

## Corporacion Financiera de Desarrollo S.A.

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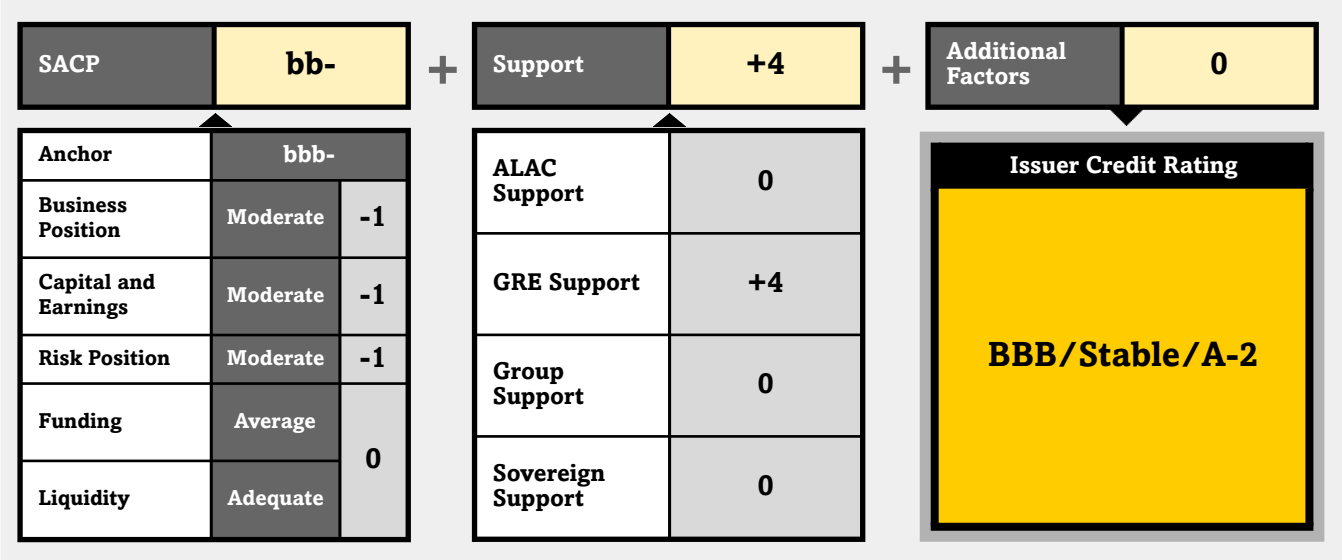
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# Corporacion Financiera de Desarrollo S.A.



## Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> <li>• Strong evidence of the government's commitment to support the bank if financial stress persists; and</li> <li>• Favorable economic growth prospects.</li> </ul>	<ul style="list-style-type: none"> <li>• Volatile asset quality metrics, although deterioration has stopped and we expect somewhat lower downside risk in Peru's infrastructure and construction sector; and</li> <li>• Credit exposure to remain concentrated by single-name and sector.</li> </ul>

## Outlook: Stable

Our revision of the outlook to stable from negative indicates our view that the bank's asset quality deterioration has stopped and our expectation of somewhat lower downside risk in the country's infrastructure and construction sector for the next 12-24 months. Moreover, we don't expect changes in the bank's credit fundamentals in the intermediate term, because it will remain an important financing tool for the government to revive Peru's infrastructure project pipeline. We expect COFIDE's credit exposure to remain single-name and sector concentrated and for it to have volatile asset quality metrics given its riskier nature, although supported by sound coverage levels.

### Downside scenario

We could lower the ratings in the next 12-24 months if its provision requirements or business stability worsen more than we expect due to difficulties in restarting infrastructure projects in Peru after the impact from corruption scandals related to the Lava Jato investigation in Brazil. Higher risk could stem from faster-than-expected asset quality erosion or delays in infrastructure investments because of ongoing corruption investigations. We could also lower the rating if we see setbacks on the measures taken to address aggressive risk tolerances and poor internal controls.

### Upside scenario

We don't expect relevant changes in the bank's credit fundamentals in the next year or so. A rating change would have to combine better prospects for the industry sector and strategic shifts in the bank's risk management that would lead to a more diversified and less vulnerable credit portfolio. In addition, we could upgrade the bank if it's able to consistently maintain a risk-adjusted capital (RAC) ratio above 7%, which we only expect to be sustainable if its profitability improves or if the entity is able to sell part of its shares in Corporacion Andina de Fomento (CAF).

