1. **Overriding Objective**

1.1. This Directive on Counterparty Credit Risk Management (Directive) establishes the rules and processes of counterparty credit risk management for the Asian Infrastructure Investment Bank’s (AIIB) treasury operations to ensure that AIIB adheres to sound credit risk management practices including (i) risk identification and measurement, (ii) risk monitoring, (iii) risk mitigation and (iv) risk reporting in managing counterparty credit risk.

1.2. The exercise and interpretation of this Directive shall seek to give effect to this overriding objective.

2. **General Principles**

2.1. AIIB takes counterparty credit risk in its treasury operations and such risk should be managed properly for the interest of the bank. Economic Capital (ECap) is measured for counterparty credit risk under AIIB’s capital management framework.

3. **Definitions**

3.1. **Counterparty Credit Risk (CCR)** is defined as the risk that the counterparty to a transaction could default before the final settlement of the transaction’s cash flows. CCR is a presettlement risk\(^1\) where an economic loss would occur if the transactions (or portfolio of transactions) with the counterparty had a positive economic value at the time of default, or during the close-out period.

3.2. **Counterparty** in the context of AIIB’s treasury operations may include (i) financial institutions, such as banks and insurance companies and (ii) central counterparties, which are clearing houses that interpose themselves between counterparties to contracts traded in one or more financial markets.

3.3. **Transactions** that give rise to counterparty credit risk include but are not limited to:

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\(^1\) In contrast, settlement risk arises at final settlement, which refers to a counterparty (or intermediary agent) that fails to deliver a security or its value in cash, as per agreement, when the security is traded, after the other counterparty or counterparties have already delivered security or cash value as per the agreement.
(a) Bank deposits, inter-bank lending, bonds and other securities, including asset backed securities, spot transactions and Securities Financing Transactions (SFT),\(^2\) etc.

(b) Derivatives, such as forwards, options, swaps, credit default swap, etc. and any structured products that involve one or more of the above instruments.

4. Responsibilities

4.1. The Chief Risk Officer (CRO) is responsible for issuing the Administrative Guidance under this Directive.

4.2. The Risk Committee (RC) exercises its responsibilities in respect of this Directive in accordance with the RC’s Terms of Reference.

4.3. The Risk Management Department (RMD), as the second line of defense, is the central unit for assessing, monitoring and reporting counterparty credit risk. It is responsible for:

(a) Developing counterparty credit risk measurement tools and models, including exposure calculation, limit assignment, etc.

(b) Designing a counterparty credit risk monitoring scheme and conducting risk monitoring, including limit utilization monitoring; notifying relevant departments of limits approaching alert level and escalating to senior management occurrences of limit breaches.

(c) Reporting to RC on AIIB’s counterparty credit risk status.

4.4. The Office of the Treasurer (TRE), as the first line of defense, is responsible for managing counterparty exposures within applicable limits, initiating new counterparties and carrying out due diligence for new businesses, designing transaction terms and informing all relevant departments.

4.5. The Office of the Controller (CTL) is responsible for performing centralized accounting treatment of counterparty transactions.

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\(^2\) Securities Financing Transactions (SFT) include repurchase agreements, reverse repurchase agreements, security lending and borrowing and margin lending transactions, where the value of the transactions depends on the market valuations and the transactions are often subject to margin agreements.
5. Counterparty Credit Risk Assessment

5.1. Counterparty Credit Rating

5.1.1. Credit Rating Assessment: A counterparty’s credit rating is the basis for measuring its credit quality. AIIB assesses counterparty credit risk based on the latest ratings from the following external credit assessment institutions (ECAI): S&P, Moody’s and Fitch. If no external credit rating is available, the counterparty’s credit quality will be assessed by the RMD and an internal rating approved by the CRO.

5.1.2. Eligible Rating Level: A minimum rating level is required for each eligible counterparty. Such rating level is established pursuant to AIIB’s General Investment Authority, General Asset Liability Management Authority and Risk Limits Policy.

5.1.3. Split Ratings: If there are multiple ratings, the following rules shall apply: (i) If there are two ratings by ECAIs and the two ratings differ, the lower rating will be applied; (ii) If there are three ECAI ratings and they are not all equivalent, the rating in the middle shall be applied.

5.1.4. Whenever there is a rating change from ECAIs, the related counterparty’s rating must be updated. For any counterparty where the rating has been downgraded to below the eligible rating level as described in 5.1.2, TRE shall submit a counterparty exit strategy and action plan to the RMD and CRO for approval.

5.2. Credit Limit Management

5.2.1. CCR Limit Definition: The counterparty credit limit represents the maximum committed exposure AIIB could undertake with each counterparty on credit business. Each eligible counterparty must be assigned a single credit limit before any bilateral transactions with such counterparty are initiated.

