CRITERIA FOR RATING SUPRANATIONAL INSTITUTIONS

Table of Contents

Scope

1. Supranational Institutions ('SIs') are typically established by several sovereign governments and are mandated to promote member country social and economic development, regional integration, expansion of cross-border trade, to support the public policy of their members or increase financial capacity in a specific market. They are often not subject to national regulation, taxes, or commercial law and tend to transcend national boundaries. Due to the fact that these entities often operate in under-penetrated markets and fulfill countercyclical or market access roles they often carry more risk than commercial institutions. However, to mitigate this risk they also often have higher amounts of capital than commercial institutions and benefit from preferential treatment and callable capital from their member states and shareholders.

Summary of the Criteria Changes

2. The criteria is a material departure from the previous criteria, titled *'Global Criteria for rating multilateral development banks, updated September 2017'*. The major changes to the criteria include the alignment to the broader GCR ratings framework and the broadening of the criteria to allow for the assessment of 'bank-like' and 'insurance like' entities under one (albeit modified) approach. This has been accomplished to ensure consistency within the asset class and across the GCR ratings universe.

3. The criteria adopts the majority of the GCR ratings framework, although not the use of group classification and support criteria and we exclude elements of the Country Risk criteria, which are not applicable for Supranationals, such as country risk hurdles and floors (*see Criteria for GCR Ratings Framework*). The management & governance criteria has been adopted. At the same time, we borrow heavily from other asset classes for elements of the operating environment and financial profile assessments. Within the company profile, we look at the supranational entity's status, mandate and track-record. Additional factors within the financial profile include the potential uplift for callable capital.

An Overview of the Ratings Framework

4. In order to improve the comparability and transparency of the ratings, GCR have adopted a framework (see below) with publicly available scoring for the major rating components. The goal is to allow each stakeholder (issuer, investor, regulator, counterparty etc.) to know in detail, each of the major rating drivers and ultimately what factors may change the ratings in the future.

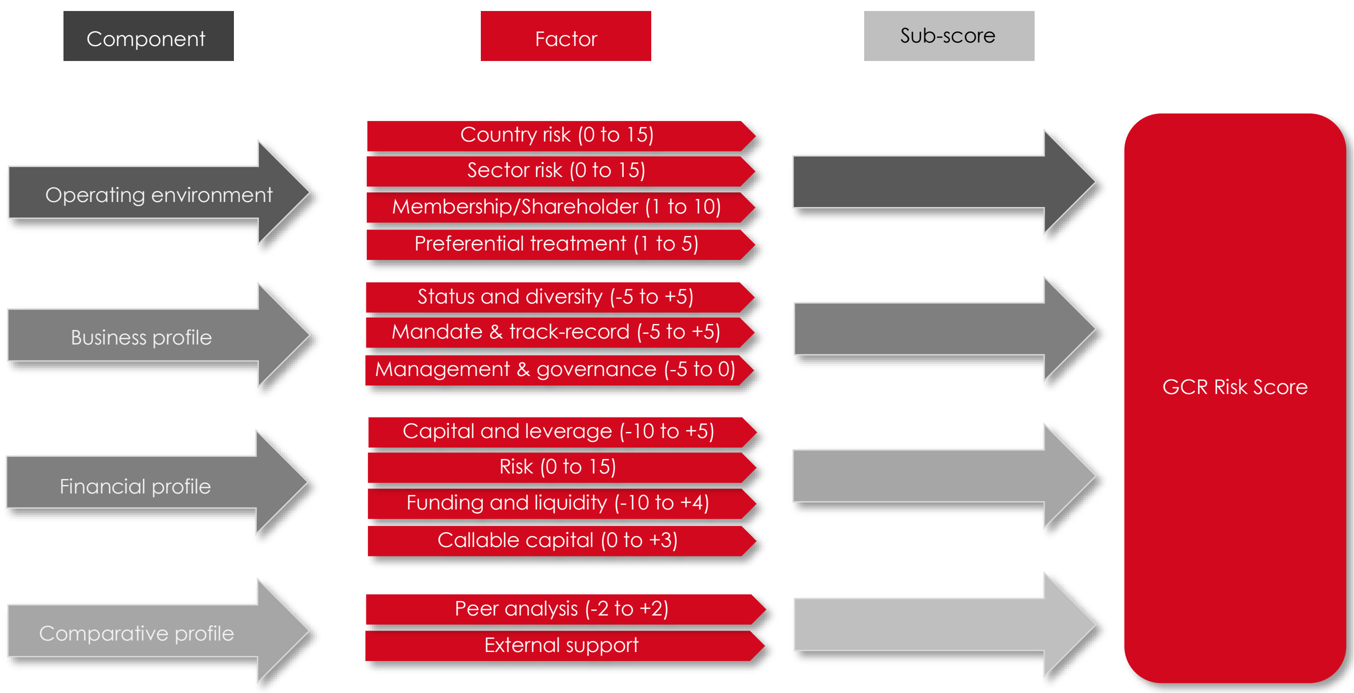
5. To achieve this, GCR has adopted four major rating components (operating environment, business profile, financial profile and comparative profile), which are all broken down into two or three major factors and sub-factors, with a publicly disclosed positive or negative score assigned to each. The summation of the scores determines the GCR Risk Score, which is translated, using the GCR Anchor Credit Evaluator, into the Anchor Credit Evaluation (ACE) and then using final rating adjustment factors into issue(r) credit ratings. It is important to note that there are no fixed weightings for the components, factors or sub-factors.

