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Research Update:

Asian Infrastructure Investment Bank 'AAA/A-1+' Ratings Affirmed On Criteria Revision; Outlook Remains Stable

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Research Update:

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Overview

- Following a review of the Asian Infrastructure Investment Bank (AIIB) under our revised criteria for multilateral lending institutions (MLIs), we are affirming our 'AAA/A-1+' ratings on AIIB and removing them from under criteria observation.
- In our view, AIIB continues making progress on delivering on its mandate by building up its operational capacity and increasing loan commitments to the region.
- The stand-alone credit profile for AIIB is 'aaa', reflecting our assessment of its "very strong" enterprise risk profile and "extremely strong" financial risk profile.
- The stable outlook reflects our expectation that, over the next 12-24 months, AIIB will continue achieving key targets as part of its start-up phase and will adhere to sound governance and risk management principles supported by an extremely strong financial profile.

Rating Action

On Feb. 15, 2019, S&P Global Ratings affirmed its 'AAA/A-1+' long- and short-term issuer credit ratings on Asian Infrastructure Investment Bank (AIIB). The outlook on AIIB remains stable.

At the same time, we removed the ratings from UCO, where we placed them on Dec. 14, 2018, after publishing our revised MLI criteria.

Rationale

The ratings on AIIB reflect our view of its very strong enterprise risk profile and extremely strong financial profile. While AIIB benefits from extraordinary support in the form of callable capital, we do not incorporate any uplift in the long-term issuer credit rating because AIIB's stand-alone credit profile is already 'aaa'. We outline these factors in our revised criteria, "Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology," published Dec. 14, 2018.

AIIB's original 57 founding members have now grown to 93, with notable new members including Canada, Spain, and Hong Kong, and including all 'AAA' rated sovereigns as well as 17 of the 20 G-20 members--which underpins our view of its enterprise risk profile. Furthermore, AIIB has a sizable capital endowment (US$100 billion), of which 20% is paid-in capital, one of the highest of all MLIs. Capital installments have been paid on time, with US$12.8 billion received as of September 2018 and 96% frontloaded for 2020. In our view, this reinforces AIIB's important role, enabling it to become one of the largest MLIs globally. As a relatively young institution founded in 2015 by international treaty and headquartered in Beijing, a key aspect to AIIB's policy importance is our expectation that it will continue to make considerable progress over the next three to five years in building a track record to support its mandate.

We continue to see important milestones in new loan commitments, which we believe underpins its growing relevance for the region. It has approved a total of US$6.4 billion in new projects as of November 2018, up from $2.0 billion in March 2017. Of these, 82% are in the sovereign sector across 13 member countries. By 2020, AIIB expects to have active projects in 24 member countries. Recently, AIIB established a limit that allows up to 15% of total approved bank financing to nonregional investments, which we view as positive so long as it continues to support global trade and connectivity and economic integration with Asia.

Of the 32 projects approved as of November 2018, 21 are cofinanced with other MLIs such as the World Bank Group and the European Investment Bank, and we positively view the increase in the overall share of stand-alone projects. While leveraging the expertise and capital of other MLIs to source deals enables AIIB to spread risk as well as reduce pressure on internal country limits, we believe that taking on a bigger share of stand-alone projects is vital given its role as a key provider of infrastructure financing in the region.

The expected size and scope of AIIB are designed to fill a very large financing gap in infrastructure in the Asian region, currently estimated at US$22.5 trillion over the next 15 years. As such, we do not see AIIB competing with other institutions, and we believe its role is critical given its niche mandate.

While preferred creditor treatment (PCT) is largely untested as a relatively new institution, our calculated arrears ratio is 0% because we assume that all borrowing members will grant AIIB PCT, supported by the strong and international backing of the institution.

The institution is predominantly owned by regional member countries, which could lead to potential conflicts of interest. Furthermore, AIIB's shareholders, on average, have somewhat lower ranking in governance compared to other 'AAA' rated peers. To mitigate such conflicts, AIIB has established that a supermajority vote of the board of governors (at least two-thirds of the governors holding 75% of the total voting powers) is needed to amend the institution's founding articles, including essential operating principles on governance and risk appetite. China is the largest, with 27% of current voting share and has veto power, followed by India (8%), Russia (6%), and Germany (4%). There are 12 directors, 11 of which are constituencies. Only India has its own seat, and China and Hong Kong represent one constituency.

