TRIS RATING

CreditNews ข่าวเครดิต

CREDIT GUARANTEE AND INVESTMENT FACILITY

No. 100/2015

19 October 2015

Company Rating: AAA

Outlook: Stable

Company Rating History:

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

Rating Rationale

TRIS Rating affirms the company rating of Credit Guarantee and Investment Facility (CGIF) at "AAA". The rating reflects CGIF's status as a supranational institution owned by the governments of the ASEAN+3 countries and the Asian Development Bank (ADB), together called "contributors". The rating also reflects CGIF's strong business platform and conservative risk management framework. The rating takes into consideration CGIF's short operational track record and the challenges it faces in expanding its business.

CGIF was founded in 2010 under the initiative of 10 ASEAN countries, together with China, Japan, Korea, and ADB. CGIF's main objectives are to provide credit guarantees which allow eligible issuers to access regional local currency bond markets. Issuers can thus avoid currency and maturity mismatches by issuing bonds within the region. ADB is the trustee of CGIF. It holds in trust all of CGIF's capital and is responsible for managing the capital. CGIF finances its operations solely from capital contributions. It is not allowed to borrow from any source, except for cash management purposes.

CGIF's strong business profile reflects its business platform, which is adequately structured to support its policy objectives and functions. CGIF's competitive edge is in providing credit guarantees for cross-border transactions, for issuers tapping bond markets in countries with high credit spreads.

CGIF's guarantee portfolio is expected to comprise bonds issued by issuers with credit risks comparable to the international-scale rating of "BB-" or better. For its investment portfolio, a bond issue must have an international-scale rating of at least "AA-" to be a part of CGIF's investment.

TRIS Rating views that CGIF provides mutual benefits for the ASEAN+3 nations that are its contributors. CGIF's objectives and functions play a strategically important role in promoting transactions and enhancing the stability in the regional bond markets. Given the financial strength of CGIF's major contributors and the importance of its policy mandate, TRIS Rating believes there is a high likelihood that CGIF will receive financial support from its major contributors in times of distress.

As of June 2015, CGIF limits its maximum guarantee capacity (MGC) at about US$1.8 billion. The MGC is computed as the product of (1) CGIF's paid-in capital plus retained earnings, less credit loss reserves, foreign exchange loss reserves, and all illiquid investments, and (2) the maximum leverage ratio of 2.5. As of June 2015, CGIF has provided credit guarantees to six issuers, on seven bond issues worth in total US$505 million, or about 28% of the MGC.

Considering CGIF's maximum leverage ratio, its prudential limits, and the credit quality guidelines of issuers for which it provides guarantees, the level of its capital should be enough to cover expected loss of the guarantee portfolio. CGIF's prudential limits specify, among other things, maximum limits for country concentration, currency concentration, aggregate sector concentration, and single borrower concentration. The current level of capital is considered very strong as the size of CGIF's guarantee portfolio is still much lower than the MGC. As CGIF expands and the size of its guarantee portfolio approaches the MGC, the ability of its capital base to sustain losses under adverse conditions will depend on the credit profile of issuers for which it provides guarantees, the tenure of the bonds, and CGIF's ability to charge guarantee fees commensurate with the credit risks it takes.

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At the end of 2014, the average effective duration of CGIF's investment portfolio was 1.5 years. CGIF estimated that a uniform one percentage point (100 bps) upward shift in the yield curve at the portfolio level would result in an unrealized loss of about US$10.8 million, or about 1.5% of its capital as at the end of 2014. According to the strategic asset allocation scheme adopted at the beginning of 2015, CGIF aims to gradually increase the average effective duration of its investment portfolio to two to four years. This move is expected to raise the overall return on CGIF's investment portfolio but CGIF may incur a higher level of interest rate risk. The return on CGIF's investment portfolio in 2014 was 1.23% per annum (p.a.).

CGIF's liquidity profile is very strong. Its investment assets mostly comprise marketable fixed-income securities with very high credit ratings. The cash inflows from its investments and guarantee fees are expected to cover the cash outflows for operating expenses over the next 12 months. In addition, CGIF is allowed to engage in repurchase transactions in order to manage its liquidity needs.

In TRIS Rating's view, CGIF will face significant challenges over the next three to five years. The integration of the regional bond market is just beginning and the bond market is dynamic and quite competitive. In addition, according to its business plan, CGIF expects to reach its MGC within two years. The country exposure limit has already, to some extent, constrained the growth of CGIF's guarantee portfolio. At the moment, it remains undecided whether CGIF's contributors will agree to inject more capital, increase the leverage ratio, or cap CGIF's business scale once the MGC is reached.