## Rationale

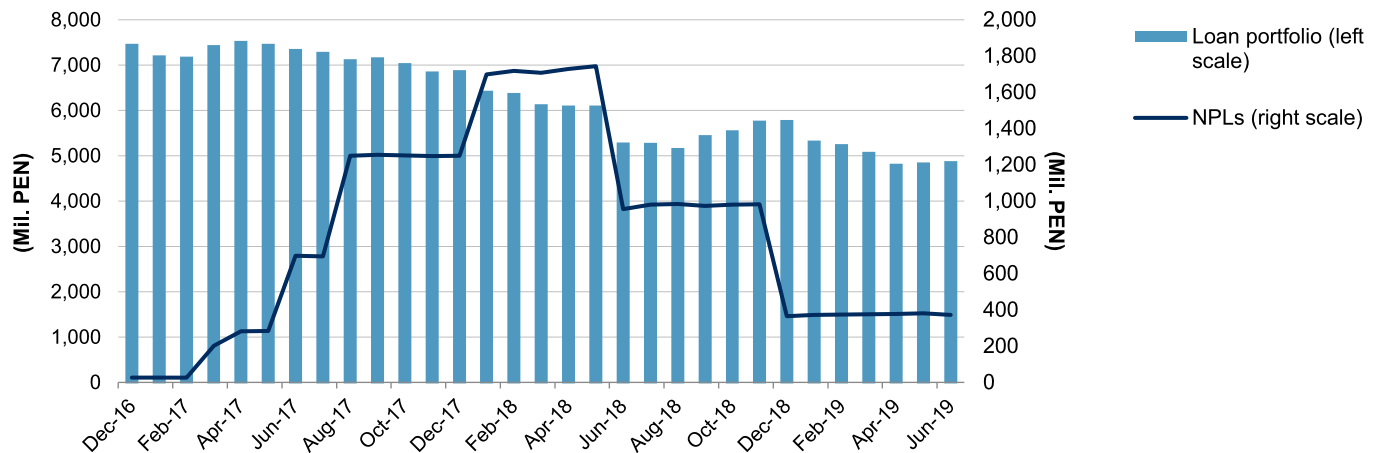
In the last two years, COFIDE's credit fundamentals have been hampered by the Lava Jato corruption probe in Brazil, which spread to Peru and impaired the country's infrastructure and construction sectors. In response, the government passed a decree in early 2017 with the objective of sanctioning construction companies operating in Peru that admitted, or were found guilty of, corruption. However, the decree has caused financial difficulties among construction companies because they had trouble accessing financing for their projects. As a result, infrastructure construction in Peru has ground to a halt, hurting the county's economy. To get these projects restarted, Congress passed legislation last year to replace the mentioned decree. (See "Will Peru's New Infrastructure Law Help Unshackle Economy And Provide Relief To Banks?," published May 24, 2018).

In this context, COFIDE's weakening credit profile in the last few years stems from souring loans to construction companies and affected projects with nonperforming loans (NPLs) peaking at 28.7% last year. COFIDE has a high concentration risk, with its 20 largest exposures--mostly from the infrastructure sector--representing about half of its credit portfolio and 1.5x of its common equity. The bank has increased its lending to the infrastructure sector in the past five years, mainly for energy and transportation projects. In our view, higher credit exposure to and concentration in complex corporate and legal structures have impaired its financial and operating performance, and we continue to

incorporate this risk into our analysis.

**Chart 1**

**Total Loan Portfolio Versus NPLs**  
NPLs under the SBS Criteria



Source: S&P Global Ratings.  
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COFIDE's credit losses and capitalization levels performed in line with our last forecast, thanks to the government's financial support: it injected about \$170 million into COFIDE in the last two years. The bank's management has presented a capital enhancement plan to address rising provision needs, which has allowed the bank to keep its RAC ratio above 5%, while addressing corporate governance issues. We now forecast the RAC ratio to be close to 6% in the next two years. Healthier financial conditions should allow the bank to gradually resume credit origination, although this would also rely on stronger recovery of Peru's new projects pipeline and private investments. The bank doesn't have large liquidity needs in the next 12 months.

