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Research Update:

AIIB 'AAA/A-1+' Ratings Affirmed On Progress Meeting Key Operational And Lending Targets; Outlook Remains Stable

Primary Credit Analyst:
Alexander Ekbom, Stockholm (46) 8-440-5911; alexander.ekbom@spglobal.com

Secondary Contact:
Alexis Smith-juvelis, New York + 1 (212) 438 0639; alexis.smith-juvelis@spglobal.com

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Overview

- In our view, Asian Infrastructure Investment Bank (AIIB) has been making progress on delivering on its mandate by building up its operational capacity and increasing loan commitments to the region.
- AIIB's very strong capital endowment, combined with increasing membership and timely capital payments, underpins our assessment of its very strong business profile.
- We are affirming our 'AAA/A-1+' long- and short-term issuer credit ratings on AIIB.
- The stable outlook reflects our expectation that, over the next 12-24 months, AIIB will continue making progress building out the institution 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 July 13, 2018, 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.

Rationale

Our ratings on AIIB reflect our view of its very strong business profile and extremely strong financial profile. A key consideration in the rating is our expectation that AIIB will continue to make considerable progress over the next three to five years in building a track record to support its mandate.

Over the past year, we've seen AIIB reach important milestones in new loan commitments, which we believe underpins its growing relevance for the region. It has committed a total of US$5.4 billion in new projects, up from $2.4 billion in March 2017. Of these, 80% 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.

As a new institution, AIIB leverages the expertise and capital of other multilateral lending institutions (MLIs) to source deals, enabling it to spread risk as well as reduce pressure on internal country limits. Nonetheless, we expect that, over time, AIIB will take on a bigger share of own projects, which we deem critical as a key provider of infrastructure financing in the region, which will consolidate its business profile. Of the 28 projects approved thus far, 19 are cofinanced with other MLIs such as the World Bank Group and the European Investment Bank.

AIIB lending focuses on green and sustainable projects. While it will not house a big research department and instead leverage off other MLIs, it has a robust environmental and social framework, in effect since December 2017. The framework applies to all projects and focuses on screening, minimizing, or offsetting environmental and social risks as well as continued monitoring and reporting.

We view AIIB's shareholder support as a key strength to the rating. Founded in 2015, AIIB is a new MLI established by international treaty and headquartered in Beijing. Its original 57 founding members have now grown to 87, with notable new members including Canada, Spain, and Hong Kong. Its membership includes all 'AAA' rated sovereigns as well as 17 of the 20 G-20 members, which we view as strengthening AIIB's governance.

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 timely, with US$12.8 billion received as of June 2018. In our view, this reflects strong shareholder support and reinforces AIIB's important role, enabling it to become, over time, one of the largest MLIs globally.

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. AIIB has made further progress sharpening its strategic focus, particularly with the rollout of its strategy in February 2018 to mobilize private capital for infrastructure. AIIB is currently pursuing and executing transactions based on third-party referrals, and we expect that over the medium term it will be originating, structuring, and executing stand-alone private-sector deals.

While preferred creditor treatment is largely untested, we factor into our rating that all borrowing members will grant AIIB preferred creditor and preferential treatment, 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. 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 member, with 27% of current voting share and has veto power, followed by India (8%), Russia (6%), and Germany (4%). There are 12 directors, 11 which are constituencies. Only India has its own seat, and China and Hong Kong represent one constituency.

AIIB has a non-resident 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 recently 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 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 175% as of Dec. 31, 2017, down from 191% as of March 31, 2017--in line with expectations as AIIB ramps up operations. While we expect the RAC ratio to continue declining during this growth phase, we believe it will stay extremely strong for the foreseeable future. The RAC ratio after diversification does not reflect the criteria correction published on July 11, 2017. We believe the impact of the correction on the ratio is not material to the rating.

We expect AIIB to become a regular benchmark issuer and have a global investor base. We assess funding as neutral because the strong and stable equity source is a positive factor but AIIB has yet to tap the market. Progress has been made, including the appointment of a head of funding and the approval of its borrowing program and funding guidelines.

Liquidity is very robust, with liquid assets at 54% of total assets as of December 2017. Supported largely by externally managed trust funds, AIIB continues to build out its in-house portfolio management capabilities.

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. However, we do not factor any uplift into our issuer credit rating because of extraordinary shareholder support as AIIB's stand-alone credit profile (SACP) is already 'aaa'. This stock could help AIIB in the unlikely case of need and underpin an extremely strong financial profile if it would deteriorate 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 preferred creditor treatment. AIIB's capital, funding, and liquidity positions are expected 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 third year in operation. We consider any significant deterioration of its financial 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.

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Governments - General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Nov. 26, 2012
- Criteria - Financial Institutions - Banks: Multilateral Lending Institutions Capital Methodology And Assumptions, Dec. 6, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Criteria For Assessing Bank Capital Corrected, July 11, 2017
- Credit FAQ: Key Considerations For Supranationals' Lending Capacity And Their Current Capital Endowment, May 18, 2017
- How Brexit Could Impact Ratings On Supranational Institutions, April 10, 2017
- How An Erosion Of Preferred Creditor Treatment Could Lead To Lower Ratings On Multilateral Lending Institutions, Aug. 26, 2013

Ratings List

Ratings Affirmed

Asian Infrastructure Investment Bank	
Issuer Credit Rating	AAA/Stable/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.