# CREDIT GUARANTEE AND INVESTMENT FACILITY

No. 128/2016 11 November 2016

**Company Rating:** AAA

**Outlook:** Stable

**Company Rating History:**

| Date | Rating | Outlook/Alert |
|---|---|---|
| 28/08/14 | AAA | Stable |
| 19/10/15 | AAA | Stable |

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**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 as it expands.

CGIF was founded in 2010 as an initiative of 10 ASEAN countries, together with China, Japan, Korea, and the ADB. CGIF's main objective is to provide credit guarantees. The guarantees allow eligible issuers to access local currency bond markets in the region. 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 beyond one year.

TRIS Rating holds the view 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 of 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 2016, CGIF limited 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 July 2016, CGIF provided credit guarantees to 10 issuers, on 14 bond issues worth in total US$864 million, or about 48% of the MGC.

Considering CGIF's Basel II capital adequacy ratio of 19.3% as at the end of June 2016, the level of its capital remains sound. Approval of guaranteed bonds follows the prudential limits and the guidelines on credit quality of issuers for which it provides guarantees. 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.

At the end of 2015, the average effective duration of CGIF's investment portfolio was 1.8 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$12.8 million, or about 1.8% of its capital as at the end of 2015. According to the strategic asset allocation scheme, 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 though CGIF may incur a higher level of interest rate risk. The return on CGIF's investment portfolio in 2015 was 1.3% per annum (p.a.).

CGIF's liquidity profile is very strong. Investment assets mostly comprise marketable fixed-income securities with very high credit ratings. The cash inflows from the 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 repo transactions in order to manage its liquidity needs.

In TRIS Rating's view, CGIF will face significant challenges in the near term. The integration of the regional bond market is in the early stage making cross-border bond issuances a challenge while the bond markets are dynamic and quite competitive. The well-developed bond markets in the region have relatively tight credit spreads, which can render the prices of CGIF's guarantees from CGIF unattractive for the issuers, and CGIF might need to extend its guarantees to relatively weaker credit issuers. In addition, the timing of a capital injection from CGIF's contributors remains unclear in order to allow more room for its business expansion. At the moment, the limit on country exposure has already, to some extent, constrained the growth of CGIF's guarantee portfolio and limited new opportunities. Despite some delay on issuances of guaranteed bonds in 2015, MGC is expected to be reached within two years according to CGIF's business plan.

**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, supporting 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 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 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 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 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 2016.*

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 board of directors 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 2016, CGIF's MGC was limited to 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) a maximum leverage ratio of 2.5 times.

CGIF commenced operation in May 2012. Excluding its first guarantee which was provided to Thai baht bonds issued by Noble Group and already redeemed in April 2016 upon its maturity, CGIF provided credit guarantees to 10 issuers, on 14 bond issues worth in total US$864 million as of July 2016, or about 48% of the MGC.

**Table 2: CGIF's Portfolio of Bond Guarantees as of Jul 2016**

| Issue Date | Issuer | Country | Bond Currency | Bond Size* (US$ Mil.) | Tenure (Years) |
|---|---|---|---|---|---|
| Dec 13 | BCAF | Indonesia | IDR | 25 | 3 |
| Mar 14 | BCAF | Indonesia | IDR | 11 | 3 |
| Aug 14 | Kolao | Lao | SGD | 48 | 3 |
| Nov 14 | Protelindo | Indonesia | SGD | 138 | 10 |
| Dec 14 | Masan | Vietnam | VND | 98 | 10 |
| Dec 14 | ASF | Indonesia | SGD | 76 | 3 |
| Oct 15 | IVL Singapore | Thailand | SGD | 137 | 10 |
| Feb 16 | Vingroup | Vietnam | VND | 87 | 5 |
| Feb 16 | Vingroup | Vietnam | VND | 47 | 10 |
| Mar 16 | AP Renewables | Philippines | PHP | 100 | 10 |
| Mar 16 | MPMF | Indonesia | IDR | 11 | 3 |
| Apr 16 | MPMF | Indonesia | IDR | 12 | 3 |
| Jul 16 | Fullerton | Singapore | SGD | 37 | 5 |
| Jul 16 | Fullerton | Singapore | SGD | 37 | 7 |
| | **Total** | | | **864** | |

*Source: CGIF*

* *US$ amounts are based on the exchange rate as at 30 Sep 2016*

## BUSINESS ANALYSIS

- ***Strong business platform supports policy objectives***

CGIF's strong business profile reflects the organization's structure which, in TRIS Rating's view, adequately supports the policy objectives and functions needed to provide credit guarantee services for investment-grade bond issuers in the 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, with its strong international credibility and exposure, for cross-border transactions for issuers tapping bond markets in countries with high credit spreads.

