Asian Infrastructure Investment Bank – Aaa stable

Regular update

Summary
The credit profile of the Asian Infrastructure Investment Bank (AIIB) reflects solid capital adequacy, a strong liquidity profile as well as a robust governance framework and very high shareholder support, notwithstanding the absence of a lengthy track record of operations. AIIB’s capital base will continue to be very large relative to its assets as the bank ramps up its lending operations, providing ample financial capacity to fulfill the bank’s mandate.

Credit strengths
» Solid capital base reflecting a large paid-in capital cushion and gradually expanding operations
» A strong governance framework that is in line with other Aaa-rated peers
» Very high shareholder support from a large membership base

Credit challenges
» A concentrated loan portfolio, both by country and sector
» A relatively short track record of operations, which implies more limited visibility over the strength of risk management
Rating outlook
The stable outlook reflects our expectation of no material changes to AIIB’s fundamental financial strength as it moves to a more rapid expansion of its lending portfolio. Nor do we expect any change to the solid shareholder support in the coming years, given AIIB’s important role in financing sustainable infrastructure in Asia. That said, AIIB’s growth phase to 2030 – with planned approved financing of around $14 billion by 2030, a 41% increase from 2021 – could test the effectiveness of its governance framework.

Factors that could lead to a downgrade
The bank aims to ramp up lending at a relatively rapid pace in the coming years. Downward pressure on the rating could emerge if the bank’s underwriting and risk management processes are not applied effectively and consistently, leading to a deterioration in its asset performance and overall credit metrics. Evidence of diminished capacity or willingness to support from key shareholders – in particular China (A1 stable) – would also weigh on the credit profile.

Key indicators

| Exhibit 2 |
|-------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Total Assets (USD million) [1] | 6,788.1 | 11,023.7 | 15,175.3 | 21,883.4 | 31,645.5 | 39,934.4 |
| Development-related Assets (DRA) / Usable Equity [1][2] | 0.1 | 7.2 | 9.4 | 12.2 | 43.2 | 63.9 |
| Non-Performing Assets / DRA | 0.0 | 0.0 | 0.0 | 0.0 | 0.2 | 0.6 |
| Return on Average Assets | 2.8 | 2.3 | 2.2 | 0.6 | 0.0 | 0.0 |
| Liquid Assets / ST Debt + CMLTD | -- | -- | -- | -- | -- | -- |
| Liquid Assets / Total Assets | 99.5 | 92.8 | 90.7 | 89.2 | 72.4 | 66.7 |
| Callable Capital / Gross Debt | -- | -- | 3,084.9 | 3,025.6 | 667.5 | 401.8 |

[1] Excludes paid-in capital receivables
[2] Usable equity is total shareholder’s equity and excludes callable capital
Source: Moody’s Investors Service

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.
Profile

AIIB was established by 57 founding member countries and began operations in January 2016. By March 2022, the number of approved members has grown to 105. Based on capital subscriptions as of March 2022, the top five shareholders are China with 30.8% of total subscriptions; India (Baa3 stable) with 8.6%; Russia with 6.7%; Germany (Aaa stable) with 4.6%; and Korea (Aa2 stable) with a 3.9% share.

The bank's mandate is to meet Asia's infrastructure funding gap. Its financings are focused on green and technology-enabled infrastructure as well as investments to increase regional trade and connectivity in Asia. It also aims to act as a catalyst for mobilising private investment in infrastructure investment in the region. While most of AIIB's lending so far has been to sovereigns or benefitting from a sovereign guarantee, the bank aims to increase the share of private-sector lending to 50%, from around 17% of signed lending as of March 2022. By sector, energy and transport are the largest exposures, each accounting for 17% of approved financings, besides the Covid Response Facility (34%). AIIB also targets to reach at least a 50% share of climate action financing in its actual financing approvals by 2025; in 2021, this figure stood at 48%, up from 39% in 2019.

