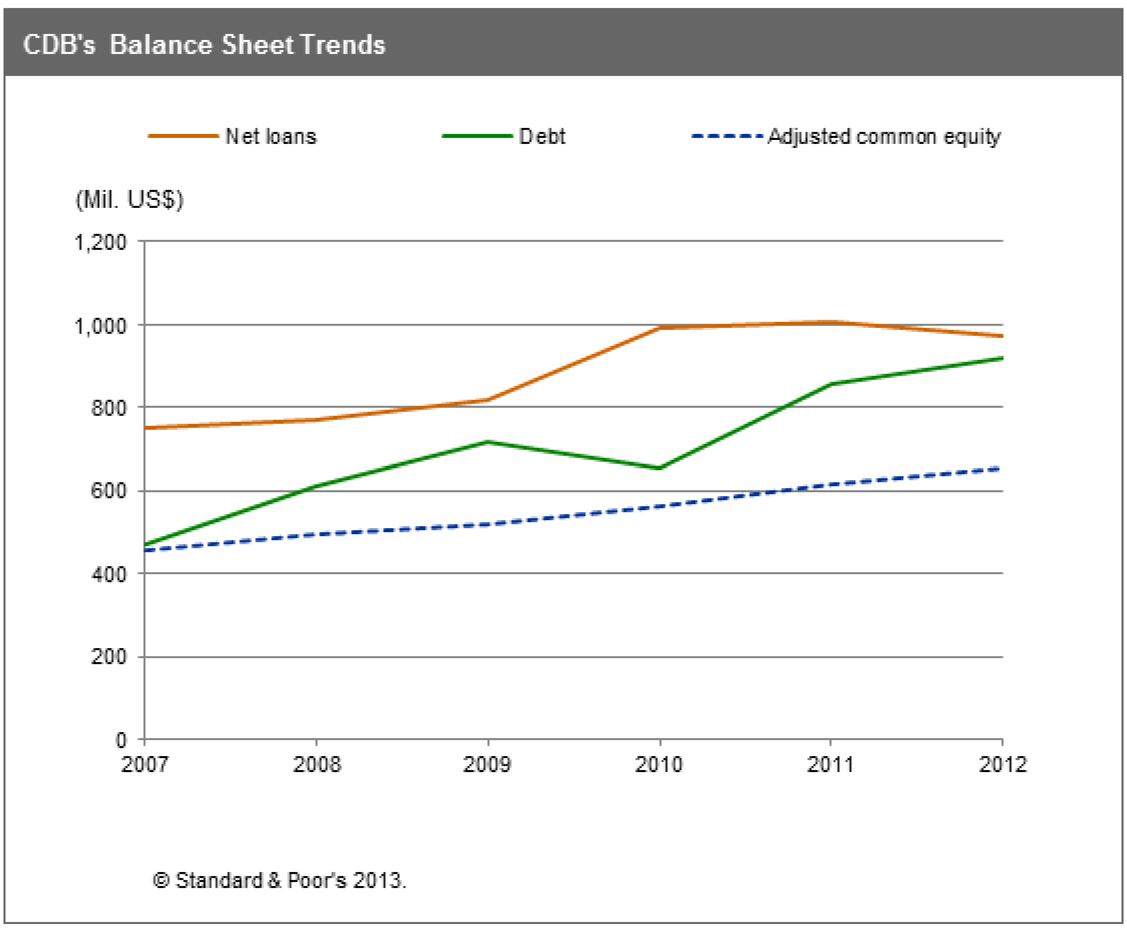
- CDB is a prominent lender to the Caribbean region with historically strong shareholder support for its mandate.
- Our policy importance assessment incorporates shareholder delays of capital payments in 2011-2012 under the 2010 capital increase and a borrower's failure to treat the bank as a preferred creditor during 2012.

Role. CDB provides financing to Caribbean-based sovereign governments, other public-sector entities, and private companies. The bank has 26 member countries, including 18 eligible borrowing members. Nearly 95% of its loans by volume are to governments and public-sector companies, but the bank also provides a handful of (often sovereign-guaranteed) loans to private-sector companies, and it provides a small number of guarantees on public- and private-sector transactions. In addition, CDB furnishes its borrowing members with detailed country poverty assessments, technical assistance, research, and administers several trust funds (the SFR), which together offer additional benefits to the Caribbean member countries and territories.

CDB has two structural components: its Ordinary Capital Resources (OCR) and Special Funds Resources (SFR), CDB's soft loan window. The bank's principal loan and guarantees originate from the OCR, the rated entity. CDB's Ordinary Capital Resources are not liable for any SFR obligation.

Public policy mandate. CDB is a prominent public-sector lender in the Caribbean, with 40 years of lending experience in the region. The bank lends countercyclically, increasing financing to governments in periods of economic stress. CDB increased net loans 19% between 2009 and 2012.