Rating Outlook

The "stable" outlook reflects the expectation that CGIF will continue to expand in line with its mission and risk management framework. The rating could face downward pressure if losses in the guarantee portfolio cause CGIF's financial profile to deteriorate significantly, or if there is evidence of weakening support from the contributors.

Credit Guarantee and Investment Facility (CGIF)

Company Rating:	AAA
Rating Outlook:	Stable

KEY RATING CONSIDERATIONS

Strengths/Opportunities

- Supranational status, owned by governments of the ASEAN+3 countries and ADB
- Strong business platform supports policy objectives
- Conservative risk management framework

Weaknesses/Threats

- Short track record
- Challenges in expanding business size

CORPORATE 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 called "contributors". CGIF's main objectives are 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 the ABMI are to develop and strengthen the local currency 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, investment-grade ratings, to help issuers reduce currency and maturity mismatches;
2. Guaranteeing bonds not in local currencies, issued by entities with local-scale, 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 cover 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 accelerate bond redemptions or continue to pay bondholders according to the original bond schedule. Upon the payments by CGIF of all or any part of the guaranteed amounts, CGIF will be entitled to all the rights, powers, and security against the issuers and co-indemnity providers to an amount equal to the paid guaranteed amounts.

Since inception, CGIF's authorized and paid-up capital from its 14 contributors has remained constant at US$700 million. CGIF finances its operations solely from capital contributions. CGIF is not allowed to borrow from any source, except for cash management purposes.

Table 1: CGIF's Contributors

	Contributor	Amount (US$)	%	Rating*
1	People's Republic of China	200,000,000	28.6	AA-
2	Japan Bank for International Cooperation	200,000,000	28.6	A+
3	Asian Development Bank	130,000,000	18.6	AAA
4	Republic of Korea	100,000,000	14.3	AA-
5	Indonesia	12,600,000	1.8	BB+
6	Malaysia	12,600,000	1.8	A-
7	Philippines	12,600,000	1.8	BBB
8	Singapore	12,600,000	1.8	AAA
9	Thailand	12,600,000	1.8	BBB+
10	Brunei Darussalam	5,600,000	0.8	n.a.
11	Vietnam	1,100,000	0.2	BB-
12	Cambodia	100,000	0.0	n.a.
13	Lao People's Democratic Republic	100,000	0.0	n.a.
14	Republic of the Union of Myanmar	100,000	0.0	n.a.
	Total	**700,000,000**	**100**	

Source: CGIF

* *Ratings are international-scale ratings assigned by Standard and Poor's as of Sep 2015.*

Aside from being a contributor, ADB is the trustee of CGIF. ADB's trustee roles are to hold in trust and manage all of CGIF's capital in accordance with CGIF's investment policy. ADB also appoints and terminates all of CGIF's executive and professional staff based on the recommendations of CGIF's boards and contributors (in case of the Chief Executive Officer or CEO), board (in case of other executive staff), and CEO (in case of professional staff).

As of June 2015, CGIF limits its MGC at about US$1.8 billion. The MGC is computed as the product of (1) CGIF's capital plus retained earnings, less foreign exchange loss reserves, credit loss reserves, and all illiquid investments, and (2) the maximum leverage ratio of 2.5 times.

CGIF commenced its full operation in May 2012. As of June 2015, CGIF has provided credit guarantees to six issuers, on seven bond issues worth in total US$505 million, or about 28% of the MGC.

Table 2: CGIF's Portfolio of Bond Guarantees as of Jun 2015

Issue Date	Issuer	Country	Bond Currency	Bond Size* (US$ Mil.)	Tenure (Years)
Apr 13	Noble	China	THB	100	3
Dec 13	BCAF	Indonesia	IDR	26	3
Mar 14	BCAF	Indonesia	IDR	11	3
Aug 14	Kolao	Lao	SGD	48	3
Nov 14	Protelindo	Indonesia	SGD	140	10
Dec 14	Masan	Vietnam	VND	100	10
Dec 14	ASF	Indonesia	SGD	80	3
	Total			**505**	

Source: CGIF

* *US$ amounts are based on the exchange rate at each issuance date.*

BUSINESS ANALYSIS

▪ ***Strong business platform supports policy objectives***

CGIF's strong business profile reflects the organization's platform which, in TRIS Rating's view, is adequately structured to support policy objectives and functions in providing credit guarantee services for investment-grade bond issuers in ASEAN+3 countries.