The composition of AIIB's membership supports its status as an international financial institution. Its broad membership base is larger than the Asian Development Bank (ADB, Aaa stable, 68 members) and other regional MDBs, such as the African Development Bank (AfDB, Aaa stable, 81 members). The distribution of voting power between member countries is in line with other large regional and global MDBs, where nonborrowers collectively hold significant voting power. Major decisions require consent from at least 75% of total voting share, which is broadly in line with members' capital subscriptions.
Detailed credit considerations

Our determination of a supranational’s rating is based on three rating factors: capital adequacy, liquidity and funding and strength of member support. For Multilateral Development Banks, the first two factors combine to form the assessment of intrinsic financial strength, as shown on the cover page graphic. Additional factors can affect the intrinsic financial strength, such as risks stemming from the operating environment or the quality of management. The strength of member support is then incorporated to yield a rating range. For more information please see our Supranational Rating Methodology.

FACTOR 1: Capital adequacy score: aa2

AIIB’s “aa2” capital adequacy score reflects its large paid-in equity and its very strong asset performance metrics to date, combined with moderate development asset credit quality. The bank’s strong capital position implies ample capacity to absorb losses and weather near-term challenges to the credit quality of some of its current investments.

The final score for capital adequacy at “aa2” is one notch lower than the initial score of “aa1” to reflect our view that AIIB’s metrics will likely weaken somewhat over the coming years as the institution ramps up its operations, with rising leverage and potentially somewhat weaker asset quality and performance metrics.

AIIB’s leverage is significantly lower than its Aaa-rated peers, despite rapidly growing operations

As of end-2021, AIIB had $19.35 billion in paid-in equity, equal to 20% of total subscribed capital. This is among the highest ratios of paid-in capital, similar to the European Bank for Reconstruction and Development (EBRD, Aaa stable). Including retained earnings AIIB’s usable equity stood at $20.17 billion last year. We compare the useable equity buffer to total development assets and Treasury assets rated A3 and lower to calculate a simple leverage ratio; at 0.42x in 2021, the AIIB’s leverage ratio is the lowest among its rating peers (see Exhibit 3), translating into a score of “aaa” for capital position. The very strong score is a reflection of AIIB’s relatively short track record of operations; while the bank has been growing its loan portfolio very fast over the past few years, the size of its portfolio is still comparatively small.

Exhibit 3
AIIB’s leverage ratio is the lowest among the Aaa-rated MDBs

Leverage ratio, %, latest 3-year average

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<thead>
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<th></th>
<th>AIIB</th>
<th>IDA</th>
<th>IFC</th>
<th>EBRD</th>
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<td>0.5</td>
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Source: Moody’s Investors Service

The bank’s lending operations continue to gather pace with cumulative project approvals rising to $34.9 billion for 176 approved projects as of April 2022, compared to $22.0 billion at the end of 2020 and $12.0 billion in 2019. The implementation of COVID-19 Crisis Recovery Facility (CRF) accelerated the already rapid growth of lending operations, with 46 projects approved under the CRF programme, totaling $11.6 billion as of March 2022. Given the high demand for the CRF, AIIB has expanded the total facility amount to $20 billion from $13 billion – which was already expanded from its initial amount of $5 billion – while extending the programme duration until the end of 2023. Key beneficiaries of the CRF so far have been India, Indonesia (Baa2 stable) and the Philippines (Baa2 stable).
Equity investments are relatively smaller compared with the bank's loan portfolio and include 19 private equity fund investments, diversified across geography and sector. AIIB has also established a $500 million Asia ESG Enhanced Credit Managed Portfolio and a $300 million Asian Climate Bond Portfolio to invest in corporate bonds as a way to catalyse private investment into infrastructure with a strong environment, social and governance (ESG) focus.

Development asset credit quality is in line with peers

AIIB's development asset credit quality (DACQ) is scored at "a", in line with regional peer, the Asian Development Bank (ADB, Aaa stable) and slightly above the median of "baa" for Aaa and Aa-rated MDBs. This score incorporates our forward-looking view that the growth in the bank's portfolio will likely reduce concentration risk while strong risk management will help to preserve strong asset performance. Reflecting the expansion of AIIB's membership, as well as demand for infrastructure finance beyond Asia, the bank has started lending to non-regional members, with the approval of projects to Egypt (B2 stable). Unlike other MDBs, which differentiate between their members in their eligibility to receive financing, AIIB explicitly authorized investments in any member, regional or non-regional, in its founding articles of agreement. Lending to non-regional members is currently limited to 15% of total approved financings.

