

# Credit Guarantee and Investment Facility

## Full Rating Report

### Rating

National Insurer Financial Strength Rating	AAA(idn)
National Long-Term Rating	AAA(idn)

### Sovereign Risk

Long-Term Foreign-Currency IDR	BBB
Long-Term Local-Currency IDR	BBB

### Outlook

National Insurer Financial Strength Rating	Stable
National Long-Term Rating	Stable
Sovereign Long-Term	Stable
Foreign-Currency IDR	
Sovereign Long-Term Local-Currency IDR	Stable

### Credit Guarantee and Investment Facility

	Dec 17
Total equity (USDm)	739
Total assets (USDm)	779
Total equity/total assets (%)	94.9
Guarantee exposure <sup>a</sup> /total equity (x)	1.11

<sup>a</sup> After reinsurance

Source: Fitch Ratings, Fitch Solutions

### Key Rating Drivers

**Leverage to Stay Manageable:** Fitch Ratings Indonesia expects Credit Guarantee and Investment Facility (CGIF) to judiciously manage its net par/capital leverage ratio – defined as total outstanding guarantee exposure after reinsurance relative to members' equity – as its guarantee portfolio expands. The ratio stood at 1.1x at end-2017 and Fitch expects it to remain at or below 2.0x.

**Prudent Investment Strategy:** CGIF invests only in fixed-income securities with maturities of more than one year that are rated at least 'A+' on an international scale for government-related issuers of CGIF contributor countries and 'AA-' for other issuers. Its investments in short-term fixed-income instruments cannot be lower than 'F1' on Fitch's rating scale and it cannot invest in the assets it guarantees.

**Short Record:** CGIF's profile is less robust than that of companies with established records of financial and operational success. This limits CGIF's ratings under Fitch's criteria, but is somewhat mitigated by operational linkage with its sponsor.

**High-Risk-Insured Portfolio:** CGIF's insured portfolio is exposed to issuers with non-investment-grade ratings as well as uncapped currency risk, as it provides largely local-currency-denominated guarantees on emerging-market Asian debt. This means that under extremely adverse scenarios, the portfolio is likely to experience periods of high default rates with low recoveries. Losses on defaulted securities would also be magnified by unfavourable movements in exchange rates.

**Sponsorship Mitigates Some Risk:** CGIF's Insurer Financial Strength (IFS) Rating has implicitly factored in the company's sponsorship by the 'AAA' rated Asian Development Bank (ADB), which is a trustee and part-owner. ADB appoints all relevant staff and manages the funds and assets. CGIF has also adopted ADB's applicable operational policies and shares the bank's multilateral supranational status. This linkage reduces some, but not all, start-up related risk, such as unpredictable business growth, given that CGIF is in expansion mode.

**Diverse Ownership Structure:** CGIF's initial capital of USD700 million was contributed by ADB and various Asian sovereign nations, several of which are highly rated, and was used to form CGIF to support the development of Asian capital markets. The contributors have committed to increase CGIF's paid-in capital by USD500 million, to USD1.2 billion, by end-2023.

### Rating Sensitivities

**Weakening Capitalisation:** Downgrade rating triggers include: a rise in the net par/capital leverage ratio to above 3.0x; an investment policy change that could increase risky asset exposure; a move towards the higher use of, or reliance on, reinsurance protection, with the ratio of net/gross notional par insured falling below 75%; an inability to bring in capital to support expansion; and deviation from Fitch's expectations.

**Highest National Scale Rating:** CGIF's National IFS Rating and National Long-Term Rating are already at the highest possible level and cannot be upgraded. Fitch sees CGIF's credit profile as stronger than Indonesia's Long-Term Local-Currency IDR of 'BBB', which supports the assignment of a 'AAA(idn)' IFS Rating on the National scale.

### Related Research

[Indonesia \(October 2018\)](#)

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## Business Profile

### Steady Build-Up of Bond Guarantee Record

CGIF was established in late 2010 to support the development of debt capital markets in Asia by providing financial guarantees on debt issues, primarily corporate issuers. It commenced operations in 2012 and wrote its first bond guarantee in 2013. Premiums from the guarantee business amounted to USD8.4 million in 2017 and USD7.7 million in 2016. CGIF had issued 14 guarantees to 10 issuers by end-2017.

