

Credit Guarantee and Investment Facility

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 1.0x at end-2019 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.

Operational linkage with AsDB: CGIF is sponsored and operated by Asian Development Bank (AsDB, AAA/Stable). CGIF is set up as a trust fund of AsDB rather than as a separate, independent legal entity. Hence, AsDB has close ties with CGIF and provides strong operational support.

High-Risk Insured Portfolio: CIGF 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.

Sponsorship Mitigates Risk: CGIF's Insurer Financial Strength (IFS) Rating factors in its sponsorship by AsDB, which is a trustee and part owner. AsDB appoints CGIF's staff and manages its funds and assets. These linkages reduce risks as CGIF's operation is conducted according to its policies and all applicable AsDB operational policies and it shares the bank's multilateral supranational status.

Diversified Ownership Structure: CGIF's initial capital of USD1.1 billion was contributed by AsDB 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 raise CGIF's paid-in capital to USD1.2 billion by end-2023.

Rating Sensitivities

Weakening Capitalisation: Negative rating action could come from a rise in the net par/capital leverage ratio to above 3.0x, losses in the guarantee portfolio adversely deviating from the company's expectation, a 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 or 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 believes CGIF's credit profile is stronger than Indonesia's Long-Term Local-Currency Issuer Default Rating (IDR) of 'BBB', which supports the assignment of an 'AAA(idn)' IFS Rating on the national scale.

Ratings

Credit Guarantee and Investment Facility

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

Outlooks

National Insurer Financial Strength	Stable
National Long-Term Rating	Stable

Financial Data

Credit Guarantee and Investment Facility (USDm)	2018	2019
Total equity	911	1,178
Total assets	958	1,255
Return on equity (%)	2	2
Net income	17	23

Source: Fitch Ratings, CGIF

Applicable Criteria

[Insurance Rating Criteria \(August 2020\)](#)
[National Scale Rating Criteria \(June 2020\)](#)

Industry Profile and Operating Environment

[Industry Profile and Operating Environment: Indonesian Insurance \(June 2020\)](#)

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Business Profile

Moderate Business Profile

Fitch ranks CGIF's business profile as 'Moderate', factoring in our view of CGIF's competitive position, business risk and diversification as 'Moderate'. The business profile credit factor has a low influence on the rating, reflecting CGIF's mandate to fulfil development goals.

Substantive Business and Smaller Operating Scale

CGIF was established in 2010 to support the development of debt capital markets in Asia by providing financial guarantees on debt issues. It commenced operation in 2012 and wrote its first bond guarantee in 2013. Its capitalisation of USD1.2 billion is above that of a guarantor with a 'Favourable' operating scale, while revenue aligns with that of a 'Least Favourable' operating scale. However, CGIF can be considered to be a much larger organisation, based on operational infrastructure, in light of its linkage with AsDB.

Premiums from the guarantee business amounted to USD12.9 million in 2019. CGIF had issued 28 guarantees to 20 issuers over the year. Fitch expects CGIF to steadily build up its operating record in the bond guarantee segment as its coverage expands. CGIF targets first-time issuers without, or with limited, local bond-market access and mainly supports corporates in south-east Asia as well as China, South Korea and Japan. The company plans to focus on its five key markets; the Philippines, Indonesia, Cambodia, Lao and Myanmar.

CGIF provides guarantees to existing issuers to extend their bond maturities and support cross-border transactions.

Risk Appetite on Par with Insurance Sector

Fitch regards CGIF as unique, as it is sponsored and operated by AsDB, an established multilateral supranational. CGIF is set up as a trust fund of AsDB rather than as a separate, independent legal entity. Hence, it is accorded the same supranational status, as incorporated under Article 13.2 of its Articles of Association, which states that "the privileges, immunities, and exemptions accorded to AsDB 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". The organisation, like the AsDB, is not subject to the laws of the Philippines, where it is based, and, as such, is immune from taxation, local business laws and bank or insurance regulations.

AsDB 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 AsDB.

Fitch also thinks CGIF's growth strategy is more favourable than that of commercial operators. There is no time pressure from AsDB or the capital contributors to quickly utilize capital for guaranteeing bond obligations, giving CGIF leeway to carefully select the issuance it guarantees, instead of adopting an aggressive or fast-growth path. This approach is in line with AsDB's philosophy.

