

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 the net par/capital leverage ratio – defined as total outstanding guarantee exposure after reinsurance relative to members' equity – as the guarantee portfolio expands. The ratio stood at 1.1x at end-2020 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 ADB: CGIF is sponsored and overseen by the Asian Development Bank (ADB, AAA/Stable). CGIF is set up as a trust fund of ADB rather than as a separate, independent legal entity. Hence, ADB has close ties with CGIF and provides strong operational support. ADB 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 ADB operational policies, and CGIF shares the bank's multilateral supranational status.

High-Risk Insured Portfolio: CGIF's insured portfolio is exposed to issuers with non-investment-grade ratings, as it provides largely local-currency-denominated guarantees on emerging-market Asian debt. CGIF is exposed to volatile credit 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. However, such risk is mitigated because any reduction in the US dollar value of guarantee fees receivable due to depreciation of a local currency against the US dollar is countervailed by the reduction in the US dollar amount of principal guaranteed.

Diversified Ownership Structure: CGIF's initial capital of USD1.1 billion 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 bond 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 6x, losses in the guarantee portfolio adversely deviating from the company's expectation and a material increase in reliance on reinsurance protection.

Highest National Scale Rating: CGIF's National Insurer Financial Strength (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		
	2019	2020
(USDm)	Audited	Audited
Total equity	1,178	1,264
Total assets	1,255	1,351
Return on equity (%)	2	2
Net income	23	24

Source: Fitch Ratings, Fitch Solutions, CGIF

Applicable Criteria

[Insurance Rating Criteria \(April 2021\)](#)

[National Scale Rating Criteria \(December 2020\)](#)

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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'.

Substantive Business and Smaller Operating Scale

CGIF was established in 2010 to support the development of bond capital markets in Asia by providing financial guarantees on local currency-denominated bond issues. It commenced operations 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, we regard CGIF as a much larger organisation, based on operational infrastructure, in light of its linkage with ADB.

Premiums from the guarantee business amounted to USD19.9 million in 2020. CGIF had issued 40 guarantees to 30 issuers over the year. Fitch expects CGIF to build up an operating record steadily in the bond guarantee segment as coverage expands. CGIF targets first-time issuers without, or with limited, local bond-market access and supports mainly 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, expand their investor base and support cross-border transactions.

Risk Appetite in Accord with Mandate

Fitch regards CGIF as unique, as ADB is the sponsor and overseer. ADB is an established multilateral supranational. CGIF is set up as a trust fund of ADB rather than as a separate, independent legal entity. Hence, CGIF is accorded the same supranational status as incorporated under section 13.2 of its 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". The organisation, like the ADB, 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.

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

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

Ownership

Fitch believes CGIF has strong contributors, but there is no explicit uplift to the ratings from this ownership, other than the benefits of operational linkages with ADB that reduce a portion of the risk associated with a short operating record. Fitch views the ownership as neutral for the rating. CGIF obtains funding exclusively from the contributors; thus, Fitch has considered the benefits and risks of 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 as of April 2021

	(%)	Rating/Outlook
ADB	16.29	AAA/Stable
Japan (Japan Bank for International Cooperation)	31.02	A/Negative
China	31.02	A+/Stable
Korea	13.36	AA-/Stable
Brunei Darussalam	0.51	n.a.
Cambodia	0.02	n.a.
Indonesia	1.41	BBB/Stable
Lao People's Democratic Republic	0.02	n.a.
Malaysia	1.14	BBB+/Stable
Republic of the Union Myanmar	0.01	n.a.
Philippines	1.95	BBB/Stable
Singapore	1.95	AAA/Stable
Thailand	1.14	BBB+/Stable
Vietnam	0.17	BB/Positive
Total	100.00	

Source: Fitch Ratings, CGIF

Capitalisation and Leverage

Sustaining the Improvement in Capitalisation

CGIF had guaranteed 33 bonds amounting to USD 2.2 billion¹ by end-2020, including bonds denominated in Singapore dollars, Vietnamese dong, Philippine peso, Thai baht, Japanese yen, Cambodian riel and Indonesian rupiah. The guaranteed bonds had average tenures of three to 10 years and were issued by corporations in various sectors, including telecommunications and automobiles. CGIF's net par/capital leverage was 1.1x at end-2020, against 1.0x at end-2019, although several transactions were 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 remained manageable over the past three years, with a return on equity of 2.0% in 2020 (2019: 2.2%). 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 forecasted business growth.

Fitch sees CGIF's guaranteed 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. CGIF's underwriting and controls appear well-thought-out and prudent, albeit untested, to manage the high risk from its guaranteed portfolio. CGIF is exposed to volatile credit risks, as it guarantees non-investment-grade corporate bond 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 guaranteed portfolio 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. Generally, bonds guaranteed by CGIF are limited to tenors of 10 years or below.

Fitch Expectations

- Maintain its prudent underwriting practice in light of its business focus on a high-risk-guaranteed portfolio.

Financial Highlights

(USDbn)	2019	2020
Total shareholders' equity	1.2	1.3
Notional insured par ^a	2.1	2.3
Net par/capital leverage (x)	1.0	1.1
Financial leverage (%)	0	0

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

Financial Highlights

(%)	2019	2020
Net income (USDm)	23.2	23.9
Return on equity	2.2	2.0

Source: Fitch Ratings, CGIF

¹The amount refers to the gross notional principal amount of all 40 CGIF guaranteed bonds since its inception of operations. The amounts were converted to USD by the use of spot exchange rate on the date of bond issuance.

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 ADB'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. 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 access to the bond issue's currency.

Fitch does not expect CGIF to face severe liquidity problems due to 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 2020, giving the portfolio a duration of three years at the end of 2020. 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 a guaranteed 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, 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 assesses credit loss reserves according to Basel standards. Credit loss reserves are assessed as the amount of expected loss, the product of each account's probability of default and loss given default, where probabilities of default correspond 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

(%)	2019	2020
Risky assets ratio	0	0
Equity investment capital	0	0

Source: Fitch Ratings, CGIF

Financial Highlights

	2019	2020
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. Nonetheless, in view of ensuring sound diversity in the guarantee portfolio, several accounts were reinsured under special acceptance cession. This exception is allowed under the guarantee and investment committee approval.

Fitch Expectations

- CGIF's risk management and risk mitigating capabilities to remain robust.

Financial Highlights

%	2019	2020
Reinsurance recoverable	0	0
Single risk par/capital	10	9
Net notional par/gross notional par insured	70	71

Source: Fitch Ratings, CGIF

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. (IFS: AA-/Negative), 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 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 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 regards CGIF’s corporate governance as 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 ADB. 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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