6. To understand the following criteria, GCR recommends that it is read in conjunction the 'Criteria for the *GCR Ratings Framework*', which will provide a more detailed view on Country Risk, Group Classification &

Support, Management & Governance, and the GCR *Rating Scales, Symbols & Definitions and the Anchor Credit Evaluator*, which is published on the GCR Website and will help translate the GCR Risk Score to the international and national scale ratings.

7. The way these key rating concepts interact with each other and result in an issue(r) credit rating is best illustrated in Figure 1, below.

Figure 1: GCR Ratings Framework, Supranational Institutions



*There are no fixed weightings to the components or factors above.

Component 1: Operating Environment

(2 TO 45: 45 BEST)

Operating Environment
Factor A: Operating Environment Score (0 to 30)
• Country Risk (0 to 15) • Sector Risk (0 to 15)
Factor B: Shareholder Strength (1 to 10)
Factor C: Preferential Treatment (1 to 5)

8. The core of the GCR rating framework is based on our opinion that an entity's operating environment anchors its creditworthiness. Whilst this opinion follows through to the Supranational criteria, we believe that Supranational Institutions require some additional considerations in comparison to commercial or single sovereign public sector entities.

9. Primarily, supranational entities exist to fulfill a specific set of policies or an explicit mandate for their members, who are typically the sovereigns which own and control them. Typically, they do not exist to maximize profitability or compete with commercial entities. Meanwhile, they often take on larger or earlier stage risk than commercial entities would consider. Furthermore, domestic or regional economic and/ or political conditions can complicate the delivery of products and services, potentially heightening the risks associated with its exposures. Consequently, the average supranational entity is arguably exposed to more risk than a commercial entity operating in the same region. To mitigate this risk and to ensure the mandate continues being met, supranational entities receive support in the form of callable capital and various types of preferential treatment. Furthermore, they are typically not exposed to regulation or subject to all commercial laws within anyone jurisdiction. Resultingly, supranational entities can mitigate external country or sector risks to a greater extent than a commercial bank or insurer. Ultimately, we believe that by analyzing the strength and diversity of its membership/ shareholder base, alongside the preferential treatment afforded to the supranational, we can uplift the supranational away from commercial or public sector entities operating with a similar business model in the same economic zone.

Component 1, Factor A: Country Risk & Sector Risk

(0 TO 30: 30 BEST)

10. We capture operating environment risks by blending the development risk exposures or premiums by geography, using the scores derived from the GCR country risk assessment and the financial institution or insurance sector risk assessments. However, we may make negative adjustments to the initial score if we believe that the supranational is exposed to structurally higher risk (therefore lower the score) than their commercial counterparties in any given jurisdiction or region.

11. To see how GCR measure the country risk and sector risk specific scores, please see the following criteria:
    - For multilateral development banks, see the Criteria for Rating Financial Institutions Sector Risk Section, to assess sector risk.
    - For multilateral insurance companies, see the Criteria for Rating Insurance Companies Sector Risk Section, to assess sector risk.
    - For the country risk score, see Criteria for the GCR Ratings Framework, to assess country risk.

12. *A worked example: A supranational (a development bank) has development risk exposures (DRE; on and off-balance sheet lending and other commitments, equity and treasury assets which are development oriented) spread across three countries. The first country has a country risk score of 5 and sector risk score of 5 (10 combined operating environment score (OE)) and contributes 75% of DRE, the second has a*

*combined OE score of 8 and contributes 20% of DRE and the third has an OE combined score of 4 and contributes 5% of DRE. In this case the weighted average operating environment score would be 9.3 or ((10*0.75) +(8*0.2)) + (4*0.05). The analyst would have the ability to round up or down depending on the expected changing nature of the exposures or operating environment trends going forward.*

Component 1, Factor B: Membership / Shareholder Base

(1 TO 10: 10 BEST)

13. To analyze the strength and diversity of the shareholders, we start by creating a weighted average risk score of the sovereign (including government agencies) and supranational voting base. We exclude the private sector shareholders from this assessment because we are trying to ascertain the level of non-financial support and strength in the member countries.