Fitch expects CGIF to steadily build up its operating record in the bond guarantee segment as its coverage further expands. CGIF targets first-time issuers without, or with limited, local bond market access and mainly provides support to corporates in China, Korea, Japan and ASEAN countries. It is also expanding into frontier markets, such as Cambodia, Laos and Myanmar; CGIF is supporting the first bond in Cambodia, with Laos as the next near-term target. Myanmar will require more time, as it does not have corporate bond market regulations.

The company seeks to give guarantees to existing issuers to extend their bond maturities without the elevated premiums associated with long tenures. CGIF supports cross-border transactions within its target markets by looking for opportunities to provide guarantees to local corporates to raise bonds in matching currencies.

### Benefits from Operational Linkage with ADB

Fitch sees CGIF as unique, as it is sponsored and operated by ADB, an established multilateral supranational that carries a 'AAA'/Stable rating on an international scale from Fitch. This sets CGIF apart from commercial start-ups. CGIF's operational linkages with ADB mitigate some, but not all, the risks of a start-up, allowing Fitch to rate CGIF well above 'BBB' rating on the international scale, the start-up constraint.

CGIF is set up as a trust fund of ADB – as opposed to a separate, independent legal entity. Hence, CGIF is accorded the same supranational status as ADB. This is incorporated under Article 13.2 of CGIF's Articles of Association, which states that "The privileges, immunities, and exemptions accorded to ADB pursuant to the Agreement Establishing the Asian Development Bank shall apply to (i) the Trustee, and (ii) the property, assets, archives, income, operations and transactions of CGIF". As with ADB, CGIF is not subject to the law of the Philippines and, as such, is immune from taxation, local business law and bank/insurance regulation.

ADB has close ties with CGIF and provides strong operational support, appointing staff as well as holding in trust and managing CGIF's funds and assets, as set out in the Articles of Association. CGIF's risk management culture and procedures are largely adopted from ADB.

Fitch also views CGIF's growth strategy more favourably than that of commercial operators. There is no time pressure from ADB or the capital contributors to quickly utilise the capital for guaranteeing bond obligations, giving CGIF more leeway to carefully select the corporate bond issuances to guarantee, as opposed to adopting an aggressive or fast-growth path. This approach is in line with ADB's philosophy.

Nonetheless, CGIF is focused on an undeveloped business segment, as the use of debt guarantees in Asia is limited. This carries higher-than-average adverse-selection risk, as it is difficult to judge whether there is a negative bias among issuers that seek to issue insured debt. This risk is core to CGIF's business model and is not mitigated by operational linkages to ADB.

## Related Criteria

[Insurance Rating Criteria \(November 2017\)](#)

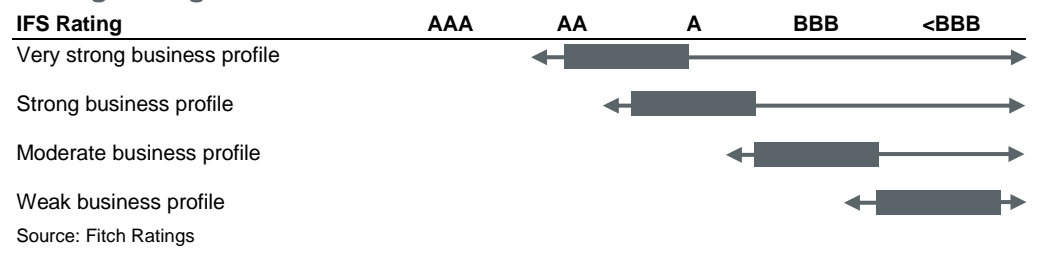
**Potential for Strong Expansion**

The table below shows how the ratings of companies with stronger business profiles in terms of diversification within and between key business lines and markets would more frequently fall into a higher range than insurers with weaker business profiles.

