

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 Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Credit Guarantee and Investment Facility

	31 Dec 15
Total equity (USDm)	722.6
Total assets (USDm)	751.6
Total equity/total assets (%)	96.1
Guarantee exposure/total equity (x)	1.04

Key Rating Drivers

Leverage to Remain Manageable: Fitch Ratings expects Credit Guarantee and Investment Facility (CGIF) to judiciously manage its net-par-to-capital leverage as its guarantee portfolio grows. CGIF's net-par-to-capital leverage, which is defined as the ratio of the total amount of outstanding guarantee exposure after reinsurance relative to CGIF's members' equity, stood at 1.42x at end-1H16. Fitch expects CGIF to keep its net-par-to-capital leverage at or below 2.0x.

Extremely Prudent Investment Strategy: CGIF invests only in fixed-income securities with maturities of more than a year that are rated at least 'AA-' on an international scale. Its investments in short-term fixed-income instruments cannot be lower than 'F1' on Fitch's rating scale. It cannot invest in the assets it guarantees.

Limited Track Record: The profile of CGIF presents far less certainty than that of a company with an established track record of financial and operational success. This limits CGIF's ratings under Fitch's criteria, although this is not fully applicable in CGIF's case.

High-Risk-Insured Portfolio: CGIF's insured portfolio is exposed to issuers with non-investment-grade ratings as well as uncapped currency risks because 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 where default rates are very high, while recoveries on defaulted securities are low. Losses on defaulted securities would also be magnified if exchange rates were to move unfavourably.

Sponsorship Mitigates Certain Risks: CGIF's Insurer Financial Strength (IFS) rating exceeds that available to most start-up organisations due to its 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. These linkages reduce many – but not all – the risks associated with CGIF's start-up nature.

Diverse Ownership Structure: CGIF's initial capital of USD700m was contributed by various Asian sovereign nations and ADB, which formed CGIF to support the development of Asian capital markets. Several of the capital contributors are very highly rated, but there are no formal commitments in place by the owners to provide additional capital, making any future contributions voluntary.

Rating Sensitivities

Weakening in Capitalisation: Downgrade rating triggers include the net-par-to-capital leverage ratio moving far above 3.0x, losses developing in the guarantee portfolio outside of expectations, and a move towards a higher use of or reliance on reinsurance protection with the ratio of net to gross notional par insured falling below 75%. The rating could also be downgraded if CGIF's capital providers fail to pre-fund business growth with capital injections, and instead allow the leverage ratio to (even temporarily) exceed targets.

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

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Business Profile

- Limited operating track record is a rating constraint
- Benefit from operational linkages to ADB
- Eventual growth in size depends on business viability

Limited Operating Track Record is a Rating Constraint

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 only wrote its first bond guarantee in 2013. Premiums from the guarantee business came to USD4.66m in 2015 and USD1.32m in 2014. There were 12 guarantees issued to nine issuers by CGIF at end-1H16.

Under Fitch's rating criteria, the IFS ratings of insurance organisations with limited operating track record are generally constrained to no higher than the 'BBB' category on the international scale. However, this constraint is not fully applicable in the case of CGIF.

The limited operating history makes it much more difficult to judge if CGIF's management will be able to execute on business and financial plans, even when such plans appear to be sound and management is experienced. For example, underwriting or other controls that appear conservative in theory may prove ineffective in practice. Fitch believes it is impossible to truly know how effective controls will be until more business is written, and time has passed to allow it to season.

Benefit from Operational Linkages to ADB

In Fitch's view, CGIF is unique as it is sponsored and operated by ADB, which is a well-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, of the aforementioned risks of a start-up, thus allowing CGIF to be rated by Fitch well above 'BBB' (based on international scale).

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, it is immune from taxation, local business law, and bank/insurance regulation.

ADB has close ties with CGIF, and provides strong operational support. As set out in the Articles of Association, ADB appoints relevant staff, and holds in trust and manages the funds and assets. CGIF's risk management culture and procedures are largely adopted from ADB's.