14. To establish the assessment, when appropriate and available, we will use the median sovereign or supranational rating established by one of the 'big three' global credit rating agencies. In the case of a significant non-sovereign shareholding, we may conduct a credit assessment to ascertain the rating strength and score. The score is measured between 1 and 10, as per Table 1, although higher scores are rarely expected reached.

Table 1: Sovereign rating strength

Average Rating*	AAA,	AA+,	AA, AA-	A+, A-	BBB+, BBB	BB+, BBB-	BB-, BB	B, B+	B-	CCC and below
Score	10	9	8	7	6	5	4	3	2	1

**or equivalent*

15. *Example: The supranational has ten shareholders. Two are rated AAA (10), five are rated A+ (7), three are rated BBB (6). The weighted shareholder strength score would be 7.3 or ((2x10) +(5*7) + (3*6))/ 10. The analyst would have the ability to round up or down depending on the expected change in membership or rating trends of the shareholders.*

16. *Once we have created the initial score, we may make adjustments for any the following factors:*

   I. A supranational entity established by treaty is viewed more favorably than those established by less formal intergovernmental agreements. We may make a negative adjustment on the latter.

   II. We can make a positive or negative adjustment if we view the diversity of the shareholder base to be a relative strength or weakness versus peers. To make a positive adjustment, we would expect significant membership penetration within its key region alongside strong external support from non-regional members. A negative adjustment may follow a low or disparate membership base, particularly within its region.

   III. Private Sector v public sector: Typically, we view high private sector shareholding (over 25%) negatively, because it could moderate the willingness to support by sovereign members, or increase the commercial focus of the SI, thereby lowering its mandate and potentially the sovereign support & preferential treatment advantages. We also look at the voting rights of the shareholders, should there be different classes and attempt to ascertain what it could mean to strategy and support.

IV. Regional members v non-regional members. If the voting power lies with non-regional members, we may lower the score, if we believe it could affect the decision making and mandate of the institution.

V. Historic and current relationships with its shareholders. If there is evidence of current or expected strain with one or more of the shareholder relationships, we can make a negative adjustment to the score.

Component 1, Factor C: Preferential Treatment

(1 TO 5: 5 BEST)

17. Supranational entities benefit from numerous types of preferential treatment, depending on the nature of the institution and the risks facing the entity. We score this component on a qualitative basis, using examples of how the entity has benefited from its special status throughout its history and whether or not preferential treatment has been enshrined in the charter of the supranational.

18. The scoring is conducted on a 1 (weakest) to 5 (strongest) basis and requires consistent demonstrable examples of its preferential treatment.

19. Typically, we will take into account the following types of preferential treatment:

I. Preferred Creditor Status (preferential sovereign creditor treatment): This relies on a sovereign prioritizing its, or its related entities, loan repayments to a supranational entity, in a stress or default situation, over other creditors. Preferred creditor status is bestowed by convention rather than by treaty or law. The preferred creditor status is not a legal status, but is embodied in practice, and is granted by the member shareholders of SIs.

II. Foreign Currency preferential treatment: exempts restrictions on the convertibility of local currencies for the purpose of meeting obligations. This, in principle, implies that the obligations to supranationals by borrowers have a priority claim on the international reserves of the central bank of a country. This preferred status, therefore, mitigates transfer and convertibility risk to a significant extent.

III. Private creditor treatment: Multilateral development banks increasingly also lend to the private sector and can use its influence with a sovereign, or its agents, in various ways to improve the recoverability on such lending. To receive a positive assessment, the supranational must have a strong track-record of low credit losses/ high recoverability on its private sector lending book. Similarly, an insurer who can prompt priority of payments from cedents is viewed positively.

IV. Compulsory cession: Typically, when a supranational reinsurer is provided with a 'right' over a certain percentage of all lines within a set region.

V. Prioritizing Projects: Preferential access to projects.

VI. Diplomatic status and tax-free operations.

Component 2: Business Profile

(-15 TO +10: +10 BEST)

Business Profile

Status & Diversity (-5 to +5)

Mandate & track-record (-5 to +5)

Management & Governance (-5 to 0)

20. GCR's business profile assessment measures the importance of the supranational to the region it operates in and its member shareholders. Whilst we believe that the market importance of a supranational can change, it is likely to be a gradual process and not prone to volatility. This process can be best verified by the steady rise in the number of overlapping supranational institutions, i.e. supranational entities created that operate in the same region(s) with a broadly similar mandate to an existing supranational. The overall growth in supranationals, over the past 70 years, has been approximately one every three years since 1945. Many of these have had overlapping, sometime even competing, mandates with preexisting supranationals. Broadly, we believe the cause for this growth can be characterized by the desire of one or more of the member state(s) to increase their influence and / or control over a supranational. This is because sovereigns either want to increase their tools of political influence, or in response to the creation of new economic partnerships or due to a general or specific discontentment regarding the operations, policies, product conditionality or developmental impact (most expressively in the distribution of development related exposures either by country, sector) of an existing supranational. To a lesser extent, we also observe that the growth in supranationals can come from a previously unobserved policy need, which needs different skills and / or structures than existing institutions.

