CREDIT GUARANTEE AND INVESTMENT FACILITY

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CORPORATES

Issuer Rating:	AAA
Outlook:	Stable

Last Review Date: 30/10/20

Company Rating History:

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

Contacts:

Annop Supachayanont, CFA

annop@trisrating.com

Preeyaporn Kosakarn

preeyaporn@trisrating.com

Narumol Charnchanavivat

narumol@trisrating.com

WWW.TRISRATING.COM

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 solid capital position, conservative risk management framework, and strong liquidity. The rating takes into consideration the challenges CGIF is facing in fulfilling its mission from potentially rising exposure to countries with higher credit risks.

KEY RATING CONSIDERATIONS

Supranational status underpins rating

The rating on CGIF reflects its status as a supranational institution. We believe there is a high likelihood that CGIF will receive financial support from its major contributors in times of financial stress, despite the absence of a callable capital mechanism. We also factor in the strategically important policy roles of CGIF, one of which is to promote development of the regional bond markets.

Additional capital injections from contributors indicate their ability and willingness to provide financial support and their commitment to CGIF's development objectives. Since the second half of 2020, CGIF has received a USD24 million capital injection from Republic of Korea, and USD3 million from Indonesia. This follows the approval of CGIF's contributors in 2017 for a capital increase proposal (CIP) to raise CGIF's paid-up capital on an uncommitted basis to USD1.2 billion by 2023 from USD700 million to support business expansion. CGIF's paid-up capital was USD1.1 billion as of 30 June 2021.

S&P Global Ratings assigned the ratings to the top four contributors, which contributed around 90% of CGIF's capital, in the range of "A+" to "AAA" as of September 2021. These contributors include Japan, People's Republic of China, ADB, and Republic of Korea.

Solid capital buffer

We expect CGIF's capital buffer to remain sufficient to absorb potential credit losses under a stress scenario. Our forecast incorporates the heightened risk of guaranteed defaults to simulate impacts from an economic recession. We also take into account its guarantee exposure at a conservative 1.42 times of total capital as of June 2021.[1] The figure was comparable to 1.46 times as of June 2020, resulting from slow growth. In our opinion, CGIF's conservative growth strategy for its bond guarantee portfolio means that it is unlikely that the figure will reach CGIF's internal limit of 2.5 times over the next few years.

CGIF's equivalent Basel-II capital adequacy ratio was 29.4% as of June 2021, up from 28.2 as of June 2020.[2] The figure remained well above its internal floor of 8.8%.

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[1] *Based on the company's information*
[2] *Based on the company's information*

Conservative risk management contains guarantee risk

In our opinion, continued improvements to the conservative risk management should help CGIF withstand lingering asset quality risks caused by Coronavirus Disease 2019 (COVID-19). For instance, risk-based guarantee pricing should provide an adequate cushion against potential claims. Well-defined risk parameters underpin credit risk assessment as well as monitoring and mitigation guidelines, whilst reinsurance and co-guarantees further mitigate CGIF's credit exposure. CGIF has been successful in maintaining excellent asset quality as there continued to be no default in the guaranteed portfolio as of June 2021.

In the medium term, CGIF aims to pursue a cautious growth strategy as it anticipates slow economic recoveries across target countries in east and southeast Asia. In so doing, it remains selective on underwriting deals in low-risk sectors with limited or positive impact from the pandemic. These include, for instance, healthcare, utilities, e-commerce and financial services. On a more positive note, a sizable reversal in expected credit loss (ECL) of USD6.5 million during the first half of 2021 reflected CGIF's view on improvements in forward-looking economic indicators.

Recent enhancements to the risk management framework complement CGIF's earlier efforts to streamline credit monitoring through early problem recognition and hands-on approaches towards vulnerable guaranteed accounts. Recent additions include tightened definitions of credit risks and refinement of internal watch lists. Similarly, there were new cross-functional credit monitoring units and more frequent reviews of client credit assessments to enhance effective and systematic monitoring. Other refinements were made to various credit-assessment criteria and guidelines on claims and loss recoveries.

Good-quality investment portfolio

Our assessment of CGIF's investment reflects its sizable liquid investment portfolio with good credit quality under a conservative investment strategy. Thanks to the sizeable investment portfolio, these investments generate a meaningful earnings contribution and provide an ample cushion in the event of claims. During the first half of 2021, interest income made up around 56% of CGIF's gross revenue, followed by guarantee fees of 38%.[3]

According to CGIF's investment strategy, the investments comprise debt securities with high credit ratings ranging from "A+" to "AAA" (based on ratings of S&P Global Ratings). These largely comprise debts issued by government-related entities (GRE), including US Treasuries and financial institutions. There is a minimum requirement of "A+" rating applied to debts issued by the GREs of contributing countries. As of June 2021, over half of the fixed-income investments issued by the government or the GREs had credit ratings of "AA-" or better. Its investment policies largely aim at stable investment income via a buy-and-hold strategy with a target effective duration of two to four years. The average effective duration of its investments was 2.84 years at the same period. The figure was down from 3.13 years as of June 2020, due in part to an anticipated rising interest rate environment. There are well-defined concentration limits on countries, single issuers, issuer types, and credit ratings. There are also conservative limits to contain value-at-risk (VaR) and unrealised market loss.

Liquidity remains strong

We expect sizable liquid assets and conservative liquidity risk management will continue to support CGIF's strong liquidity profile. CGIF's investment portfolios comprise high-grade marketable fixed-income securities, which we believe can be readily liquidated with minimal loss to support funding needs. The two-tier approach 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.

BASE-CASE ASSUMPTIONS (2021-2023)

- Leverage ratio to be 1.4 to 1.7 times.
- New guarantees to be around USD400 million per annum.
- Investment yields to be around 1.95% to 2% per annum.

[3] *Based on unaudited financial statements*

RATING OUTLOOK

The "stable" outlook reflects TRIS Rating's view on the ability and willingness of the major contributors to support CGIF and our expectation that CGIF will continue to serve strategic roles in developing regional bond markets. The outlook also reflects our expectation that CGIF will maintain a strong credit profile, a prudent risk management framework, and healthy financial performance.

RATING SENSITIVITIES

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.

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 * 2021	--------------Year Ended 31 December ----------			
		2020	2019	2018	2017
Interest income	13.9	28.9	26.2	19.7	12.5
Guarantee income	9.4	17.4	12.9	8.7	8.4
Other revenue**	1.7	3.4	2.8	1.1	0.1
Total revenue	24.9	49.6	41.9	29.5	21.0
Net income from operations	22.6	23.7	22.6	17.5	10.7
Total assets	1,374.5	1,351.7	1,255.1	957.8	779.1
Total liabilities	80.9	87.1	76.6	46.8	39.9
Shareholders' equity	1,293.6	1,264.5	1,178.4	911.0	739.2

* *Unaudited and not annualised*

** *Including realised gain (loss) from securities, fair value changes from derivatives, commission from reinsurance, and miscellaneous income*

RELATED CRITERIA

- Rating Methodology for Supranational Institutions, 24 July, 2014

Credit Guarantee Investment Facility (CGIF)

Issuer Rating:	AAA
Rating Outlook:	Stable

TRIS Rating Co., Ltd.
Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 0-2098-3000