FitchRatings

02 Jul 2020 | Affirmation

Fitch Affirms AIIB at 'AAA'; Stable Outlook

Fitch Ratings-London-02 July 2020:

Fitch Ratings has affirmed Asian Infrastructure Investment Bank's (AIIB) Long-Term Issuer Default Rating (IDR) at 'AAA' with a Stable Outlook.

A full list of rating actions is at the end of this rating action commentary.

Key Rating Drivers

AIIB's 'AAA' IDR continues to reflect its intrinsic credit strengths. Given the relatively early years of development at AIIB, Fitch bases its projections on an eight-year forecast period (2020-2028). Based on this, the bank's 'excellent' capitalisation and 'low' risk profile translate into a 'aa+' assessment of solvency. Liquidity is assessed at 'aaa'. AIIB's 'medium' risk business environment leads to a one-notch uplift over the lower of solvency and liquidity, to 'aaa' for the bank's intrinsic assessment. Our assessment of the bank's solvency, liquidity and business environment are unchanged from last year. Shareholders' support, assessed at 'a+' (unchanged from last year), does not provide a rating uplift.

AIIB's 'excellent' capitalisation assessment is based on Fitch's expectation that both the equity-to-assets ratio and Fitch's risk-weighted capitalisation (FRA) ratio will remain above the respective 'excellent' thresholds of 25% and 35%. However, Fitch has revised down its forecasts for these two capitalisation ratios, in line with the bank's own projections, reflecting a significant shift in the bank's strategy compared with last year. This was driven by AIIB's revised strategy of significantly increasing its treasury portfolio to support a more rapid increase in lending. Fitch now expects the equity-to-assets ratio to be around 27% in 2028 (compared with our previous forecast of 35%) and the FRA ratio to be around 55% (compared with our previous forecast of 75%).

As part of the ongoing formation of AIIB's Corporate Strategy, the bank is looking to ensure that it has the capability to respond to future major crises without impacting the bank's capital position, by increasing the size of its liquid assets portfolio. It has demonstrated this in response to the COVID-19 pandemic given it is currently majority equity-funded.

In April 2020, AIIB established its 'COVID-19 Crisis Recovery Facility' (CRF) to support its members and clients to mitigate both economic and public health pressures. The facility, available until

October 2021, will provide between USD5 billion-USD10 billion of support to its members including policy loans directly extended to sovereigns and co-financed with other multilateral development banks. The creation of the CRF has seen a sharper-than-expected acceleration in the growth of the bank's loan book in the short term (far greater than our expectation last year) but over the medium to long term, we do not expect the CRF to result in an increase in the projected stock of loans by 2028.

AIIB's risk profile is primarily driven by its 'low' credit risk assessment. Fitch continues to expect that the average rating of the loan portfolio will be 'BB' in 2028 (from 'BB+' as of May 2020). Since the last rating review, the bank has revised its long-term expectation of the share of its lending operations focussing on sovereign and non-sovereign sectors, from 60%/40% last year, to 50%/50%. However, this is a long-term strategy that will not be achieved before 2030. Given the bank's policy response to the COVID-19 pandemic, in the form of the CRF which is expected to be pre-dominantly to its sovereign members, the share of non-sovereign borrowers will actually be diluted over the medium term, to approximately 30% by 2028, compared with our previous expectations.

AIIB continues to benefit from 'strong' preferred creditor status (PCS), in Fitch's view, translating into a two-notch uplift over the average rating of loans to 'BBB-'. This assessment reflects the long-term expected share of the sovereign portfolio (50% of financing approvals by 2030) and the assumption that non-performing sovereign loans will be very limited at a maximum of 0.5%. The agency continues to expect overall non-performing loans to account for approximately 2% of total loans and be concentrated on the non-sovereign portfolio. As of March 2020, there were nine sovereign loans and five non-sovereign loans classified as 'Stage 2' under the IFRS 9 accounting standard, reflecting the weakening in the credit quality of these borrowers since initial recognition in the bank's books. As of end-June, management expects no loans to be classified as 'Stage 3' in the portfolio, with all loans currently performing.

Risk management rules and objectives are in line with 'AAA' rated peers, although given its recent creation in 2015, the bank currently lacks a longer track record of operating under prudent risk management. In terms of concentration limits, Fitch expects the top five exposures will account for 50% of total loans. The bank's policy foresees that equity participations will be kept below 10% of banking exposure. AIIB will use financial derivatives to hedge its balance sheet and manage interest rate and currency risks. Loan loss reserves are based on expected loss as per IFRS 9 standards.