5.2.2. Credit Limit Model: RMD’s limit model is used to assess a counterparty’s credit limit. The limit model broadly considers the counterparty’s financial and credit status and AIIB’s investment constraints and loss tolerance to generate a reference limit, which is subject to adjustment based on other qualitative assessments.

5.2.3. The Credit Limit Management Cycle includes the following: (i) requests for limit assignment and information collection; (ii) counterparty assessment, limit calculation and submission for approval; (iii) limit approval; (iv) limit utilization and monitoring and (v) limit review and adjustment.
5.2.4. The CRO is responsible for approving a counterparty’s credit limit subject to the result of the Credit Limit Model and shall inform the RC of such approval. The RC must approve an individual counterparty’s credit limit if such limit exceeds the model result.

5.2.5. The counterparty credit limit shall be monitored against the net credit risk exposure arising from treasury transactions with counterparties.

5.2.6. A counterparty’s limit is revolving and various credit and derivative products specified in paragraph 3.3 share the limit for transactions with the same counterparty. When a transaction is initiated, the net credit exposure shall be booked under its limit until the closure or replacement of the transaction, whereby the limit utilized shall be released.

5.2.7. The Administrative Guidance shall provide a detailed methodology for counterparty limit setting.

5.3. Exposure Calculation

5.3.1. Derivatives Exposure: AIIB adopts the standardized approach for counterparty credit risk (SA-CCR)\(^3\) to measure counterparty-level Exposure at Default (EAD). Provided that robust netting and collateral documentation has been put in place, EAD is calculated as the net exposure, considering the discount of mark-to-market collateral value as well as cash margin deduction. For margined exposures, EAD will be capped at EAD as calculated for unmargined exposures.

5.3.2. SFT Exposure: The exposure of SFT should be the financing amount net of collaterals, floored at zero.

5.3.3. Other Exposure: (i) For on-balance-sheet items such as inter-bank lending, exposure is measured as the transaction’s notional amount; (ii) For Off-Balance-Sheet items, the exposure will be converted to credit exposure equivalents.

5.3.4. The Administrative Guidance shall provide a detailed methodology for counterparty exposure calculation.

6. Counterparty Exposure Monitoring

\(^3\) The standardized approach for measuring counterparty credit risk exposures, Basel Committee on Banking Supervision. [https://www.bis.org/publ/bcbs279.pdf](https://www.bis.org/publ/bcbs279.pdf)
6.1. The RMD will conduct counterparty exposures monitoring at least on a weekly basis, and inform TRE of the latest limit utilization status.

6.2. TRE shall check the limit utilization status before any new trade and make certain trade information and data available to the RMD to conduct monitoring.

6.3. For any limit breach due to market fluctuations, the excess limit shall be reported to the RMD and approved by the CRO, with the RC kept informed. TRE shall perform risk mitigation actions accordingly in a timely manner.

7. **Risk Mitigation and Control**

7.1. Over-the-Counter(OTC) derivatives may only be traded with a counterparty with whom an appropriate and up-to-date netting master agreement and collateral documentation have been signed.

7.2. AIIB shall actively manage collateral and margin based on the terms stipulated in the collateral documentation: (i) Upon receiving margin or collateral from a counterparty, TRE shall check the transaction as well as valuation details, confirming that the margin or collateral meets requirements; (ii) TRE shall periodically check positions and valuation results with counterparty, and, in the event of valuation difference, TRE shall work with the counterparty to reconcile these differences and (iii) TRE shall ensure timely calls for variation margin or provision for collaterals, and call back the AIIB-provided collaterals or margin when necessary.

7.3. The eligible counterparty’s credit quality shall be closely monitored to alert AIIB to any downside risk such as credit rating migration, key financial performance deterioration, potential event on cross default, etc. Early actions such as limit adjustment and collateral monitoring shall be taken.

7.4. In case of a counterparty default, a workout team shall be established under the leadership of the RMD with staff members from the TRE, Office of the General Counsel, CTL and other departments as necessary. Such team shall design a timely workout plan, including any necessary recovery actions.

8. **Risk Reporting**

8.1. The RMD is responsible for reporting to the RC AIIB’s CCR status.
8.2. The CCR report shall include but not be limited to the following:

(a) The overall CCR rating and exposure, including exposure to central counterparties.
(b) Exposure concentrations and credit status of counterparties with the largest exposures.
(c) Credit limit utilization.

9. Information Disclosure by AIIB

9.1. AIIB’s Policy on Public Information (PPI) and its related Directive and Administrative Guidance govern the disclosure of all information in AIIB’s possession, including this Directive.

10. Implementation

10.1. The CRO shall oversee this Directive, introduce any related Administrative Guidance, and provide adequate resources to ensure the efficient and accurate implementation of this Directive and any related Administrative Guidance.

11. Authority

11.1. The CRO shall make all final decisions regarding the application of this Directive.