FITCH AFFIRMS GUARANTCO LIMITED AT IFS 'AA-'; OUTLOOK STABLE

Fitch Ratings-London-10 July 2017: Fitch Ratings has affirmed GuarantCo Limited's (GuarantCo) Insurer Financial Strength (IFS) Rating at 'AA-' (Very Strong). The Outlook is Stable.

KEY RATING DRIVERS
The affirmation reflects the financially strong owners of GuarantCo, its very strong capital position, an established track record of providing local currency guarantees to finance private infrastructure projects in emerging markets and its low investment risk. These strengths are partly offset by the company's fairly small size and historically moderately weak profitability.

GuarantCo is backed by public institutions, but it is run on a commercial basis, and allows European countries to finance private sector projects in low-income countries without directly committing their own funds. It is indirectly owned by the development agencies of the UK (AA/Negative), Switzerland (AAA/Stable), Sweden (AAA/Stable) and Australia (AAA/Stable), via the Private Infrastructure Development Group Trust (PIDG Trust; 89% at end-2016) and directly by the Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V. (FMO; AAA/Stable; 11% at end-2016).

The paid-in capital contributions GuarantCo has received from its owners to date and the increase of the company's capital base by a subscription of GBP40 million of callable capital from the UK's Department for International Development (DFID) via PIDG in January 2017 are indicative of the owners' commitment to the company. The company also received additional paid-in capital in 2016 via PIDG from DFID (GBP13 million) and the Australian Department of Foreign Affairs and Trade (AUD4 million).

However, unlimited formal support, such as an unconditional guarantee from the public shareholders to support GuarantCo, does not exist. Consequently, future financial support in excess of paid-in and callable capital from the five development agencies cannot be guaranteed. The rating reflects strong and committed sponsors, but it is not aligned with those of the owners due to the absence of explicit unconditional support.

GuarantCo's capitalisation is very strong, with a net par-to-capital ratio (excluding available capital from callable capital and a USD30 million stand-by facility from FMO) of 1.0x at end-1Q17. Fitch regards the callable capital and the stand-by facility as available capital in its capital assessment, which results in an exceptionally strong adjusted par-to-capital ratio of 0.8x at end-1Q17. GuarantCo plans to further extend its capital base with callable capital from highly rated development finance institutions (DFIs) and a layer of excess of loss (XL) cover from reinsurers in 2017. Fitch expects GuarantCo's capitalisation to weaken as the company grows, but it should remain commensurate with the rating.

Fitch views GuarantCo as a small, highly specialised financial guarantor. However, the company's size is not a limiting rating factor as it is a public-sponsored organisation and its mission does not hinge on attaining material business volumes. Its products are intended to support government initiatives established by its sponsors.

As GuarantCo's primary objectives are to encourage private sector involvement in the domestic financing of infrastructure projects and to promote local capital market development, profitability is not a key performance metric. The company's profitability has been moderately weak in recent years, largely driven by a low interest rate environment and fairly high fixed costs. However, we expect the company to return to profitability in the medium term, and a return on capital target has been established over the longer term at 3%-6%.

The company provides guarantees for mainly non-US dollar denominated debt issued by speculative-grade issuers ("high frequency, high severity" guarantee portfolio as defined in Fitch's Insurance Rating Methodology) and is exposed to currency risk. Fitch views this risk as manageable due to GuarantCo's strong capitalisation. However, it is possible that currency risk will increase as the company grows, and Fitch will continue to closely monitor this exposure.

At end-2016, GuarantCo's investments consisted of 18% cash, and two investment portfolios managed by Fidelity (money market instruments, global investment-grade corporate bonds and US Treasuries) and PIMCO (US dollar-denominated investment grade bonds and ABS). Fitch expects GuarantCo's investment risk to remain low.

RATING SENSITIVITIES
Fitch views an upgrade as unlikely given the company's fairly small size.

Should the UK sovereign rating be downgraded by more than one notch this would lead to a downgrade of GuarantCo's rating.

A downgrade may also result from a weakened capital position evidenced by a net par-to-capital ratio, including available capital in the form of callable capital from owners and DFIs, the stand-by facility as well as XL cover, exceeding 2.5x. Any reduction in the commitment by the owners to GuarantCo, possibly as a result of a change in government policy priorities, could also trigger a downgrade.

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Applicable Criteria
Insurance Rating Methodology (pub. 26 Apr 2017)
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