CGIF has received technical and administrative assistance from ADB during the initial stage. CGIF has developed its internal credit risk assessment methods, as well as adopted governance and internal audit policies under international standards.

CGIF's competitive edge is providing credit guarantees for cross-border transactions for issuers tapping bond markets in countries with high credit spreads. A cross-border deal requires guarantors with strong international credibility and exposure, two qualities that CGIF has.

In general, a guarantor should charge guarantee fees at a rate that is equal to the expected losses of that issuer plus the guarantor's required rate of return. Countries with high credit spreads offer good tradeoffs for issuers between guarantee fees and funding cost saving from credit enhancements. A country with low credit spreads offer issuers with low cost saving from credit enhancements, making it difficult to charge guarantee fees commensurate with an issuer's expected losses and the guarantor's expected returns combined. At the minimum, CGIF's guarantee fees cover in full its expected losses and provide a portion of expected returns.

▪ ***Conservative risk management policy***

CGIF's strong business profile is underscored by the organization's conservative risk management framework regarding criteria for underwriting credit guarantees and asset allocation policies.

CGIF's rating takes into account its prudent risk mitigation policy on the guarantee portfolio, which limits guarantee exposures on currency, sector, country, and issuer in order to control concentration and correlation risks.

Over the next three years, CGIF's guarantee portfolio is expected to comprise bonds issued by issuers with credit risks comparable to the international-scale rating of "BB-" or better.

Table 3: CGIF's Prudential Limits on Guarantee Portfolio

Guarantee Exposure	Limit
Currency	40% of MGC
Sector	40% of MGC
Industry	20% of MGC
Country	20% of MGC
Industry in a country	10% of MGC
Single entity	20% of paid-in capital
Corporate group	20% of paid-in capital
Intermediate jurisdiction	20% of MGC
All intermediate jurisdiction	40% of MGC

Source: CGIF

The rating also reflects CGIF's conservative asset allocation strategy. Eligible long-term securities for CGIF's investments must have international-scale ratings above "AA-". Credit risk and market risk are controlled by limits that restrict the amount of assets CGIF can hold in a given industry sector or a given bond issuer. Short-term deposits are placed in banks with international-scale ratings of at least "A-1".

Table 4: Prudential Limits on CGIF's Investment Portfolio

	Limit
Corporate, non-financial	10% of CGIF equity
Financial institution	20% of CGIF equity
Government (other than the US) and its related entities	30% of CGIF equity
US treasuries and US agencies	50% of CGIF equity
Single entity	10% of that entity's debt

Source: CGIF

- ***Rating is enhanced by supranational status***

CGIF's rating is enhanced from its stand-alone profile to reflect its status as a supranational institution. CGIF is owned and supported by a group of sovereign and supranational contributors, with very strong credit profiles. The four largest contributors, together representing 90% of CGIF's capital, are assigned international ratings from "A+" to "AAA". The average international rating of CGIF's major contributors, weighted by the percentage of contribution, is in the "AA" category. An international-scale rating of "AA" is considered higher than the national-scale rating of "AAA" assigned by TRIS Rating.

TRIS Rating views that CGIF provides mutual benefits for the ASEAN+3 nations that are its contributors. CGIF's objectives and functions play a strategically important role in promoting transactions and enhancing the stability in the regional bond markets. Given the financial strength of CGIF's major contributors and the importance of its policy mandate, TRIS Rating believes there is a high likelihood that CGIF will receive financial support from its major contributors in times of distress.

- ***Short track record***

CGIF's business profile is partially constrained by the organization's short track record and challenges in growing business scale in the medium term. TRIS Rating acknowledges that despite CGIF's strong fundamentals, it has been in operation for only a few years and has issued only seven guarantees.

Since inception, CGIF has revised some of its policies to accommodate changing market conditions. For example, the cap on the leverage ratio has been lifted from 1 times to 2.5 times to allow more headroom for CGIF to expand without a capital increase.

In TRIS Rating's view, CGIF faces significant challenges over the next three to five years. The integration of the regional bond market is just beginning and the bond market is dynamic and quite competitive. In the future, CGIF's guarantee portfolio is expected to include more issuers with lower ratings.

CGIF expects to reach the MGC within two years. At the moment, it remains undecided whether CGIF's contributors will agree to inject more capital, increase the leverage ratio, or cap CGIF's business scale once the MGC is reached.

