

## **FITCH AFFIRMS AIIB AT 'AAA'; STABLE OUTLOOK**

Fitch Ratings-Paris/London-11 July 2018: Fitch Ratings has affirmed Asian Infrastructure Investment Bank's (AIIB) Long-Term Issuer Default Rating (IDR) at 'AAA' with a Stable Outlook. The Short-Term IDR has been affirmed at 'F1+'.

### **KEY RATING DRIVERS**

AIIB's 'AAA' rating is based on its intrinsic credit quality. Under Fitch's long-term projections for key solvency, risk and liquidity indicators, AIIB's 'excellent' capitalisation and 'low' risk profile result in a solvency assessment of 'aa+'. The banks' 'medium risk' business environment reflects its 'medium risk' business risk profile and 'medium risk' operating environment, which translate into a one-notch uplift to 'aaa' for the intrinsic rating. Shareholders' support, assessed at 'a+', does not provide a rating uplift.

AIIB's 'AAA' IDR reflects the following key rating drivers:

AIIB's capitalisation is 'excellent'. The equity to asset ratio, at 100% currently, is set to erode sharply as the bank expands its operations, but it will remain well above the 25% threshold for 'excellent'. Fitch's forecasts reflect the expected completion of paid-in capital payments (USD20 billion to be fully paid by 2024 vs. USD13 billion as of June 2018 and USD19 billion expected by 2019), low earnings fully allocated to reserves, and rapid growth in the balance sheet (+12% y/y after 2020) to USD71 billion in 2028 from USD11 billion at end-2017.

Fitch assesses the overall risk profile as 'low'. Based on AIIB's stated objectives and credit policies, we expect the average rating of loans at 'BB' ('BB' for sovereign-backed loans that account for 60% of total loans and 'BB-' for non-sovereign) over its forecast horizon. Credit quality will be enhanced by AIIB's preferred creditor status on its sovereign exposures and Fitch expects impaired loans of 2% over the forecast horizon. The five largest exposures will account for 50% of the total, a 'moderate' concentration. Equity participations will be limited to 10% of shareholders' equity (5% of total banking exposure).

Fitch has changed its assessment on the risk management framework to 'strong' from 'moderate'. AIIB has established a set of comprehensive risk management policies and objectives that are consistent with those of other 'AAA' rated multi-lateral development banks. However, given AIIB's recent creation, the bank lacks a track record of prudent risk management. The agency assesses market risks as 'very low'. In line with rated peers, AIIB will use financial derivatives to hedge its balance sheet and manage interest rate and currency risks.

AIIB's liquidity assessment is 'aaa'. Fitch expects liquidity buffers to be 'excellent'. Based on AIIB's liquidity rules treasury assets must cover at least 40% of net cash requirement for the next 36 months and 100% of any upcoming 12 months. The share of 'AAA'/'AA' liquid assets was 32% as of end-2017, reflecting the large amount of excess liquidity deposited in 'A' rated Asian banks. Over time, Fitch expects 'AAA'/'AA' assets to account for 50% of the total. AIIB's access to capital markets has not been tested yet but we expect it to be 'excellent'.

Fitch assesses AIIB's business environment as 'medium' risk, translating into a one-notch uplift, principally reflecting the high quality of management and governance standards of the institution within the business profile assessment. Fitch expects the size of the newly created bank to grow rapidly (+12% y/y after 2020) and the size of the banking portfolio to be above USD50 billion by the end of the forecast period, a size we assess as 'low' risk.

Loans will be concentrated in infrastructure projects in Emerging Asia with non-sovereign exposures accounting for 40% of total loans. The relatively low credit quality and political risk in countries of operations translate into a 'medium risk' operating environment. This is mitigated by the expectation of strong operational support for the bank by member states.

AIIB's rating does not benefit from a credit uplift from shareholders' support. Fitch's assesses the capacity to support at 'A+', reflecting the coverage of net debt by callable capital rated 'A+' and above at the forecast horizon. Propensity to support is considered 'strong' and therefore we have not applied any discount to the capacity to support. The high ratio of paid-in to subscribed capital (20%) highlights the strong shareholders' commitment to provide support to the bank. The share of non-regional shareholders in the capital, at 23% as of June 2018; is in line with peers.

#### RATING SENSITIVITIES

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

- Lending growth more rapid than anticipated, leading to the equity to assets ratio falling below 25%, which would affect our 'excellent' assessment of AIIB's capitalisation ratio.
- Deterioration in expected asset quality leading to a weakening in the average rating of loans or a marked increase in the impaired loan ratio relative to our forecast.
- Any material change to AIIB's conservative approach to risk management and liquidity policies.

#### KEY ASSUMPTIONS

In its projections, Fitch assumes that capital will be paid in according to the schedule and that the return on equity will average 2.5% every year. The size of the loan portfolio will reach USD50 billion by 2028 with an average rating of 'BB'. The liquidity ratio will cover more than 150% of short-term debt, and consist of investment-grade assets, with at least 50% of them invested in AAA/AA assets.

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Applicable Criteria  
Supranationals Rating Criteria (pub. 24 May 2018)  
<https://www.fitchratings.com/site/re/10031448>

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