Chart 1



Shareholder delays on payment of capital subscription installments temper our view of CDB's mandate. Shareholders increased CDB's paid-in capital in May 2010--a $217 million cash capital increase (or 38% over the 2009 year-end shareholders' equity) that is being paid in over 2011-2016, an amount proportionally greater than some larger peers received. However, some shareholders have experienced delays on their capital installments payments (usually caused by parliamentary or administrative delays). To date, members collectively had paid in 90% of capital installments anticipated under the May 2010 general capital increase ($36 million per year). As of Dec. 31, 2012, $11 million of payments due under the GCI were in arrears and $4 million had been prepaid.

Table 1

CDB's Membership, Capital, And Voting Shares

	--2012--	
	Paid-up capital	**% total votes**
Eligible borrower members	191	58
Noneligible borrower members	137	42
More developed borrowing regional member countries		
Jamaica	64	19
Trinidad and Tobago	64	19
Bahamas	19	6
Guyana	14	4
Barbados	12	4
Subtotal	173	52
Less developed borrowing regional member countries		
Belize	3	1
Dominica	3	1
Antigua and Barbuda	1	0
St. Lucia	3	1
St. Vincent and the Grenadines	3	1
St. Kitts and Nevis	1	0
Grenada	1	0
British Virgin Islands*	0	*
Cayman Islands*	0	*
Montserrat*	0	*
Turks and Caicos Islands*	1	*
Anguilla§	1	*
Haiti	1	0
Subtotal	18	6
Nonborrowing regional member countries		
Venezuela	4	1
Colombia	10	3
Mexico	4	1
Subtotal	19	6

Table 1

CDB's Membership, Capital, And Voting Shares (cont.)

Nonregional member countries		
Canada	34	10
U.K.	34	10
Italy	8	3
Germany	21	6
China, People's Republic of	21	6
Subtotal	118	36
Total	328	100

*These territories collectively share one governor and have 0.9% of shares, 0.9% of paid-up capital, and 1.1% of votes. §Anguilla was formerly part of St. Kitts-Nevis-Anguilla but became an independent entity in 1980; it now shares a governor with the four other territories.

Table 2

CDB's Distribution Of Additional Share Capital Under The 2010 General Capital Increase

(Mil. US$)

Member countries	Capital to be subscribed	Additional paid-in capital	Annual payment over six years (2011-2016)
Borrowing			
Jamaica	175	39	6
Trinidad and Tobago	175	39	6
Bahamas	52	11	2
Guyana	38	8	1
Barbados	33	7	1
Haiti	8	2	0.3
Antigua	8	2	0.3
Belize	8	2	0.3
Dominica	8	2	0.3
St. Kitts and Nevis	8	2	0.3
St. Lucia	8	2	0.3
St. Vincent and the Grenadines	8	2	0.3
Grenada	7	1	0.2
Montserrat	2	0.4	0.1
British Virgin Islands	2	0.4	0.1
Cayman Islands	2	0.4	0.1
Turks and Caicos	2	0.4	0.1
Anguilla	2	0.4	0.1
Subtotal	543	119	20
Nonborrowing			
Colombia	28	6	1
Mexico	28	6	1
Venezuela	28	6	1
Canada	94	21	3
U.K.	94	21	3
Germany	56	12	2

Table 2

CDB's Distribution Of Additional Share Capital Under The 2010 General Capital Increase (cont.)			
Italy	56	12	2
China, People's Republic of	56	12	2
Subtotal	442	97	16
Total	985	217	36

Strength and stability of the relationship with shareholders. Historically, shareholders have demonstrated firm support to CDB, although the institution suffered some delays on capital payments in 2011-2012. Membership is expanding, and we expect another country to join imminently. Shareholders established CDB by treaty and exempt the institution from paying corporate income tax. By forgoing dividends and generally avoiding transfers to off-balance-sheet funds (the SFR), shareholders provide CDB traditionally high earnings retention. The bank has retained 88% of its earnings over the past decade, despite paying out most of its earnings to the SFR in 2012. (We calculate our earnings measure as comprehensive income net of: prior period adjustments, accounting adjustments reported through changes in shareholders' equity, and currency translation adjustments. We then calculated the annual earnings retention ratio and obtained the average thereafter.) We expect CDB will maintain a high retention rate.

Preferred creditor treatment. A sovereign borrower failed to afford preferred creditor treatment to the bank during 2012. (Standard & Poor's measures PCT as a practice demonstrated by sovereign borrowers over time. We view that PCT is not applicable to MLIs on a contractual basis, but rather that is a function of the importance of their policy role and depends, in practice, on the decision of the individual defaulting sovereign.) The sovereign borrower accumulated principal and interest arrears of more than 180 days due to CDB's primary balance sheet during 2012 while servicing some of its commercial obligations during the same period. The sovereign borrower cleared the debt service arrears to CDB prior to Dec. 31, 2012, and remained current on its obligations as of the end of July 2013.

Historically, borrowing members have treated CDB as a preferred creditor. In exceptional circumstances, the support from CDB's soft loan window has enabled this PCT. The soft loan window has provided relief following natural disasters, such as extensive hurricane damage (Dominica and Grenada) and a volcanic eruption (Montserrat). More recently, the SFR was used to support OCR loans during the St. Kitts and Nevis debt restructuring. This sovereign defaulted on $8 million commercial debt that CDB had guaranteed. When the creditors called the guarantee, CDB paid on it, creating a loan receivable from St. Kitts and Nevis to CDB's OCR. In 2012, CDB's board authorized the use of SFR funds to repay the OCR and to issue a new concessional loan originated from the SFR to St. Kitts and Nevis. We note, however, that the soft loan window has limited additional capacity for such operations.