21. We firstly assess the status and diversity of a supranational because the business and operational stability of large and diverse entities are likely to be less impacted by dissatisfied member states. To clarify, we are not analyzing the number of discontent member states (this would be factored in the shareholder strength adjustments in the operating environment section) but the potential impact if one or more lowers its support. Secondly, we assess the mandate and track-record of a supranational as these are the factors that may lead to a weakening of member state support.

Component 2, Factor A: Status & Diversity

(-5 TO +5: +5 BEST)

22. Status & Diversity is the first entity specific score based on a scale, from 'lowest' (-5) to 'highest' (+5) using the two below characteristics. Neither subfactor is meant to be more important than the other. A supranational can only achieve the highest scores if it ranks strongly in both of the sub-factors.

23. **Status:** We look at the size of the institution's development exposures, to measure its developmental reach. We also look at the franchise of the supranational in regards to its political and economic influence.

24. **Diversity:** We look at the diversity of the supranational in regards to the products it offers, the sectors it operates in (i.e. infrastructure, power, trade, health, utilities, agriculture) and the geographic area that it covers.

Table 2: Status		
Assessment	Score	Status- typical characteristics*
Highest	4,5	Development related exposures above US$20bln, and the entity's development reach would have a very strong geographic, product and sectoral diversification. Typically, the entity would be a leading Supranational institution globally or the Premier one within one or more continents. Extremely influential, often leading the debate on development, environment, social and governance matters.
High	2,3	Development related exposures above US$5bln. The developmental reach should be well diversified by geography and sector, with some product diversification. Typically, a regional SI. Influential within its region and its area of focus.
Intermediate	1 0 -1	Development related exposures of up to US$5bln. There is limited geographic, sectoral or product diversification. Typically, a sub-regional SI. **OR** There may be some operational challenges, political or mandate challenges that threaten the sustainability of the DFI over the long term. Influential within a smaller region.
Low	-2, -3	There are operational challenges, political or mandate challenges that threaten the sustainability of the DFI over the medium term. Has lost its franchise and influence among member states.
Lowest	-4, -5	Close to failing

The above highlights typical characteristics of a highest, high, intermediate, low and lowest assessments. It is likely that an entity has one or more characteristics. GCR allows analytical decision making to decide what the most pertinent factors for each rated entity are. However, to achieve a stronger score, the entity is likely to have a number of cumulative strengths. Conversely, any one risk can bring the score down to the lowest levels.

Component 2, Factor B: Mandate & track-record

(-5 TO +5: +5 BEST)

25. Mandate & Track-record is the second factor of competitive profile, it too is based on a scale, from 'lowest' (-5) to 'highest' (+5) using the two below characteristics. Neither sub-factor is meant to be more important than the other. A supranational can only achieve the highest scores if it ranks strongly in both.

26. **Mandate:** We focus on the strength and the importance of the mandate against the stated shareholder needs. Then, GCR take a view to what extent does the supranational conduct a policy or economic function that cannot or will not be performed by other institutions.

27. **Track-record & Relevance:** We look at the strategy and impact of the supranational against its stated mandate through the credit cycle. If the supranational has successfully fulfilled its mandate over time, it is more likely to gain support from member shareholders when needed.

Table 3: Mandate and track record		
Assessment	Score	Mandate & track-record typical characteristics*
Highest	4,5	The mandate is well articulated, firmly in line with more than one of the policies and / or key development needs for member states. We believe entity cannot be replaced by another institution. The entity has a long and measurable track-record of delivering on its mandate. The strategic focus is fully aligned to the mandate.
High	2,3	The mandate addresses the policies and / or development need(s) of the member states and cannot be easily replaced by another entity. The mandate is being fulfilled. The strategic focus is fully aligned to the mandate.
Intermediate	1, 0, -1	The mandate has a limited developmental impact, only partially fulfilling a development or policy need(s) for member states. There is limited measurable proof that the entity is fulfilling its mandate. The strategy is confusing or not in line with the mandate. The role of the entity could be replaced by a government arm or private sector entity.
Low	-2, -3	The mandate or purpose is unclear or no longer within the development needs of the member states. Increasingly, its role is being taken by private sector participants.
Lowest	-4, -5	The core business lines of the entity are already being done by another entity or there is a significant failure to fulfil a mandate. There is a weak strategic focus or questionable mandate.

**the above highlights typical characteristics of a highest, high, intermediate, low and lowest assessments. It is likely that an entity has one or more characteristics. GCR allows analytical decision making to decide what the most pertinent factors for each rated entity are. However, to achieve a stronger score, the entity is likely to have a number of cumulative strengths. Conversely, any one risk can bring the score down to the lowest levels.*

Component 2, Factor C: Management & Governance

(-5 TO 0: 0 BEST)

28. We apply the universal Management & Governance criteria, please click here to access the criteria. Whilst some of the elements of the criteria may not be relevant, others will be and we will be additionally focused on any procedural or management shortfalls, which may also lower shareholder support.

