MOODY'S
INVESTORS SERVICE

CREDIT OPINION
16 September 2020

Update

Rate this Research

RATINGS

**Agencia Financiera de Desarrollo**

| | |
|---|---|
| Domicile | Paraguay |
| Long Term CRR | Ba1 |
| Type | LT Counterparty Risk Rating - Fgn Curr |
| Outlook | Not Assigned |
| Long Term Issuer Rating | Not Available |
| Type | Not Available |
| Outlook | Stable |

*Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.*


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# Agencia Financiera de Desarrollo

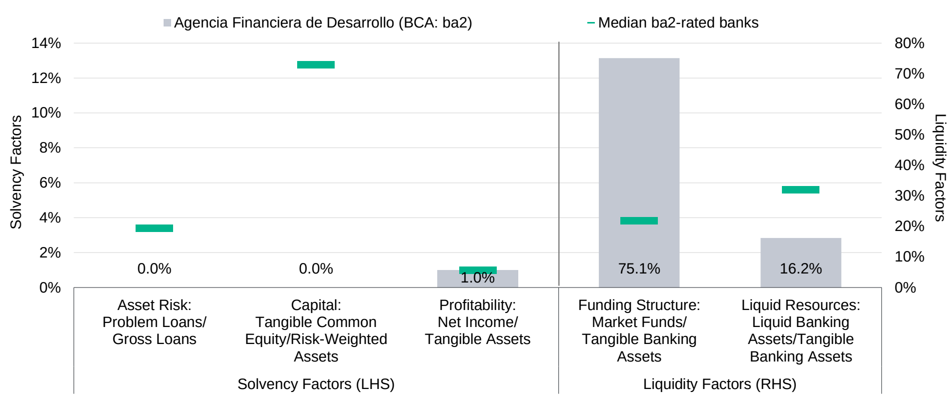
## Update following rating affirmation, stable outlook

## Summary


Agencia Financiera de Desarrollo's (AFD) issuer rating of Ba1 incorporates the agency's role as a fully government-owned "second floor" bank in Paraguay that onlends to other financial institutions for the government's development goals. AFD is the sole provider of long-term funding to leading financial institutions in Paraguay and its financial obligations in both local and foreign currency are guaranteed by the Paraguayan government. AFD's issuer rating is determined by (i) the institution's baseline credit assessment (BCA) of ba2, as determined by Moody's Banks rating methodology, which reflects the agency's sound standalone credit fundamentals and Paraguay's Moderate - Macro Profile, and (ii) the incorporation of support from its owner, the Government of Paraguay (Ba1, stable). AFD's issuer rating receives one notch of uplift from its BCA based on the government´s guarantee of its financial obligations as prescribed by law, its legal status as a wholly-owned government development bank , and its important policy role. As a result, Moody's rates AFD at the same level as the Ba1 Paraguayan government bond rating.

On 14 September 2020, Moody's affirmed AFD's ratings and assessments noting its very strong asset quality and high levels of capitalization, as well as its low profitability relative to private sector banking peers, and reliance on market funding, as a non deposit taking financial institution.


Exhibit 1
**Rating Scorecard - Key Financial Ratios**




*Source: Moody's Financial Metrics*

## Credit strengths

» Very strong asset quality as shown by no history of delinquencies

» Strong levels of capitalization

» Government backed level of ongoing public support as evidenced by annual capital injections and debt guarantees

## Credit challenges

» Complete dependence on wholesale funding as a non-deposit taking institution

» Low profitability, reflecting the agency's development role

## Rating outlook

The stable outlook is in line with the stable outlook on the Government of Paraguay and also reflects our expectation that AFD's asset risk will remain very low and capital will remain robust

## Factors that could lead to an upgrade

» AFD's issuer rating will face upward pressure if the Government of Paraguay's rating is upgraded.

» AFD's BCA could be upgraded if it were to diversify its funding, improve its profitability and/or increase its holdings of liquid assets. Absent an upgrade of Paraguay's sovereign rating, however, this would have no effect on AFD's issuer rating.

## Factors that could lead to a downgrade

» A downgrade in the bond rating of Paraguay would lead to a downgrade in AFD's issuer ratings

» AFD's BCA would be downgraded should its asset risk show deterioration and its already low profitability decline markedly through rising provisioning costs. Absent a downgrade of Paraguay's sovereign rating, however, this is unlikely to effect AFD's issuer rating.