In addition, Fitch views the growth strategy of CGIF more favourably than it would a commercial start-up. There is no time pressure from ADB or the capital contributors to quickly utilise the USD700m 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 focuses on a business segment that is not yet developed, as the use of debt guarantees has been quite limited in Asia. This means CGIF's business carries higher-than-average uncertainties with respect to the risk of adverse selection. It is difficult to judge at this time whether there is a negative bias among issuers that seek to issue insured debt. This risk is core to CGIF's business model, and not mitigated by the operational linkages to the ADB.

Related Criteria

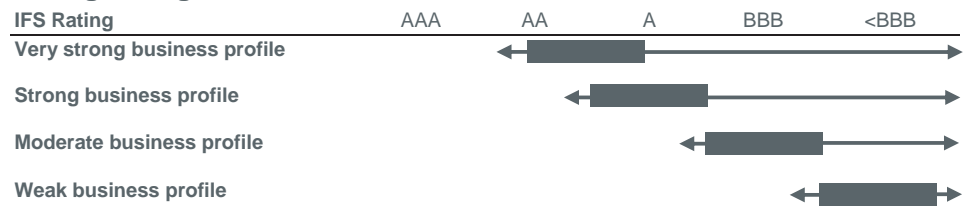
[Insurance Rating Methodology](#)
(September 2016)

[Life and Non-Life Insurance](#)
(Asia-Pacific Ex-Japan): Sector Credit Factors
(November 2016)

Eventual Growth in Size Depends on Business Viability

The figure 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.

Ratings Range Based on Business Profile



Source: Fitch

CGIF is categorised as having a “moderate business profile,” based on Fitch’s guidelines for capital and revenue, as capitalisation of USD700m is just below that of a guarantor with “strong business profile”, and its current revenue size clearly aligns it with those of a small company. However, when viewed in the context of the much larger ADB, CGIF could also be considered a much larger organisation from the perspective of operational infrastructure. Furthermore, if the business model proves successful, CGIF could grow over the next few years to meet the attributes of a medium – or even large – financial guarantor. CGIF plans to double its capitalisation to USD1.4bn in the future, subject to the volume of its business.

Sound Corporate Governance and Management

Effective Corporate Governance via Layered Decision-Making Process

The governance structure of CGIF consists of the Meeting of Contributors, an eight-member board and three board committees, and two management committees.

The Meeting of Contributors is the highest decision-making body. It determines strategic objectives, provides the board and the CEO with strategic guidance on overall operations and management, and elects the chairperson and other members of the board. It also reviews and approves the recommendations of the board that involve investment operations that CGIF may undertake for the development of the bond markets; the use of leverage; and the maximum leverage ratio and any revision to country limits in CGIF’s operations. The capital contributors meet at least once a year.

The eight-member board comprises the CEO, two representatives each from China and Japan, and one each from the Association of Southeast Asian Nations (ASEAN), Korea and ADB. These country 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: namely, the Audit Committee, Internal Control and Risk Management Committee, and Nomination and Remuneration Committee, which 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 the fields of investment banking, risk management and credit evaluation.

Ownership is Neutral to the Rating

Fitch believes CGIF has a strong group of owners/capital providers, but there is no explicit uplift to CGIF’s ratings due to ownership – other than the previously discussed benefits of operational linkages to the ADB that help mitigate a portion of start-up risks.

Japan, China and Korea contributed 90% 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, and hence the largest capital contributors retain the strongest decision-making power.