**Anchor: 'bbb-' for banks operating in Peru**

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) economic and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for banks operating only in Peru is 'bbb-'.

Peru's economic risk reflects its low per capita GDP (about \$7,000 in 2019), manageable economic imbalance, but relatively high exposure to foreign-currency lending and to lending to cyclical small and midsize enterprises (SMEs). We forecast real GDP growth of 3.4% for 2019 and rising toward 4% by 2021. Credit growth has picked up in 2018 thanks to improved investor and business confidence, but political and corruption turmoil, combined with social conflicts such as Las Bambas mines blockade, have weakened investor confidence. Foreign currency lending has remained relatively stable (about 27.5% of total loans as of April 2019) and lending to construction companies has begun to pick up.

In general, we consider the industry risk for banks operating in Peru to be lower than that of its international peers in the same BICRA group. We believe Peru has a sound regulatory framework, with ample supervisory coverage and periodic risk-based supervision under a highly professional regulator. Both the central bank and Superintendencia de Banca y Seguros (SBS)--which regulates banks and insurance companies--are very active. Moreover, Peru is fairly far along in implementing Basel III standards tailored for the domestic financial system. Peruvian banks have benefited from strong profitability and adequate capitalization levels. We also believe the country's financial system has a healthy and diversified funding mix with a significant share of deposits from loyal customers, as well as strong government support to provide liquidity if needed.

**Table 1**

Corporacion Financiera de Desarrollo S.A. Key Figures					
	--Year-ended Dec. 31--				
(Mil. PEN)	2019*	2018	2017	2016	2015
Adjusted assets	11,384.6	11,115.9	11,970.1	13,432.3	13,539.0
Customer loans (gross)	4,887.5	5,803.7	6,867.5	7,841.4	7,950.9
Adjusted common equity	1,929.9	1,922.8	1,908.8	2,441.6	2,392.6
Operating revenues	54.9	124.2	140.3	227.6	218.5
Noninterest expenses	35.5	68.6	75.3	81.6	76.6
Core earnings	7.6	14.3	1.7	83.1	82.3

\*Data as of June 30. PEN--Peruvian nuevo sol.

### **Business position: Difficulties raising revenue amid stagnant conditions in the infrastructure sector**

Our view of COFIDE's business position reflects its weaker risk and financial management controls than those of its industry peers. Since September 2016, the new management has focused on overhauling the risk management strategy and raising provisioning. COFIDE has increased its lending to the construction sector in the past five years, mainly for energy and transportation projects. In our view, higher credit exposure to and concentration in complex corporate and legal structures have recently impaired financial and operating performance. Despite management's measures to address aggressive risk tolerances and poor internal controls, we believe that the controlling ownership may still negatively influence strategic decisions made as a result of COFIDE's role in promoting infrastructure investments in the country amid increasing structural rigidities and private investment scrutiny.

COFIDE's business position also reflects its role in fulfilling Peru's considerable infrastructure needs as the only development bank in the country and the second-largest government-owned bank with about 2% of the market share in terms of loans. It has a 33% market share among public banks. COFIDE's long-term financing of infrastructure projects and corporate lending constitute roughly 75% of its lending exposure, while the remaining exposures are SME loans through other financial institutions, such as banks, municipal and rural entities, and credit unions. We expect the lending mix to remain stable for the next two years. However, COFIDE's lower net interest margins (NIMs) and increasing credit loss provisions over the past few quarters have dented its bottom-line results. In our view, stronger financial results depend on the success of the new infrastructure law's capacity to stanch the problems in the construction and infrastructure sector, which could help get projects back on track and revive the country's infrastructure program. Meanwhile, we continue to monitor for any potentially problematic exposures for the bank.

**Table 2**

<b>Corporacion Financiera de Desarrollo S.A. Business Position</b>					
	<b>--Year-ended Dec. 31--</b>				
<b>(%)</b>	<b>2019*</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
Return on average common equity	0.8	0.9	0.2	2.8	3.3

\*Data as of June 30.

**Capital and earnings: Recent developments are in line with our forecast assumptions.**

We continue to forecast that the RAC ratio will average 6%% in the next two years. The bank's capitalization levels have remained above 5% because the government's support has compensated for the rising credit loss provisioning. In addition, we continue to believe that the government will provide capital in exchange for COFIDE's shares in Corporacion Andina de Fomento (CAF) to cover unexpected losses, which could boost capitalization metrics if financial difficulties persist.

