

Credit Guarantee and Investment Facility

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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 1.11x at end-2018, 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.

Short Operational Record: CGIF’s profile is less robust than that of companies with established records of financial and operational success. This limits its ratings under Fitch’s criteria, but is partially mitigated by operational linkage with its sponsor, the Asian Development Bank (ADB, AAA/Stable).

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 its sponsorship by the ‘AAA’ rated ADB, which is a trustee and part-owner. ADB appoints all relevant staff and manages the funds and assets. CGIF’s operations are likewise conducted according to its policies, and all applicable ADB operational policies and it shares the bank’s multilateral supranational status. This linkage reduces some, but not all, start-up related risks, such as unpredictable business growth in light of CGIF’s expansion mode.

Diversified 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 raise CGIF’s paid-in capital by USD500 million to USD1.2 billion by end-2023.

Rating Sensitivities

Weakening Capitalisation: Downgrade rating sensitivities include a rise in the net par/capital leverage ratio to above 3.0x, an investment policy change that may 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 rating 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

Entity Name

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)	2017	2018	
Total equity	779	911	
Total assets ^a	739	958	
Return on equity (%)	2	2	
Net income	11	17	
Par-to-capital ratio ^a (x)	312	237	

^a Excludes reinsurance assets
Source: Fitch Ratings, CGIF

Applicable Criteria

[Insurance Rating Criteria \(November 2019\)](#)

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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 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. Its capitalisation of USD911 million is above that of a guarantor with a 'Favourable' operating scale while its revenue size aligns with that of a 'Least Favourable' operating scale. However, it can be considered a much larger organisation, based on operational infrastructure, in light of its linkage with ADB.

Premiums from the guarantee business amounted to USD8.7 million in 2018 and USD8.4 million in 2017. CGIF had issued 23 guarantees to 15 issuers by end-2018. 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 provides support to corporates in ASEAN countries as well as China, South Korea and Japan. It is also expanding into frontier markets with its support of the first bond in Cambodia, and Laos as the next near-term target. Myanmar will require more time due to the lack of corporate bond market regulations.

The company seeks to give guarantees to existing issuers to extend their bond maturities. 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.

Risk Appetite on a Par with Insurance Sector

Fitch sees CGIF as unique as it is sponsored and operated by ADB, an established multilateral supranational. 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' on the international scale, the start-up threshold.

CGIF is set up as a trust fund of ADB rather than a separate, independent legal entity. Hence, it 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". 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 quickly utilise the capital for guaranteeing bond obligations, giving CGIF more leeway to carefully select the corporate bond issuance it guarantees, instead of adopting an aggressive or fast-growth path. This approach is in line with ADB's philosophy.

Nonetheless, CGIF is focussed on an undeveloped business segment as the use of debt guarantees in Asia is limited. This carries higher-than-average risk of making adverse selections 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 ADB. It guarantees bonds in diverse sectors including telecommunications, financial institutions and healthcare. CGIF 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 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. 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 powers.

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 2019

	(%)	Rating/Outlook
Asian Development Bank	15.13	AAA/Stable
Japan (Japan Bank for International Cooperation)	39.89	A/Stable
China	23.27	A+/Stable
Korea	11.64	AA-/Stable
Brunei Darussalam	0.65	n.a.
Cambodia	0.02	n.a.
Indonesia	1.47	BBB/Stable
Lao People's Democratic Republic	0.02	n.a.
Malaysia	1.47	A-/Stable
Republic of the Union Myanmar	0.01	n.a.
Philippines	2.32	BBB/Stable
Singapore	2.51	AAA/Stable
Thailand	1.47	BBB+/Positive
Vietnam	0.13	BB/Positive
Total	100.00	

Source: Fitch Ratings, CGIF

Capitalisation and Leverage

Sustaining the Improvement in Capitalisation

Financial Highlights

(USDm)	2014	2015	2016	2017	2018	Fitch's expectation
Total shareholders' equity	716	723	728	739	911	Capitalisation to remain solid, with the net par/capital ratio below 2.0x over the long term.
Net par ^a	616	749	1,120	1,096	1,410	
Net par to capital leverage (x)	0.86	1.04	1.16	1.11	1.11	
Financial leverage (%)	0	0	0	0	0	

Source: Fitch Ratings, CGIF

^aMaximum guaranteed amount includes principal and coupon

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 frequency or severity standards that apply to financial guarantee organisations that face the possibility of very high frequency and high severity defaults on bonds they guarantee.

CGIF had guaranteed 23 bonds amounting to USD1.4 billion by end-2018, 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 unchanged at 1.11x at end-2018 from 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, 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.

Financial Performance and Earnings

Steady Financial Performance

Financial Highlights

(%)	2014	2015	2016	2017	2018	Fitch's expectation
Net income (USDm)	3.5	7.8	10.1	10.8	16.8	The company's operating results are likely to remain volatile in the near term as it is in the early phase of its expansion.
Return on equity	0.5	1.1	1.4	1.5	2.0	
Combined ratio	438	125	90	102	118	
Investment yield	1.2	1.3	1.5	1.6	2.3	

Source: Fitch Ratings, CGIF

Steady Improvement in Operating Profitability

CGIF's operating results improved gradually over the last three years, with a return on equity of 2.0% in 2018 (2017: 1.5%). However, its combined ratio – the sum of the loss and expense ratios – was 118% (2017: 102%) due to higher administrative expenses 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 earnings growth and dividend targets. This makes CGIF's performance goals similar to those of many mutual insurance companies or government agencies whose profit margins are set to ensure reasonable compensation for the risks 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 risks because it guarantees non-investment grade corporate issuance. 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.