CGIF is categorised as having a moderate business profile based on Fitch’s guidelines for capital and revenue, as its capitalisation of USD700 million is just below that of a guarantor with a strong business profile while its revenue size aligns with that of a small company. However, if considering CGIF’s linkage with ADB, it could be considered as a much larger organisation based on operational infrastructure.

Furthermore, if the business model proves successful, CGIF could expand over the next few years to meet the attributes of a medium or large financial guarantor. It plans to increase its paid-in capital to USD1.2 billion by 2023.

**Ratings Range Based on Business Profile**



**Corporate Governance and Management**

- CGIF’s corporate governance is considered to be effective and neutral to the ratings.
- CGIF’s governance structure consists of the Meeting of Contributors, an eight-member board and three board committees, and two management committees.
- The Meeting of Contributors determines strategic objectives, provides the board and CEO with strategic guidance on overall operations and management and elects the chairperson and other board members.
- The eight-member board comprises the CEO, two representatives each from China and Japan and one each from the ASEAN, Korea and ADB. These representatives are from the ministries of finance or development banks. The board meets at least three times a year.
- Reporting to the board are three committees: audit, internal control and risk management as well as nomination and remuneration. These committees meet regularly.
- There are also two management committees at the operational level – the executive committee chaired by the CEO and the guarantee and investment committee chaired by the chief risk officer. The management team has experience across investment banking, risk management and credit evaluation.

### Ownership Neutral to Rating

Fitch believes CGIF has a strong group of owners/capital providers, but there is no explicit uplift to its ratings due to ownership, other than the benefits of operational linkages with ADB that help mitigate a portion of the risk associated with a short operating record.

Japan, China and Korea contributed 75% of the capital, with the average rating of these key contributors in the 'AA' category on an international scale. The number of votes for each contributor is equivalent to the proportion of its capital contribution. Hence, the largest contributors retain the strongest decision-making power.

Callable capital facilities are used with certain other supranational organisations, but CGIF's capital providers chose not to use such an approach.

### Capital Contributors of CGIF at January 2018

	(%)	Rating/Outlook
Asian Development Bank	15.21	AAA/Stable
Japan (Japan Bank for International Cooperation)	40.10	A/Stable
China	23.40	A+/Stable
Korea	11.70	AA-/Stable
Brunei Darussalam	0.66	n.a.
Cambodia	0.01	n.a.
Indonesia	1.47	BBB/Stable
Lao People's Democratic Republic	0.01	n.a.
Malaysia	1.47	A-/Stable
Republic of the Union Myanmar	0.01	n.a.
Philippines	1.83	BBB/Stable
Singapore	2.53	AAA/Stable
Thailand	1.47	BBB+/Stable
Vietnam	0.13	BB/Stable
<b>Total</b>	<b>100.00</b>	

Source: Fitch Ratings, Fitch Solutions, CGIF

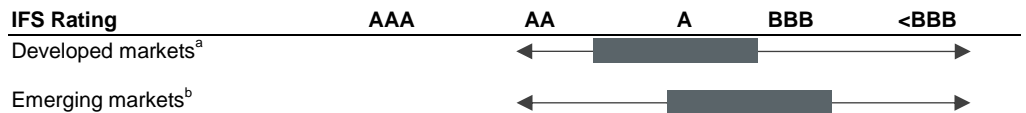
**Sovereign- and Country-Related Constraints**

CGIF enjoys the same supranational status as ADB, so its rating is not constrained by any particular sovereign or macroeconomic risks. Thus, while CGIF is based in the Philippines, Fitch's 'BBB' sovereign rating does not constrain the rating of CGIF.

**Industry Profile and Operating Environment**

Asia-Pacific consists of developed and emerging markets, with the majority of Fitch-rated insurers in developed markets having IFS Ratings in the 'A' category and those in emerging markets in the 'A' to 'BBB' range.

**Asia-Pacific Ratings Range, Based on Industry Profile/Operating Environment**



<sup>a</sup> Consist of Australia, New Zealand, Hong Kong, Korea, Taiwan and Singapore

<sup>b</sup> Consist of the rest of Asia-Pacific, excluding the Japan region

Source: Fitch Ratings

Fitch considers the financial guarantee industry to be a grouping of niche markets. Financial guarantees in Asia are typically granted through direct guarantees by government institutions or commercial guarantees provided by private institutions, the proportion of which differs between markets. Credit guarantees to corporates in Indonesia, Japan, Korea, Malaysia and Taiwan are mostly provided by the government or government-related institutions, while such guarantees in China are largely granted by commercial enterprises.