Governance and management expertise

- CDB reviewed its risk management framework during 2012 with the assistance of an external consultant.
- The bank has begun to implement changes that should strengthen its risk monitoring and reporting systems during 2013 and 2014.

CDB's governance and management expertise have been supporting factors for the ratings. The bank instituted an institutional review following downgrades in 2012. The principal results include:

- CDB established a risk management office and hired a chief risk officer (CRO) from outside the organization. The CRO reports directly to the president as well as to the board. He participates in several committees, including the bank's investment and senior advisory management committees, and he chairs the bank's newly established enterprise risk committee. A risk management committee composed of the CRO and senior management now reports to the president.

- CDB reviewed and updated its capital adequacy metrics. The bank also plans to increase the frequency of its asset quality reporting to senior management. The bank has not amended its liquidity policy, but management reports the bank was compliant at year-end 2012 and remains so in 2013.
- CDB incorporated an amortizing principal feature into its November 2012 bond issue, reducing the bank's rollover risk and smoothing its debt maturity schedule.

These changes are positive from a credit perspective. We expect the benefits of the new policies and procedures will accrue over time.

The bank's annual financial reporting is generally transparent and adheres to International Financial Reporting Standards. Its 2012 annual financial statements received an unqualified opinion from Ernst & Young. CDB publishes audited financial statements and detailed notes to them once annually, available on its Web site (www.caribank.org).

CDB's Governance Structure

CDB's constitutive agreement vests all of the institution's powers in its board of governors. Each governor casts the votes of the members he or she represents. One governor represents the territories of Anguilla, Montserrat, the British Virgin Islands, the Cayman Islands, and the Turks and Caicos Islands. The governors hold an annual meeting, and they or the board of directors may call other meetings. A majority of the board of governors constitutes a quorum, provided the majority includes no less than two-thirds of the total voting power of the members. Except for certain specific exceptions listed in the agreement, a majority vote makes all decisions. The governors delegate to the board of directors all powers, except specified ones, including those to admit new members, change CDB's authorized capital, elect and determine the remuneration of directors and the president of the bank, amend the agreement, and determine the allocation of the bank's net income.

CDB's board of directors has 17 members, of which 12 represent regional members and five represent nonregional members. The countries and territories select the directors who represent them. Directors are responsible for the direction of the bank's general operations, including approval of each loan, and they ordinarily convene five times per year.

CDB's president is also its CEO, who is elected by no less than two-thirds of the governors representing no less than three-fourths of the total voting power of the members. The president, who serves for a term of up to five years and may be reelected, oversees a staff headquartered in Barbados.

Financial Profile: CDB Maintained Its Very Strong Capital Adequacy And Improved Its Liquidity During 2012

CDB's financial profile reflects its very strong capital adequacy and its improved liquidity position at year-end 2012 relative to year-end 2011 and the bank's funding constraints as an infrequent capital market issuer.

Capital adequacy

- CDB has a 38% RAC ratio before MLI-specific adjustments.
- CDB was profitable in 2012, with $15 million in comprehensive income and a 2.4% return on average adjusted

common equity.

- Shareholders' capital subscription payment rate improved to 90% of expected payments at year-end 2012 versus 2011.

The majority of the bank's credit risk originates from sovereign loans, its primary business line, and a small portfolio of nonsovereign lending. Net loans grew strongly during 2010, largely on the back of faster-disbursing PBLs, in response to the economic downturn. (CDB's board waived its PBL limit, following strong demand in 2009-2010.) Net loan growth tapered off during 2011 and 2012 as Caribbean governments' infrastructure budgets contracted. CDB's net outstanding loans declined 3% during 2012. The share of the bank's outstanding PBLs held steady at 28% of total loans during 2012.

Table 3

CDB’s Loan Portfolio Characteristics

	--As of Dec. 31--				
(Mil. US$, unless otherwise noted)	**2012**	**2011**	**2010**	**2009**	**2008**
Growth of net loans (% change)	(3)	1	21	6	3
Net loans (as a % share of assets)	59	65	78	64	65
Public-sector loans (gross)	927	960	946	780	740
As a % share of total loans	95	95	95	95	96
Policy-based loans (PBLs) (gross)	272	272	239	64	14
% change	0	14	274	372	80
As a % share of total loans	28	27	24	8	2
PBLs disbursed during the year	0	33	175	50	6
Private-sector loans (gross)	53	52	50	40	30
As a % share of total loans	5	5	5	5	4
Total loans (gross)	980	1,013	996	820	770

Caribbean Development Bank's capital adequacy before MLI-specific adjustments is extremely strong compared with commercial banks. It has a RAC ratio of 38%, as of Dec. 31, 2012.