However, there are no formal commitments in place by the owners to provide additional capital, making any future capital contributions strictly voluntary. 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 End-2015

	(%)	Rating/Outlook
Asian Development Bank	18.57	AAA/Stable
Japan	28.57	A/Negative
China	28.57	A+/Stable
Korea	14.29	AA-/Stable
Bank Islam Brunei Darussalam Berhad	0.80	n.a.
Cambodia	0.01	n.a.
Indonesia	1.80	BBB-/Positive
Lao People's Democratic Republic	0.01	n.a.
Malaysia	1.80	A-/Stable
Myanmar	0.01	n.a.
Philippines	1.80	BBB-/Positive
Singapore	1.80	AAA/Stable
Thailand	1.80	BBB+/Stable
Vietnam	0.16	BB-/Stable
Total	100	

Source: Company information

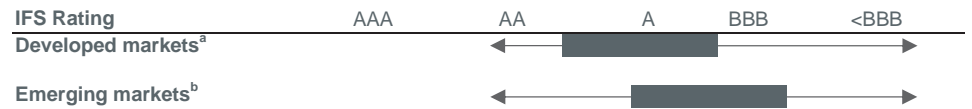
Sovereign- and Country-Related Constraints

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 (APAC) consists of developed and emerging markets. The majority of Fitch-rated APAC insurers in developed markets have IFS ratings in the 'A' category, while most insurers in emerging markets have IFS ratings in the 'A' to 'BBB' range.

APAC Ratings Range, Based on Industry Profile/Operating Environment



^a Consist of Australia, New Zealand, Hong Kong, Korea, Taiwan and Singapore

^b Consist of the rest of the APAC ex-Japan region

Source: Fitch

Fitch considers the current financial guarantee industry to be a grouping of niche markets. In Asia, financial guarantees are typically granted either through direct guarantees by government institutions or commercial guarantees provided by private institutions, and the proportion of these two types differs from market to market. In countries such as Indonesia, Japan, Korea, Malaysia, and Taiwan, the credit guarantees to corporates are mostly provided by the government or government-related institutions. In comparison, these credit 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 Asian Financial Crisis in the late 1990s, and was subsequently wound up.

The key challenges facing management in the financial guarantee industry in Asia include the need to maintain sufficient capital buffer to combat any large regional shock. This is due to the high correlation risk within the Asian markets, as well as exposure to foreign-currency risks – particularly if the guarantees are provided to overseas corporates. They also need to guard against adverse selection risks, as the market for financial guarantee in Asia is not yet mature.

Capitalisation and Leverage

	2011	2012	2013	2014	2015	Fitch's expectation
Shareholders' equity (USDm)	687	714	715	716	723	Capitalisation to remain solid, with the par-to-capital ratio below 2.0x on a net basis for the foreseeable future.
Maximum guaranteed amount ^a (USDm)	0	0	125	616	749	
Net par to capital leverage (x)	0	0	0.17	0.86	1.04	
Total financing commitment ratio (x)	0	0	0	0	0	
Financial leverage (%)	0	0	0	0	0	
Shareholders' equity to total assets (%)	99.9	99.9	99.6	96.8	96.1	

^a Maximum guaranteed amount includes principal and coupon
Source: The company and Fitch's calculation

Capital and Leverage – Solid Buffer Maintained

- Strong capital quality, with no debt issuance
- Carefully managed par-to-capital leverage
- Additional capital infusion to support growth

Strong Capital Quality, with no Debt Issuance

Fitch views CGIF's capital quality as very high, consisting entirely of ordinary equity and retained profit. The company does not issue any corporate debt, so there is no constraint on financial and operational flexibility in terms of interest servicing and debt repayment. Its operating policies strictly prohibit any debt issuance to finance its operations.

Manageable Net Par-to-Capital Leverage

Fitch expects CGIF to manage its net par-to-capital leverage at 2.0x. This target falls within Fitch's ratings guideline for an 'A' rating on an international scale and is more closely aligned to that of 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 the bonds they guarantee.

CGIF had 12 outstanding guarantees at end-1H16, comprising bonds denominated in Indonesian rupiah, Singapore dollar, Vietnamese dong and Philippine peso. The total amount of guarantees amounted to USD1.0bn at end-1H16. These guaranteed bonds, which had tenures of three to 10 years, were issued by corporates in different sectors, such as telecommunications and automobiles. CGIF's net-par-to-capital leverage was 1.42x at 1H16.