Not all Asian financial guarantee companies have been successful. For instance, Asian Securitisation and Infrastructure Assurance Ltd, which was set up in 1995 in Singapore as Asia's first regional credit guarantee company, was severely affected by the 1997 Asian financial crisis and was subsequently wound up.

The key challenges facing Asia's financial guarantee industry include the need to maintain a sufficient capital buffer to combat any large regional shock. This is due to high correlation risk within Asian markets and exposure to foreign-currency risks – particularly if guarantees are provided to overseas corporates. The industry also faces adverse selection risk, as the market remains immature.

## Capitalisation and Leverage

	2013	2014	2015	2016	2017	Fitch's expectation
Shareholder equity (USDm)	715	716	723	728	739	Capitalisation to remain solid, with the net par/capital ratio below 2.0x over the long term.
Maximum guaranteed amount <sup>a</sup> (USDm)	125	616	749	1,120	1,096	
Net par/capital leverage (x)	0.17	0.86	1.04	1.16	1.11	
Total financing commitment ratio (x)	0	0	0	0	0	
Financial leverage (%)	0	0	0	0	0	
Shareholder equity/total assets (%)	99.6	96.8	96.1	94.2	94.9	

<sup>a</sup> Maximum guaranteed amount includes principal and coupon  
Source: Fitch Ratings, Fitch Solutions, CGIF

### Manageable Net Par/Capital Leverage

Fitch expects CGIF to manage its net par/capital leverage at 2.0x. This target falls within Fitch's ratings guideline for an 'A' rating on an international scale and is closely aligned to the very high frequency/high severity standard that applies to financial guarantee organisations that face the possibility of very high frequency and high severity defaults on bonds they guarantee.

CGIF had guaranteed 14 bonds amounting to USD1.1 billion by end-2017, including bonds denominated in the Singapore dollar, Vietnamese dong, Philippine peso, Thai baht and Indonesian rupiah. The guaranteed bonds had tenures of three to 10 years and were issued by corporates in various sectors, including telecommunications and automobiles. CGIF's net-par/capital leverage amounted to 1.1x at end-2017, although several transactions were still in the pipeline.

### Additional Capital Infusion to Support Expansion

CGIF contributors approved a USD500 million increase in CGIF's authorised capital in view of its current growth pace, increasing total capital to USD1.2 billion when the additional capital is fully subscribed by end-2023. The capital increase will be implemented in stages, with the first paid-in capital made in December 2017.

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**Debt Service Capability and Financial Flexibility**

	2013	2014	2015	2016	2017	Fitch's expectation
Fixed-charge coverage (x)	n.a.	n.a.	n.a.	n.a.	n.a.	CGIF is prohibited from issuing debt to finance its operations according to its operating policies.
Interest expense (USDm)	0	0	0	0	0	

Source: CGIF

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**Debt Issuance Prohibited**

The company's operating policies strictly prohibit any debt issuance to finance operations. This means there is no constraint on financial and operational flexibility in terms of interest servicing and debt repayment.

## Financial Performance and Earnings

	2013	2014	2015	2016	2017	Fitch's expectation
Net income (USDm)	2.7	3.5	7.8	10.1	10.8	The company's operating result is likely to remain volatile in the near term given its early phase of expansion.
Pre-tax operating return on assets (%)	0.4	0.5	1.0	1.3	1.4	
Return on equity (%)	0.4	0.5	1.1	1.4	1.5	
Combined ratio (%)	1,110	438	125	99	120	
Investment yield (%)	1.1	1.2	1.3	1.5	1.6	

Source: Fitch Ratings, Fitch Solutions, CGIF

### Steady Improvement in Operating Profitability

CGIF's operating result has gradually improved over the previous three years, with a pre-tax return on assets of 1.4% in 2017 (2016: 1.3%). However, its combined ratio, which is the sum of the loss ratio and expense ratio, was 120% (2016: 99%) due to a higher administrative expense during the year.