The quality of CDB's "cash" capital, which we call adjusted common equity (ACE), is high, although its reported shareholders' equity is of a lower quality than that of some peers. We deduct $54 million on net from shareholders' equity to calculate CDB's $653 million of ACE. These adjustments include $11 million capital subscription arrears, $44 million non-negotiable demand notes (akin to promissory notes), and $3 million maintenance of value receivables on foreign currency holdings. We also include uplift for $4 million capital subscriptions that CDB received in advance. After these adjustments, CDB's cash capital consists of paid-in capital, capital subscriptions matured and paid-in, and retained earnings and reserves.

Table 4

CDB's Adjusted Common Equity (ACE)

	-- As of Dec. 31 --				
(Mil. US$)	**2012**	**2011**	**2010**	**2009**	**2008**
As reported by the institution:					
Subscribed capital	1,549	1,502	937	713	713

Table 4

CDB's Adjusted Common Equity (ACE) (cont.)					
Callable capital (less)	(1,208)	(1,171)	(730)	(556)	(556)
Paid-in capital	341	331	207	157	157
Subscriptions not yet due (less)	(123)	(145)	(49)	0	0
Capital subscriptions matured	219	186	157	157	157
Retained earnings and reserves	488	488	447	406	385
Shareholders' equity (as reported by the institution)	707	674	605	563	542
Standard & Poor's adjustments:					
Capital payments committed (subscribed) but not yet due (-)	0	0	0	0	0
Past-due capital payments receivable (-)	(11)	(16)	(1)	(1)	0
Capital payments received in advance from shareholders (+)	4	5	6	0	0
Members' promissory notes* (-)	(44)	(44)	(44)	(43)	(44)
Maintenance of value payment receivables (foreign currency holdings) due on capital subscriptions (-)	(3)	(1)	(1)	(1)	(2)
Capital subscriptions in restricted currencies (-)	0	0	0	0	0
Other adjustments (-), of which:	0	0	0	0	0
Unrecognized pension deficit (-)	0	0	0	0	0
Adjusted common equity (ACE)	653	618	564	518	496

*CDB's non-negotiable demand notes receivable from members.

Following comprehensive income of more than $40 million the previous two years, CDB's comprehensive income declined to $15 million in 2012. This reflects a $31 million revaluation decrease in the fair value of its cross-currency interest rate swaps pertaining to the bank's two yen bond issues. (This was partially offset by a $24 million foreign exchange translation gain on the yen borrowings.) CDB carries the value of its two yen borrowings at face value on the balance sheet, but it marks to market the fair value of the cross-currency interest rate swap hedge through other comprehensive income. The difference in accounting treatments causes the size of the change in value of the derivatives and the size of the foreign exchange translation effect not to be equivalent. This introduces volatility to CDB's capital base, despite the hedge covering 100% of the yen borrowings.

The bank earned a 1.0% return on average adjusted assets and a 2.4% return on average adjusted shareholders' equity. Similar to other MLIs that serve a public policy purpose, CDB does not maximize profits, and its margins are typically less than those of a commercial bank. The bank's $33 million net interest and investment income in 2012 moderated only $2.4 million from 2011, reflecting increased borrowing costs.

Table 5

CDB's Profitability					
	--As of Dec. 31--				
(%)	**2012**	**2011**	**2010**	**2009**	**2008**
Comprehensive income/average adjusted assets	1.0	3.0	3.4	1.8	4.0
Comprehensive income/average adjusted common equity	2.4	6.9	7.7	4.1	8.8
Administrative expense/average adjusted assets	0.7	0.8	0.8	0.8	0.9
Memo:					
Comprehensive income (mil. US$)	15	41	41	20.978	42.028

The bank's shareholders' equity increased by 5% in 2012. This was lower than the 12% expansion of shareholders' equity in 2011, reflecting less comprehensive income, shareholders' lower than 100% payment rate of new capital installments under the GCI, and an allocation to the SFR. Although the bank does not regularly fund off-balance-sheet activities with transfers from net income, the board of governors approved a $15 million transfer to the SFR in 2012 (as part of the seventh general replenishment of the Special Development Fund organized under the SFR umbrella) and a $11 million transfer in 2008 (to create an interest subsidy fund). The bank, which does not distribute dividends, has an 88% average earnings retention rate over the past decade. We expect this high rate of internal capital generation to continue.

Table 6

CDB's Change In Shareholders' Equity

	--As of Dec. 31--				
(Mil. US$)	**2012**	**2011**	**2010**	**2009**	**2008**
Balance as of Jan. 1	674.2	604.5	563.0	542.0	511.4
Total comprehensive income for the year	15.3	40.8	41.5	21.0	42.0
Prior period adjustment, net	0.0	0.0	0.0	0.0	(0.4)
Allocation from net income to SFR	(15.0)	0.0	0.0	0.0	(11.0)
Issued share (paid-in) capital	32.4	28.9	0.0	0.0	0.0
Balance as of Dec. 31	706.9	674.2	604.5	563.0	542.0

Note: In 2012, $15 million was transferred to SDF-United (SFR) for general replenishment. In 2008, $11 million was transferred to SFR to establish an interest subsidy fund.