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 administrative expense and required rate of return. Countries with high credit spreads offer a good opportunity for issuers to weigh the tradeoffs between paying the guarantee fees and lowering the funding cost through the use of credit enhancements. On the other hand, a country with low credit spreads means issuers will not cut the funding cost by much with credit enhancements. It is thus 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 at least some of the expected returns.

- ***Conservative risk management policy***

CGIF's strong business profile is underscored by the organization's conservative risk management framework regarding the criteria used for underwriting credit guarantees and its 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 so that CGIF can control concentration and correlation risks.

Looking forward, 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 at the issuance.

**Table 3: CGIF's Prudential Limits on the 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**

| Investment | 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 total outstanding amount of bonds |

*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 respective percentages of the contributions, 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 holds the view 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 of 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 the challenge it faces as it grows in the medium term. TRIS Rating acknowledges that despite CGIF's strong fundamentals, it has been in operation for only a few years. As of July 2016, CGIF provided its credit guarantees to just 10 issuers.

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 will face significant challenges in the near term. The integration of the regional bond market is only at the early stage, which makes cross-border bond issuances challenging, while the bond markets are dynamic and quite competitive. The well-developed bond markets in the region have relatively tight credit spreads, which can render CGIF's guarantee prices unattractive for the issuers, and CGIF might need to extend its guarantees to relatively weaker credit issuers.

In addition, the timing remains unclear for new capital injection from CGIF's contributors in order to allow more room for its business expansion. At the moment, the country exposure limit has already, to some extent, constrained the growth of CGIF's guarantee portfolio and business opportunities. Despite some delay on issuances of the guaranteed bonds in 2015, MGC is expected to be reached within two years according to CGIF's business plan.

## FINANCIAL ANALYSIS

- ***Financial policy***

CGIF's operational currency is the US dollar. The fees earned from a guarantee are recognized on an accrual basis over the life of the guarantee contract. 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 2015, CGIF's total revenue was US$14.8 million. Income from its investments was US$9.4 million, or about 64% of total revenue. Revenue from guarantee operations jumped more than threefold to US$4.8 million in 2015, up from US$1.3 million in 2014. Guarantee operations have increased from just 13% of revenue in 2014 to about one-third of revenue in 2015. Operating expenses in 2015 totaled US$6.6 million while net profit was US$8.2 million.

- ***Strong growth 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 from 2015 to 2019 will grow by more than 30% per year on average. Revenue from guarantee fees will climb as CGIF continues to expand, and is expected to exceed over US$20 million in 2019. Another key revenue driver is rises 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. The gradual lengthening of the effective duration of CGIF's portfolio should provide higher yields in the investment portfolio.

TRIS Rating's base-case forecast assumes net profit will follow the rise in revenues during 2016-2019. CGIF is not expected to pay any dividends to contributors.

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

Considering CGIF's Basel II capital adequacy ratio of 19.3% as at the end of June 2016, the level of its capital remains sound. Approval of guaranteed bonds follows the prudential limits and the guidelines on credit quality of issuers for which it provides guarantees. 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 the 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 largely comprised 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 portfolio duration at five years. At the end of 2015, CGIF's investment portfolio was invested in securities with maturities of up to 4.5 years, with an average effective duration of 1.8 years. CGIF estimated that a uniform one percentage point upward shift in the yield curve at the portfolio level would result in an unrealized loss of about US$12.8 million, or about 1.8% of its capital as at the end of 2015.

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 around 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 2015 was 1.3% p.a.

CGIF is exposed to the risk of the US dollar depreciating against the currency of the bonds for which it provides guarantees. However, TRIS Rating holds the view that the risk is adequately covered by CGIF's capital base.

- ***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 repurchase transactions in order to manage its liquidity needs.

**Key Financial Statistics**

*Unit: US$ million*

| | ------------------------- Year Ended 31 December ---------------------- | | | | |
|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2012 | 2011 |
| Income on investment | 9.4 | 8.8 | 7.6 | 8.0 | 7.5 |
| Income from guarantee | 4.8 | 1.3 | 0.4 | 0.0 | 0.0 |
| Total revenue | 14.8 | 10.1 | 8.1 | 8.0 | 7.5 |
| Net income from operations | 8.2 | 3.6 | 2.7 | 4.1 | 6.2 |
| Total assets | 751.6 | 740.5 | 718.0 | 714.7 | 687.6 |
| Total liabilities | 29.0 | 24.0 | 2.7 | 0.8 | 1.0 |
| Shareholders' equity | 722.6 | 716.5 | 715.2 | 713.9 | 686.6 |

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