The bank's weighted average borrower rating (WABR), the starting point of our DACQ assessment, was "ba3" at the end of 2021, slightly lower than the "ba2" score in 2020. The score balances moderate outstanding exposures to lower-rated countries such as Sri Lanka (Ca stable) and Pakistan (B3 stable) against more rapid growth in projects in higher-rated jurisdictions such as India and Indonesia. While AIIB's infrastructure development mandate means that the bank has a heavy concentration within a single asset class, concentration by sector, country and single name exposure has consistently improved over the past few years as the portfolio has grown. The bank's exposure to Russia and Belarus (Ca negative) is small (see also Recent development section).

AIIB has maintained strong asset performance, although it may face pressures due to weakening credit profiles of Sri Lanka and Russia

AIIB's asset performance has been strong, with very limited nonperforming exposures to date, and is reflected in a score of "aa1". Last year a $75 million non-sovereign loan from Cambodia (B2 stable) became nonperforming, accounting for 0.6% of total development-related assets.

In 2022, asset performance will likely come under some pressure, reflecting not only the impact of the Russia-Ukraine conflict and the resultant higher commodity prices, but also country-specific credit pressures in some of AIIB’s countries of operations, in particular Sri Lanka, Russia and potentially others such as Turkey (B2 negative) and Georgia (Ba2 negative). Sri Lanka and Russia together constitutes 4% of the bank’s total loan exposure, while Turkey accounts for a larger share of over 11%. In the longer term, we expect...
AIIB to maintain a strong asset performance given its implementation of a strong risk management framework, even as its investment operations expands significantly over the years.

**FACTOR 2: Liquidity and funding score: aa2**

AIIB’s “aa2” liquidity and funding score reflects our expectation that the bank will strictly adhere to its conservative liquidity policy and that its access to market funding will strengthen over time.

**AIIB holds ample liquid resources to cover loan disbursements, debt servicing and other potential cash outflows**

AIIB holds ample liquid resources on its balance sheet, leading to a score of “aaa” for this metric, which compares projected net outflows over the coming 18 months to liquid assets in a stressed scenario of no market access. AIIB’s liquidity policy is in line with, and in some cases more stringent than, those of its rating peers. It requires the maintenance of a liquidity portfolio in excess of 40% of the projected net cash flow requirements for the coming 36 months. In practice, actual liquidity levels will be maintained significantly higher than the required policy level to provide flexibility for meeting operational cash flow and in accessing funding markets. In addition, AIIB maintains an adequate stock of high-quality liquid assets to meet potential liquidity requirements for a 30-day stress scenario and its Risk Appetite Statement requires that, in the case of extreme stress, it can meet its payment obligations even in the absence of market access for a period of 12 months.

By comparison, the net cash requirements for ADB and AfDB typically cover 100% of projected needs for 12 months. The requirement for the European Investment Bank (EIB, Aaa stable) is even less at 25% of net cash outflow needs, although our assessment of EIB’s strong liquidity position is supported by its access to the European Central Bank’s liquidity operations, among other mitigants. Regardless of specific policy requirements, Aaa-rated MDBs typically maintain liquid resources well above their estimated net cash outflows corresponding to “aaa” or “aa” scores for their liquidity position. AIIB’s adherence to its liquidity policy ensures an availability of liquid resources score no lower than “aa.”

**Growing access to funding from a diverse investor base**

In line with our view of the evolution of a strong funding franchise, AIIB’s issuance activities have taken off in 2020 and 2021, and continue to gather momentum in 2022. In December 2019, AIIB launched its Global Medium-Term Note Program, and annual issuance stood at $8.8 billion in 2020 and $8.5 billion in 2021. Drawdowns from the program include an increasingly diverse range of currencies, although 70% of total financing continues to be USD-denominated. In April 2022, the AIIB issued its inaugural Euro-denominated bond of EUR150 million, with the bank targeting a full-year issuance of up to $10 billion. Annual issuance volumes will gradually rise to around $15 billion per year by the end of the decade.

