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

Fitch Ratings-London-15 July 2016: Fitch Ratings has affirmed GuarantCo Limited's (GuarantCo) Insurer Financial Strength (IFS) rating at 'AA-'. The Outlook is Stable.

KEY RATING DRIVERS
The affirmation reflects GuarantCo's strong owners, solid capital position, 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 weak profitability.

Although GuarantCo is backed by public institutions, it is run on a commercial basis, allowing 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-2Q16) and directly by the FMO (AAA/Stable; 11% at end-2Q16).

The capital contributions GuarantCo has received from its owners to date and the plans to increase the company's capital base by subscribing to GBP40m of callable capital by end-2016 are indicative of the owners' commitment to the company. The company received additional paid-in capital via the PIDG Trust from the UK's Department for International Development in 1Q16 (GBP13m) and the Australian Department of Foreign Affairs and Trade in 2Q16 (AUD4m). However, there is no formal support like e.g. an unconditional guarantee from the public shareholders to support GuarantCo. Consequently, future financial support from the four development agencies cannot be guaranteed. While the rating reflects strong and committed sponsors, it is not aligned with those of the owners due to the absence of explicit support.

GuarantCo's capitalisation is strong, with a net par-to-capital ratio (excluding available capital from an USD450m counter-guarantee facility) at 1.2x at end-1Q16 (end-2015: 1.3x). Fitch regards the drawn tranches of the counter-guarantee facility (USD250m at end-1Q16) as equity in its capital assessment, which results in a solid adjusted par-to-capital ratio of 0.6x. Although Fitch expects GuarantCo's capitalisation to weaken as it grows, 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 weak in recent years, largely driven by a low interest rate environment and fairly high fixed costs. However, the company is expected to return to profitability, 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 it 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-1Q16, GuarantCo's investments consisted of cash (22%; end-15: 19%), 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 from the counter-guarantee facility, or in the future callable capital from owners and other development finance institutions as well as excess-of-loss reinsurance coverage, exceeding 2x. A 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. 17 May 2016)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=881564