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CREDIT GUARANTEE AND INVESTMENT FACILITY

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SUPRANATIONALS

Issuer Rating:	AAA
Outlook:	Stable

Last Review Date: 28/10/21

Company Rating History:

Date	Rating	Outlook/Alert
28/08/14	AAA	Stable

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RATIONALE

TRIS Rating affirms the issuer rating on Credit Guarantee and Investment Facility (CGIF), a trust fund of Asian Development Bank (ADB), at “AAA”, with a “stable” rating outlook. The rating reflects CGIF’s status as a supranational institution owned by the governments of the ASEAN+3 countries and ADB, together referred to as “contributors”. The rating also reflects CGIF’s very strong public policy mandate, strong governance and management expertise, solid capital position underpinned by conservative risk management as well as sound funding and liquidity profile. CGIF’s exposure to issuers and countries with relatively high credit risks given its policy mandate remains a key challenge for CGIF. Nonetheless, the risk is mitigated by its prudent underwriting standard.

KEY RATING CONSIDERATIONS

Extremely strong enterprise risk profile

CGIF was established as part of the Asian Bond Markets Initiative to fulfil an important public policy mandate as a catalyst to develop the ASEAN bond markets. CGIF’s priorities are to support bond issuers in ASEAN and the frontier markets, first-time issuers, cross-border issuers that issue bonds in local currency as well as newly developed financing activities. The latter includes, for instance, green bonds, social bonds, and sukuk. As such, we do not expect other private financial guarantors or supranational institutions to easily fulfil this role.

Continuous payment for subscription of new shares under the capital increase program from contributors indicates the strong and stable relationship CGIF has with the shareholders and their commitment to CGIF’s development objectives. The diverse shareholding structure and zero-dividend practice to date also imply strong governance principles. The capital increase follows the approval of CGIF’s contributors in 2017 to raise paid-up capital on an uncommitted basis to USD1.2 billion by 2023 from USD700 million to support business expansion. The paid-up capital was USD1.1 billion as of 30 June 2022.

In terms of management expertise, CGIF’s management team has been able to meet performance benchmarks and operate within risk-return targets. These include meeting financial targets and maintaining portfolio quality based on its internal risk rating (IRR). The executive and professional staff at CGIF comprise a diversified team of internationally recruited qualified personnel.

Solid capital buffer

In our view, CGIF has a very strong capital buffer to absorb potential losses from guarantee calls. This is despite an absence of callable capital. Its guarantee exposure was a conservative 1.28 times of total capital as of June 2022, down from 1.42 times as of June 2021 because some guarantees have expired and capital has been strengthened. In view of CGIF’s conservative growth strategy, it is unlikely that the figure will reach the internal limit of 2.5 times in the next few years. CGIF’s reported Basel-II equivalent capital adequacy ratio was 35.7% as of June 2022, up from 29.4% as of June 2021. These were well above the internal floor of 8.8%.

Conservative risk management and expansion

In our view, CGIF's conservative growth strategy and continuous enhancements of its enterprise risk management framework are instrumental in containing the risk of future guarantee calls and other types of risks. The framework contains detailed guidelines of the guarantee process and well-defined risk limits. These range from credit risk assessment, setting of guarantee fees, classification of and provisioning for guarantee exposure, and reinsurance policy. There are also guidelines on guarantee exposure monitoring, claim servicing and loss recovery.

CGIF recently updated multiple guidelines on the credit and operational risk monitoring after the first guarantee call of KNM Group Berhad's (KNM) THB bonds. One notable enhancement was the detailed guidelines for defaulted guarantees relating to loss recoveries, monitoring, and classification and provisioning. Amid challenging business environments post-COVID-19, CGIF maintains a conservative growth strategy with more focus on member countries with relatively strong macroeconomic fundamentals and bond issuers with stronger credit profiles.

For KNM's default, CGIF paid out a guarantee call before reinsurance of around USD85 million on 17 December 2021. The guarantee payment to KNM's bondholders had a limited impact on CGIF's capital. Expected credit loss (ECL) of USD9.5 million was set aside in the fourth quarter of 2021, representing less than 1% of CGIF's capital as of June 2021. The recovery process is still on-going, and CGIF expects to recover most, if not all, of the guarantee receivable from KNM.

Conservative funding profile and strong liquidity

CGIF's guarantee activities and operations are funded by capital contribution from shareholders, and so it does not borrow from any source. It can only borrow from eligible counterparties for cash management purposes to meet liquidity requirements or for guarantee calls or other operational requirements.

As for liquidity management, we also take into account CGIF's conservative liquidity risk management. We are of the view that CGIF has sufficient liquid assets to meet potential liquidity needs and potential guarantee calls in a stressed scenario, based on our assessment.

