Research Update:

Credit Guarantee and Investment Facility 'AA/A-1+' Ratings Affirmed; Outlook Stable

February 24, 2021

PRIMARY CREDIT ANALYST

YeeFarn Phua
Singapore
+ 65 6239 6341
yeefarn.phua
@spglobal.com

SECONDARY CONTACT

Rain Yin
Singapore
+ (65) 6239 6342
rain.yin
@spglobal.com

Overview

- The COVID-19 pandemic has not hurt the credit quality of CGIF's portfolio. The trust fund of the Asian Development Bank (ADB) continues to execute its guarantees.
- CGIF is likely to maintain its extremely strong financial profile underpinned by its robust capital position and increasing capital contributions. The facility's short lifespan and small footprint limit its business profile.
- We are affirming our 'AA/A-1+' foreign currency issuer credit ratings on CGIF. We are also affirming the 'AA' long-term issue rating on CGIF's guaranteed notes.
- The stable outlook reflects our expectation that CGIF will maintain a solid buffer against potential guarantee calls over the next 24 months.

Rating Action

On Feb. 24, 2021, S&P Global Ratings affirmed its 'AA' long-term and 'A-1+' short-term foreign currency issuer credit ratings on Credit Guarantee and Investment Facility (CGIF). The outlook is stable. We are also affirming the 'AA' long-term issue rating on CGIF's guaranteed notes.

Rationale

We affirmed the ratings on CGIF because we expect the facility to maintain its adequate enterprise risk profile and extremely strong financial risk profile. CGIF has no callable capital. The long-term issuer credit rating therefore reflects our assessment of the facility's 'aa' stand-alone credit profile.

Our assessment of CGIF's enterprise risk profile reflects the facility's role as a bond guarantor for the past four years. CGIF has been steadily increasing its guarantee portfolio on the back of a larger equity base. The facility's shorter track record of fulfilling its policy mandate than other supranational institutions' constrains its enterprise risk profile.

CGIF acts as a catalyst for bond deals, rather than helping to deepen the capital markets by boosting volumes. We believe deepening of the Association of South East Asian Nations (ASEAN) bond markets through credit enhancement will remain limited. So will the role of CGIF because its function could partially be filled by a commercial entity. To strengthen its policy role, CGIF has been focusing on frontier markets in ASEAN, first-time issuers in local currencies, and the policy priorities of the Asian Bond Market Initiatives to contribute to market creation.

In response to the COVID-19 pandemic, CGIF has enhanced its credit risk management systems and surveillance frequency to better gauge the riskiness of its portfolio.

We believe CGIF has a conservative approach to underwriting. However, some of its accounts fall within high-risk sectors such as oil and gas, real estate, and microfinance lending. These are vulnerable to the effects of the pandemic. These high-risk portfolios account for around one-fifth of CGIF's portfolio. To date, CGIF's accounts, including the high-risk sectors, maintain a comfortable liquidity position and no guarantee calls have been invoked.

Established in November 2010, CGIF's mandate is to deepen and develop liquid local-currency bond markets among ASEAN members. The institution provides guarantees on bonds issued by corporates in ASEAN. As of Feb. 24, 2021, CGIF had issued 41 guarantees in Singapore, Philippines, Thailand, Indonesia, and Vietnam. The guaranteed amount typically ranges between US$50 million and US$100 million and generally has a tenor of three to 10 years. This compares with CGIF's equity base of US$1.2 billion as of end-2020.

CGIF was set up as a trust fund of the ADB. We believe CGIF's creditworthiness benefits from its relationship with its contributors and the mandate they have entrusted it with. CGIF has a balanced shareholder base, and all shareholders are either governments or government-related agencies with strong government links. The current voting rights are dominated by four contributors: China (31.1%), Japan (31.1%), Korea (13.4%), and the ADB (16.3%). The 10 ASEAN governments collectively hold the remaining voting rights (8.1%).

CGIF's shareholders have demonstrated their support by approving its first ever capital increase to US$1.2 billion from US$700 million in December 2017. The subscription increase is on a voluntary and proportional basis. 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 US$1.75 billion. As of end-September 2020, CGIF's paid in capital was $1,102 million. In our view, the successful completion of this exercise will highlight CGIF's strong shareholder support.

