Moody's

**Rating Action:** **Moody's affirms CDB's Aa1 rating; maintains stable outlook**

24 Jul 2023

New York, July 24, 2023 -- Moody's Investors Service, ("Moody's") has today affirmed the Caribbean Development Bank (CDB)'s Aa1 long-term issuer and senior unsecured bond ratings, and maintained the stable outlook.

The decision to affirm the ratings and maintain the stable outlook reflects the following considerations:

• Strong credit metrics, including high capital and liquidity position, balance weak asset quality

• CDB's strong regional presence and focus on supporting climate resilience in member countries drive strong membership support

RATINGS RATIONALE

RATIONALE FOR THE AFFIRMATION OF CDB's Aa1 RATING

FIRST DRIVER – STRONG CREDIT METRICS, INCLUDING HIGH CAPITAL AND LIQUIDITY POSITION, BALANCE WEAK ASSET QUALITY

CDB has low leverage and solid capital at its disposal, which is appropriate given its concentration in the Caribbean region and the weak credit quality of its borrowing members. At the end of 2022, the leverage ratio increased to 1.57x from 1.4x in 2021 due to higher disbursements, but remains below the Aa-rated median. Moody's expects the leverage ratio to drop again in 2023 and reach 1.18x by the end of 2024, below the policy limit of 1.65x, based on its expectation of loan repayments in the coming year.

Moody's considers CDB's liquidity position to be strong, which reflects the bank's holding of ample liquidity which has steadily improved over the past five years and is in line with similarly-rated peers. CDB's objective is to ensure that it can meet all foreseeable funding commitments when due with ready access to capital markets. To this end, the Bank maintains a portfolio of highly liquid assets, which are invested in highly-rated assets. Access to liquidity is further ensured by maintaining a diversified funding base and auxiliary access to liquidity facilities from large commercial banks. Since 2015, liquid assets provided more than four times coverage of short-term and currently-maturing long-term debt on average, reflecting a relatively modest debt stock and a favorable maturity profile.

The strength of the CDB's capital and liquidity positions mitigates the risks stemming from high portfolio concentration and overall weak borrower creditworthiness. The CDB's regional mandate leads to high geographical concentration, where a majority of its borrowing members have experienced shocks and declining creditworthiness. However, despite recent histories of default, members have consistently remained current on their debt obligations to the CDB, a reflection of the bank's strong role in the region and preferred creditor status. The CDB also has very low non-performing assets on its lending portfolio which comprises one counterparty on its private loan portfolio. To reduce the impact of its highly-concentrated portfolio on its balance sheet, the CDB is in discussions with one of its non-borrowing shareholders on the provision of a credit guarantee to increase the CDB's lending capacity by releasing risk-weighted capital. Other options to reduce balance sheet risk under consideration include private sector insurance that would cover the risk of non-payment and exposure exchange agreements with other MDBs with operations in other regions.

The CDB's weighted average borrowing rating (WABR) remained at Caa1 in 2022, up from Caa2 in 2019 as the bank diversified its lending portfolio. Moody's expects incremental improvement in the CDB's asset quality given the improved outlook for some of its largest borrowers as economies have rebounded from the pandemic. Ongoing efforts to expand the Bank's membership to higher-rated sovereigns would also improve asset quality. Despite this improvement, the overall credit quality of the CDB's loan portfolio will remain low, constrained by the relatively weak sovereign credit profiles in the region.

SECOND DRIVER – CDB'S REGIONAL MANDATE AND FOCUS ON SUPPORTING CLIMATE RESILIENCE IN MEMBER COUNTRIES DRIVE STRONG MEMBERSHIP SUPPORT

The CDB plays an important role as key development partner in the Caribbean region and enjoys high support from its borrowing and non-borrowing members. Non-borrowing members and development partners, including donor countries and multilateral development agencies see the CDB as a key partner in the region and a gateway to extend support to the Caribbean region, given the Bank's strong presence and close ties with borrowing-member countries. Although borrowing members are constrained in providing additional financial support, they have remained current on their payment obligations to the CDB and despite multiple sovereign defaults in the region, the CDB did not experience any missed loan payment. Non-regional members, such as Canada and the UK have demonstrated their support and channeled assistance to the region through the CDB during times of regional stress, such as hurricanes.

