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Research Update:

**Societe de Promotion et de
Participation pour la Cooperation
Economique Rated 'AA/A-1+';
Outlook Stable**

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Societe de Promotion et de Participation pour la Cooperation Economique Rated 'AA/A-1+'; Outlook Stable

Overview

- We consider that French financing agency Société de Promotion et de Participation pour la Coopération Economique (Proparco) is strongly integrated within the Agence Française de Développement (AFD) group, and we view it as a core subsidiary of AFD.
- In our view, Proparco would receive timely extraordinary financial support from its main owner AFD if needed.
- We are consequently assigning our 'AA/A-1+' ratings to Proparco, in line with those on AFD.
- The outlook on Proparco is stable, mirroring that on AFD and reflecting our view that the subsidiary will remain core to AFD.

Rating Action

On Feb. 16, 2018, S&P Global Ratings assigned its 'AA' long-term and 'A-1+' short-term issuer credit ratings to French financing institution Société de Promotion et de Participation pour la Coopération Economique (Proparco). The outlook is stable.

Rationale

We equalize our ratings on Proparco with those on its main owner Agence Française de Développement (AFD; AA/Stable/A-1+), which itself is owned by the French government. Proparco's very close integration within and extremely high strategic importance to AFD underpins our assessment. We regard Proparco as core to AFD and consider that there's an almost certain likelihood of financial support from the group to Proparco under almost all foreseeable circumstances.

In operation for more than 40 years, Proparco has a balance sheet exceeding €5 billion and its size is growing. AFD, which is the legally mandated agency for the French government's strategic policy of bilateral aid and concessionary lending to developing countries and French overseas territories, owns 64.9% of Proparco. Other shareholders are private and development banks. Proparco acts as a subsidiary to fund and acquire equity stakes in the private sector in developing countries. It has developed solid experience in specific geographic areas, with the help of its private banking partners.

Following the 2015 United Nations Climate Change Conference, or COP 21 summit, and in line with French diplomatic policy, AFD's activity is poised to increase materially. Fully owned and directly controlled by public institutions, AFD has committed to achieve €12.7 billion of annual commitments in 2020, versus almost €9.4 billion in 2016. It will likely focus its activities on Sub-Saharan Africa and Mediterranean countries, and on sustainable and ecological projects.

We consider Proparco's development to be fully in line with its main parent's overall strategy. In recent years, strengthening the private sector has become a crucial goal for many development financial institutions including AFD. Proparco's loan and equity portfolios show a predominance to Sub-Saharan Africa (around 35% of the total as of year-end 2016) and the Middle East and North Africa (20% for loans and 25% of total for equity as of year-end 2016). Furthermore, Proparco has indicated it intends to achieve €6.8 billion of commitments over 2017-2020 (of which 40% are earmarked for Africa). It primarily funds financial institutions (51%), infrastructure projects (32%), and corporates (17%). As regards equity stakes, the main sectors are funds (43%), other financial institutions (26%), corporates (19%), and infrastructure (12%). As a financial institution, Proparco is regulated by The Autorité de Contrôle Prudentiel et de Résolution (ACPR). The supervision is performed directly via the AFD, itself a financial institution.

We view Proparco as a non-severable part of AFD, underpinning our assessment of it as a core subsidiary within the group. We take into account:

- Proparco's total strategic alignment with AFD (even though businesses at the two agencies differ in nature);
- AFD's role as sole source of funding for Proparco;
- Their myriad of shared resources (IT, human resources, and accounting/monitoring, among others); and
- The coordinated relationship between the two entities with respect to their risk framework and financial planning (including capital support).

Proparco reported net income of €60 million for the year ended Dec. 31, 2016, and has not registered substantial losses in recent years. Still, net income could be hindered by substantial capital gains or losses on its equity portfolio. We consequently estimate Proparco's core earnings at about €40 million in 2017-2018. We expect modest profitability in the coming years, with return on equity fluctuating in the 4%-5% range. We consider that Proparco's goals for 2020 are challenging, given the stiffening competition from other financial institutions, weak private sector creditworthiness in some geographic areas, and lack of targeted projects. We expect Proparco will further develop its offering of concessional instruments to meet its objectives. Noninterest expenses are set to increase in the coming years, with necessarily elevated investments in human capital accompanying growth (including risk and compliance). The cost-to-income ratio, before capital gains on securities, will likely therefore deteriorate to 43%-45% by year-end 2019, from below 38% in 2016, albeit remaining at good level in a wider context. The lean cost structure, compared with a classic commercial bank with large branches, enables Proparco to post adequate profits despite structurally

elevate credit losses exceeding 100 basis points (bps) through the cycle, in our view (after 127 bps in 2016).

