S&P Global
Ratings

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Research Update:

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

February 28, 2023

Overview

- The issuance of guarantees by Credit Guarantee and Investment Facility (CGIF) has slightly slowed amid rising funding costs and uncertain operating conditions, despite the lifting of restrictions related to COVID-19.
- CGIF is still working on asset recovery following the first default by a guaranteed entity in December 2021. We believe this default, which is contained in size, will not affect CGIF's ability to execute guarantees to catalyze the ASEAN corporate bond market and foster economic development in the region.
- We expect CGIF to maintain its extremely strong financial profile, underpinned by its robust capital position and increasing capital contributions. The facility's short lifespan and small presence limit its business profile.
- We affirmed our 'AA' long-term and 'A-1+' short-term foreign currency issuer credit ratings on CGIF. We also affirmed the 'AA' long-term issue rating on CGIF's guaranteed notes.
- The stable outlook on the long-term rating reflects our view that CGIF will maintain a solid buffer against potential guarantee calls over the next 24 months.

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Rating Action

On Feb. 28, 2023, S&P Global Ratings affirmed its 'AA' long-term and 'A-1+' short-term foreign currency issuer credit ratings on Credit Guarantee and Investment Facility (CGIF). The outlook on the long-term rating is stable. We also affirmed the 'AA' long-term issue rating on CGIF's guaranteed notes.

Rationale

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

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

With most members of Association Of Southeast Asian Nations (ASEAN) phasing out COVID restrictions, the impact of pandemic-related mobility restrictions on sectors, including travel and hospitality, has eased. However, three years of disruptions from COVID have weakened the balance sheets of some corporates. Funding costs have also increased as central banks across the region raised policy rates to control inflation. This has reduced the number of corporate issuances in 2022 and the number of guarantees issued by CGIF. These conditions could persist into 2023.

During the COVID-19 pandemic, CGIF enhanced its credit risk management systems and increased surveillance frequency to better gauge the riskiness of its portfolio. This has helped the entity with early identification and to better manage the first default in its guarantee portfolio by KNM Group Bhd. KNM missed payments on principal (US$83 million) and coupon (US$1.3 million) on its bonds issued in Thailand on Nov. 18, 2021. CGIF met the call on the guarantee in full and on time in December 2021.

The guarantee was backed by collateral, and the recovery process is still underway. The asset disposal process has been more protracted than we expected initially. An extended court process could also delay the timeline for recovery. Nevertheless, the impact on CGIF's portfolio is likely limited. We estimate that if CGIF could recover 50% of the payout (net of reinsurance coverage), the final loss would be roughly equal to one year of CGIF's retained earnings.

Despite the KNM default, CGIF's asset quality remains sound, in our assessment. This is a result of the facility's guaranteed exposure representing companies in the region with relatively better credit quality, as well as CGIF's conservative risk appetite.

We believe CGIF's capital and liquidity buffers are robust and could withstand additional pressure. Should a default occur, the typical size of each issue at 7%-12% of CGIF's capital levels and well spread-out maturity walls will limit the impact.

Established in November 2010, CGIF's mandate is to deepen and develop liquid local-currency bond markets among ASEAN members. The institution provides guarantees on bonds issued by corporates in ASEAN. As of Feb. 1, 2023, CGIF had issued 57 guarantees, with 40 guarantees outstanding. The guaranteed amount typically ranges between US$50 million and US$100 million and generally has a tenor of three to 10 years. This compares with CGIF's equity base of US$1.2 billion as of end-2022. Following additional capital injections and retained earnings, CGIF's maximum guarantee capacity grew by US$42 million in 2022.

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

CGIF was set up as a trust fund of the Asian Development Bank (ADB). We believe CGIF's creditworthiness benefits from its relationship with its contributors and the mandate they have entrusted it with. CGIF has a balanced shareholder base, and all shareholders are either governments or government-related agencies with strong government links. The current voting rights are dominated by four contributors: China (29.9%); Japan (29.9%); Korea (14.9%); and the ADB (15.7%). The 10 ASEAN governments collectively hold most of the remaining voting rights (9.8%).

