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Credit Guarantee and Investment Facility

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Table Of Contents

Credit Guarantee and Investment Facility

Rationale

Issuer Credit Rating
Foreign Currency
AA/Stable/A-1+
ASEAN Regional Scale
NR/--/--

Our rating on Credit Guarantee and Investment Facility (CGIF) reflects our view of the institution's adequate business profile and extremely strong financial profile. The ratings do not benefit from extraordinary support because CGIF does not have callable capital.

A supranational institution established in November 2010, CGIF's mandate is to help deepen and develop liquid local-currency bond markets among members of the Association of Southeast Asian Nations (ASEAN). CGIF provides guarantees on bonds issued by corporates in the ASEAN region. As of May 2018, CGIF had issued 21 guarantees in the markets of Singapore, Philippines, Thailand, Indonesia, and Vietnam primarily to the region's blue chip companies. The guaranteed amount typically oscillates between US$50 million-US$80 million and generally have a tenor of five to 10 years.

CGIF's shareholders have demonstrated their support by approving a capital increase that will ultimately boost the institution's guarantee capacity to US$3 billion from the current US$1.75 billion. CGIF's renewal of its reinsurance arrangement adds further support to its guarantee capacity, in our view.

We consider CGIF's extremely strong financial profile to be a positive ratings factor. The facility's risk-adjusted capital (RAC) ratio was 47% before adjustments at year-end 2017. After adjustments specific to multilateral institutions, CGIF's RAC ratio falls to 26%, an extremely strong capital adequacy assessment, and up from 21% at the end of 2016.

CGIF does not borrow; it obtains funding for its activities solely through retained earnings and contributors' equity. While we believe supranational backing provides one of the most stable sources of funding, this model also represents a concentration risk that in severe stress could be tested. Nonetheless, we assess CGIF's liquidity position as robust.

Our liquidity ratios indicate that CGIF would be able to comfortably pay out its guarantees for at least a year under stressed market conditions, without recourse to liquidity facilities from contributors or from the market. The facility's liquid assets are invested mostly in bonds of highly rated governments or government-related entities. They formed the bulk of CGIF's balance-sheet assets at year-end 2017.

CGIF was established as a trust fund of the Asian Development Bank (ADB). We believe that CGIF's creditworthiness benefits from its relationship with its contributors and the mandate they have entrusted it with. The current voting rights are dominated by four contributors: China (23.3%), Japan (39.9%), Korea (11.6%), and the ADB (15.1%). The 10 ASEAN governments collectively hold the remaining voting rights (10.1%).

Constraining our assessment on CGIF's business profile is the facility's relatively short track record of fulfilling its policy mandate compared with other supranational institutions. We believe that the deepening of the ASEAN bond markets by credit enhancement will remain limited, and as such, so will the role of the institution that could partially be filled by a commercial entity. CGIF acts as a catalyst for bond deals, rather than deepening the capital markets through volume.

Asset quality has so far been pristine because no bond issuance has defaulted and required the payout on CGIF's guarantees during its seven years of existence. We believe this to be a result of the guaranteed exposure representing the main companies in the region with relatively high credit quality as well as CGIF's conservative risk appetite. Should a default occur, we take some comfort in that the typical sizes of each issue being around 7%-11% of the capital levels today.

The extent of the facility benefitting from preferential treatment is not established due to its short track record. CGIF benefits from being established as a multilateral institution, which should exempt it from transfer and convertibility restrictions on sovereigns--but it has yet to be tested. However, its private-sector focused mandate excludes it from being treated as a preferred creditor given that private-sector companies cannot selectively default to one group of creditors while paying others as sovereigns can. Hence, we envisage potential future losses on the guaranteed bonds to be commensurate with market trends. That said, CGIF has made small yearly profits since inception, and we expect the facility to remain profitable.

CGIF's management team has the necessary expertise and experience to conduct its business and achieve its mandate. Its guarantee operations are controlled by conservative risk parameters in accordance with governance standards laid out in its articles of agreement. CGIF has expanded at a gradual pace, allowing its staffing capacity to catch up with the scale of operations. ADB manages CGIF's capital, which results in conservative investment policies.

Outlook

The stable outlook reflects our expectation that CGIF will maintain a solid balance sheet and prudent risk-management practices as it pursues new guarantee growth over the next 24 months. We believe changes to the rating most likely will be driven by CGIF's capital adequacy assessment and the effectiveness of its role in the local-currency ASEAN bond markets.