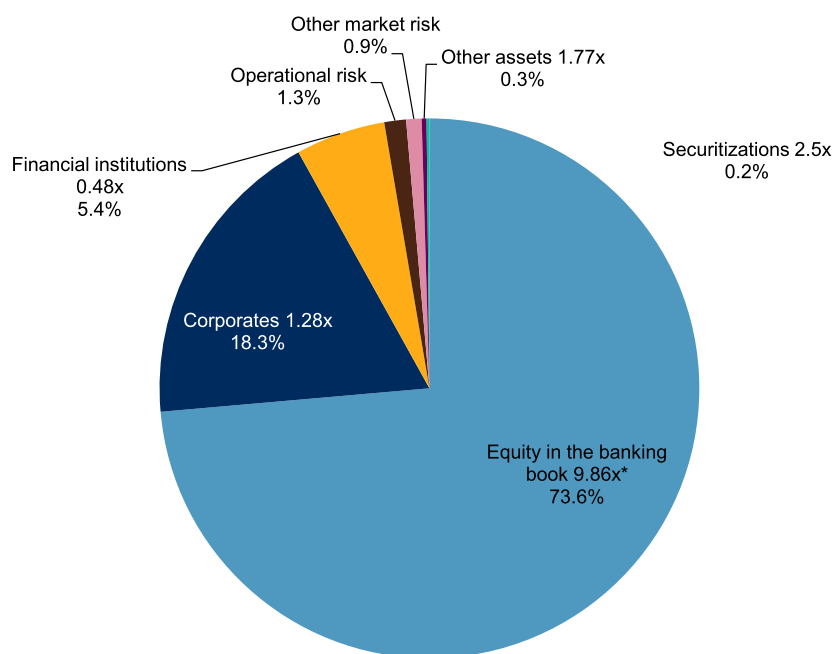
Our base-case scenario assumes the following factors:

- Peru's GDP growth of 3.4% for 2019 and 3.7% for 2020.
- Customer loans to contract about 10% in 2019, due to pre-payments and slow credit origination, and to grow 10% in 2020 amid the likely recovery in the infrastructure sector in the intermediate term.
- Weak NIMs, below 1%, given the still high delinquency levels that impair loan payments and interest collection.
- Credit loss provisions to stabilize this year and the bank to keep its loan-loss coverage at least above 100%.
- Retention of 100% of net income in the next two years.

**Chart 2**

**Risk-Weighted Assets Breakdown**

As of December 2018



\*Ratios in the labels refer to the weights for each category in our RAC (Risk-Adjusted Capital) Framework. Source: S&P Global Ratings. Copyright © 2019 by Standard & Poor's Financial Services LLC. All rights reserved.

**Table 3**

**Corporacion Financiera de Desarrollo S.A. Capital And Earnings**

(%)	--Year-ended Dec. 31--				
	2019*	2018	2017	2016	2015
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	75.9	76.8	78.7	82.8	84.3
Fee income/operating revenues	24.1	23.2	21.3	17.2	15.1
Noninterest expenses/operating revenues	64.7	55.2	53.7	35.8	35.1
Preprovision operating income/average assets	0.3	0.5	0.5	1.1	1.2
Core earnings/average managed assets	0.1	0.1	0.0	0.6	0.7

\*Data as of June 30.