## Key Indicators

Exhibit 2

**Agencia Financiera de Desarrollo (Consolidated Financials) [1]**

| | 06-20[2] | 12-19[2] | 12-18[2] | 12-17[2] | 12-16[2] | CAGR/Avg.[3] |
|---|---|---|---|---|---|---|
| Total Assets (PYG Billion) | 6,819.8 | 6,210.1 | 5,465.0 | 4,307.6 | 3,863.7 | 17.6[4] |
| Total Assets (USD Million) | 1,001.2 | 962.3 | 917.6 | 770.5 | 669.9 | 12.2[4] |
| Tangible Common Equity (PYG Billion) | 1,632.4 | 1,476.1 | 1,402.6 | 1,233.5 | 1,009.4 | 14.7[4] |
| Tangible Common Equity (USD Million) | 239.6 | 228.7 | 235.5 | 220.6 | 175.0 | 9.4[4] |
| Net Interest Margin (%) | 1.5 | 1.8 | 1.7 | 1.5 | 1.7 | 1.7[5] |
| Net Income / Tangible Assets (%) | 1.1 | 1.2 | 0.9 | 0.8 | 1.0 | 1.0[5] |
| Cost / Income Ratio (%) | 23.3 | 23.2 | 32.4 | 36.5 | 32.4 | 29.6[5] |
| Market Funds / Tangible Banking Assets (%) | 75.0 | 75.1 | 73.2 | 70.9 | 73.5 | 73.5[5] |
| Liquid Banking Assets / Tangible Banking Assets (%) | 17.6 | 16.2 | 14.0 | 14.7 | 22.9 | 17.1[5] |

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel I; LOCAL GAAP. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime.
*Sources: Moody's Investors Service and company filings*

## Profile

Founded in 2006 under Law 2640, Agencia Financiera de Desarrollo is the sole “second floor” bank in Paraguay, onlending to financial institutions to promote the development and employment goals of the Paraguayan government. The agency is headquartered in Asuncion and as of June 2020 it had total loans of PGY 5,603 billion and total assets of PGY 6,820 billion.

## Detailed credit considerations

### No history of delinquencies

Moody's assigns a score of baa2 to asset risk, which is two notches below the initial score based on the agency's delinquency rate of zero, due to its sector concentration in the banking industry. AFD's asset quality is supported by the bank's history of zero delinquencies since its founding given its conservative underwriting standards and exclusive focus on lending to solid financial institutions in Paraguay, as well as legal provisions which protect the agency's exposures.

As of June 2020, 81% of AFD's PGY 5.6 trillion (USD 823 million) loan book was directed to banks, 15% to cooperatives, and the remainder mainly to finance companies (empresas financieras). Under law, AFD's loans to financial institutions have privileged status and in bankruptcy would have senior claims over depositors and secured creditors.

Despite its history of zero delinquencies and the preferential status of its loans, AFD also provisions against its loan exposures under a scale vetted by the Central Bank of Paraguay (BCP). As of June 2020, loan loss reserves to gross loans were 0.35%, providing a buffer against unexpected losses.

On a sector basis, over 36% of AFD's onlending is used to finance the development housing sector, through the Mi Casa, Mi Primera Casa and Primera Vivienda lines. Among the other twelve products that AFD offers are directed to the agricultural sector (FIMAGRO, PROCAMPO), small to mid-sized enterprises (PROPYMES, PROCRECER), cooperatives (PROCOOP) as well as educton (PROEDUC).

AFD has been a key tool to sustain the economy during the covid crisis. In order to do so, AFD has launched three new products: 1) “Refinanciamento”, with a budget of PYG800 billions (USD115 millions) that has been 53% used as of July 2020, and aims to convert short term to long term debt, allowing for a grace period; 2) “Proreativación”, with a budget of PYG360 billions (USD50 millions) that was 41% used, consists of injecting new money through new operations; and 3) “Fideicomiso”, that has a budget of PYG600 billions (USD85 millions) 26 spend, and provides support to SMEs.