AIIB has a nonresident board, unlike many peers, but we do not believe this constrains decision-making or information flow to a meaningful extent. In fact, the board meets in person quarterly and holds virtual meetings as needed. Notably, in April 2018, the board of directors approved an accountability framework, which shifts more responsibility to management. This will enable management to approve loans, in line with agreed policies and strategies, and the appropriate risk functions, in effect streamlining decision-making and upholding its lean management philosophy. Currently, loan granting is carried out by simple majority by the board.

AIIB's risk management and governance polices continue to evolve and, in our view, will be in line with highly rated peers. AIIB has made significant progress with the establishment of a robust risk management framework. It established core operating policies, including financial policies and risk limits, by 2016. Since then, the asset liability management policy and directives on market, liquidity, and counterparty risk were rolled out. AIIB approved its risk appetite statement in January 2018 and uses an economic capital model to manage and measure the allocation of risk over its business activities.

The institution's senior management team is diverse and has extensive experience in the MLI sector. AIIB does not have nationality restrictions and has committed to maintain two-thirds of the workforce international, which, in our view, contributes to AIIB's high standards. We expect AIIB to continue to face some challenges hiring and retaining personnel but believe it will manage these bottlenecks appropriately. So far, we believe that growth in operations has been supported by key operational structures and functions, and we expect that AIIB will continue to be managed prudently.

AIIB's financial strength remains unparalleled among MLIs. It had a risk-adjusted capital (RAC) ratio after MLI adjustments of 156% as of Dec. 31, 2017, down from 175% under the former criteria because of changes in the way we compute the single-name concentration, which was partially offset by our incorporation of PCT. We expect the RAC ratio to continue declining during this growth phase, but we believe it will stay extremely strong for the foreseeable future.

We expect AIIB to become a regular benchmark issuer and have a global investor base. In December 2018, AIIB launched its Euro Commercial Paper Program, where it can issue a maximum outstanding aggregate principal amount of $5 billion. We assess funding as neutral because the strong and stable equity source is a positive factor but AIIB has yet to actively tap the market.

Given the large liquidity reserves and emergent pipeline, our calculations of

AIIB's liquidity incorporating stressed market conditions show that it could survive an extremely stressed scenario without market access for 12 months without withdrawing principal resources from borrowing members should they be brought forward in time. As the bank increases commitments and taps the market, we expect its liquidity ratios to deteriorate. Nonetheless, we assume that AIIB will maintain ample liquidity, mainly because of a conservative policy that establishes a minimum liquidity level of 40% of the next three years' net cash flow requirements.

AIIB has a robust callable capital base, benefiting from $10 billion in callable capital from 'AAA' rated shareholders. This would support AIIB if needed--though that's unlikely--and would underpin an extremely strong financial profile if it deteriorates on a stand-alone basis.

Outlook

The stable outlook reflects our expectation that, over the next two years, AIIB will maintain a similar pace of developing a track record in delivering on its mandate. We expect the institution to continue growing loan commitments and disbursements. We also expect AIIB to continue building up its operations, risk management function, staff, and IT systems to support growth. We expect a strong adherence to what we consider sound governance and risk policies, as well as shareholders to remain supportive and grant the institution PCT. We expect AIIB's capital, funding, and liquidity positions to deteriorate from currently extremely robust levels but remain a significant relative strength compared with peers and underpin its financial profile.

We could lower the ratings if AIIB fails to deliver on any of the main items described above. We reiterate that our rating on AIIB continues to rely heavily on a prospective view of its profile considering this is only its fourth year in operation. We consider any significant deterioration of its financial risk profile to be unlikely, but if it does deteriorate, AIIB's highly rated callable capital, which is the strongest among all MLIs, would act as a buffer.

Ratings Score Snapshot

Issuer Credit Rating	AAA/Stable/A-1+
SACP	aaa
Enterprise Risk Profile	Very Strong
Policy Importance	Very strong
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, Dec. 14, 2018
- 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Criteria Guidance: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- Supranationals Special Edition, Oct. 11, 2018

Ratings List

Ratings Affirmed

Asian Infrastructure Investment Bank	
Issuer Credit Rating	
Foreign Currency	AAA/Stable/A-1+
Commercial Paper	A-1+

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.