CGIF does not have specific profit targets or mandates, aside from its objective of supporting the development of the Asian bond market. This differs from most privately owned and commercially run organisations, which have earning growth and dividend expectations. This makes CGIF's performance goals similar to those of many mutual insurance companies or government agencies, where profit margins are set to assure reasonable compensation for the risks being assumed and to support long-term growth in capital commensurate with forecast business growth.

### Managing a High-Risk Insured Portfolio with Uncapped Currency Risk

Fitch sees CGIF's insured portfolio as high risk within the context of its ratings criteria for financial guarantors; a high risk portfolio is characterised by a high frequency and severity of losses and uncapped currency risk. CGIF's underwriting and controls appear well-thought-out and prudent, albeit as yet untested, to manage the high risk from its insured portfolio.

CGIF is exposed to volatile guarantee risk because it provides guarantees to corporate issuances that are rated at non-investment grade. It is also exposed to foreign-currency risk, as it provides largely local-currency-denominated guarantees to emerging markets, including ASEAN countries, Japan, Korea and China.

CGIF caps the size of each bond guarantee at 20% of its paid-in capital, with sub-limits of up to 20% of its maximum guarantee capacity per country and up to 40% of its maximum guarantee capacity per currency. This ensures business diversification and curbs exposure to any single country or currency. CGIF factors in the level of paid-in capital and retained surplus, credit loss reserves, foreign-exchange loss reserves, the amount of illiquid investments and the maximum leverage ratio to determine the level of maximum guarantee capacity. Bonds guaranteed by CGIF are generally limited to tenors of 10 years or below.



## Investments and Asset Risk

	2013	2014	2015	2016	2017	Fitch's expectation
Total invested assets (USDm)	712	715	722	728	740	No significant change to the risk profile of CGIF's investments given its investment approach.
Cash and cash equivalents/total invested assets (%)	1.6	5.2	1.4	1.4	5.6	
Fixed-income securities/total invested assets (%)	98.4	94.8	98.6	98.6	94.4	
Stocks/total invested assets (%)	0	0	0	0	0	
Risky assets/shareholder equity (%)	0	0	0	0	0	
Liquid assets/net claim reserves (%)	n.a.	n.a.	n.a.	n.a.	n.a.	

Source: Fitch Ratings, Fitch Solutions, CGIF

### Prudent Investment Guidelines

CGIF's key investment objective is to protect the principal amount of its investments by investing in liquid, low-risk and high-credit-quality instruments.

Investments are managed by ADB treasury in accordance with CGIF's investment guidelines, which have been adopted in agreement with ADB. CGIF invests in only cash and deposits and fixed-income securities. No equity investments are considered. Eligible fixed-income securities with maturity terms of more than one year must be rated at least 'A+' on an international scale for government-related issuers of CGIF contributor countries and 'AA-' for other issuers. CGIF may invest in fixed-income securities with shorter terms, but such investments have so far been minimal. Return on investment was 1.6% in 2017 (2016: 1.5%) against an approved investment return target of 1.35% for the year.

It is CGIF's policy to limit its aggregate exposure to central government or government-related entities of any jurisdiction to below 10% of the organisation's equity for 'A+' rated governments and 30% of the equity for others.

### Foreign-Currency Risk Exposure

CGIF has significant exposure to foreign-currency risk because it guarantees bonds denominated in the various currencies of the market of issuance while its functional currency is the US dollar.

This means under extremely adverse scenarios, the portfolio is likely to experience periods of high default rates with low recoveries. However, due to the weakening local currencies against CGIF's capital, which denominated in US dollars, losses to default rates and low recoveries are likely to be mitigated.

CGIF retains the right to pay in US dollars if it is unable to obtain a sufficient amount of the bond issue's currency at the time of payment and it determines the method of calculating the exchange rate upfront as part of the policy language. Thus, CGIF is not at risk of defaulting on a guarantee due to a lack of the bond issue's currency.