Under the terms of contracts signed with AFD, the agency's clients need to ensure that the loans they make that are funded with AFD resources are and remain classified at the lowest risk levels (I-II) on the Paraguayan Central Bank's scale.Regardless, AFD bears none of the credit risk of the ultimate borrowers of its funds. These risks are entirely borne by the banks and financial institutions that onlend AFD's resources.

### Strong levels of capitalization

Moody's assign a score of baa2 to capital as we estimate that agency has a very strong level of capitalization, even though it does not report a regulatory capital ratio or risk-weighted assets. Rated development banks in the region average ratio of RWA on Total Assets of 87%. Applying the same ratio to AFD would match to a very strong ratio of 27.4% tangible common equity (TCE) on risk weighted assets. Even assuming a 150% RWA on Total Assets (which would be extremely conservative given its focus on lending to financial institutions), AFD would still have a 16.0% RCE / RWA, a very strong capitalization ratio.

Capital injections from FONACIDE (Fondo Nacional de Inversion Publica y Desarollo), that made up 11% of tangible common equity as of December 2018, were reallocated. In compensation, AFD received PYG120 billion (USD100 million) for the economic ministry (“ministerio de la hacienda”), equivalent to 7.4% of TCE, to fight coronavirus.

However, we note that capital has been decreasing in recent years as capital consumption has grown more rapidely than capital injections. From 2016 - June 2020, AFD's loan book grew at a compound annual growth rate (CAGR) of 19.9% whereas its tangible common equity grew at a slower pace (14.7% annually). As AFD continues to expand its operations, we expect its TCE will continue to trend downward as a percentage of assets, but it will nevertheless remain at high levels.

### Profitability will continue to be low reflecting the agency's development role

The macro score of b1 for profitability is two notches below the initial score of ba3 based on the agency's ratio of net income to tangible assets. This adjustment considers our assessment that AFD's earnings will face negative pressure as it expands its low margin lending operations. AFD's strategic focus is on development and job creation and not on maximizing profitability. As a result, AFD's profitability, as measured by net income to tangible assets, was just 1.08% in June 2020, well below that of rated commercial banks in Paraguay. As almost 99% of its revenues come from interest income, its low return on assets directly stems from its concessional lending rates, as shown by its very low net interest margin of 1.54% in June 2020.

In addition, the agency makes fee income through its managing of certain state funds such as FOGAPY, FONACIDE, IPS and PPP (Public Private Partnertship Projects Fund). However, this accounted for less than 5% of its pretax net income. The agency's profitability is also driven its strong efficiency levels, with operating costs equal to just 23.3% of its gross income, which is comparable to commercial banks in Paraguay and lower than regional peers.

### Funding derived from multilateral agencies and bond issuances

Moody's assign a score of caa3 to funding structure which maps directly off its very high market funds to tangible assets ratio of 75%. AFD does not take deposits and instead funds itself through equity, local currency bonds, and loans from multilateral agencies. As of June 2020, half of AFD's funding derived from multilateral agencies. The remainder of its funding came from local and foreign currency bonds. However, these are mainly held by the Paraguayan deposit guarantee fund (Fondo de Guarantia de Depositos), as well as the state pension fund (Instituto de Prevision Social) and Caja Fiscal of The Ministry of Finance, significantly reducing the agency's exposure to refinancing and interest rate risk. The agency's multilateral agency lenders were Banco Interamericano de Desarrolo (BID) and KFW, the German state owned development bank, responsible for 49.4% and 0.7% of its total funding respectively. Given the agency's government ownership and guarantee, as well as its social mission, we believe this multilateral funding will be very stable as well.

AFD's bond issuances need to be approved by the Paraguayan government and the total amount that the agency can issue is detailed in the government's budget plans for a given year. As of June 2020, AFD issued PGY800 billion.

### Liquid assets are low to counter market funding risk

Moody's assign a score of ba3 to AFD's liquid resources score which maps directly off its liquid assets to tangible assets ratio of 16%. Under the conditions of article 14 of Law 2640, 2005, AFD's liquid assets are held at the central bank, but the amount held is insufficient to cover the extent of the Agency's market funding.

## ESG considerations

AFD's exposure to environmental risks is low, consistent with our general assessment for the global banking sector. See our Environmental risk heat maps for further information.