CGIF renewed its annual reinsurance arrangement with a syndicate of reinsurers rated between 'AA-' and 'A'. This will boost its guarantee capacity and manage credit concentration risk limits. In 2020, one new name joined the treaty panel, increasing the count to five global reinsurers. The arrangement covers 25% of CGIF's existing guarantee portfolio. Including additional insurance on specific transactions, the coverage by the panel increases to about 30% of the portfolio. Current country and currency exposures have been alleviated by approximately 15% as a result of the transfer of exposure to the reinsurers. Coupled with the capital increase, the reinsurance agreement will enhance CGIF's guarantee capacity.

CGIF's private-sector focused mandate excludes it from being treated as a preferred creditor. That is because private-sector companies cannot selectively default to one group of creditors while paying others as sovereigns can. Hence, we do not incorporate preferred creditor treatment in our assessment of CGIF's enterprise risk profile.

However, given CGIF's status as a multilateral lending institution, we consider preferential treatment for the institution from the governments of countries in which it operates. We incorporate this factor into our assessment of CGIF's financial risk profile. These benefits include free from transfer and convertibility restrictions, which would aid in recovery and collateral repossession if there is a guarantee call.

We believe CGIF's management team has the necessary expertise and experience to conduct its business and achieve its mandate. That said, CGIF has a short record of operations. Its guarantee operations are controlled by prudent 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.

We consider CGIF's extremely strong financial profile to be a positive rating factor. The facility's risk-adjusted capital (RAC) ratio after adjustments as of year-end 2020 stood at 39.1%--well above our 23% threshold for an extremely strong capital adequacy assessment. The RAC ratio has remained broadly stable; it was 39.3% as of end-June 2019. We expect this trend to continue over the next few years, with CGIF maintaining the RAC ratio comfortably above 23%.

CGIF's asset quality has so far been pristine. No bond issuance has defaulted and required the payout on CGIF's guarantees. We believe this is a result of the guaranteed exposure representing companies in the region with relatively high ratings, as well as CGIF's conservative risk appetite. Should a default occur, the typical sizes of each issue at 7%-12% of CGIF's capital levels will limit the impact.

CGIF does not borrow; it obtains funding for its activities solely through retained earnings and contributors' equity. We believe sovereign and supranational backing provides one of the most stable sources of funding. However, this model also represents a concentration risk that could be tested in case of severe stress. We assign a neutral funding score because we believe the positive factor of paid-in capital base is counterbalanced by the lack of access to the wholesale market.

We assess CGIF's liquidity position as robust. The institution should 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. As of Dec. 31, 2020, our stressed liquidity ratio for CGIF was 9.3x for the next 12 months. The facility's liquid assets, managed by the ADB, are invested mostly in bonds of highly rated governments or government-related entities. They form the bulk of CGIF's balance sheet assets.

Outlook

The stable outlook on CGIF reflects our expectation that the facility will maintain a solid balance sheet over the next 24 months. This will buffer against potential guarantee calls amid weaker macroeconomic conditions induced by the global pandemic.

We believe changes to the rating will most likely be driven by the effectiveness of CGIF's 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 if its financial metrics weaken. This could happen if: (1) the facility aggressively expands its guarantee portfolio beyond the natural growth capacity provided with the increase in capital; or (2) it has inadequate risk management to deal with sudden surges in guarantee calls.

Further, we believe a drastic pull-back in CGIF's guarantee deals over a prolonged period would indicate a diminishing policy role and lead to a downgrade.

Upside scenario

Upward pressure on the rating could emerge if CGIF shows a record of significantly contributing to a vibrant local currency regional capital market backed by ongoing shareholder support.

Ratings Score Snapshot

Issuer Credit Rating: AA/Stable/A-1+

SACP: aa

Enterprise Risk Profile: Adequate

- Policy Importance: Adequate
- Governance and management: Adequate

Financial Risk Profile: Extremely Strong

- Capital Adequacy: Extremely Strong
- Funding and Liquidity: Strong

Extraordinary Support: 0

- Callable Capital: 0
- Group Support: 0

Holistic Approach: 0

Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Supranationals Special Edition 2020: Report Says Multilateral Lenders Are Addressing Challenges from COVID-19, Oct. 21, 2020
- Supranationals Special Edition 2020: Comparative Data For Multilateral Lending Institutions, Oct. 21, 2020
- Introduction to Supranationals Special Edition, Oct. 20, 2020
- How Multilateral Lending Institutions Are Responding To The COVID-19 Pandemic, June 9, 2020

- Can Multilateral Lenders' Capital Bases Hold Up Against COVID-19, June 9, 2020
- ESG Industry Report Card: Supranationals, Feb. 11, 2020

Ratings List

Ratings Affirmed	
Credit Guarantee and Investment Facility	
Issuer Credit Rating	
Foreign Currency	AA/Stable/A-1+