Component 3: Financial Profile

29. Supranational institutions can have materially different financial profiles depending on the nature of the organizations. At the time of publication, GCR only rate bank like (multilateral development banks: MDBs) and insurance like (multilateral insurance companies: MICs) institutions.

30. MDB's financial profile section starts on page 14.

Component 3a: Financial Profile for Multilateral Insurance Companies

31. Given the similarities between supranational and commercial insurers, GCR has not created a separate methodology for this section. See the financial profile section of the Insurance Criteria for more details.

32. The key differences include:
    a. The inclusion of callable capital, if appropriate, which is the same as the MDB criteria on page 23.

Component 3b: Multilateral Development Banks

(-30 TO +14: +14 BEST)

33. For the financial profile assessment of Multilateral Development Banks ('MDBs'), GCR assesses four subfactors, using a mixture of quantitative benchmarks that lead to qualitative assessments:

- Capital & leverage (-10 to +5),
- Risk (-10 to +2),
- Funding Structure versus Liquidity (-10 to +4), and
- Callable Capital (0 to +3).

These fundamental rating factors provide a guide regarding how well an MDB will weather its current and expected operating environment.

Financial Profile

Capital & Leverage (-10 to +5)
- Capitalization & Leverage
- Adjustments

Risk Position (-10 to +2)
- Credit Risk
- Concentration Risk
- Operational Risk
- Market Risk
- Sovereign Risk

Funding & Liquidity (-10 to +4)
- Funding breakdown & stability
- Liquidity

Callable Capital (0 to +3)

Component 3b, Factor A: Capital & Leverage

(-10 TO +5: +5 BEST)

34. Multilateral Development Banks are typically very well capitalized in comparison to commercial organizations. The quality of their capital is also usually very high, as they do not issue hybrid instruments.

35. The assessment is based on a scale from 'very weak' (-10) to 'very strong' (+5).

36. GCR review of capital adequacy begins by defining our own assessment of nominal core capital (the numerator). GCR core capital reflects core equity (share capital, premium, distributable loss bearing reserves and retained profits), minus intangibles, minus equity investments in non-consolidated financial companies (including the investments callable capital), minus deferred tax assets. For the denominator, we use total adjusted assets, which comprises total balance sheet assets plus off-balance sheet exposures or commitments, plus expected disbursements over the next 12months, but excluding cash in hand.

37. We have chosen to measure capital adequacy on financial leverage basis because MDBs are not regulated, they do not always measure their assets on a risk-weighted basis, and the vagaries of the internal modelling could lead to some inconsistencies if we relied on MDBs to report to us their RWA.

38. We have however, included an elementary version of risk weighting by anchoring the GCR MDB leverage ratio against its country risk score (scoring of which is detailed above). The theory being that an MDB needs to hold a greater amount of capital as the country risk exposures increases and vice versa. If there is significant risk mitigation, where risk is transferred to higher quality counterparties operating in lower risk operating environments, we will take this into account.

Table 4: GCR leverage v Blended Country Risk

Assessment	Score	>10	5-10	<5
Highest	5	>20%	>22.5%	>25%
High	4	15% to 20%	17.5% to 22.5%	20% to 25%
Modestly High	2, 3	10% to 15%	12.5% to 17.5%	15% to 20%
Intermediate	-1, 0, 1	7.5% to 10%	7.5% to 12.5%	10% to 15%
Low	-2, -3	5% to 7.5%	5% to 7.5%	7.5% to 10%
Lowest	-4 to -10	<5%	<5%	<7.5%

39. GCR has the option to make one or more adjustments to the initial Capital Assessment score, in the following situations:

I. (**Negative**) If the nominal size capital is small, at less than $100mln, it could be more vulnerable to a single-event/ stress loss, even if the ratios are relatively strong. In this case, GCR may cap the capital score within the above intermediate category or remove up to two notches. However, this is a qualitative judgement call and needs to consider the size of loans, diversity of business and quality of risk management.

II. (**Negative**) Reserve Coverage: General or specific reserves are formulated on the balance sheet to cover expected losses originating from the loan book or other risk / fixed assets. We take a view on the sufficiency of reserves in both nominal and percentage terms. If there is a deficiency in the reserving, whether observable in the audited accounts, or from expected losses in the future, or occurring due to failure to recognize impaired or non-performing loans, or overvalued collateral levels, we may subtract the shortfall from nominal capital. This is a negative adjustment to capital only.

III. GCR does not include hybrid instruments, even if they are loss bearing, as CGR is not sure what the optics of an instrument default would have on an MDB.

