

FITCH AFFIRMS AIIB AT 'AAA'; STABLE OUTLOOK

Fitch Ratings-Paris/London-09 July 2019: 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 reflects its intrinsic credit strength. Based on Fitch's 10-year projections, 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. Shareholders' support, assessed at 'a+', does not provide a rating uplift.

AIIB's 'excellent' capitalisation assessment is based on Fitch's forecast that the equity to assets ratio will remain well above 25% by 2028. This reflects the bank's sizeable paid-in capital (USD20 billion), the expectation that the banking exposure will grow to about USD50 billion by 2028 (from USD1.4 billion at end-2018) and a rate of internal capital generation of 2.5% on average over the forecast. Fitch's risk-weighted capitalisation ratio (FRA ratio) is forecast to be over 70%, well above the threshold for 'excellent' (35%). The FRA ratio takes into account AIIB's highly rated callable capital (USD21 billion AAA-AA callable) and the projected credit quality of the bank's assets.

AIIB's risk profile is primarily driven by its 'low' credit risk. Fitch expects that the average rating of the loan portfolio will be 'BB' (from 'BB+' as of May 2019) assuming that sovereign loans will account for 60% of total loans and lending will be directed towards emerging Asia, including India (BBB-/Stable), Indonesia (BBB/Stable) and Turkey (BB/Negative).

AIIB is set to benefit from 'strong' preferred creditor status (PCS), translating into a two-notch uplift over the average rating of loans to 'BBB-'. This assessment reflects the expected share of the sovereign portfolio by the end of the forecast (60% of total loans) and the assumption that non-performing sovereign loans will be very limited at a maximum of 0.5%. The agency expects non-performing loans will account for 2% of total loans and be concentrated on the non-sovereign portfolio.

Risk management rules and objectives are in line with 'AAA' rated peers although given its recent creation, the bank lacks a 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 banking exposure. The bank 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 credit losses.

The bank's liquidity is assessed at 'aaa'. Given its large paid-in capital (USD19.3 billion subscribed and USD16.2 billion received as of May 2019) and the recent USD2.5 billion debt issuance, 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 above 150% at the forecast horizon. As of end-2018, 54% of treasury assets were rated 'AAA'/'AA'. The agency expects the share of 'AAA'-'AA' treasury assets to remain around 50%, in line with management's objective.

AIIB issued an inaugural USD2.5 billion bond in May this year (SEC-registered transaction) under terms comparable with other 'AAA' rated MDBs. As the bank grows, borrowing is expected to increase to around USD8 billion-USD10 billion per year in the mid-2020s.

AIIB's business environment is considered 'medium' risk. 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. In Fitch's view, political risk in the countries of operations is 'medium'. The share of non-sovereign loans will gradually increase to around 40% (from 16% currently).

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

RATING SENSITIVITIES

The Outlook on the IDR is Stable. However, the factors that could, individually or collectively, lead to negative rating action are:

- More rapid lending growth than Fitch's projections, leading to a weaker assessment of capitalisation.
- Weaker asset quality than Fitch's projections and/or a 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 and liquidity policies.

KEY ASSUMPTIONS

Fitch assumes that AIIB capital will be fully subscribed and that paid-in capital will be fully received by 2024. Fitch further assumes the banking exposure will be close to USD50 billion by 2028, and that loans to sovereign will account for 60% of total loans.

The full list of rating actions is as follows:

Long-Term IDR affirmed at 'AAA'; Outlook Stable

Short-Term IDR affirmed at 'F1+'

Issue ratings on long-term senior unsecured bonds affirmed at 'AAA'

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Applicable Criteria

Supranationals Rating Criteria (pub. 23 May 2019)

<https://www.fitchratings.com/site/re/10074974>

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