Additional Capital Infusion to Support Growth

In view of the current growth pace, CGIF plans to increase its capital by another USD700m to USD1.4bn in the future. However, no formal infusion schedule has been set. The management of CGIF said it aims to reach an agreement with its sponsors on the capital infusion plan by mid-2017.

Financial Performance and Earnings

	2011	2012	2013	2014	2015	Fitch's expectation
Net income (USDm)	5.851	4.109	2.718	3.548	7,781	Operating results are likely to remain volatile in the near term, given its start-up phase.
Pre-tax return on assets (%)	0.6	0.6	0.4	0.5	1.1	
Return on equity (%)	0.9	0.6	0.4	0.5	1.1	
Combined ratio (%)	n.a.	n.a.	1,110	438	125	

Source: The company and Fitch's calculation

Financial Performance – Risk Management Focus

- Steady improvement in operating profitability
- Managing a high-risk-insured portfolio with uncapped currency risks

Steady Improvement in Operating Profitability

CGIF's operating result has gradually improved over the last three years. Its pre-tax return on assets amounted to 1.1% in 2015 (2013: 0.4%). Its combined ratio, which is the sum of loss ratio and expense ratio, amounted to 125% in 2015 given its moderate premiums volumes.

CGIF does not need to achieve any specific profit targets or mandates aside from its objective of supporting the development of the Asian bond markets. This differs from most privately owned and commercially run organisations that have earnings growth and dividend expectations.

It makes CGIF's performance goals similar to those of many mutual insurance companies or government agencies, in which profit margins are set to assure reasonable compensation for the risks being assumed, and to support long-term growth in capital commensurate with expected business growth.

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

Within the context of its ratings criteria for financial guarantors, Fitch views CGIF's insured portfolio as "high risk" – characterised by a portfolio expected to demonstrate high frequency/high severity losses, and with uncapped currency risks. CGIF's underwriting and controls appear to be well-thought-through and prudent (albeit as yet untested) to manage the high risks 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 risks as it provides largely local-currency-denominated guarantees to emerging markets such as the ASEAN+3 countries (ASEAN and Japan, Korea and China).

CGIF has capped the size of each bond guarantee at 20% of its paid-in capital, with sub-limits of up to 20% of its paid-in capital per country and up to 40% per currency, to ensure business diversification and curb CGIF's exposure to any single country or currency. The bonds guaranteed by CGIF are generally limited to tenors of 10 years or below.

Investments and Asset Risk

	2011	2012	2013	2014	2015	Fitch's expectation
Total investment assets (USDm)	686	711	712	715	722	Fitch does not anticipate the risk profile of CGIF's investments to change significantly, given its current investment approach.
Cash and cash equivalents to total invested assets (%)	38.8	12.6	1.6	5.2	1.4	
Fixed-income securities/total invested assets (%)	61.2	87.4	98.4	94.8	98.6	
Stocks/total invested assets (%)	0	0	0	0	0	
Risky assets to shareholders' equity (%)	0	0	0	0	0	
Liquid assets to net claims reserves (%)	n.a.	n.a.	n.a.	n.a.	n.a.	

Source: Company information, and Fitch's calculations

Investments – Conservative Strategy

- Prudent investment guidelines
- Significant foreign-currency exposure – unhedged, but reserved
- Liquidity risk reasonably managed

Prudent Investment Guidelines

CGIF's key investment objective is to protect the principal amount of the 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 to be considered. Eligible fixed-income securities with maturity terms of more than one year must be rated at least 'AA-' on an international scale. CGIF may invest in fixed-income securities with shorter terms, but such investments have so far been minimal. The approved investment return target given to CGIF is 1.15% in 2015.

It is CGIF's policy to limit its aggregate exposure to any non-bank corporate to a level below 10% of the organisation's equity.

Significant Foreign-Currency Exposure – Unhedged, but Reserved

CGIF's has significant exposure to foreign-currency risk because it guarantees bonds denominated in the various currencies of the markets of issuance, while its functional currency is the US dollar. Once CGIF receives its guarantee fees in the local currency, it will immediately convert to them to US dollars.