Risk position

- CDB has a 20% RAC ratio after MLI-specific adjustments.
- The bank's capitalization helps to offset some of the correlation risk among its sovereign loans. We expect economic conditions will remain adverse for many tourism-dependent Caribbean countries, and that, combined with large external public debt burdens of some countries and territories, could increase the default risk of borrowers to CDB.

As of Dec. 31, 2012, CDB had a 20% RAC ratio after MLI-specific adjustments for concentrations using static sovereign credit ratings, reflecting the bank's financial information as of Dec. 31, 2012, and our ratings as of July 19, 2013. CDB's two largest MLI-specific adjustment are for its sovereign exposures. First, we add a penalty for CDB's sovereign lending concentrations. Second, we add a benefit for our expectation that most members will continue to treat the bank as a preferred creditor.

Table 7

CDB's RAC Ratios*

		--Ratings as of July 19, 2013--		--Ratings as of Dec. 31, 2012--	
	Exposure at default (US$000s)	**Standard & Poor's risk-weighted assets (RWA) (US$000s)**	**Average Standard & Poor's risk weight (%)**	**Standard & Poor's risk-weighted assets (RWA) (US$000s)**	**Average Standard & Poor's risk weight (%)**
Credit risk					
Government and central banks	1,457,056	1,476,466	101	1,477,168	101
Financial institutions	178,648	79,852	45	89,257	50
Corporate	0	0	0	0	0

Table 7

CDB's RAC Ratios* (cont.)					
Other assets	105,176	64,709	62	64,709	62
Credit risk total	1,740,879	1,621,027	93	1,631,134	94
Market risk					
Equity in the banking book*	0	0	0	0	0
Trading book market risk	--	3	--	3	--
Market risk total	--	3	--	3	--
Insurance risk					
Insurance risk RWA	--	0	--	0	--
Operational risk					
Operational risk RWA	--	76,513	--	76,513	--
		Standard & Poor's RWA	**Percent of Standard & Poor's RWA**	**Standard & Poor's RWA**	**Percent of Standard & Poor's RWA**
Total before diversification					
RWA before diversification		1,697,543	100	1,707,651	100
Diversification and concentration adjustments					
Geographic		(112,857)	(7)	(113,333)	(7)
Preferred creditor treatment		(209,333)	(14)	(209,333)	(14)
Single name (on sovereign exposures)		1,784,325	121	1,819,767	123
High risk exposure cap		0	0	0	0
Total diversification/concentration adjustments and PCT		1,462,134	86	1,497,100	88
Total after diversification					
RWA after diversification		3,159,677	186	3,204,751	188
		Adjusted common equity (US$000s)	**Standard & Poor's RAC ratio (%)**	**Adjusted common equity (US$000s)**	**Standard & Poor's RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments§		653,325	38	653,325	38
Capital ratio after adjustments§			21		20

*Equity exposure includes the minority equity holdings in financial institutions. §RAC reflects CDB's financial position as of Dec. 31, 2012. Risk weights reflect Standard & Poor's credit ratings as of Dec. 31, 2012. Between Dec. 31, 2012, and July 19, 2013, downgrades of two sovereign issuers contributed to the decline of CDB's RAC after adjustments to 20% after reflecting credit ratings as of July 19, 2013, and CDB's Dec. 31, 2012, year-end financial data.

CDB has sovereign and Caribbean regional concentration on its balance sheet. The five largest risk-weighted sovereign loan exposures before MLI-specific adjustments were Jamaica (24% of risk-weighted sovereign asset exposures before MLI specific concentration adjustments and exposure caps), St. Vincent and the Grenadines (15%), St. Kitts and Nevis (13%), St. Lucia (13%), and Belize (9%), reflecting financial data as of Dec. 31, 2012. Although these percentages are not as high as those of some other MLIs, we believe the correlation of economic performance among these sovereigns is higher, given the similarities of their economic structures, tourism markets, and the nature of their monetary arrangements. On an unweighted basis, Jamaica, Barbados, and St. Vincent and the Grenadines represent 15% or more of adjusted common equity. We expect that the bank will continue to direct significant resources to Jamaica and other low-income-per-capita islands (a tenet of the bank's development mandate), reinforcing the need to maintain higher-than-average capitalization (as CDB has done historically) because of the weaker creditworthiness of many of the borrowers to which CDB has large exposures.

CDB amended its lending concentration policies. First, the bank relaxed its single largest borrower concentration limit by inserting a new provision enabling the largest single borrower exposure to reach the greater of 40% of total loans outstanding or 50% of available (cash) capital. Previously, the bank had limited the single largest borrower exposure to 50% of available capital. (Jamaica, CDB's largest borrower exposure, represented 24% of outstanding loans and guarantees and 36% of ACE at year-end 2012.)The bank calculates available capital as the sum of paid-in capital, total reserves, retained earnings, and subscriptions received in advance, less subscriptions not yet due or past due and demand obligations from borrowers.