Nonetheless, CGIF is focussed on undeveloped business segments, as the use of debt guarantees in Asia is limited. This carries higher-than-average risk of making an adverse selection, as it is difficult to judge the business viability of the companies that seek to issue insured debt. This risk is core to CGIF's business model and is not mitigated by operational linkages with AsDB. CGIF guarantees bonds in diverse sectors, including telecommunications, financial institutions and healthcare. It also support cross-border transactions within its target markets by looking for opportunities to provide guarantees to local corporates.

Ownership

Fitch believes CGIF has a strong group of owners and capital providers, but there is no explicit uplift to its ratings from this ownership, other than the benefits of operational linkages with AsDB that mitigate a portion of the risk associated with a short operating record. The company obtains its funding exclusively from the sponsors; thus, Fitch has considered the benefits and risks of its ties to parent funding in the ownership evaluation.

Japan, China and Korea contributed around 75% of the capital. 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 for some supranational organisations, but CGIF's capital providers chose not to use such an approach.

CGIF Capital Contributors at April 2020

	(%)	Rating/Outlook
AsDB	16.70	AAA/Stable
Japan (Japan Bank for International Cooperation)	31.81	A/Negative
China	31.81	A+/Stable
Korea	11.49	AA-/Stable
Brunei Darussalam	0.52	n.a.
Cambodia	0.02	n.a.
Indonesia	1.17	BBB/Stable
Lao People's Democratic Republic	0.02	n.a.
Malaysia	1.17	BBB+/Stable
Republic of the Union Myanmar	0.01	n.a.
Philippines	2.00	BBB/Stable
Singapore	2.00	AAA/Stable
Thailand	1.17	BBB+/Stable
Vietnam	0.10	BB/Stable
Total	100.00	

Source: Fitch Ratings, CGIF

Capitalisation and Leverage

Sustaining the Improvement in Capitalisation

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 with the standards of financial-guarantee organisations that face the possibility of a high frequency and severity of default on the bonds they guarantee. CGIF had guaranteed 28 bonds amounting to USD1.6 billion by end-2019, including bonds denominated in Singapore dollars, 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 was 1.0x at end-2019, from 1.1x at end-2018, although several transactions were still in the pipeline.

CGIF contributors approved a USD500 million increase in CGIF's authorised capital in view of its growth pace, which will increase 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. The current capital amount may be sufficient for CGIF's business, while the second round increase of paid-in capital will provide additional support.

Fitch Expectations

Capitalisation to remain solid, with a net par/capital ratio of below 2.0x over the long term.

Financial Performance and Earnings

Steady Financial Performance

CGIF's operating results have improved over the last three years, with a return on equity of 2.2% in 2019 (2018: 2.0%) and a combined ratio – the sum of the loss and expense ratios – of 83% (2018: 118%). 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 earnings growth and dividend targets. This makes CGIF's performance goals similar to those of mutual insurance companies and government agencies whose profit margins are set to ensure reasonable compensation for the risk assumed and to support long-term capital growth that is commensurate with forecast business growth.

Fitch sees CGIF's insured portfolio as high risk within the context of its ratings criteria for 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 untested, to manage the high risk from its insured portfolio. CGIF is exposed to volatile guarantee risks because it guarantees non-investment-grade corporate issuance. It is also exposed to foreign-currency risk, as it provides local currency-denominated guarantees to emerging markets.

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.

Fitch Expectations

Operating results to remain volatile in the near term as the company is in the early phase of expansion.

Financial Highlights

(USDbn)	2018	2019
Total shareholders' equity	0.9	1.2
Notional insured par	1.4 ^a	2.1
Net par/capital leverage (x)	1.1	1.0
Financial leverage (%)	0	0

^a Maximum guaranteed amount includes principal and coupon
Source: Fitch Ratings, CGIF

Financial Highlights

(%)	2018	2019
Net income (USDm)	16.9	23.2
Return on equity	2.0	2.2
Combined ratio	118	83
Investment yield	2.3	2.4

Source: Fitch Ratings, CGIF

Investment and Asset Risk

Prudent Investment Strategy Mitigates Risk

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 AsDB's treasury in accordance with CGIF's treasury risk management guidelines, which have been adopted in agreement with the sponsor. 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 remaining terms to maturity of up to one year with short term credit ratings of at least 'A-' or equivalent.