CGIF does not plan to fully hedge its foreign-currency exposure. However, the company says it plans to establish reserves against adverse exchange-rate movements, which will reduce the amount of capital the management uses to calculate its leverage ratio. This will result in a reduction in the amount of bonds that can be guaranteed. Fitch believes the general approach is prudent, but CGIF's ability to establish adequate currency reserves is yet untested.

If CGIF is unable to obtain a sufficient amount of the bond issue's currency at the time of payment, the company retains the right to pay in US dollars, and the method of calculating the exchange rate will be determined 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 risks. As far as possible and practicable, CGIF will match the duration of investments closely with the tenor of the guarantee obligations. The duration of CGIF's portfolio will be limited to less than five years.

Fitch views favourably CGIF's right to accelerate or retain the original interest/principal payment schedule in the event of a default on an insured bond. Thus, the possibility of an unexpected liquidity crisis is quite limited, as there is no real liability-acceleration risk.

In the event that bond defaults are high during a period in which interest rates are also high (implying unrealised losses exist on the investment bond portfolio), management indicates it would pledge securities as collateral to obtain liquidity in the repo market, when necessary, as opposed to simply liquidating a security before maturity (especially if at a loss). As a contingency, CGIF said that a standby loan facility might be used in times of need.

Reserve Adequacy

(%)	2011	2012	2013	2014	2015	Fitch's expectation
Net claims reserves/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, given the limited track record on the development of the company's claims liabilities. Nonetheless, no bond that CGIF has guaranteed is in default so far.
Net claims reserves/shareholders' equity (x)	0	0	0	0	0	
Cash and bank deposits/net claims reserves (%)	n.a.	n.a.	n.a.	n.a.	n.a.	
Net technical reserve/shareholders' equity (%)	0.0	0.0	0.2	3.1	3.9	
Net claims paid/net claims incurred (%)	n.a.	n.a.	n.a.	n.a.	n.a.	
Change in net claims reserves/net premiums earned (%)	n.a.	n.a.	0	0	0	
Reinsurance recoverables to equity (%)	0	0	0	0	0	
Net par to gross par	n.a.	n.a.	100	100	100	

Source: The company and Fitch's calculation net technical reserve = net claim reserves plus unearned premium reserves

No Bond Guaranteed by CGIF is in Default

- Conservative credit loss-reserve process

Conservative Credit Loss-Reserve Process

No bond that CGIF has guaranteed is in default status so far. While as yet untested, CGIF appears to have in place a conservative approach for establishing credit-loss reserves. A robust approach is necessary due to the high-risk nature of GCIF's business that will result in periodic losses.

Provisions for credit losses ranging from 20%-100% of the guarantee amount will be set according to the internally generated bond ratings assigned to individual bonds. These provisions are generated based on statistical estimation/assumptions of probability of defaults and loss given default.

As a control, during CGIF's initial operations, ratings from board-approved parties will be obtained to assess the consistency between 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.

Each outstanding guarantee will be reviewed and re-rated at least on an annual basis; and in the case of deterioration in the credit profile of the bond issuer, 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 the ongoing monitoring of all guarantees outstanding.

Reinsurance

CGIF has arranged a quota-share reinsurance treaty to support its underwriting capacity from 4Q16. The treaty, however, contains a cap on the amount that is supposed to be borne by reinsurers for each issuer if defaults occur. All reinsurers under this treaty have an IFS rating of at least 'A'.

Appendix B: Other Ratings Considerations

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

Group IFS Rating Approach

Group IFS rating approach is not applicable for the company.

Notching

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

For notching purpose, CGIF follows ‘Other’ regulatory environment classification although the regulatory environment of the Philippines is assessed by Fitch as being Effective and classified as following a ‘Ringfencing’ approach.

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 IDR. This is given its status as a multilateral organisation and the limited scope of regulation assumed by Fitch.

Debt

Not applicable.

Hybrids

Not applicable.

Source: Fitch

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