IV. (**Negative**) Unfunded benefit schemes or other staff liability should be deducted from nominal capital.

V. (**Positive**) & (**Negative**) *Quality and Quantity of Earnings:* Whilst MDBs are not profit maximizing, we still believe that earnings can affect the viability and future capital stability of any organization. When we are assessing the capital adequacy of the MDB, we forecast the leverage ratio two years forward.

40. Financial innovation: Supranationals are increasingly adopting various financial products, such as credit insurance on their loan books or insurance coverage of callable capital or taking guarantees by higher rated entities or conducting credit default swaps, to improve their capitalization or lower risk asset concentrations. Where the instrument(s) impacts on the MDB as it operates as a going concern (before an MDB misses its own capital or debt guidelines or before covenants are triggered or before capital is called) we will consider the impact on the capital or risk or callable capital assessment.

Component 3b, Factor B: Risk

(-10 TO +2: +2 BEST)

41. When we assess the risk position of an MDB we predominantly look at credit and concentration risks to guide the factor. However, such entities can be exposed to elements of market and operational risk as well, which may guide the scoring. The assessment is based on a scale from 'lowest' (-10) to 'highest' (+2). We have a lower potential uplift for risk in comparison to a commercial bank because inherently MDBs should take higher levels, larger or early stage risk and / or fulfill countercyclical roles.

42. Credit Risk is the first of all risks in term of importance for development banks. Importantly, we do not adjust automatically in the risk position if the MDB has a bias towards public or private sector lending. Naturally, for those MDBs that extend loans to the private sector, we may expect lower asset quality and lower risk concentrations. The interplay of which will affect the rating. However, this is not always the case so each MDB will be judged on the track record using the below considerations.

I. Estimated Credit losses: GCR will estimate a future range of expected credit losses by analyzing the probability and loss given default of a MDBs loan book, alongside other exposures. Viewing historic and current non-performing loans can be a good guide for future credit losses but they can also materially overstate or understate the risk depending on the grace periods, restructuring approach, surveillance and monitoring of credit risk by the institution, and the ultimately the write off policy. Once again, GCR takes a view on the sufficiency of reserving and reliability of collateral valuations into account. A higher risk position score may be reflected only when there have been lower recent and projected losses than banking peers with similar economic scores.

II. Risk asset concentrations can be a significant source of risk to an MDB, including the risk of country concentrations, large single obligor default(s), or stress from industry(s)/ sectors. Diversity of risks generally leads to lower credit losses through the cycle. GCR explicitly look at the largest five countries and top twenty loans, against GCR Capital and total loans to view the underwriting capabilities, concentration risks and single obligor risks.

III. Risk asset growth: The rapid growth of loans is nearly always a risk, either because it strains the underwriting capabilities of the institution and because it can hide the seasoning of the loan book and make non-performing loans and credit losses appear artificially low.

IV. Underwriting: We take cognizance of the grace periods afforded, the percentage of bullet repayments versus amortizing loans, restructurings and collateral sufficiency. We also look at off-balance-sheet activities, which can hide lending exposures or other risks.

43. Equity Risk: We view listed and unlisted equity investments to be of higher risk than lending because it can add volatility from both a market and credit perspective. If private equity and / or other Level 3 assets account for 15% of GCR capital or GCR have concerns over the valuation or quality of those investments, GCR could make a negative adjustment for risk (which may be mitigated by other factors).

44. Operational Risk: The risk of direct or indirect losses, resulting from the inadequate or failed internal processes, people and systems of from external events.

45. Foreign Exchange Risk: Currency risk materializes from incurring losses, above or below the line, due to changes in exchange rates. The losses can occur in one of two ways for an MDB:

I. Credit losses: A sharp change is exchange rates can deteriorate a counterparties ability to pay, as leverage becomes artificially higher or access to FX becomes harder in a time of stress. The importance of this risk changes depending on the preferential treatment afforded to the MDB and the construction of the loan book, i.e. we would consider FX private sector loans to be of higher risk than FX public sector loans.

II. The changing value of currencies has a direct impact on the value of the balance sheet. Depending on the type and classification of the assets, this can be accounted for either through trading income or other comprehensive income. Both can quickly deteriorate capitalization and therefore, ascertaining the management of the banking books 'open position' is an important factor.

46. Interest Rate Risk: the impact on earnings due to the movements of interest rates, either directly from interest earning assets or interest-bearing liabilities or indirectly from the impact on loan losses from changes to base rates.