Downside scenario

We may lower the rating if CGIF struggles to execute its mandate at a profit or its financial metrics weaken. This could happen if the facility aggressively expands its guarantee portfolio beyond the natural growth capacity provided with the likely increase in capital.

Upside scenario

Upward pressure on the rating is in our view remote but could emerge if CGIF builds a track record and an ability to significantly contribute to a vibrant local currency regional capital market backed by ongoing shareholder support.

Stand-Alone Credit Profile: 'aa'

Our assessment of CGIF's stand-alone credit profile at 'aa' combines our opinion that CGIF's business profile is adequate and its financial profile is extremely strong.

Business Profile: Adequate

We base our assessment of CGIF's business profile on the institution's governance, role, and public policy mandate.

Policy importance assessment

CGIF's mandate is to aid the development of deep and liquid Asian local-currency and regional bond markets to: (1) promote economic development, (2) promote resilience in financial markets, and (3) prevent disruptions to the international financial order in the Asia-Pacific region. CGIF provides guarantees to enable ASEAN+3 (Japan, Korea, China) issuers to access local currency bond markets. CGIF are also actively working towards enabling the development of the Cambodia, Laos and Myanmar capital markets, which have not yet had a corporate bond issuance. CGIF's goal is to aid efficient allocation of Asian savings within the region by facilitating access by companies to such markets, while promoting the issuance of debt securities with longer-term maturities to match the gestation of investment projects. We consider CGIF acts as a catalyst for ASEAN bond issuance rather than deepening capital markets via volume.

CGIF was established by an international agreement in 2010--the Articles Of Agreement of Credit Guarantee And Investment Facility--which is binding on the bank's 13 member countries and ADB (its shareholders). Under the founding charter, CGIF's earnings are exempt from taxes.

We consider CGIF's track record to be relatively short, because it does not cover a number of credit cycles and increases in capital subscriptions. We also think the extent of the facility benefitting from preferred creditor treatment is not clear, because CGIF's remit is to provide guarantees or investment mainly to private-sector companies or projects. We believe the facility's role of deepening the ASEAN bond markets via credit enhancement will remain limited for the medium term because of the relatively small size of the entity currently. Nevertheless, CGIF's status as a multilateral institution exempts it from a sovereign's transfer and convertibility restriction. No shareholder has withdrawn from the facility.

CGIF's shareholders have demonstrated their support by approving its first ever capital increase to US$1.2 billion from US$700 million before December 2017. The subscription increase is on a voluntary basis, and proposed to be a proportional increase across all current shareholders. The shareholder payments are likely to be completed by the end of 2023. By increasing its capital, CGIF's guarantee capacity will be boosted to US$3 billion, from the current capacity of US$1.75 billion. While six months remain to voluntarily sign up to the increase in share capital, all large shareholders would contribute to increase the institution's capacity and starting to establish a track record of shareholder support.

Governance and management expertise

Currently, CGIF has a balanced regional shareholder base. All the shareholders are either governments or government-related agencies with strong government links, and ADB, a highly rated multilateral financial institution. There are no private-sector shareholders. There is a small risk that shareholder composition will change as a result of the voluntary proposed capital increase, however we don't expect this to negatively affect CGIF's shareholder stability.

The facility's founding charter delineates strong governance standards and a clear mandate. We believe the management team has the necessary expertise and experience to achieve its mandate, despite its relatively short track record. CGIFs guarantee operations are controlled by conservative prudential limits: no single country, single borrower, or single industry can make up more than 20% of the guarantees portfolio; no single currency can make up more than 40%. The management has also chosen to grow at a steady pace, allowing its staffing capacity to catch up to the scale of operations.

Financial Profile: Extremely Strong

Our opinion of CGIF's financial profile is based on its capital adequacy, funding and liquidity.

Table 1

Credit Guarantee and Investment Facility--RACF [Risk-Adjusted Capital Framework] Year-End 2017

(mil. US$)	Exposure	S&P Global Ratings' RWA	Average S&P Global Ratings RW (%)
Credit Risk			
Government and central banks	540	19	3
Institutions	467	95	20
Corporate	822	1355	165
Securitization	0	0	0
Other assets	0	0	60
Total credit risk	1830	1469	80
Market Risk			
Equity in the Banking Book	0	0	--
Trading book market risk	0	0	--
Total market risk	0	0	--
Insurance risk	0	0	--
Operational risk	0	36	--
Total operational risk	--	36	--
RWA before MLI adjustments		1505	100
MLI Adjustments			
Industry and geographic diversification		-546	-21
Preferred creditor treatment		0	0
Single-name concentration		1745	103
High-risk exposure cap		0	0
Total MLI adjustments		1199	80
RWA after MLI adjustments		2704	180
		Adjusted Common Equity	**S&P Global Ratings RAC ratio (%)**
Capital ratio before adjustments		703	47
Capital ratio after adjustments		703	26

MLI-- Multilateral lending institutions. RW-- Risk weighting. RWA-- Risk-weighted assets. RAC--Risk-adjusted capital. mil.--Million.