Overall, we believe banks face moderate social risks. The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which are partly mitigated by sizable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage because of product mis-selling or other types of misconduct are a further social risk. Social trends are also relevant in a number of areas, such as shifting customer preferences toward digital banking services increasing information technology cost, aging population concerns in several countries affecting demand for financial services or socially driven policy agendas that may translate into regulations that affect banks' revenue base. See our Social heat maps for further information.

Governance is highly relevant for AFD, as it is to all participants in the banking industry. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit a bank's credit profile. Governance risks are largely internal rather than externally driven, and for AFD, we do not have any particular governance concerns. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

## Support and structural considerations

### Government Support

The Ba1 local currency issuer rating assigned to AFD incorporates one notch of uplift from the entity's BCA of ba2 based on Moody's assessment that the agency is government-backed by the Government of Paraguay (Ba1, stable) in an event of stress, based on its legal status as a development bank wholly owned by the government, legally-mandated annual capital injections from government sources, and the government guarantee of its financial obligations.

## Rating methodology and scorecard factors

Exhibit 3

**Agencia Financiera de Desarrollo**

| **Macro Factors** | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Weighted Macro Profile** | **Moderate -** | **100%** | | | | | |
| **Factor** | **Historic Ratio** | **Initial Score** | **Expected Trend** | **Assigned Score** | **Key driver #1** | **Key driver #2** | |
| Solvency | | | | | | | |
| Asset Risk | | | | | | | |
| Problem Loans / Gross Loans | 0.0% | a3 | ←→ | baa2 | Sector concentration | | |
| Capital | | | | | | | |
| Tangible Common Equity / Risk Weighted Assets (Basel I) | | | #N/A | baa2 | Expected trend | | |
| Profitability | | | | | | | |
| Net Income / Tangible Assets | 1.0% | ba2 | ←→ | b1 | Earnings quality | | |
| Combined Solvency Score | | | | baa3 | | | |
| Liquidity | | | | | | | |
| Funding Structure | | | | | | | |
| Market Funds / Tangible Banking Assets | 75.1% | caa3 | ←→ | caa3 | Market funding quality | | |
| Liquid Resources | | | | | | | |
| Liquid Banking Assets / Tangible Banking Assets | 16.2% | ba3 | ←→ | ba3 | | | |
| Combined Liquidity Score | | b3 | | b3 | | | |
| Financial Profile | | | | ba2 | | | |
| Qualitative Adjustments | | | | Adjustment | | | |
| Business Diversification | | | | 0 | | | |
| Opacity and Complexity | | | | 0 | | | |
| Corporate Behavior | | | | 0 | | | |
| Total Qualitative Adjustments | | | | 0 | | | |
| Sovereign or Affiliate constraint | | | | Ba1 | | | |
| BCA Scorecard-indicated Outcome - Range | | | | ba1 - ba3 | | | |
| Assigned BCA | | | | ba2 | | | |
| Affiliate Support notching | | | | 0 | | | |
| Adjusted BCA | | | | ba2 | | | |

| **Instrument Class** | **Loss Given Failure notching** | **Additional notching** | **Preliminary Rating Assessment** | **Government Support notching** | **Local Currency Rating** | **Foreign Currency Rating** |
|---|---|---|---|---|---|---|
| Counterparty Risk Rating | 1 | 0 | ba1 | 0 | Ba1 | Ba1 |
| Counterparty Risk Assessment | 1 | 0 | ba1 (cr) | 0 | Ba1(cr) | |
| Senior unsecured bank debt | 0 | 0 | ba2 | 1 | Ba1 | |

*Source: Moody's Investors Service*

## Ratings

Exhibit 4

| **Category** | **Moody's Rating** |
|---|---|
| **AGENCIA FINANCIERA DE DESARROLLO** | |
| Outlook | Stable |
| Counterparty Risk Rating | Ba1/NP |
| Baseline Credit Assessment | ba2 |
| Adjusted Baseline Credit Assessment | ba2 |
| Counterparty Risk Assessment | Ba1(cr)/NP(cr) |
| Issuer Rating -Dom Curr | Ba1 |
| ST Issuer Rating -Dom Curr | NP |

*Source: Moody's Investors Service*

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