Investment and Asset Risk

Prudent Investment Strategy Mitigates Risk

Financial Highlights

(%)	2014	2015	2016	2017	2018	Fitch's expectation
Risky asset ratio	0	0	0	0	0	No significant change to the risk profile of
Equity investment to capital	0	0	0	0	0	CGIF's investments in light of its investment approach

Source: Fitch Ratings, 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 the ADB treasury in accordance with CGIF's investment 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 credit ratings of at least 'A-' or the equivalent.

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, defaults and low recoveries are likely to be mitigated by the weakening of the 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 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 is Reasonably Managed

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 2018, giving the portfolio a duration of 2.6 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 the liability-acceleration risk.

CGIF has a global master repurchase agreement with a European bank that allows the organisation 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 – instead of liquidating a security before maturity, especially if it is at a loss.

Reserve Adequacy

Stable Reserving Trends and Practices

Financial Highlights

	2014	2015	2016	2017	2018	Fitch's expectation
Net loss reserves/incurred losses (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 to date.
Paid/incurred losses (x)	n.a.	n.a.	n.a.	n.a.	n.a.	
Change in ratio of reserves/earned premiums (%)	0	0	0	0	0	

Source: Fitch Ratings, CGIF

Conservative Credit Loss-Reserve Process

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 estimations and assumptions of probability of default and loss given a default.

Ratings from board-approved parties will be obtained to assess the consistency of CGIF's internal ratings with those assigned by the parties to ensure CGIF makes the correct application of international technical standards and its internal risk-rating system is effective during its 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, Risk Mitigation and Catastrophe Risk

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 current 25% quota share reinsurance treaty programme.

Appendix A: Industry Profile and Operating Environment

This section discusses Indonesia's insurance industry as the company's public ratings are Indonesia National Ratings.

Regulatory Oversight

Fitch considers the regulatory environment in Indonesia to be 'developing with limited level of transparency'. Indonesia's insurers are governed by the Financial Services Authority (OJK). The regulator has implemented a minimum risk-based capital (RBC) ratio of 120% and under new regulation circulated in 2017, the RBC covers five specified risk categories. The regulator's enforcement ranges from warnings and fines to rescinding registrations and barring offending individuals from key executive positions, which has been applied with moderate consistency. OJK, as a relatively new authority established in 2013, is gradually reinforcing its role in monitoring and supervising the insurance and reinsurance sectors.

Technical Sophistication of Insurance Market; Diversity and Breadth

The non-life segment is dominated by property and motor with business expanding in the engineering sector following massive infrastructure developments. Unit-linked products remain the biggest segment of the life insurance industry, accounting for 50% of total domestic life premiums. Technical skills in the industry are also developing but are considered less sophisticated than that of insurers in developed countries. Indonesia's insurance penetration is modest, accounting for around 3% of GDP.

Competitive Profile

The competitive landscape is often not rational and very challenging. The non-life segment pays high commissions to brokers, resulting in an industry combined ratio of 96%. The life insurance segment focuses on product diversification and services (i.e. digitalisation) to meet the challenges. Indonesia has a fragmented and competitive insurance market with 60 life insurers and 79 non-life insurance companies. The top-five life insurers account for 46%, while the top five non-life insurers account for more than 30% of total premiums.

Financial-Market Developments

Fitch considers Indonesia's debt and equity markets as not fully developed, and the market capitalisation of the country's listed companies is lower than that of its regional peers. The capital-market utilisation to finance investments is considered low with limited intermediation by non-bank financial institutions. The debt market is oriented towards the short term (one-three years), especially for life or other sectors selling long-duration products.

Country Risk

Fitch rates the local-currency sovereign obligations of Indonesia at 'BBB' with a Stable Outlook. Based on the industry profile and operating environment range suggested by the performance of the above sub-factors, the mid-point of the six-notch Industry Profile and Operating Environment score is in-line with the local-currency sovereign rating of Indonesia.

Appendix B: 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 its 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 is focused on providing infrastructure guarantees in Africa and Asia.

Peer Comparison

(USDm)	IFS Rating	Total assets	Shareholders' equity	Maximum guaranteed amount	Net par to capital leverage (x)	Financial leverage (%)	Return on equity (%)	Risky assets to equity (%)
CGIF	AAA(idn)/Stable	958	911	1,410	1.1	0	2	0
GuarantCo	AA-/Stable	296	270	524	1.3	0	-2	0

Source: Fitch Ratings, CGIF, GuarantCo

Appendix C: 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 ring-fencing 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 Issuer Default Rating, 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.

IFS – Insurer Financial Strength. IDR – Issuer Default Rating
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 of CGIF consists of the meeting of contributors, an eight-member board and three board committees, and two management committees. The eight-member board comprises the CEO, two representatives each from China and Japan, and one each from 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.

Transfer and Convertibility Risk (Country Ceiling)

None

Criteria Variations

None

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