Although the bank has received large amounts of paid-in capital and it has no ostensible borrowing need, we expect regular issuance as AIIB further expands its investor base. As the bank has established hedging mechanisms, loans are denominated in any currency in which the bank can efficiently hedge itself.

The investor base for AIIB’s debt issuance resembles that of the ADB, including Asian central banks and institutional investors in other jurisdictions with portfolio allocations for highly rated Asian exposure. AIIB projects that most of its funding will come from markets and investors outside of China, aided by the regulatory treatment of its debt securities for the purpose of assessing bank capital requirements. Specifically, the Basel Committee on Banking Supervision has assigned a zero risk weight for AIIB securities in line with that for long established and highly rated MDBs, such as the ADB, AfDB, EBRD and IADB. AIIB bonds have also been designated high quality liquid assets (HQLA1) by the Bank for International Settlements and several central banks and are eligible as collateral for central bank operations.
Qualitative adjustments to intrinsic financial strength

Operating environment

We do not apply a negative adjustment for AIIB’s operating environment. Although we expect that some member countries may face macroeconomic challenges in the near term given the elevated commodity prices, we do not expect a significant deterioration of AIIB’s asset performance.

Quality of management

Because of its relatively short history of operation, we have not applied a positive adjustment for AIIB’s quality of management. Nevertheless, we assess the bank’s operational capabilities and governance frameworks to be evolving in a manner consistent with the highest-rated MDBs. Our evaluation of the quality of AIIB’s risk management framework, and the quality and diversity of its loan and investment portfolio, rests on the assumption that AIIB will retain full operational autonomy from its largest shareholders including China and that its operational strategy will remain broadly focused on infrastructure development across a wide range of emerging markets. Full autonomy also implies immunity from expropriation, moratoriums and capital account restrictions.

AIIB’s risk management framework includes an annual risk appetite statement, introduced in 2018, which integrates an overarching view of risks associated with the bank’s various activities according to the economic capital methodology and allocates risk accordingly. The bank also introduced an Asset Liability Management Policy in December 2017, setting forth practices related to the first line of defense responsibilities for interest rate risk and currency risk management. Additionally, the bank has a Capital Adequacy and Stress Testing Policy which sets out practices to ensure that the bank maintain its credit quality even when it has been subjected to a severe and protracted shock. On top of the stress-testing performed at the end of last year, AIIB has also performed an additional round of stress-testing in the first quarter of 2022 to determine the impact on the bank following Russia’s invasion of Ukraine (Caa2 review for downgrade).

To ensure the implementation of approved projects meets environmental and socially sustainable outcomes, AIIB has an Environmental and Social Framework (ESF) that was adopted at the founding of the organization and was further revised in 2019 and 2021 to expand its scope. The bank highlights that because the ESF was implemented before lending operations commenced, it has screened and assessed every development asset for its environmental and social soundness and sustainability. Therefore, AIIB’s has no legacy assets that do not meet its current criteria for ESG considerations.

Environment and social risk is embedded within the risk management framework as approved in the annual risk appetite statement (it is considered “low appetite” in terms of risk allocation). The use of the economic capital framework allows for the integration of environmental and social risk in stress testing.
**FACTOR 3: Strength of member support score: Very High**

We have adjusted our score for AIIB’s strength of member support to “Very High” from a scorecard-indicated outcome of “High”. This adjustment reflects the stronger ability of China and the bank’s non-borrowing members, which together comprise about 70% of capital subscriptions, to provide support than what is currently implied by the weighted average shareholder rating of the total membership base.

**AIIB members’ ability to provide support is broadly in line with Aaa-Aa3 rated MDBs**

Our assessment for members’ ability to support is based on a weighted average shareholder rating (WASR) of “baa1” at the end of 2021, unchanged from the previous year. In 2020, the downgrade for India, AIIB’s second largest shareholder, due the impact of the coronavirus pandemic has strained the WASR, although it had not materially shifted it. However, the deteriorating credit quality of Russia, AIIB’s third largest shareholder, following its invasion into Ukraine will put additional pressures to the bank’s WASR going forward.