Second, the bank made its concentration limit to its three largest borrowers more restrictive. The new policy limits exposure of the three largest borrowers to the greater of 60% of outstanding loans or 90% of total available capital. Formerly, the policy restricted the three largest borrower exposures to 120% of capital. (The bank's three largest exposures--to Jamaica, Barbados, and St. Vincent and the Grenadines--represented 47% of loans and guarantees and 70% of ACE at year-end 2012.)

CDB's sovereign loan portfolio suffered arrears of more than 180 days from a government borrower (representing 3% of loans) during 2012. The sovereign borrower cured its late debt payments, including interest penalties, by Dec. 31, 2012, and was current on its loans as of July 2013. A second sovereign borrower (whose total exposure was $35 million or 4% of loans) had debt service arrears of 30-90 days to CDB as of Dec. 31, 2012. This borrower paid its arrears by Jan. 17, 2013, and was current on its loan obligations as of July 2013. CDB reviews loans once annually for impairment. In practice, the bank did not have any provision for its public-sector loans aa of Dec. 31, 2012. Therefore, we expect any losses would immediately reduce earnings or capital. Altogether, CDB's past-due-but-not-impaired public-sector loans were 4% of loans and 5% of ACE at year-end 2012.

CDB's private-sector loan portfolio is small (5% of loans), but its asset quality deteriorated in recent years. The bank had $55 million in gross private-sector exposure ($48 million net of provisions) at the end of 2012. CDB had $11 million in impaired loans relating to two borrowers, against which it had $8 million in collateral (including an estimated property value) and $8 million in loan loss reserves at year-end 2012. The largest impaired loan is to a hotel that was placed in receivership in 2012 and subsequently sold during the first half of 2013. The sale proceeds covered the unprovisioned portion of the loan, and the bank recognized a $500,000 recovery that the bank expects to release to income. The second impaired private-sector loan is to a Caribbean-based financial institution, which remained nonaccrual as of July 2013.

Collectively, the sum of the bank's adjusted common equity and loan loss provisions was 14x its impaired plus past-due-but-not-impaired loans year-end 2012.

CDB has a defined benefit pension plan and a former hybrid pension scheme, which together represented a $4 million recognized liability (0.2% of assets and 0.6% of adjusted common equity) on the bank's balance sheet at the end of

2012. We view this pension liability as small and as a credit risk that the bank continues to manage and report transparently.

Funding and liquidity

- CDB's liquidity improved to 30% of assets at year-end 2012.
- Short-term debt maturing during 2013 represented 22% of total debt as of Dec. 31, 2012. The bank had sufficient balance sheet resources to meet scheduled loan disbursements and debt service during 2013.
- The bank is a small and infrequent issuer in the capital markets relative to large MLIs.

The bank increased its leverage (to 1.4x adjusted common equity at year-end 2012 from 1.0x at year-end 2007) to finance greater lending in recent years. This has increased the bank's debt service expense, and a greater 22% share of debt comes due in 2013 (lower than 26% in 2012) than during 2005-2010 (when the bank's refinancing needs fluctuated between 1% and 15% of total debt).

Table 8

CDB's General Liquidity And Leverage Indicators

	--Dec. 31--				
	2012	**2011**	**2010**	**2009**	**2008**
Liquidity					
Liquid assets/total assets (%)	30	21	9	26	23
Cash and deposits/total assets (%)	6	5	1	8	8
Net loans/total assets (%)	59	65	78	64	65
Liquid assets/gross debt (%)	54	38	17	47	45
Liquid assets/debt maturing in one year or less (x)	3	1	8	3	6
Leverage					
Gross debt/adjusted common equity (x)	1.4	1.4	1.2	1.4	1.2
Short-term debt/gross debt (%)	22	26	2	17	8
Short-term debt/total assets (%)	12	15	1	9	4

To reduce its rollover risk, CDB incorporated a feature--which amortizes the principal over the last five years to maturity--into its last $300 million, 15-year bond issue in November 2012. The infrequency of the bank's capital market issues raises its issuance costs and can make its debt maturity schedule uneven. We expect that this bond feature will reduce the bunching of maturities.

CDB's liquidity strengthened to 30% of total assets, as of Dec. 31, 2012. The bank maintained sufficient liquidity on a cumulative basis such that it could meet its scheduled loan disbursements, debt service, and payable derivatives during 2013 without recourse to further borrowing. The bank's liquidity declined during 2011 and caused it to become noncompliant with its internal liquidity policy. CDB's strengthened liquidity position brought it back into compliance with its internal policy at year-end 2012. We expect that the bank will maintain liquidity and prudent funding at current levels.