CGIF's shareholders demonstrated their support by approving its first-ever capital increase to US$1.2 billion from US$700 million in December 2017. The subscription increase was on a voluntary and proportional basis. The shareholder payments are likely to be completed by the end of 2023. By increasing its capital, CGIF's guarantee capacity will be boosted to US$3 billion, from US$1.75 billion. As of end-2022, CGIF's paid-in capital was US$1,149 million. In our view, the successful completion of this exercise will underscore CGIF's strong shareholder support.

CGIF renewed its annual reinsurance arrangement with a syndicate of reinsurers rated between 'AA-' and 'A'. This will boost its guarantee capacity and manage credit concentration risk limits. The arrangement covers 25% of CGIF's existing guarantee portfolio. Including additional insurance on specific transactions, the coverage by the syndicate increases to about 33% of the portfolio. Coupled with the capital increase, the reinsurance agreement enhances CGIF's guarantee capacity.

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

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

We believe CGIF's management team has the necessary expertise and experience to conduct its business and achieve its mandate. That said, CGIF has a short record of operations. Its guarantee operations are controlled by prudent risk parameters in accordance with governance standards laid out in its articles of agreement. CGIF has expanded at a gradual pace, allowing its staffing capacity to catch up with the scale of operations. ADB manages CGIF's capital, which results in conservative investment policies.

We consider CGIF's extremely strong financial profile to be a positive rating factor. The facility's risk-adjusted capital (RAC) ratio after adjustments as of end-2022 stood at 50.3%--well above our 23% threshold for an extremely strong capital adequacy assessment. The RAC ratio has remained broadly stable; it was 44.4% as of end-2021. We expect this trend to continue over the next few years, with CGIF maintaining the RAC ratio well above 23%.

We believe CGIF has a conservative approach to underwriting. However, some of its accounts fall within high-risk sectors such as oil and gas, real estate, and microfinance lending. These high-risk portfolios account for around one-fifth of CGIF's portfolio. To date, CGIF's accounts, including the high-risk sectors, maintain sufficient liquidity, and a majority of its guarantee positions are backed by substantial collateral.

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

We assess CGIF's liquidity position as robust. The institution should be able to comfortably pay out under its guarantees for at least a year in stressed market conditions, without recourse to liquidity facilities from contributors or from the market. As of Dec. 31, 2022, our stressed liquidity ratio for CGIF was 6.42x for the next 12 months. The facility's liquid assets, managed by the ADB, are invested mostly in bonds of highly rated governments or government-related entities. They form the bulk of CGIF's balance sheet assets.

Outlook

The stable outlook on CGIF reflects our expectation that the facility will maintain a solid balance sheet over the next 24 months. This will act as a cushion against potential guarantee calls amid uncertain macroeconomic conditions.

We believe changes to the rating will most likely be driven by the effectiveness of CGIF's role in the local-currency ASEAN bond markets.

Downside scenario

We may lower the rating if CGIF struggles to execute its mandate at a profit, or if its financial metrics weaken. This could happen if: (1) the facility aggressively expands its guarantee portfolio beyond the natural growth capacity provided with the increase in capital; or (2) it has inadequate risk management to deal with sudden surges in guarantee calls.

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

Upside scenario

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

Ratings Score Snapshot

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

SACP: aa

Enterprise Risk Profile: Adequate

- Policy Importance: Adequate
- Governance and management: Adequate

Financial Risk Profile: Extremely Strong

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

Extraordinary Support: 0

- Callable capital: 0
- Group Support: 0

Holistic Approach: 0

Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Jan. 31, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Introduction To Supranationals Special Edition 2022, Oct. 11, 2022
- Supranationals Special Edition 2022, Oct. 11, 2022
- Supranationals Edition 2022: Comparative Data For Multilateral Lending Institutions, Oct. 10, 2022

Ratings List

Ratings Affirmed	
Credit Guarantee and Investment Facility	
Sovereign Credit Rating	
Foreign Currency	AA/Stable/A-1+
CJ Logistics Asia Pte. Ltd.	
Senior Unsecured	AA

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.