FINANCIAL ANALYSIS

- ***Financial policy***

CGIF's operational currency is the US dollar. Fees earned from guarantees are recognized on an accrual basis over the life of the guarantee contracts. Expected losses from guarantees are recorded when payouts for the issuers' expected losses are probable and can be reliably estimated. Since inception, CGIF has not recorded any provision or expense related to the expected losses from the outstanding guarantees.

In 2014, CGIF's total revenue was US$10.1 million. Income from its investments was US$8.8 million, or about 87% of total revenue. Revenue from guarantee operations jumped three-fold to US$1.3 million in 2014, up from US$0.4 million in 2013. However, guarantee operations remain a small source of revenue. Operating expenses in 2014 totaled US$6.5 million while net profit was US$3.5 million.

- ***Strong financial growth is expected***

TRIS Rating expects CGIF's operating performance will improve strongly over the next few years as it expands. TRIS Rating's base-case forecast assumes CGIF's total revenue will increase from US$10.1 million in 2014 to about US$20 in 2016. Interest income from investments and revenue from guarantee fees will be roughly equal by 2016. The growth will be driven by growing size of the guarantee portfolio. Another key revenue driver is a rise in the rates CGIF charges because the guarantees will cover issuers with lower ratings. Interest income is also expected to rise, but at a slower pace, on the back of a gradual rise in interest rates worldwide and a gradual lengthening of the effective duration of CGIF's portfolio.

TRIS Rating's base-case forecast assumes CGIF's net profit will rise from US$3.5 million in 2014 to about US$11 million in 2016. CGIF is not expected to pay any dividends to contributors.

- ***Strong capital relative to the guarantee portfolio***

Considering CGIF's maximum leverage ratio, its prudential limits, and the credit quality guidelines of issuers for which it provides guarantees, the level of its capital should be enough to cover expected loss of the guarantee portfolio. CGIF's prudential limits specify, among other things, maximum limits for country concentration, currency concentration, aggregate sector concentration, and single borrower concentration. The current level of capital is considered very strong as the size of CGIF's guarantee portfolio is still much lower than the MGC. As CGIF expands and the size of its guarantee portfolio approaches the MGC, the ability of its capital base to sustain losses under adverse conditions will depend on the credit profile of issuers for which it provides guarantees, the tenure of the bonds, and CGIF's ability to charge guarantee fees commensurate with the credit risks it takes.

- ***Investment portfolio comprises very high quality securities***

CGIF's financial profile is supported by an investment portfolio comprised largely of fixed-income securities with very high credit ratings. All its investments are denominated in US dollars or hedged back to the US dollar.

CGIF controls the market risk of its investments by limiting the average duration of all outstanding investments at five years. At the end of 2014, CGIF's investment portfolio was invested with maturities up to three years, with an average effective duration of 1.5 years. CGIF estimated that a uniform one percentage point (100 bps) upward shift in the yield curve at the portfolio level would result in an unrealized loss of about US$10.8 million, or about 1.5% of its capital as at the end of 2014.

According to the strategic asset allocation scheme adopted in the beginning of 2015, CGIF aims to gradually increase the average effective duration of its investment portfolio to two to four years. This move is expected to raise the overall return on CGIF's investment portfolio but CGIF may incur a higher level of interest rate risk. The return on CGIF's investment in 2014 was 1.23% p.a.

CGIF is exposed to the risk of US dollar depreciating against the currency of the bonds for which it provides guarantees. However, TRIS Rating views that the risk is expected to be adequately covered by CGIF's capital base. In addition, CGIF may have the option to pay the bondholders of the issuer in default in US dollars if CGIF determines that it is impossible, or impractical, or unable to obtain the currency of the defaulted bonds on reasonable terms.

- ***Very strong liquidity profile***

CGIF's liquidity profile is very strong. Its investment assets mostly comprise marketable fixed-income securities with very high credit ratings.

The cash inflows from its investments and guarantee fees are expected to cover cash outflows for operating expenses over the next 12 months. In addition, CGIF is allowed to engage in the repurchase transactions in order to manage its liquidity needs.

Key Financial Statistics

Unit: US$ million

	------------------- Year Ended 31 December ------------			
	2014	2013	2012	2011
Income on investment	8.8	7.6	8.0	7.5
Income from guarantee	1.3	0.4	0.0	0.0
Total revenue	10.1	8.1	8.0	7.5
Net income from operations	3.6	2.7	4.1	6.2
Total assets	740.5	718.0	714.7	687.6
Total liabilities	24.0	2.7	0.8	1.0
Shareholders' equity	716.5	715.2	713.9	686.6

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