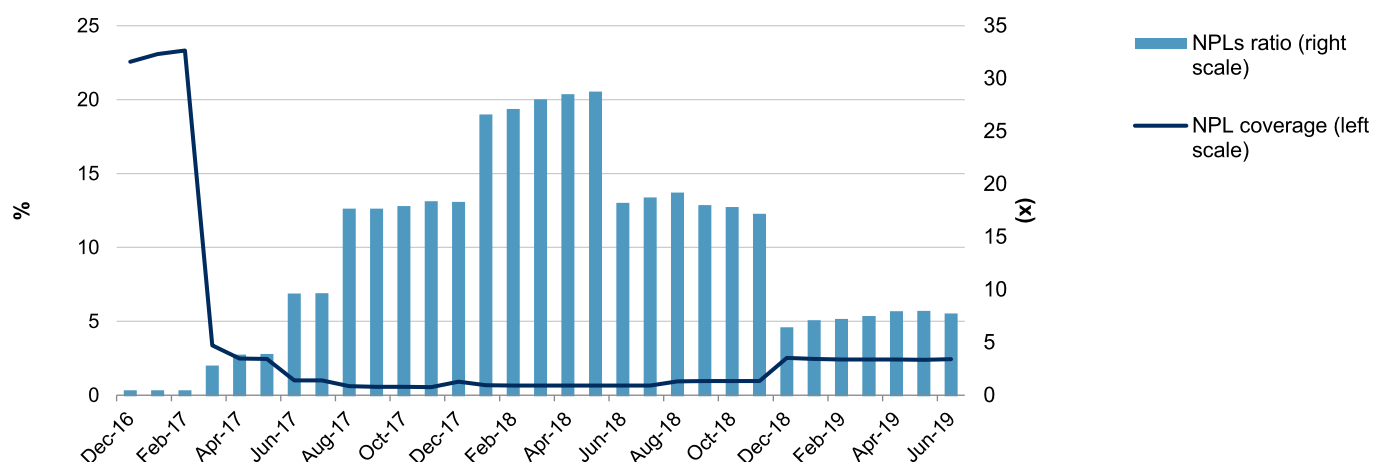
**Risk position: Volatile asset quality, high concentration in infrastructure projects, and overestimation of capital charges**

COFIDE ended the first half of the year with NPLs at 7.6% of its credit portfolio, stable in nominal terms compared to 2018 year-end figures. The improvement in asset quality is explained by the charge-off of troubled projects: Gasoducto Sur Peruano (\$140 million), Líneas de Transmisión Peruanas (\$63 million), and Generadora Eléctrica Molloco (\$30 million). In addition, the rest of the drop in NPLs reflects the ongoing negotiation over the loan to Consorcio

Corredores Segregados de Buses de Alta Capacidad (COSAC). However, we still see challenges stemming from ongoing negotiations over problematic loans and sluggish recovery of Peru's infrastructure and construction sectors, which could make asset quality metrics volatile.

**Chart 3**

**Selected Asset Quality Metrics Evolution**  
NPLs under the SBS Criteria



Source: S&P Global Ratings.

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In line with its role to promote infrastructure in Peru, COFIDE usually finances more complex projects than the market is willing to invest in, which may carry construction risk and greater cash flow sensitivity. Our base-case scenario considers that NPLs could rise up to nominal levels of PEN950 million, considering existing problematic loans (mainly the loans to COSAC and Minera IRL). Although we currently don't foresee that its other loans for projects will run into difficulties, we deem the bank's concentration in infrastructure lending as high, which could potentially further weaken the asset quality indicators. Nonetheless, these risks are mitigated by our expectation that the government would provide capital in exchange for the bank's shares in CAF. We still believe that our RAC ratio overestimates COFIDE's risks relative to those of its peers, supporting the bank's current risk position assessment.

**Table 4**

Corporacion Financiera de Desarrollo S.A. Risk Position					
	--Year-ended Dec. 31--				
(%)	2019*	2018	2017	2016	2015
Growth in customer loans	(31.6)	(15.5)	(12.4)	(1.4)	37.3
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	118.0	105.2	97.3	N/A
Total managed assets/adjusted common equity (x)	5.9	5.8	6.3	5.5	5.7
New loan loss provisions/average customer loans	0.3	0.5	0.8	(0.2)	0.9
Net charge-offs/average customer loans	(0.7)	10.9	(0.0)	(0.0)	(0.0)
Gross nonperforming assets/customer loans + other real estate owned	7.6	6.3	18.2	0.3	0.7



**Table 4**

<b>Corporacion Financiera de Desarrollo S.A. Risk Position (cont.)</b>					
<b>(%)</b>	<b>--Year-ended Dec. 31--</b>				
	<b>2019*</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
Loan loss reserves/gross nonperforming assets	243.9	253.0	91.2	2,255.6	1,105.1

\*Data as of June 30. N/A--Not applicable.