Table 5: Risk

Assessment	Score	Risk Position (typical characteristics)
Highest	2	A significant market outlier in terms of credit losses through the cycle, with exceptional asset and loan diversification. The top five geographic exposures (compounding all commitments) accounts for less than 100% of GCR total capital. The top twenty loans account for less than 2x of GCR total capital. Equity participations are less than 15% of total capital. There is limited market risks and good control over operational and interest rate risks. FX risks are well controlled.
High	1	Strong record of credit losses through the cycle, comparing well to both MDB and commercial banking peers operating in the same region. Good asset and loan diversification. The top five geographic exposures (compounding all commitments) accounts for less than 150% of GCR total capital. The top twenty loans account for less than 2.5x of GCR total capital. Equity participations are less than 20% of total capital. There is limited market risks and good control over operational and interest rate risks. FX risks are well controlled.
Intermediate	1, 0, -1	Credit losses in line with regional peers, including MDB and commercial banking peers. Average concentrations risks. The top five geographic exposures (compounding all commitments) accounts for less than 250% of GCR total capital. The top twenty loans account for less than 3x of GCR total capital. Equity participations are less than 25% of total capital. There is limited market risks and good control over operational and interest rate risks. FX risks are well controlled.
Low	-2, -3, -4	Weaker track-record of credit losses than regional peers. The top five geographic exposures (compounding all commitments) accounts for over 250% of GCR total capital. The top twenty loans account for less than 4x of GCR total capital. Equity participations are over 35% of total capital. There are higher market risks but good control over operational and interest rate risks. FX risks are well controlled.
Lowest	-5 to -10	Any of the risks detailed above which are materially threatening the capital adequacy of the institution.

**the above highlights typical characteristics of a highest, high, intermediate, low and lowest assessments. It is likely that an entity has one or more characteristics. GCR allows analytical decision making to decide what the most pertinent factors for each rated entity are. However, to achieve a stronger score, the entity is likely to have a number of cumulative strengths. Conversely, any one risk can bring the score down to the lowest levels.*

Component 3b, Factor C: Funding Structure & Liquidity

(-10 TO +4: +4 BEST)

47. This score is judged on a scale, from 'lowest' (-10) to 'highest' (+4). The downside bias reflects the correlation between unstable funds, weak liquidity and default as well as the reliance on market funding and limited Central Bank access, alongside potential asset liability mismatches. However, there is potentially greater upside for MDBs than commercial banks due to former being relatively less confidence sensitive.

48. When assessing the funding structure of an MDB we benchmark scores, on a qualitative basis, against global and regional peers. Generally, those entities with a longer term, stable, unsecured, lower cost and well-diversified funding base will compare well. Proof of strong capital market access is a definite boon to

the assessment. Conversely, those with a reliance on short term, confidence sensitive or secured funding or those with significant single name concentrations will likely have a weaker assessment.

49. Unlike funding, liquidity is an absolute and will be viewed only in the context of the MDBs funding structure. An MDB without appropriate liquidity is at higher risk than an MDB with a capital shortfall or asset quality issues (all else being even). However, an MDB can reasonably be funded by less stable sources or have shorter term funding than market peers, if it has a correspondingly superior liquid asset cushion (size and mix). Consequently, we focus most of our analysis on the liquid asset coverage of the short/ medium term and confidence sensitive liabilities. To achieve a positive score the entity may cover all funding needs (including all refinancing requirements, expected loan disbursements and assuming no access to further funding) over a rolling one-year period. To this end, we also take into account the amount and quality of the liquid assets (including the nature and quality of sovereign debt) and how easily they can be realized. We disregard, in our liquidity analysis of MDBs, all encumbered assets, and investments that may not have liquidity in times of stress (for example level 3 assets). However, we will take into account 50% of loan repayments as long as the entity has a strong credit loss track-record.

50. When analyzing funding and liquidity, we also take great cognizance of any covenants. Understanding covenants and their triggers/ repercussions is fundamentally important to consider how stable funds will be and how much liquidity is needed. The presence of covenants that trigger funding accelerations or event of default clauses are of particular importance. The scoring, always negative, will be affected by the proximity to triggers.

51. Having a significant currency mismatch on the balance sheet exacerbates the asset-liability risks of an MDB. Typically, MDBs keep appropriate liquid asset coverage of each currency of funding, or have strong committed lines, or derivatives in place to survive a major refinancing risk in a foreign currency.

Table 6: Funding and liquidity		
Assessment	**Score**	**Funding & Liquidity (typical characteristics) ***
Highest	3,4	A regular issuer of global benchmark bonds, with exceptional diversification of the funding sources by counterparty as well as across geographies, currencies, tenors. Liquid assets are of high quality and cover all refinancing risk and expected loan distributions over the next 12months. No debt covenants. No FX asset liability mismatch.
High	1,2	A regular issuer of regional benchmark bonds, with good diversification of funding sources and no concentrations in counterparty or tenor. Liquidity should be robust, with the mixture of high and lower quality liquid assets, plus loan repayments covering one year's funding requirements. No debt covenants. No FX asset liability mismatch.
Intermediate	0 -1	Well diversified funding base, without material single name concentrations and staggered across tenors. Liquidity is ample, but lacks high quality assets, and so is reliant on lower quality assets and or loan repayments to meet one years' funding requirements. Covenants are present. FX asset liability mismatch exists but is well managed.
Low	-2 -3	Funding base is confidence sensitive, short term or concentrated. Liquidity covers less than one years' funding requirements. Covenants that accelerate funds or an event of default are present but they are remote. FX risk is material.
Lowest	-4 to -10	Cannot access funding, liquidity is weak, covenants are close or have been triggered.