**Members’ willingness to support is very strong**

In assessing members’ willingness to support, the “aaa” contractual support score incorporates our expectation that callable capital will continue to amply cover the amount of AIIB’s future borrowings. In turn, this reflects the large stock of the bank’s callable capital, as well as statutory requirements that limit the size of its development portfolio to the sum of its unimpaired subscribed capital, reserves, and retained earnings. The latter obviates the need for shareholder support beyond that furnished by callable capital.

We also assess AIIB’s non-contractual support at “Very High”. We believe that there is a strong likelihood that shareholders with a strategic interest in sustaining the bank’s operations will provide extraordinary support beyond committed amounts represented by callable capital. This is particularly true for China because of its role in founding AIIB and its large shareholding.

In addition, AIIB’s broad shareholder base – at 105 approved countries, its membership is larger than that of some other Aaa-rated regional MDBs – mitigates concentration risks arising from economic and financial linkages that could impede the provision of extraordinary support in the event of need.

Membership in the bank can be seen as a financial investment that transcends related geopolitical considerations. Amid territorial disputes in the South China Sea, for example, borrowers such as Malaysia (A3 stable), the Philippines and Vietnam (Ba3 positive) have retained their membership despite periodic bilateral tensions with China. Similarly, despite tensions related to projects under China’s Belt and Road Initiative (BRI), Malaysia, the Maldives (Caa1 stable) and Sri Lanka have also continued to engage with AIIB. India, AIIB’s largest borrower and its second-largest shareholder, has thus far declined to join the BRI, while many of the bank’s non-borrowing members have been critical of the Chinese initiative.
ESG considerations

Asian Infrastructure Investment Bank (AIIB)’s ESG Credit Impact Score is Positive CIS-1

Exhibit 10
ESG Credit Impact Score

CIS-1
Positive

For an issuer scored CIS-1 (Positive), its ESG attributes are overall considered as having a positive impact on the rating. The overall positive influence from its ESG attributes on the rating is material.

Source: Moody’s Investors Service

The credit impact score for AIIB is positive (CIS-1). This reflects a combination of very strong governance and neutral-to-low exposure to environmental and social risks.

Exhibit 11
ESG Issuer Profile Scores

<table>
<thead>
<tr>
<th>ENVIRONMENTAL</th>
<th>SOCIAL</th>
<th>GOVERNANCE</th>
</tr>
</thead>
<tbody>
<tr>
<td>E-2 Neutral-to-Low</td>
<td>S-2 Neutral-to-Low</td>
<td>G-1 Positive</td>
</tr>
</tbody>
</table>

Source: Moody’s Investors Service

Environmental

AIIB’s environmental issuer profile score is neutral-to-low (E-2). AIIB has relatively high exposure to countries with high exposure to environmental risks, both with regards to physical climate and carbon transition risk. However, the AIIB’s loan portfolio is growing rapidly and its increasing diversification will reduce risk exposure. Also, the AIIB has been set up specifically as an MDB with sustainability as part of its mandate. All projects are being screened and assessed under its ES Framework right from the start, and AIIB has no legacy assets, reducing exposure to carbon transition risks for instance.

Social

AIIB’s social issuer profile score is neutral-to-low (S-2), with a strong focus on responsible production as a key determinant for the score. Focus on lean and efficient processes allows rapid disbursement of loans, as seen in the Covid response in 2020. Similar to other leading MDBs, AIIB has established an independent evaluation office and has robust processes in place for stakeholders to air grievances and complaints, with information easily accessible.

Governance

Very strong governance results in a positive governance issuer profile score (G-1). The bank has established its risk management practices with the highest standards in mind, on par with the strongest MDBs; its financial and risk management is very robust and management has established a strong track record, with a focus on efficiency, and lean and transparent operations.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.
All of these considerations are further discussed in the "Detailed credit considerations" section above. Our approach to ESG is explained in our cross-sector methodology General Principles for Assessing ESG Risks. Additional information about our rating approach is provided in our Supranational Rating Methodology.

