Directive on Credit and Other Investment Risk Management
(Private Investment Operations)
Dec. 31, 2020

1. Overriding Objective

1.1. This Asian Infrastructure Investment Bank (**AIIB** or the **Bank**) *Directive on Credit and Other Investment Risk Management (Private Investment Operations)* (**Directive**) sets out the key principles underlying the management of credit risk to ensure that non-sovereign-backed financings (**NSBF**s) and sovereign-backed financings involving commercial entities (together **private investment operations**) are consistent with the Bank's *Operational Policy on Financing*, *Financial and Risk Management Policy* as in effect from time to time and sound banking principles.

1.2. In its lending, guarantee, equity and other investment operations, the Bank seeks to (i) identify, measure, manage and mitigate credit risks and (ii) report on its credit risk position in a timely and transparent manner.

1.3. Robust credit risk management based on sound banking principles for private investment operations requires that risks are identified, assessed and mitigated through adequate review, challenge and control throughout the life-cycle of the specific set of activities financed by the Bank (each such set a **Project**).

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

2. Management of Credit and Other Investment Risk

2.1 The process of approving and managing credit and other investment risk relies on effective interaction between Investment Operations (**IO**), the Risk Management Department (**RMD**) and other Bank Departments, as necessary. IO and RMD are expected to be objective and maintain a risk culture that seeks a balance between business origination and risk taking.

2.2 RMD is responsible for setting out and periodically updating procedures for the assessment of credit and other investment risk in the origination of new Projects and the management of existing Projects consistent with the Bank's *Operational Policy on Financing* and *Financial and Risk Management Policy*.

2.3 The purpose of credit and other investment risk assessment is to identify and evaluate the credit and other investment risk to which the Bank may be exposed over the life of a Project and to structure the transaction in such a way as to make this risk acceptable to the Bank and the client.

2.4 IO has the primary responsibility for performing the credit and other investment risk assessment. Such assessment entails in-depth appraisal of the Project, preparation of financial forecasts including downside scenarios based on realistic assumptions, identifying and mitigating key risks and structuring a coherent financing or investment proposal that balances risks and rewards among stakeholders.

2.5 RMD is responsible for the independent review of the creditworthiness or investment quality of Projects and provides recommendations to the Investment Committee based on the analysis presented by IO.

2.6 RMD is responsible for signing off on Internal Credit Rating (**ICR**), Probability of Default (**PD**) and Loss Given Default (**LGD**) ratings and ensuring independent and adequate challenge.

2.7 The ICR and PD ratings are generated by IO using a rating methodology and/or rating tool best suited to the profile of the client and the transaction. The rating methodology and applicability of rating tools is subject to approval by the Risk Committee (**RC**).

2.8 The LGD is established by RMD based on the transaction structure, collateral assigned and any other legal rights the Bank has over the obligor and its assets.

2.9 Economic Capital (**ECap**) is measured and provided by RMD for all credit and other investment risk under the Bank's *Capital Adequacy Policy* and *Stress Testing Directive*.

2.10 Throughout Project preparation, RMD provides advice and assistance to IO in structuring the transaction. This includes choice of product, security, key borrowing and investment terms, covenants and initial determination of integrity risks and reflects RMD's experience of the full spectrum of the Bank's Projects, including lessons learned by the Bank and from peer institutions.

2.11 IO is expected to approach RMD early in the transaction approval life cycle to discuss the suitability of a prospective Project. Feedback from RMD helps select bankable deals, assists in focused due diligence and ensures targeting an appropriate risk reward for each transaction.

3. Credit and Other Investment Risk Mitigation

3.1 Risk mitigation measures are developed to protect (i) the Bank against events that could cause the credit or other investment risk of a Project to deteriorate to unacceptable levels or (ii) the Bank's preferred position as a lender or investor at the date of signing and disbursement.

3.2 The proposed risk mitigation measures vary according to the risks identified and the probability of their occurrence. In structuring the financing, IO considers all the variables and develops a combination which best meets the Bank's and client's requirements.

