Research Update:

Asian Infrastructure Investment Bank 'AAA/A-1+' Ratings Affirmed; Outlook Remains Stable

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Overview

- In our view, AIIB continues making progress on delivering on its mandate by building up its operational capacity and increasing loan commitments to the region.
- We are affirming our 'AAA/A-1+' ratings on AIIB.
- The stable outlook reflects our expectation that, over the next 12-24 months, AIIB will continue achieving key targets 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 Dec. 16, 2019, 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

AIIB is a relatively young institution--it started operations in 2016--that aims to execute an important mandate of filling the infrastructure financing gap in Asia. The expected size and scope of AIIB are designed to fill this very large financing gap, currently estimated at US$26 trillion through 2030. We expect that AIIB will continue to make considerable progress in building a track record to support its mandate.

We continue to see AIIB reach important milestones in new loan commitments, which we believe underpins its growing relevance for the region. Since its inception, it has approved a total of US$9 billion in new projects as of August 2019, up from $7.5 billion as of December 2018. Of these, 71% are in the sovereign sector across 13 member countries. By 2020, AIIB expects to have active projects in 24 member countries. AIIB has also 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 of August 2019, 49% (67% as of June 2018) of the projects were co-financed with other MLIs, such as the World Bank Group and the European Investment Bank, and we positively view the increase in the overall share of stand-alone projects. While leveraging the expertise and capital of other MLIs to source deals enables AIIB to spread risk as well as reduce pressure on internal country limits, we believe that taking on a bigger share of stand-alone projects is vital given its role as a key provider of infrastructure financing in the region.

AIIB's original 57 founding members have now grown to 100, with notable new members including Belgium and Greece, and include all 'AAA' rated sovereigns as well as 17 of the 20 G-20 members--which underpins our view of its enterprise risk profile.

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 on time, with US$16.4 billion received as of September 2019 and 96% frontloaded for 2020. In our view, this reinforces AIIB's important role, enabling it to become one of the largest MLIs globally.

Preferred creditor treatment (PCT) for AIIB, as a relatively new institution, is largely untested. However, our calculated arrears ratio is 0% because we assume that all borrowing members will grant AIIB PCT, supported by the strong and international backing of the institution.

The institution is predominantly owned by regional member countries, which could lead to conflicts of interest. Furthermore, AIIB's shareholders, on average, have somewhat lower ranking in governance compared with 'AAA' rated peers. 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, with 27% of current voting share and has veto power, followed by India (8%), Russia (6%), and Germany (4%). There are 12 directors, 11 of which are constituencies. Only India has its own seat, and China and Hong Kong represent one constituency.

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 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 internationally, which, in our view, contributes to AIIB's high standards. We expect AIIB to continue to face some challenges hiring and retaining personnel but believe it will manage these bottlenecks appropriately. So far, we believe that key operational structures and functions have supported growth in operations, 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 162.6% as of June 30, 2019, down from 186.4% as of Dec. 31, 2018, largely because of an increase in loans and equity investments. We expect the RAC ratio to continue declining during this growth phase, but we believe it will stay extremely strong for the foreseeable future.

We expect AIIB to become a regular benchmark issuer and have a global investor base. In December 2018, AIIB launched its Euro Commercial Paper Program, where it can issue a maximum outstanding aggregate principal amount of $5 billion, and in May 2019, AIIB issued its first USD$2.5 billion inaugural bond. We assess funding as neutral because the strong and stable equity source is a positive factor but AIIB has yet to actively tap the market.

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, benefiting from $10 billion in callable capital from 'AAA' rated shareholders. This would support AIIB if needed--though that's unlikely--and would underpin an extremely strong financial profile if it deteriorates on a stand-alone basis.

Outlook

The stable outlook reflects our expectation that, over the next two years, AIIB will continue to develop a track record of 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. In addition, 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 PCT.

We also expect AIIB's capital, funding, and liquidity 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 items described above. We consider any significant deterioration of its financial risk 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.

Ratings Score Snapshot

Issuer Credit Rating: AAA/Stable/A-1+

SACP: aaa

Enterprise Risk Profile: Very Strong

- Policy Importance: Very Strong
- Governance and Management: Adequate

Financial Risk Profile: Extremely Strong

- Capital Adequacy: Extremely Strong
- Funding and Liquidity: Strong

Extraordinary Support: 0

- Callable Capital: 0
- Group Support: 0

Holistic Approach: 0

Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Supranationals Special Edition 2019, Oct. 16, 2019

Ratings List

Ratings Affirmed	
Asian Infrastructure Investment Bank	
Issuer Credit Rating	
Foreign Currency	AAA/Stable/A-1+
Senior Unsecured	AAA
Commercial Paper	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.