Capital and Earnings

As of fiscal year-end 2017, our RAC ratio for CGIF was an extremely strong 47% before adjustments – a very high ratio. After adjustments specific to multilateral institutions, CGIF's RAC ratio stands at 26%.

The ratio after adjustments has improved significantly from 21% at the end of 2016, as a result of increased diversification benefits from single-name corporate exposures. CGIF added three guarantees to new issuers in 2017 adding diversification benefits in its guarantee portfolio. Over the next few years, we consider the capital increase to extend CGIF's existing guarantee capacity, maintaining the RAC ratio above our threshold of 23%. The criteria correction explained in "Criteria For Assessing Bank Capital Corrected," published on July 11, 2017, is not factored into the RAC ratio after diversification. The impact of the correction on the ratio is not material to the rating.

CGIF renewed its annual reinsurance arrangement with a syndicate of reinsurers rated between 'AA-' and 'A' to boost its guarantee capacity and manage credit concentration risk limits. This arrangement covers 25% of the existing guarantee portfolio and all new guarantees written up until the end of 2018.

As a result of the reinsurance arrangement, the facility's current country and currency exposure has been alleviated by approximately 15%. We have used a conservative calculation to capture reinsurance exposures. Incorporating this as well as the capital increase, we anticipate continuing to assess CGIF's financial profile as extremely strong in the medium term.

As of Dec. 31, 2017, CGIF had no debt. Its Articles Of Agreement prohibits CGIF from borrowing (Operational Policies, Article 188). However, a meeting of contributors in 2013 agreed to increase CGIF's ratio of total outstanding guaranteed debts to paid-up capital plus retained earnings to 2.5:1 from 1:1 to allow for future increases of the facility's activities. As of end 2017, the leverage ratio was around 1.4x. For the portion of leverage more than 2x above paid-up capital plus retained earnings, the institution's shareholders require the facility to re-insure the exposure.

The increase in CGIF's paid in capital will enhance the facility's financial capacity for further expansion of the business, a positive development in our view. In the medium to long term, as CGIF guarantees more bonds, then more capital and, perhaps leverage, will be required. The amount of additional capital depends on the shareholders and CGIF's decision on where to strike a balance between business expansion and maintaining the prudence of its financial profile. Nevertheless, while leverage might increase, as CGIF's portfolio of bond guarantees increases, its concentration risk on single transactions should decline, if the portfolio is further diversified by country and industry.

Earnings

CGIF does not seek to maximize income. Instead, it seeks to balance its development goals against maintaining its financial strength and increasing its risk-bearing capacity. Its retained earnings contribute to its risk-bearing capacity. The capital structure and the operational cost structure of the facility are self-sufficient to maintain CGIF's financial soundness. Since its inception, CGIF has been recording small profits.

Funding and liquidity

CGIF's funding ratios indicate that the entity is structurally able to cover any outflows. Funding for CGIF's activities comes entirely from shareholders' equity and retained earnings, which is considered to be one of the most stable forms of funding. However, this represents a concentration risk that could be tested in times of severe stress.

CGIF's liquidity is robust. Our liquidity ratios for CGIF indicate that the facility would be able to comfortably fulfill its mandate for at least one year, without access to capital markets or recourse to liquidity facilities from shareholders. This is true even under extremely stressed market conditions. The bulk of its balance-sheet assets are in high-investment-grade securities of government and government-related entities. These formed the bulk of CGIF's balance-sheet assets at year-end 2017.

Over the next 24 months, CGIF has guarantees worth US$24 million maturing. These are comfortably covered by its current equity base of US$739 million. As CGIF does not lend or borrow, any material outflow of funds would be towards default payments under guarantees--of which there are none to date.

Likelihood Of Extraordinary Shareholder Support

We assign no uplift for the likelihood of extraordinary shareholder support, as we expect it will not be as strong as those entities that have callable capital. Besides, the shareholders' obligations are limited to their paid-up capital in the charter. However, because of the mandate given to CGIF by the shareholders, we believe some support by shareholders is possible.

