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Research Update:

Asian Infrastructure Investment Bank Assigned 'AAA/A-1+' Rating; Outlook Stable

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Overview

- Asian Infrastructure Investment Bank (AIIB) has been granted a very strong capital endowment from 80 sovereigns globally, and stands to have a significant impact in supporting Asia's large infrastructure needs.
- Our prospective view for the next few years factors in the AIIB delivering on its mandate, significantly strengthening its operational capacity, and adhering to sound governance and risk management principles.
- We are assigning our 'AAA/A-1+' long- and short-term issuer credit ratings to AIIB.
- The stable outlook reflects our view that AIIB will develop a track record of delivering on its mandate while building its operational capacity and benefiting from strong shareholder support through preferred creditor treatment as well as maintaining an extremely strong financial profile.

Rating Action

On July 18, 2017, S&P Global Ratings assigned its 'AAA/A-1+' long- and short-term issuer credit ratings to Asian Infrastructure Investment Bank (AIIB). The outlook is stable.

Rationale

The ratings reflect our opinion that over the next three to five years AIIB will establish a track record and significantly enhance its operational setup, supporting our assessment of its very strong business profile and its extremely strong financial profile. AIIB has a robust callable capital base. However, we do not factor in any uplift into our issuer credit rating because of extraordinary shareholder support as AIIB's stand-alone credit profile (SACP) is already 'aaa'.

Founded in 2015, AIIB is a multilateral lending institution (MLI) established by international treaty. Its headquarters is in Beijing and China is the largest shareholder with 27.5% of the votes. Its original 57 founding members (now 80) include almost all 'AAA' rated sovereigns globally (Canada has been approved as a member but has not yet ratified the treaty). The members have entrusted the institution with a very significant capital endowment of $100 billion of which 20% represents paid-in resources to be funded in full over the next five-to-seven years. This means AIIB will be, from the start, one of the largest MLIs globally. We base our assessment on our forward-looking view that AIIB will deploy a significant portion of its resources to establish a track record and a strong footprint in Asia. Should it fail to do so we would likely reconsider our view of its business profile.

We believe its important role is underpinned by the high need for infrastructure investment in the region. A recent Asian Development Bank study estimates this need at around $1.5 trillion on a yearly basis for the next 15 years. While the addition of AIIB, alongside other MLIs, will not come close to bridging the gap, we believe it will grow rapidly and in the medium term will become a significant financier of projects in Asia in line with its mandate. It will focus on both sovereign and private lending as well as a smaller equity portfolio. To date it has approved 17 projects (mostly sovereign and co-financed with other MLIs), committing $2.8 billion. Despite China being the largest shareholder, we expect exposure to China to be minimal.

Strong shareholder support is a key rating factor underpinning our assessment of AIIB's business profile. The fact that 80 sovereigns, including 17 of the G-20 countries, have come together to endorse a newly established institution with very significant resources is a strong signal of ongoing future support. The U.S. and Japan are not members. We believe this may reflect political divergence with China, but we do not think this will impair the bank's ability to do business given Asia's very large infrastructure financing needs.

We assess AIIB's risk management and governance polices as sound and similar to its highly rated peers. We expect AIIB to abide by the same high standards as leading peers in terms of governance, procurement, and social responsibility, as required in the projects that AIIB co-finances with the Asian Development Bank and World Bank Group Institutions. Over time we expect AIIB to build expertise in the field as well as establish a strong risk management framework including systems that will handle loan-portfolio, funding, and liquidity risks. That said, we note that the institution is new and much of its structure remains untested. There is significant work in progress that could entail meaningful operational risks.

We note two aspects of AIIB's governance structure. One: it has a nonresident board, unlike many other peers. We do not see this as undermining its oversight or the decision making is any meaningful way. Two: it has a shareholder majority of regional members that we believe could lead to potential conflict 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. Currently this means that both China but also nonregional members (taken together) have a veto to block any such decision. However, on a lower level of decision making, as with any decision taken by the board of directors, the approval of loans is carried out by simple majority. That said, any loan to be approved needs to comply with all AIIB's operational and financial policies including addressing environmental and social impacts as well as paying due attention to the prospect of repayment and fair pricing of risks.

Given AIIB's very short period of operations, it has not yet built a track record of strong repayment behavior and preferred creditor treatment from borrowing countries. However, we believe that the institution's diversified ownership and strong ties with China, the major economy in the region, will encourage adherence to this established principle. We therefore factor into our rating that borrowing members will grant AIIB preferred creditor and preferential treatment. If we saw significant deviation from this, we would likely reassess the rating.

AIIB's senior management team has wide experience in the multilateral realm with significant hands-on involvement in running the critical departments of development institutions. We believe management is strong, balanced, and selected according to merit rather than political affiliation, and is capable of delivering its mandate. Rapid growth will produce challenges while the institution's operational structures are established, but we expect management to continue its so-far prudent approach.

AIIB's financial strength is currently unparalleled in the MLI domain. It had a risk-adjusted capital (RAC) ratio of 191% as of March 31, 2017, reflecting the equity financing of its entire balance sheet. While we expect the RAC to drop during the ramp-up period, we believe it will stay extremely strong for the foreseeable future.

With a sizable capital base, the need for funding is limited but we expect AIIB to become a regular benchmark issuer over the medium term as it builds recognition in the market. We assess funding as neutral for the rating because we weigh its strong and stable equity source against its untested access to the market.

Liquidity is very robust and currently placed with Chinese banks as well as in an externally managed low-risk treasury fund. While we expect it to deteriorate as the portfolio grows, we estimate that AIIB currently, as well as in the foreseeable future, could survive an extremely stressed scenario without market access for 12 months and without withdrawing any principal resources from borrowing members.

AIIB enjoys a deep reserve of callable capital provided by 'AAA' rated shareholders. Currently some $10 billion, or 1.5 times its paid-in resources as of year-end 2016, is provided by 'AAA' rated sovereigns. This stock could help AIIB in the unlikely case of need and would underpin an extremely strong financial profile if its finances deteriorated on a stand-alone basis.

Outlook

The stable outlook reflects our view that over the next two years AIIB will develop a track record of delivering on its mandate, cementing its role as a major MLI in Asia. We expect the institution to make significant progress in its loan commitments and disbursements and deploy part of the significant capital with which it has been entrusted. We also expect AIIB to significantly strengthen its operations, risk management, staff, and IT-systems to support its growth trajectory. We assume it will adhere strongly to what we consider sound policies in governance and risk, as well as social and environmental impacts. We expect shareholders to remain supportive and grant the institution preferred creditor treatment. AIIB capital, funding, and liquidity positions are expected to deteriorate from currently extremely robust levels but to remain a significant relative strength compared to peers, and to underpin its financial profile.

Downside scenario

While the financial profile is unlikely to put downward pressure on the ratings, we could lower them if AIIB failed to deliver on any of the aforementioned key aspects of its business profile. We reiterate that our rating on AIIB is predicated on a prospective view of its profile considering it is just starting its operations. In the unlikely event of a significant deterioration of the financial profile, the rating could be underpinned by the strong buffer of highly rated callable capital.

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: Bank Capital Methodology And Assumptions, Dec. 6, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- 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

New Rating; Outlook Action

Asian Infrastructure Investment Bank
 Issuer Credit Rating

Foreign Currency	AAA/Stable/A-1+

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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.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.