Between 1983-2019, the bank's membership has made $1.4 billion available to CDB through the Special Development Fund (SDF), its largest pool of concessionary funds. More recently, in February 2021, member countrie increased their concessional funding through the 10th replenishment of SDF (2021-24 period), approving a $383mn program to finance social, economic and environmental resilience.

CDB's lending and programs have a strong focus on assisting members address climate risk and adaptation to climate change, where environmental sustainability and climate resilience actions are integrated into CDB's operations. This focus on mitigating climate risks has attracted donor and membership support for the CDB through a number of initiatives. Moody's expects the CDB will continue to play an important role in channeling funding and expertise towards building resilience to climate change and investing in infrastructure in the Caribbean, which will contribute to members' support.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects Moody's assessment that conservative risk management practices and continued compliance with the CDB's internal risk management guidelines will restore the bank's capital adequacy ratio to 24%, maintaining the bank's strong capital and liquidity metrics.

At the end of 2022, the CDB's capital adequacy ratio dropped to 23.3%, just below the capital adequacy target of 24%, as a result of unrealized losses on its derivatives and investment portfolios. In response to these losses, CDB instituted a hedging account in relation to its derivatives position in October 2022 to dampen the impact of market volatility on its balance sheet. The Board of Directors granted a temporary waiver for the breach until the end of 2023. The CDB is in compliance with all other risk management thresholds as of May 31, 2023. Moody's expects the CDB's capital position will recover to the target by the end of this year as mandated by its Board.

The stable outlook also reflects CDB's continued efforts to reduce portfolio concentration through ongoing efforts to attract new members, and the potential improvement in the weighted average of the credit quality of its borrowing members. Portfolio concentration is also contained by the Bank's existing single exposure limits, mitigating the credit risk and high regional concentration of its loan portfolio.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

CDB's credit impact score (CIS-2) reflects moderately negative exposure to environmental risks which is mitigated by financial and governance capacity. Resilience is supported by CDB's committed shareholder base, in addition to financial support from non-regional members and other funding sources from non-regional development agencies, which is often channeled through the CDB as an active MDB in the region.

Environmental considerations are material for the CDB's rating. CDB's environmental issuer profile score (E-3) signals exposure to climate risks. This reflects primarily exposure to physical climate risk because of portfolio concentration in the Caribbean region that is subject to extreme weather events, which may weaken the CDB's asset quality. CDB's top sovereign borrowers have high environmental risk scores denoting the fact that they are prone to severe physical climate-related shocks. The CDB conducts systematic screening of all investment projects for climate and disaster risks, and finances programs that provide structural and nature based solutions to climate risks, and assists borrowing members develop climate resilience strategies.

CDB's neutral-to-low social issuer profile score (S-2) reflects strong customer relations with its borrowers and its financial relevance to the region where its lending products have effectively addressed specific needs of its members.

CDB's governance issuer profile score of neutral-to-low (G-2) is based on conservative risk management policies that have proved effective in limiting and managing risks associated with its lending portfolio. Risk management practices also mitigate some of the CDB's portfolio exposure to climate risk. Although the CDB experienced a decline in its capital adequacy ratio last year, Moody's maintains its assessment of the governance strength based on remedial action already taken and expectations of quick resolution of the target breach.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

WHAT COULD CHANGE THE RATING UP

The rating could be upgraded if the average quality of the CDB's borrowers were to improve materially and the concentration of its loan book were to decline significantly. Given the bank's mission to serve the Caribbean, coupled with the economic and financial challenges facing the region, we view this as unlikely in the medium term, notwithstanding management's plans to increase lending to higher rated members.

WHAT COULD CHANGE THE RATING DOWN

The rating could face downward pressure if the bank's capitalization and/or liquidity metrics were to deteriorate materially for an extended period of time. Such a deterioration could emerge as a result of significant losses or impairments on the bank's loan portfolio, or if the bank fails to comply with or weaken its prudential financial policies. A repeated breach of internal risk management targets or financial policies would signal weakening risk management and could also lead to a downgrade. Evidence of waning support from non-regional members and donors would likely also place downward pressure on the rating.

The principal methodology used in these ratings was Multilateral Development Banks and Other Supranational Entities Methodology published in October 2020 and available at https://ratings.moodys.com/rmc-documents/69182. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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