

### Research Update:

## Inter-American Investment Corp. Long-Term Rating Raised To 'AA' From 'AA-'; Outlook Stable

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## Overview

- The Inter-American Investment Corp.'s improved strategic and operational profile over the past years--coupled with better risk management--has increased the company's financial resilience.
- At the same time, strong support from the shareholders (including the ongoing clearance of capital payment arrears by the U.S.) reflects their recognition of the IIC's important mandate and the developmental impact of its operations.
- As a result, we have raised the long-term issuer credit rating on the corporation to 'AA' from 'AA-'.
- The outlook is stable, reflecting the balance of IIC's strengthened credit profile and its continuing difficult mandate.

## Rating Action

On July 29, 2010, Standard & Poor's Ratings Services raised its long-term credit rating on the Inter-American Investment Corp. (IIC) to 'AA' from 'AA-'. At the same time, Standard & Poor's affirmed its 'A-1+' short-term credit rating on the corporation. The outlook is stable.

## Rationale

The upgrade reflects the corporation's increased financial resilience and effective risk-management policies, as its ability to preserve its strong credit profile throughout the global economic downturn demonstrates. Latin America, where IIC's operations are concentrated, was spared the worst effects of the global economic downturn. However, the downturn undoubtedly affected the Caribbean and Central American regions, vulnerable small and medium-size enterprises (SMEs) in Latin America, and financial markets, in general. In light of this, we believe the IIC's ability to preserve its financial performance, a result of the positive operational and strategic transformation which started in early 2000s, is notable.

In the economically difficult last two years, the company has maintained relatively stable asset quality and good capitalization. In addition, it has proactively managed its investment, liquidity, and credit risks while maximizing the developmental impact of its operations. Although the corporation's small size and its challenging mandate remain inherent credit constraints, the IIC's improved financial fundamentals, more flexible policies, and new strategic framework better enable the corporation to meet its operational goals while maintaining a solid credit profile. The ongoing

support for the IIC's mandate from the board and the corporation's members (as the ongoing repayment of arrears on capital contribution by the U.S., among other things, demonstrates) gives further strength to the IIC's credit standing.

IIC began operations in 1989 with a mandate to finance the establishment, expansion, and modernization of SMEs. It had 44 member countries at year-end 2009, including all the Inter-American Development Bank's Latin American and Caribbean member countries. IIC is the second smallest (by assets and shareholders' equity) multilateral development finance institution (MDFI) that Standard & Poor's rates. The corporation's shareholders' equity was US\$759 million at year-end 2009. Its total assets at year-end 2009 were US\$1.42 billion, of which US\$858 million were loans and US\$32 million were equity investments.

IIC's enhanced risk-management strategies better positioned the company to face the ongoing economic downturn in terms of loan portfolio quality, provisioning, liquidity, and funding. Impaired loans increased manageably to 3.6% of total loans in 2009 from 0.1% 2008. In dollar terms, the impaired loans have increased to US\$31 million by December 2009 from US\$1 million at year-end 2008 and were stable until IIC wrote-off an US\$11 million loan in June 2010. This decreased the impaired loans to 2.2% of total loans, which is better performance than many private-sector lending MDFIs (when compared to their private-sector lending portfolio). Importantly, two impaired loans totaling US\$25 million (more than 80% of the total impaired loans at year-end 2009) were in this status for reasons unrelated to the economic crisis. Also worth mentioning is that no new loans have become impaired since September 2009. The loan loss allowance was roughly 181% of nonaccrual loans and 213% of impaired loans at year-end 2009. Though lower than in 2008, it is a solid level compared with those of most multilateral institutions (MLIs).

IIC prepared itself to face the difficult external conditions by more than doubling its cash and trading investments to US\$424 million in 2008 compared with 2007. These liquid assets increased to \$430 million by year-end 2009. In addition, IIC had close to US\$750 million of undrawn balances in various committed credit facilities (including the credit facility with the Inter-American Development Bank) as of December 2009. That compares with the US\$646 million in outstanding borrowings in December 2009 (of which US\$110 million is due by the end of this year). The amortization profile for the next four years is smooth.

IIC has also entered the global economic downturn with a strengthened capital base, a result of the 1999 decision by the corporation's members to increase IIC's paid-in capital to US\$703.7 million (and then further to US\$705.9 million in 2008) from US\$203.7 million. Ninety-four percent of the approved capital increase was paid by July 2010. Outstanding contributions from the U.S. and Costa Rica should increase the IIC's paid-in capital further over the next two years. Capitalization ratios continue to favorably distinguish IIC from other MLIs. IIC's ratio of provisions for losses plus shareholders' equity (its narrow risk-bearing capacity) to development-related exposure (comprising loans, equity investments, and guarantees) was 92% at year-end 2009, up from 85% in 2008 and among the highest for rated MDFIs.

IIC's net income fell in 2009 to US\$5 million from US\$14 million in 2008 as lower income on investments and loans more than offset reduced borrowing

costs. The return on average assets was 0.4% in 2009, down from 1% the year before. Many factors influencing IIC's weaker profitability in 2008-2009 were cyclical (lower interest rate environment and higher provisions), and we expect that its profitability will turn around in 2010. In fact, the company recorded net income of US\$6.1 million in the first half of 2010 (according to provisional numbers), higher than for all of 2009.

Despite steps taken to improve its financial profile, IIC continues to operate under a difficult model: maintaining the value of shareholders' capital while maximizing the developmental impact of its operations. Because of its relatively small size, IIC continues to suffer from diseconomies of scale and be challenged in its ability to provide a meaningful developmental impact compared with larger institutions. To address this challenge, the IIC has changed some of its operational guidelines and introduced a portfolio approach, in which it evaluates each individual project according to its development impact and financial contribution. IIC shareholders regard this system favorably.

## Outlook

The stable outlook reflects the balance between the IIC's strengthened financial profile and improved risk management, boosting the company's financial resilience, on one hand, and the difficult operating environment and challenging mandate, on the other. The ongoing support for the IIC's mandate from the board and the corporation's members helps the company navigate the challenging market environment. Downward pressures on the rating will emerge if the corporation's asset quality were to deteriorate materially or if the capitalization ratios were to worsen (as a result of less conservative leverage policies, for instance). We will also monitor risks that might stem from the likely change in the IIC's upper management in 2012. Upward pressure on the rating would correlate with a meaningful increase in the corporation's capital that would allow it further increase its developmental impact in the region.

## Related Criteria And Research

- Criteria For Multilateral Lending Institutions, Oct. 19, 2007.

## Ratings List

Upgraded

	To	From
Inter-American Investment Corporation		
Issuer Credit Rating		
Foreign Currency	AA/Stable/A-1+	AA-/Positive/A-1+
Senior Unsecured	AA	AA-

Complete ratings information is available to RatingsDirect on the Global Credit Portal subscribers at [www.globalcreditportal.com](http://www.globalcreditportal.com) and RatingsDirect subscribers at [www.ratingsdirect.com](http://www.ratingsdirect.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at

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