Chart 2

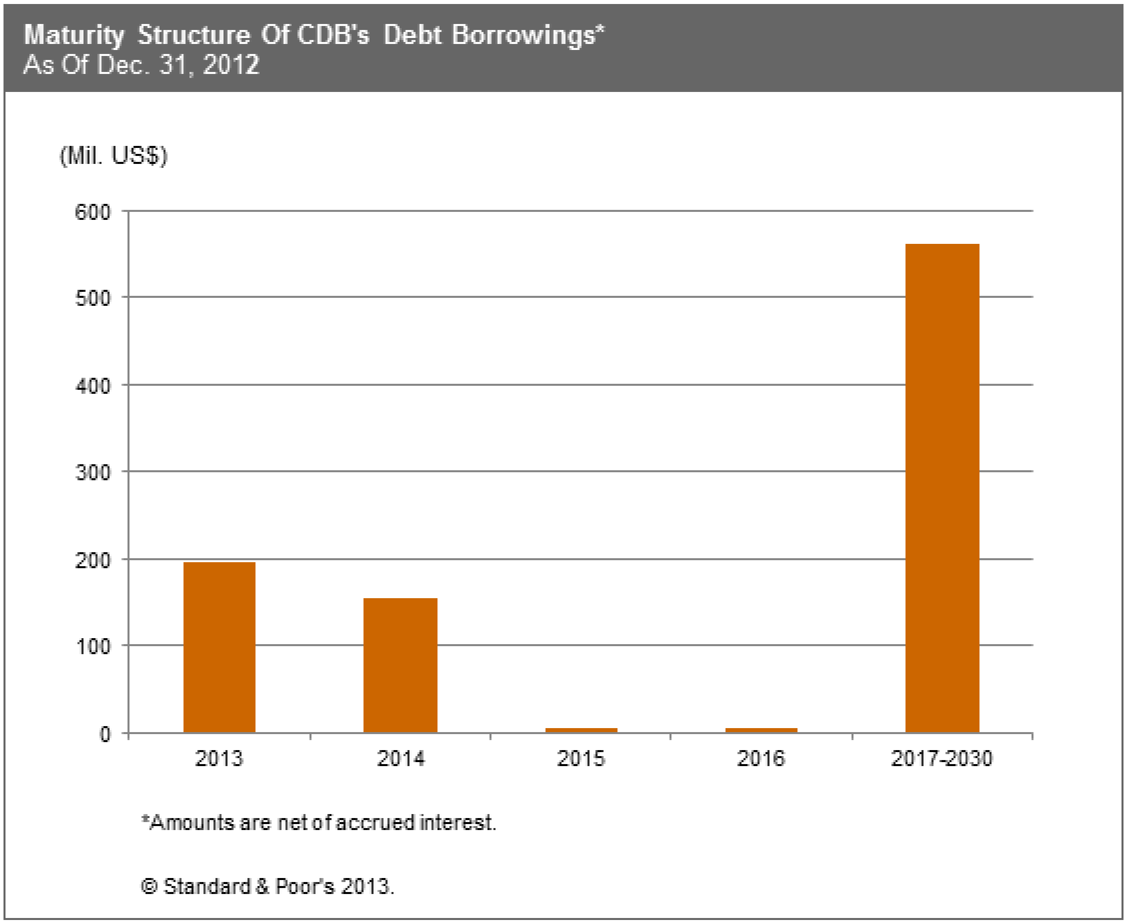


Table 9

CDB's Static Funding Gap*		
	--As of Dec. 31, 2012--	
	Without scheduled loans (x)	With scheduled loans (x)
Three months	5.8	4.8
Six months	7.3	5.0
One year	1.4	1.1
Two years	1.1	0.8
Five years	2.2	1.6

*The static funding gap measures maturing assets divided by maturing liabilities (measured by scheduled commitments) at the respective point in time. A number greater than 1 indicates a funding surplus of assets, and a number less than 1 signals a deficit.

Treasury activities are not a significant source of income for CDB. Rather, they are intended to ensure the bank has sufficient liquidity to meet all of the bank's financial commitments at a minimum cost. Therefore, CDB seeks to narrowly contain the risks from its treasury activities.

Credit risk. CDB held 46% of its liquid debt securities in sovereign and supranational bonds rated 'AA-' or higher by Standard & Poor's or their equivalent at year-end 2012. Counterparty commercial banks must be rated 'A-' by Standard & Poor's (or the equivalent by another independent credit rating agency) or higher to limit CDB's risk on deposits and financial institution debt securities. The bank has counterparty risk on its derivative transactions. Swap and any other derivative counterparty must be rated 'A' (or 'A-2') or better, according to the bank's OCR derivative policy.

Interest rate risk. CDB manages its interest rate risk first by providing floating-rate loans and issuing floating-rate debt when possible or by swapping its fixed-rate issues effectively to floating-rate obligations. CDB's loan pricing included a spread of 50 basis points (bps) to 100 bps, as of Dec. 31, 2012. Since then, board has removed spread ceiling, which could allow an increase in loan pricing.

Exchange rate risk. CDB lends fully in U.S. dollars and borrows mostly in the same currency. CDB has two outstanding yen issues as of year-end 2012, which it swaps into U.S. dollar obligations.

Likelihood Of Extraordinary Shareholder Support

We assign one notch of uplift for the likelihood of extraordinary shareholder support above the stand-alone credit profile. We expect that CDB's shareholders rated above the SACP would provide extraordinary shareholder support in the form of callable capital in the event of a capital call. CDB has $328 million in callable capital from equivalent or higher-rated shareholders (Canada, the U.K., and Germany), reflecting the bank's financial data as of Dec. 31, 2012, and our credit ratings as of July 19, 2013.