Table 2

Credit Guarantee and Investment Facility--Assets And Liabilities

(US$, '000)	2017	2016	2015	2014	2013	2012
Assets						
Cash	6,599	2,210	3,183	1,905	3,053	1,709
Investments	733,392	725,720	718,272	712,856	709,374	709,091
Government or government guaranteed obligations	639,448	608,747	646,406	666,560	690,208	621,091
Corporate obligations	59,364	109,267	65,068	10,697	11,165	0
Time deposits	34,580	7,706	6,798	35,599	8,001	88,000
Accrued interest income	3,466	3,324	3,430	4,150	3,226	2,903
Guarantee fee receivable	34,528	38,565	25,533	20,732	1,183	-
Other assets	1,124	2,183	1,082	843	1,137	993
Total	779,109	772,002	751,569	740,486	717,973	714,696
Liabilities and members' equity						
Guarantee liability	37,277	41,804	27,841	22,499	1,765	0
Deferred earnings on guarantees	261	167	89	11	4	0
Accrued expenses	657	1245	382	777	272	127
Payable to others fund	0	0	0	0	0	12
Derivative liabilities	991	565	0	0	0	0
Other liabilities	700	700	700	700	700	696
Total liabilities	39,885	44,481	29,012	23,987	2,741	835
Members' equity (CGIF-4)						
Capital stock (Subscribed capital)	703,000	700,000	700,000	700,000	700,000	700,000
Less receivables from contributors	0	0	0	0	0	0
Unrealized gain on available-for-sale investments	(9,391)	(7,250)	(2,131)	(408)	1,873	3,220

Table 2

Credit Guarantee and Investment Facility--Assets And Liabilities (cont.)						
(US$, '000)	**2017**	**2016**	**2015**	**2014**	**2013**	**2012**
Reserves	34,771	24,689	16,907	13,359	10,641	6,532
Retained earnings	10,844	10,082	7,781	3,548	2,718	4,109
Total members' equity	739,224	727,521	722,557	716,499	715,232	713,861
Total	779,109	772,002	751,569	740,486	717,973	714,696

Table 3

Credit Guarantee and Investment Facility--Profit And Loss					
(US$, '000)	**2017**	**2016**	**2015**	**2014**	**2013**
Revenue					
Interest income	12,545	10,432	9,268	8,310	7,648
Guarantee fees	8,397	7,698	4,664	1,322	419
Realized gain from securities	26	509	219	487	0
Fair value changes - derivatives	(602)	(220)	76	0	0
Others	682	787	524	13	65
Total revenue	21,048	19,206	14,751	10,132	8,132
Expenses					
Administrative expenses	7,144	6,848	5,566	5,511	4,405
Financial expenses	59	54	50	56	49
Depreciation expenses	289	258	241	276	246
Reinsurance expenses	2,198	540	0	0	0
Other miscellaneous expenses	700	700	700	700	700
Total expenses	10,390	8,400	6,557	6,543	5,400
Total operating income	10,658	10,806	8,194	3,589	2,732
Changes in fair value of derivatives	0	0	0	0	0
Translation (loss) gain	186	(724)	(413)	(41)	(14)
Net income	10,844	10,082	7,781	3,548	2,718

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Governments - General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Nov. 26, 2012
- Criteria - Financial Institutions - Banks: Multilateral Lending Institutions Capital Methodology And Assumptions, Dec. 6, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Credit Guarantee and Investment Facility 'AA/A-1+' Ratings Affirmed; Outlook Remains Stable, June 22, 2018.
- Asian Development Bank Ratings Affirmed At 'AAA/A-1+' With Stable Outlook, June 22, 2017

Ratings Detail (As Of July 23, 2018)		
Credit Guarantee and Investment Facility		
Issuer Credit Rating		
Foreign Currency		AA/Stable/A-1+
ASEAN Regional Scale		NR/--/--
Issuer Credit Ratings History		
18-Jun-2014	*Foreign Currency*	AA/Stable/A-1+
24-May-2012		AA+/Stable/A-1+
29-Aug-2017	*ASEAN Regional Scale*	NR/--/--
24-May-2012		axAAA/--/--
Related Entities		
Asian Development Bank		
Issuer Credit Rating		
Foreign Currency		AAA/Stable/A-1+
Commercial Paper		
Foreign Currency		A-1+
Senior Unsecured		AAA

*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.