We anticipate less aggressive business growth for Proparco than for the overall AFD group. The size of total equity stakes are poised to increase, as well as loans to corporate and infrastructure projects. The Tier 1 solvency ratio stood at 15.9% in 2016, but should trend down gradually as the growth of risk-weighted assets outpaces that of retained earnings by 2020. We consider that Proparco will achieve its growth ambitions thanks to AFD's backing, and we believe AFD has enough capital on its own to support Proparco if necessary, due to Proparco small size compared with its parent. If Proparco's solvency ratio were to decline more rapidly than management expects--for instance in the event of larger credit losses than anticipated--coming closer to its minimum prudential level, we would expect AFD to provide extraordinary capital support to Proparco, enabling it to achieve its medium-term strategic goals.

We consider that Proparco is subject to greater credit risk than AFD's, primarily because Proparco does not benefit from any implicit or explicit state guarantees on its exposures. Most of the exposures are in the form of loans to developing market counterparties (mostly banks), but Proparco's equity portfolio is growing. Furthermore, as is the case for AFD, Proparco's concentration risk is material, with low granularity in its loan and equity portfolios. Nonperforming assets are mainly concentrated in the loan portfolio. As of mid-2017, arrears amount to €65.9 million, and nonperforming loans (NPLs) reached a high 5.6%, compared with 5.2% in 2016, and 4.7% in 2015. We expect the NPL ratio will remain between 5.5% and 6.0% in 2017 and 2018. In the equity portfolio, nonperforming assets represent 10.6% of the total portfolio based on historical value. We consider Proparco's coverage as adequate, but not overabundant, since it stands at 62% in the loan portfolio and 28% in the equity portfolio. Reflecting the risky nature of some counterparties and material concentration risk, credit losses could rise rapidly in the next couple of years, potentially well above 150 basis points of customer loans. AFD is in charge of hedging all of Proparco's foreign exchange risk (mostly with swaps). Still, in its equity portfolio, foreign-exchange movements affect unrealized gains or losses.

Proparco is completely funded by AFD in that Proparco's funding needs are matched by AFD in maturity and currency. We do not expect any change in the near term. This recently reapproved policy shows the extremely strong integration of Proparco inside AFD. Liquidity risk is therefore nonmaterial, in our view, even though Proparco does not hold a sizable liquidity portfolio.

Outlook

The stable outlook on Proparco mirrors that on AFD. It also reflects our view that Proparco will remain a core subsidiary of the group in the next two years. As long as we continue to assess Proparco as a core subsidiary of AFD, our ratings and outlook on Proparco will move in tandem with those on AFD.

We could therefore upgrade or downgrade Proparco in the next two years if we took a similar action on the parent, and ultimately on France.

We could consider lowering our ratings on Proparco if we observed a lessening interest or incentive from AFD to support Proparco, if needed. Although not our base-case scenario, this could happen if financing the private sector in developing markets was no longer central to AFD's strategy, or if Proparco's degree of integration within AFD (strategic alignment, full refinancing, shared risk tolerance and controls, pooling of human or IT resources, among others) substantially changed. Material changes in Proparco's funding strategy, for instance from recourse to non-group funding, or a significant decrease in AFD's ownership stake could also prompt us to reassess Proparco's subsidiary status and consequently lower our ratings.

Related Criteria

- 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
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- French Development Bank Agence Francaise de Developpement Affirmed At 'AA/A-1+'; Outlook Stable, Feb. 22, 2017

Ratings List

New Rating

Societe de Promotion et de Participation pour la Cooperation Economique
Counterparty Credit Rating AA/Stable/A-1+

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