3.3 The credit and other investment risk identification and financial analysis identify the primary source of repayment. Repayment shall mirror cash available for debt service or investment return evidenced in the base case forecasts. The Bank seeks repayment as early as practicable following generation of cash flows by the Project or achievement of its purpose.

3.4 Cash flow generated by the Project is expected to be the primary source of repayment with reliance on a secondary source if the primary source is impaired. The secondary source of repayment may be from the proceeds of a guarantee or enforcement of collateral.

3.5 Proposed loan and investment covenants, thresholds, representations and warranties shall be related to the Project and appropriate for a financing or investment type and industry segment. Generally, financial covenants and thresholds are set at levels required to trigger a default or remedy before the financing or investment becomes seriously impaired.

4. Pricing for Risk

4.1 Pricing for private loans, guarantees or investments follows market principles and is informed by comparison to internal and external benchmarks. Loan or investment pricing is subject to negotiation with the client and approval by the IC.

4.2 Pricing is evaluated on a Risk-Adjusted Return on Capital (**RAROC**) basis, reflecting the risk, tenor and costs to the Bank. RMD is responsible for maintaining the Bank's RAROC model and validates pricing proposals from IO.

5. Credit and Other Investment Risk Monitoring

5.1 The Bank manages its financing and other investment portfolio in a manner that limits concentrations in terms of risk rating, country, sector, maturity, large exposures and correlations to common factors. Portfolio management allows RMD to identify and manage the size and risk-return profile of the portfolio in its entirety in addition to Project-specific implementation monitoring.

5.2 The originating IO Vice Presidency (**IOVP**) and (after transfer of implementation monitoring management from the IOVP IO) the Implementation Monitoring Department (**IMD**) have the primary responsibility for proactive and ongoing credit and investment monitoring of each Project. This includes updating the financial model, checking for covenant and other compliance, tracking Project implementation, updating the ICR and conducting integrity risk checks.

5.3 As the first line of defense, the IOVP concerned/IMD is responsible for identifying existing high-risk clients and engaging with RMD to implement a two-tiered Early Warning System (**EWS**). The EWS helps track relevant developments and formulate appropriate action plans on exposures with deteriorating credit and investment risk to ensure management takes proactive and rigorous action to protect the Bank's interests.

5.4 As part of project implementation monitoring, the IOVP concerned/IMD identifies and highlights any NSBF with deteriorating credit or investment risk that does not perform to the standards expected by the Bank at approval and at signing.

5.5 The Bank's response to such deterioration consists of developing and implementing appropriate action plans for remedial actions for such NSBF (including restructuring and workout) and exercising rights and remedies as deemed appropriate, to be carried out by:

- The IOVP concerned/IMD for NSBFs where there is no threat to the repayment of the NSBFs and no expectation of a loss to be suffered by the Bank; and
- the Restructuring and Workout (RW) function established by RMD where RW involvement is required or deemed appropriate.

5.6 In the application of sound banking principles, RW shall take all necessary steps to protect the Bank's interests and minimize loss with respect to NSBFs and other investments assigned to it.

6. Credit and Investment Portfolio Management

6.1 As the Bank's portfolio grows over time, proactive management of the portfolio will create additional headroom for new investments. At the appropriate time, the Bank will consider ways to manage its portfolio through measures such as selling assets or risk participations in assets, buying insurance and/or structuring/securitizing infrastructure debt in a manner appealing to diverse investor groups.

7. Credit and Investment Risk Reporting

7.1 RMD is responsible for reporting to the Risk Committee (**RC**) the Bank's credit and investment risk status.

8. Implementation

8.1 The Chief Risk Officer (**CRO**) has oversight responsibility for this Directive, introduces any related Administrative Guidance and provides adequate resources to ensure efficient implementation of this Directive and any related Administrative Guidance.

9. Authority

9.1 The CRO makes all final decisions regarding the application of this Directive following appropriate consultation with the RC.