CGIF implements a two-tier approach for liquidity management, which requires regular monitoring of liquidity to meet day-to-day requirements and a stress test in the event of major claims. The approach relies on conservative test assumptions. For instance, liquidity gap monitoring requires expected cash inflows from investments and guarantee fees to cover cash outflows from operating expenses and potential claim payments over the next six months. Another good example is the stress scenario, which assumes defaults of the top 20% of guaranteed entities and applies haircuts to investment portfolios.

High-quality investment portfolio

According to its treasury risk management framework, CGIF only invests in high-grade marketable fixed-income securities, which can be liquidated with minimal loss. The credit ratings range from "A+" to "AAA" (based on ratings of S&P Global Ratings), with a minimum rating requirement of "A+" for debts issued by the government-related entities (GREs) of contributing countries.

CGIF's investment policy largely aims at stable investment income via a buy-and-hold strategy with a target effective duration of around three years. There are also explicit concentration limits on countries, single issuers, issuer types, and credit ratings, and conservative limits on the value-at-risk (VAR) and unrealised market loss.

As of June 2022, over half of its investments in fixed-income securities issued by the sovereigns or the GREs had credit ratings of "AA-" or better. The average effective duration of its investments was 2.73 years, slightly below the 2.84 years as of June 2021, to address tightened monetary conditions globally.

BASE-CASE ASSUMPTIONS (2022-2024)

- Leverage ratio to be 1.4 to 1.5 times.
- New guarantees to be around USD500-USD600 million per annum.
- Investment yields to be around 2.0%-2.5% per annum.

RATING OUTLOOK

The "stable" outlook reflects TRIS Rating's view on CGIF's strong and stable relationship with major contributors for the continued support of CGIF's operations. The outlook also indicates our expectation that CGIF will continue to perform its important public policy mandate in developing regional bond markets and maintain prudent governance and risk management standards. The outlook also takes into account our expectation that CGIF will maintain a strong capital position, sound funding and liquidity management, and healthy financial performance.

RATING SENSITIVITIES

The rating could face downward pressure if losses in the guarantee portfolio cause CGIF's risk position to deteriorate significantly, or if there is evidence of weakening capital support from the contributors as well as in the governance risk management framework.

ORGANISATION OVERVIEW

CGIF was founded in November 2010 by the governments of the ASEAN+3 countries (10 ASEAN countries plus China, Japan, and Korea) and ADB, together referred to as "contributors". CGIF's main objective is to provide credit guarantees which allow eligible issuers to access local currency bond markets. Issuers can thus avoid currency and maturity mismatches by issuing bonds within the region. The establishment of CGIF was a continual development process following the Asian Bond Markets Initiative (ABMI) introduced in 2003 by the ASEAN+3 countries. The aims of ABMI are to develop and strengthen the local currencies and regional bond markets to promote economic growth and financial development, and to prevent disruptions to the international financial order so as to enable savings in the region to be used within the region.

CGIF has four business functions:

1. Guaranteeing bonds in local currencies, issued by entities with local-scale and investment-grade ratings, to help issuers reduce currency and maturity mismatches;
2. Guaranteeing bonds not in local currencies, issued by entities with local-scale and investment-grade ratings, given that issuers have natural or financial hedges in place, such as a currency matching their underlying business;
3. Making investments for the development of the regional bond markets; and
4. Undertaking other activities and services consistent with the objectives.

Since its inception, CGIF has focused mainly on the first two functions. The latter two functions are for the future.

In a typical guarantee contract, CGIF's insurance services will provide coverage only when an issuer breaches the non-payment event clause. In addition, when a non-payment event occurs, CGIF retains the sole right to decide whether it will early redeem the bonds or continue to pay bondholders according to the original bond schedule. Upon payment by CGIF of all or any part of the guaranteed amounts, CGIF will be entitled to all the rights, powers, and security that bondholders had against the issuers and co-indemnity providers to an amount equal to the paid guaranteed amount.

CGIF finances its operations solely from capital contributions. CGIF is not allowed to borrow from any source, except for cash management purposes.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Mil. USD

	Jan-Jun * 2022	--------------Year Ended 31 December ------------ 2021	2020	2019	2018
Interest income	13.0	27.3	28.9	26.2	19.7
Guarantee income	9.9	19.4	17.4	12.9	8.7
Other revenue**	1.7	4.4	3.4	2.8	1.1
Total revenue	24.6	51.1	49.6	41.9	29.5
Net income from operations	19.3	32.0	23.7	22.6	17.5
Total assets	1,343.7	1,372.8	1,351.7	1,255.1	957.8
Total liabilities	93.4	80.4	87.1	76.6	46.8
Shareholders' equity	1,250.3	1,292.4	1,264.5	1,178.4	911.0

* *Unaudited and not annualised*
** *Including realised gain (loss) from securities, fair value changes from derivatives, commission from reinsurance, and miscellaneous income*

RELATED CRITERIA

- Supranational Institutions Rating Methodology, 15 November, 2022

Credit Guarantee Investment Facility (CGIF)

Issuer Rating:	AAA
Rating Outlook:	Stable

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