The bank's liquidity is assessed at 'aaa'. Given its large paid-in capital (USD19.3 billion subscribed) and increasing market presence, the bank will have excess liquidity for the next few years. Fitch expects the ratio of liquid assets to short-term debt to be well in excess of 150% over the forecast period. As of end-2019, 61% of treasury assets were rated 'AAA'/'AA' (FYE18: 54%). Fitch has revised up its expectation of the share of 'AAA'-'AA' treasury assets to around 50%-60% (from 50% previously), in line with forecasts provided by the management team.

In line with the revised strategy adopted by AIIB, the growth in the bank's total assets will be supported by an increase in leverage and more frequent debt issuances over the short to medium term, compared with our expectation last year. By the mid-to-end 2020s, our previous expectation was that borrowing would increase to around USD10 billion per year, but it is now closer to USD15 billion per year. The bank continues to issue in US dollars, following its inaugural USD2.5 billion bond in May 2019, and this year AIIB successfully launched its inaugural RMB3 billion Panda bond, as well as its inaugural private placements.

AIIB's business environment is considered 'medium' risk, in line with last year. While the expansion of the balance sheet will be very fast in the coming years, the bank is expected to remain highly capitalised and liquid throughout the forecast period. Lending will primarily be extended to emerging Asian countries, mostly rated sub-investment grade and classified as lower-middle-income countries by the World Bank. Fitch has revised its assessment of the 'income per capita' in the countries of operations to 'high' risk based on peer analysis using World Bank figures. Political risk in the countries of operations remains 'medium'.

The bank's support assessment remains unchanged at 'a+', reflecting full coverage of net debt by callable capital rated 'A+' and above in the year 2028. Under Fitch's definition, AIIB's key shareholders are China (31% of capital, A+), India (9%, BBB-), Russia (7%, BBB) and Germany (5%, AAA). Their average rating is 'A'. The high ratio of paid-in to subscribed capital (20%) is evidence of the importance of the bank for the shareholders. This translates into a 'strong' propensity to support.

RATING SENSITIVITIES

The factors that could, individually or collectively, lead to positive rating action/upgrade are:

The ratings are at the highest level on Fitch's scale and cannot be upgraded.

The factors that could, individually or collectively, lead to negative rating action/downgrade are:

- Greater-than-expected growth in the bank's lending operations and/or treasury portfolio, which could lead to a weaker assessment of capitalisation.

- Weaker asset quality than expected in Fitch's projections and/or marked increase in the non-performing loan ratio, leading to a weakening in our assessment of the risk profile.

- Any material change to AIIB's conservative approach to risk management / liquidity policies or unexpected changes in strategic direction that could undermine our assessment of the bank's governance quality.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

Key Assumptions

Fitch assumes that AIIB's capital will be fully subscribed and that paid-in capital will be fully received by 2024. Fitch further assumes that total banking exposure will be close to USD50 billion by 2028.

We assume that the global economy develops in line with our Global Economic Outlook published on 29 June, including a deep but short-lived recession in 2020 due to the pandemic.

Sources of Information

The source(s) of information used to assess these ratings were AIIB's financial statements, and other information provided by AIIB.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING
The principal sources of information used in the analysis are described in the Applicable Criteria.

Asian Infrastructure Investment Bank; Long Term Issuer Default Rating; Affirmed; AAA; RO:Sta

----; Short Term Issuer Default Rating; Affirmed; F1+
----senior unsecured; Long Term Rating; Affirmed; AAA

Contacts:
Primary Rating Analyst
Nick Perry,
Associate Director
+40 20 3530 2727
Fitch Ratings Ltd
30 North Colonnade, Canary Wharf
London E14 5GN

Secondary Rating Analyst
Arnaud Louis,
Senior Director
+33 1 44 29 91 42

Committee Chairperson
Tony Stringer,
Managing Director
+44 20 3530 1219

Media Relations: Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email:
peter.fitzpatrick@thefitchgroup.com

Additional information is available on www.fitchratings.com

Applicable Criteria
Supranationals Rating Criteria (pub. 30 Apr 2020) (including rating assumption sensitivity)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Status
Endorsement Policy

rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

ENDORSEMENT POLICY - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.