Recent developments

Increased pressure on asset performance following the Russia-Ukraine military conflict

Given Russia weakening credit profile, which constitutes 2.5% of AIIB’s total loan exposure at the end of 2021, AIIB will likely see an increased level of non-performing assets this year. In particular, a local currency loan to Russian Railways whose carrying value was $295 million (out of the $330 million exposure to Russia) as of 31 March 2022 has since defaulted on interest payments in March 2022. However, AIIB is confident on full loan payments, also because the loan is denominated in RUB. Financial restrictions imposed on Russian banks may impede the payment delivery in USD. All activities related to Russia and Belarus are on hold and under review.

Elsewhere, Sri Lanka, which constitutes 1.6% of AIIB’s total loan exposure, has also missed interest payments on its sovereign bonds in April 2022, while loans to other member countries that are exposed to the rising commodity prices are also at increased risks of impairment.

Nevertheless, we do not expect AIIB’s asset performance to deteriorate significantly, given that the bank had been in a strong position, recording just one non-performing loan in 2021 - a $75 million non-sovereign loan to Cambodia. Looking over the past three years, non-performing assets averaged just 0.3%, lower than the Aaa-median of 0.5%.

Expanded COVID-19 Crisis Recovery Facility (CRF), supporting lending operations

In February 2022, AIIB expanded its CRF facility to $20 billion from $13 billion, after having increased it from an initial $5 billion, due to the high demand for the facility. By March 2022, AIIB had approved 47 projects under the CRF totaling $11.6 billion (around 34% of total approved financing since the bank’s inception), up from 30 projects amounting to $7.9 billion a year ago. The programme has also been extended to the end of 2023, albeit with a narrower scope for financing pandemic-related response going forward.

Given the high level of financing under the CRF, AIIB’s overall lending operations continue to grow rapidly. By April 2022, total approved financing stood at $34.9 billion from $22 billion at the end of 2020 and $12 billion in 2019. Total number of approved projects have also increased to 176, with 16 projects approved in the year-to-date.

Lower profits in 2021

AIIB recorded a net profit of nearly $55 million last year, significantly lower than in 2020 when net profits stood at $175.2 million. The main driver was significantly lower net interest income, due to lower interest income and higher interest cost as a result of AIIB’s rising debt levels. Going forward, AIIB expects increased volatility of its net profit, which reflects an increasing share of floating rates for both its assets and liabilities. At the same time, the bank has started to shift its excess liquidity towards investment assets measured at fair value, compared to the predominance of term deposits used so far. To mitigate such volatility, the bank has gradually increased allocation of its liquidity portfolio towards a Hold to Maturity strategy in order to provide income stability over an interest rate cycle.
## Rating methodology and scorecard factors

<table>
<thead>
<tr>
<th>Rating factor grid - Asian Infrastructure Investment Bank</th>
<th>Initial score</th>
<th>Adjusted score</th>
<th>Assigned score</th>
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<tr>
<td><strong>Factor 1: Capital adequacy (50%)</strong></td>
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<tr>
<td>Capital position (20%)</td>
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<td>aa2</td>
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<td>Leverage ratio</td>
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<td>Trend</td>
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<tr>
<td>Impact of profit and loss on leverage</td>
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<td>Development asset credit quality (10%)</td>
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<td>DACQ assessment</td>
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<td>Non-performing assets</td>
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<td>Trend</td>
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<td>Excessive development asset growth</td>
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<td>Availability of liquid resources</td>
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<td>Trend in coverage outflow</td>
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<td>Access to extraordinary liquidity</td>
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<td><strong>Adjusted intrinsic financial strength</strong></td>
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<td><strong>Factor 3: Strength of member support (+3,+2,+1,0)</strong></td>
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<td>Ability to support - weighted average shareholder rating (50%)</td>
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<td>Willingness to support (50%)</td>
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<td>Contractual support (25%)</td>
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Note: Our ratings are forward-looking and reflect our expectations for future financial and operating performance. However, historical results are helpful in understanding patterns and trends of an issuer’s performance as well as for peer comparisons. Additional considerations that may not be captured when historical metrics are used in the scorecard may be reflected in differences between the adjusted and assigned factor scores. Furthermore, in our ratings we often incorporate directional views of risks and mitigants in a qualitative way. For more information please see our Multilateral Development Banks and Other Supranational Entities rating methodology.
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» **Rating Methodology:** Multilateral Development Banks and Other Supranational Entities, 28 October 2020

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