### **Funding and liquidity: Long-term debt maturity profile has supported liquidity amid financial deterioration**

The bank's funding assessment reflects its stable funding ratio (SFR) of 109% as of June 2019 (103% on average for the past three years), similar to that of the majority of Peruvian banks. Our baseline expectation is that COFIDE's SFR will be above 100% for the next two years. Unlike private banks, COFIDE isn't allowed to receive deposits. However, its financial flexibility benefits from the government's ongoing support, allowing COFIDE to refinance its debt, as seen in the strong demand for its issuances. Although the bank receives higher-than-average external funding, we believe it has an adequate funding profile, given the latter's long-term nature required for the loans. We expect the bank to continue matching tenors and currencies on its balance sheet to mitigate risks. As of June 2019, the bank's funding consisted of debt issuances in international capital markets (65%), loans from Peruvian commercial banks (17%), debt from local capital markets (11%), credit lines from multilateral lending organizations (4%), and loans from international commercial banks (3%).

COFIDE continues to maintain a sufficient liquidity cushion to cope with unexpected cash outflows over the next 12 months. Its broad liquid assets covered 1.46x of its short-term wholesale funding. The debt maturity profile provides the bank sufficient time to manage its liquidity risk. COFIDE's international bonds' next due date is mid-2022. We expect the bank to hold its currently comfortable liquidity position to cope with those obligations amid the slow lending pace.

**Table 5**

<b>Corporacion Financiera de Desarrollo S.A. Funding And Liquidity</b>					
<b>(%)</b>	<b>--Year-ended Dec. 31--</b>				
	<b>2019*</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
Core deposits/funding base	0.0	0.0	0.0	0.0	0.3
Customer loans (net)/customer deposits	N.M.	N.M.	N.M.	N.M.	22,448.1
Long-term funding ratio	74.9	75.8	89.8	87.4	81.3
Stable funding ratio	109.2	97.3	109.2	103.0	99.5
Short-term wholesale funding/funding base	30.9	29.6	12.5	16.3	23.6
Broad liquid assets/short-term wholesale funding (x)	1.5	1.1	2.6	1.7	1.2
Net broad liquid assets/short-term customer deposits	N.M.	N.M.	N.M.	N.M.	1,476.8
Short-term wholesale funding/total wholesale funding	30.9	29.6	12.5	16.3	23.6

\*Data as of June 30. N.M.--Not meaningful.

### **Support: Very high likelihood of government support**

Our assessment of the likelihood of extraordinary government support reflects COFIDE's increasing role in meeting the government's key economic objectives and greater evidence of government support. For the government,

developing infrastructure is one of the main priorities to boost economic growth and productivity for the next few years. Therefore, COFIDE is an important financing tool in restarting the pipeline of projects and compensating for the drop in private investments in Peru.

The government's explicit commitment to supporting the bank corroborates our review of this assessment. On May 23, 2017, the government announced its intention to buy up to 20% of the bank's shares in CAF in the next four years, if needed. On July 4, 2017, Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado (FONAFE) approved the retention of the bank's 2016-2018 net income. In November 2017, FONAFE injected \$18 million into the bank, then injected \$102 million in January 2018, and finally injected \$51 million in May 2018.

## **Related Criteria**

- General Criteria: Group Rating Methodology, July 1, 2019
- 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: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## **Related Research**

- Banking Industry Country Risk Assessment: Peru, July 17, 2019

Anchor Matrix										
Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

### Ratings Detail (As Of August 23, 2019)\*

#### Corporacion Financiera de Desarrollo S.A.

Issuer Credit Rating BBB/Stable/A-2

Senior Unsecured BBB

Subordinated BBB-

#### Issuer Credit Ratings History

13-Aug-2019 BBB/Stable/A-2

17-Aug-2017 BBB/Negative/A-2

20-Aug-2013 BBB+/Stable/A-2

#### Sovereign Rating

Peru

*Foreign Currency* BBB+/Stable/A-2

*Local Currency* A-/Stable/A-2

#### Related Entities

##### Fondo Mivivienda S.A.

Issuer Credit Rating BBB+/Stable/--

Senior Unsecured BBB+

##### Peru

Issuer Credit Rating

*Foreign Currency* BBB+/Stable/A-2

*Local Currency* A-/Stable/A-2

Certificate Of Deposit

*Local Currency* A-2

Senior Unsecured A-

Senior Unsecured BBB+

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.



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