Summary Financials And Comparative Statistics

Table 10

Peer Comparison

	--Financial data as of fiscal year-end 2011--					
	CDB	**AFDB**	**CABEI**	**CAF**	**IADB**	**IBRD**
Total assets (mil. US$)	1,543	31,531	6,953	21,535	89,432	338,178
RAC ratio before adjustments*	31	28	28	30	25	31
RAC ratio after MLI-specific adjustments*	21	18	10	19	15	31
Adjusted shareholders' equity/adjusted total assets (%)	41	24	29	29	22	11
Purpose-related exposure to/in five countries of largest exposure/adjusted shareholders' equity (%)	104	136	248	183	260	167
Adjusted shareholders' equity/impaired loans (x)	57	16	12	775	150	79
Net income/average adjusted shareholders' equity (%)	7.1	1.1	5.2	2.5	(1.4)	(1.8)
Liquid assets/total assets (%)	22.0	39.0	21.0	26.0	17.0	12.0
Static funding gap (one year, x)§	0.9	1.4	1.3	1.2	1.3	1.5
Gross debt/adjusted shareholders' equity (x)	1.4	2.6	2.3	2.3	3.3	4.0

*Ratings used in the RAC calculation are as of March 31, 2013. §Static funding gap--maturing assets divided by maturing liabilities (measured by scheduled commitments). AFDB--African Development Bank. CABEI--Central American Bank for Economic Integration. CAF--Corporacion Andina de Fomento. IADB--Inter-American Development Bank. IBRD--International Bank for Reconstruction and Development. Source: Standard & Poor's Supranational Special Edition 2012.

Table 11

CDB's Summary Balance Sheet

	--Dec. 31--				
(Mil. US$)	**2012**	**2011**	**2010**	**2009**	**2008**
Assets					
Cash due from banks	21	22	4	18	16
Time deposits (maturity of three months or less)	75	57	5	81	80
Cash and cash equivalents	96	79	9	99	96
Investments (debt securities at fair value through profit and loss)	401	244	103	241	179
Liquid assets	497	323	113	339	275
Gross loans	980	1,013	996	820	770
Allowance for private-sector loan losses (-)	(8)	(5)	(2)	(2)	(1)
Net loans	972	1,008	994	818	769
Derivative financial instruments	95	128	97	56	70
Receivable from members	58	61	47	45	46
Other receivables	10	15	11	18	8
Other assets	8	8	8	8	8
Total assets	1,641	1,543	1,269	1,285	1,176
Liabilities					
Short-term debt (maturing in one year or less)	198	226	14	119	48
Long-term debt	722	632	640	599	561
Borrowings	920	858	653	718	609
Liabilities to members for maintenance of value payments	0	0	0	0	0
Accounts payable and accrued liabilities	5	2	2	2	24
Subscriptions in advance	4	5	6	0	0
Deferred income	1	1	1	1	0
Postemployment benefit obligations	4	3	2	1	1
Other liabilities	14	11	11	4	25
Total liabilities	934	869	664	722	634
Capital					
Paid-in capital	219	186	157	157	157
Retained earnings and reserves	488	488	447	406	385
Shareholders' equity	707	674	605	563	542

Note: CDB prepares its financial statements in accordance with International Financial Reporting Standards (IFRS). Ernst & Young (based in Bridgetown, Barbados) rendered an unqualified opinion of CDB's 2012 annual financial statements.

Table 12

CDB's Summary Statement Of Net Income

	--As of Dec. 31--				
(Mil. US$)	**2012**	**2011**	**2010**	**2009**	**2008**
Interest and similar income from loans	40	41	43	46	47
Interest and similar income from investments and cash balances	3	3	4	6	6
Interest expense and similar charges	(10)	(8)	(8)	(12)	(18)

Table 12

CDB's Summary Statement Of Net Income (cont.)					
Net interest and investment income	33	36	38	40	34
Provision for loan losses	(3)	(3)	0	(1)	(1)
Other income (expense)	1	0	0	0	0
Administrative expense	(11)	(10)	(10)	(9)	(9)
Realized and unrealized fair value gains (losses)	1	(1)	(0)	(1)	2
Foreign exchange translation	24	(13)	(28)	5	(39)
Derivative fair value adjustment	(31)	32	41	(13)	55
Comprehensive income	15	41	41	21	42

Related Criteria And Research

- Caribbean Development Bank 'AA/A-1+' Issuer Credit Ratings Affirmed; Outlook Remains Negative, June 13, 2013
- Supranationals Special Edition 2012, May 29, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Nov. 26, 2012
- Principles Of Credit Ratings, Feb. 16, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Ratings Detail (As Of July 26, 2013)		
Caribbean Development Bank		
Counterparty Credit Rating		
Foreign Currency		AA/Negative/A-1+
Senior Unsecured		AA
Counterparty Credit Ratings History		
12-Dec-2012	*Foreign Currency*	AA/Negative/A-1+
12-Jun-2012		AA+/Stable/A-1+
10-May-2004		AAA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.