**Liquidity Risk Reasonably Managed**

Fitch does not expect CGIF to face any severe liquidity problems given its appropriate management of liquidity risk. By policy, all CGIF investments must be marketable within a reasonable time. CGIF allocated more than 90% of its investments in bonds and time deposits with maturity duration of less than five years in 2017. CGIF's portfolio duration was 2.85 years as at end-2017.

The possibility of an unexpected liquidity crisis is limited due to CGIF's right to accelerate or retain the original interest/principal payment schedule in the event of a default on an insured bond, eliminating the liability-acceleration risk.

CGIF has a global master repurchase agreement with an European bank that allows CGIF to transact in repos, when necessary – for instance, when bond defaults are high during a period of high interest rates, implying unrealised losses exist on the investment bond portfolio – as opposed to simply liquidating a security before maturity, especially if at a loss.

**Reserve Adequacy**

(%)	2013	2014	2015	2016	2017	Fitch's expectation
Net claim reserve/net claims incurred (x)	n.a.	n.a.	n.a.	n.a.	n.a.	CGIF's claim reserve ratio could be volatile in the short-term due to its limited claim liability development record. Nonetheless, no bond that CGIF has guaranteed is in default so far.
Net claim reserve/shareholder equity (x)	0	0	0	0	0	
Cash and bank deposits/net claim reserve (%)	n.a.	n.a.	n.a.	n.a.	n.a.	
Net technical reserve/shareholder equity (%)	0.2	3.1	3.9	5.7	5.0	
Net claims paid/net claims incurred (%)	n.a.	n.a.	n.a.	n.a.	n.a.	
Change in net claim reserve/net premium earned (%)	0	0	0	0	0	
Reinsurance recoverables/equity (%)	0	0	0	0	0	

Net technical reserve is the net claim reserve plus the unearned premium reserve.

Source: Fitch Ratings, Fitch Solutions, CGIF.

**Conservative Credit Loss-Reserve Process**

No bond that CGIF has guaranteed is in default status so far. No provision for credit losses has been established under its balance sheet.

CGIF appears to have a conservative, although untested, approach for establishing credit-loss reserves in light of the high-risk nature of its business, which is likely to result in periodic losses. Provisions for credit losses ranging from 20%-100% of the guarantee amount are set according to the internally generated bond ratings assigned to individual bonds. The provisions are based on statistical estimation and assumptions of probability of default and loss given default.

Ratings from board-approved parties will be obtained to assess the consistency of CGIF's internal ratings and those assigned by such parties to ensure the correct application of the international technical standards by CGIF and the effectiveness of its internal risk-rating system during CGIF's initial operations. Each outstanding guarantee will be reviewed and re-rated at least annually. In the case of deterioration in the bond issuer's credit profile, additional provisions will be set aside based on the perceived lower credit rating. In addition, management will make specific provisions for any guarantee that is at risk on a case-by-case basis based on ongoing monitoring of all guarantees outstanding.

**Reinsurance**

CGIF has arranged a quota-share reinsurance treaty to support its underwriting capacity. All reinsurers under this treaty have an IFS Rating of at least 'A-'.

## Appendix: Other Rating Considerations

Below is a summary of additional rating considerations of a technical nature that are part of Fitch's rating criteria.

### Group IFS Rating Approach

Group IFS Rating approach is not applicable for the company.

### Notching

CGIF is based in the Philippines but has the same multilateral organisation status as that of ADB. As such, it is not subject to local business or insurance regulations or capital regulatory frameworks.

CGIF follows the 'Other' regulatory environment classification for notching purpose, although Fitch assesses the regulatory environment of the Philippines as 'Effective' and classified as following a ringfencing approach.

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### Notching Summary

**Holding company**

Not applicable.

**IFS Ratings**

A recovery assumption of 'Average' applies to the IFS Rating and non-standard notching associated with the noted recovery assumption was used from the IFS anchor Rating to the operating company Issuer Default Rating, given CGIF's status as a multilateral organisation and the limited scope of regulation assumed by Fitch.

**Debt**

Not applicable.

**Hybrids**

Not applicable.

Source: Fitch Ratings

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### Criteria Variations

None.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

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