CGIF has significant exposure to foreign-currency risk because it guarantees bonds denominated in 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, this is likely to be mitigated by the weakening of local currencies against CGIF's capital, which is denominated in US dollars. 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 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.

Fitch does not expect CGIF to face severe liquidity problems due to its appropriate management of liquidity risk. All CGIF investments, by policy, must be marketable within a reasonable time. CGIF allocated more than 90% of its investments in bonds and time deposits with maturity durations of less than five years in 2019, giving the portfolio a duration of 3.1 years at the end of the year. The possibility of a liquidity crisis is limited due to CGIF's right to accelerate or retain the original interest or principal payment schedule in the event of a default on an insured bond, eliminating liability-acceleration risk. CGIF has a global master repurchase agreement with a European bank that allows it 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 invested bond portfolio – instead of liquidating a security before maturity, especially at a loss.

Fitch Expectations

No significant change to the risk profile of CGIF's investments in light of its investment approach.

Reserve Adequacy

Stable Reserving Trends and Practices

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 internally generated bond ratings assigned to individual bonds. The provisions are based on statistical estimations and assumptions of probability of default and loss given a default. Ratings from board-approved parties are used to assess the consistency of CGIF's internal ratings to ensure it correctly applies international technical standards and that its internal risk-rating system is effective during its initial operation. Each outstanding guarantee is reviewed and re-rated at least annually. Should a bond issuer's credit profile deteriorate, additional provisions are set aside based on the perceived lower credit rating. Management also makes specific provisions for any at-risk guarantee on a case-by-case basis based on ongoing monitoring of all guarantees outstanding.

Fitch Expectations

Short term volatility in CGIF's claim reserve ratio due to its limited claim liability development record. Nonetheless, no bond that CGIF has guaranteed is in default to date.

Financial Highlights

(%)	2018	2019
Risky asset ratio	0	0
Equity investment capital	0	0

Source: Fitch Ratings, CGIF

Financial Highlights

	2018	2019
Net loss reserves/incurred losses (x)	n.a	n.a
Paid/incurred losses (x)	n.a	n.a
Change in ratio of reserves/earned premium (%)	0	0

Source: Fitch Ratings, CGIF

Reinsurance, Risk Mitigation and Catastrophe Management

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-'. There has been no material change to the 25% quota share reinsurance treaty programme.

Appendix A: Peer Analysis

Unique Business Profile, No Direct Peers

CGIF has no equivalent like-for-like peers for a relevant peer comparison, given its specialised nature and focus on supporting the development of debt capital markets in Asia by providing financial guarantees on debt issues.

Fitch compares CGIF with GuarantCo Ltd., a financial guarantor that is also owned by government agencies and follows development objectives. GuarantCo provides infrastructure guarantees in Africa and Asia.

Peer Comparison

(USDm)	IFS Rating	Shareholders' Equity	Gross par/Par	Net par/capital (x)	Financial Leverage (%)	Return on Equity	Risky assets/equity
CGIF	AAA(idn)/ Stable	1,178	2,090	1.0	0	2	0
GuarantCo	AA-/Negative	273	653	1.6	0	1	0

Source: Fitch Ratings, CGIF, GuarantCo

Appendix B: Other Ratings Considerations

Below is a summary of additional ratings considerations that are part of Fitch’s ratings criteria.

Group IFS Rating Approach

Group IFS rating approach is not applicable for this company.

Notching

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

CGIF follows the ‘Other’ regulatory environment classification for nothing purposes, although Fitch assesses the regulatory environment of the Philippines as ‘Effective’ and classified as following a ringfencing approach.

Notching Summary

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 IDR, given CGIF’s status as a multilateral organisation and the limited scope of regulation assumed by Fitch.
Operating Company Debt
n.a
Holding Company IDR
n.a
Holding Company Debt
n.a
Hybrids
n.a
Source: Fitch Ratings

Short-Term Ratings

Not applicable

Hybrid – Equity/Debt Treatment

Not applicable

Corporate Governance and Management

Fitch considers CGIF’s corporate governance to be effective and neutral to the ratings. The governance structure consists of the meeting of contributors, an eight-member board, three board committees and two management committees. The board comprises the CEO, two representatives, each from China and Japan, and one each from south-east Asia, Korea and AsDB. These country representatives are from the ministries of finance or development banks. The board meets at least three times a year.

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