**the above highlights typical characteristics of a highest, high, intermediate, low and lowest assessments. It is likely that an entity has one or more characteristics. GCR allows analytical decision making to decide what the most pertinent factors for each rated entity are. However, to achieve a stronger score, the entity is likely to have a number of cumulative strengths. Conversely, any one risk can bring the score down to the lowest levels.*

Component 3b, Factor D: Callable Capital

(0 TO +3: +3 BEST)

52. Callable capital acts as protection for holders of bonds and guarantees issued by a supranational in the unlikely event that it is not able to meet its financial obligations. However, it is not a legal guarantee. Callable capital is that portion of subscribed capital stock that is not paid in but subject to call only as and when required by the supranational to service its debt obligations. The proportion of paid in and callable share capital is generally stipulated in supranational charters. For example, the charter may stipulate that for every six shares subscribed by a shareholder, one share will be paid-in and five shares will be callable. Callable capital is generally restricted to member countries but can also be open to non-member countries and other investors.

53. Despite callable capital typically being a recognized obligation for shareholders under international treaty, the reliability of such a benefit remains unclear. This is because capital calls have to date been untested and ultimately, they must be decided upon by the shareholder(s). Furthermore, the shareholders' ability to meet a call on capital in a timely manner is a contentious issue, partially because the administration of such a call is untested but also because many subscribing shareholders are financially weaker than the MLIs or may have long drawn-out process to release funding.

54. As a result, to provide uplift for Callable Capital, GCR require that the sovereign or supranational shareholders (or qualifying insurance providers) have an equivalent A- or above rating from one of the three major CRAs, and be rated above the supranational.

55. We will add risk scores for the following callable capital coverage levels over net debt.

Table 7: Callable capital	
Coverage of net debt by A- (or better rated) rated shareholder callable capital (%)	Risk score
25%	1
50%	2
75%	3

Component 4: Comparative Profile

Component 4, Factor A: Peer Comparison

(-2 TO +2: +2 BEST)

56. GCR allow up to two positive or negative risk score adjustments for peer comparisons to create greater credit differentiation. Typically, this should be used when a supranational is a generally better or worse performing company than its peer group, across a number of fields but no one factor has created a ratings differential.

Final Rating Adjustment Factors

57. Once the risk score and the ACE has been established on the national or international scale(s), GCR then create the formal ratings on legal entities. In this stage, we move off the risk scoring framework and start adjusting the national/ international ratings because we are trying to establish the most applicable credit ratings hierarchy within a financial group and best hierarchy within a market/ asset class.

Rating Adjustment Factor 1: Instrument Rating(s)

58. The notching from the legal entity rating will depend on the nature of the instrument, whilst always respecting the credit hierarchy. We currently do not rate entities further down the credit hierarchy as we are unsure what the default of such an instrument would have on the entity.

Table 8: Instrument ratings		
Debt Rating Types	Notching	Typical Characteristics
Senior Unsecured	0	Reflects the relevant legal entity rating on the supranational issuing the debt.
Senior Subordinated	-1	Contractually subordinated debt, no early write off trigger.

GLOSSARY OF TERMS/ACRONYMS USED IN THIS DOCUMENT AS PER GCR'S GLOSSARY

Administration	A debtor unable to pay a judgement of debt or who cannot meet its financial obligations and does not have sufficient realisable assets that can be attached in satisfaction of judgement or obligations. The debtor can apply for an administration order interims of the Magistrates' Court Act 32 of 1944 (South Africa).
Agent	An agreement where one party (agent) concludes a juristic act on behalf of the other (principal). The agent undertakes to perform a task or mandate on behalf of the principal.
Agreement	A negotiated and usually legally enforceable understanding between two or more legally competent parties.
Asset Quality	Refers primarily to the credit quality of a bank's earning assets, the bulk of which comprises its loan portfolio, but will also include its investment portfolio as well as off balance sheet items. Quality in this context means the degree to which the loans that the bank has extended are performing (ie, being paid back in accordance with their terms) and the likelihood that they will continue to perform.
Asset	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
Assets	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
Balance Sheet	Also known as Statement of Financial Position. A statement of a company's assets and liabilities provided for the benefit of shareholders and regulators. It gives a snapshot at a specific point in time of the assets the company holds and how they have been financed.
Banking Book	Assets on a bank's balance sheet that are expected to be held to maturity. Banks are not required to mark these to market. Unless there is reason to believe that the counterparty will default on its obligation, they are held at historical cost.
Bond	A long term debt instrument issued by either a company, institution or the government to raise funds.
Borrower	The party indebted or the person making repayments for its borrowings.
Bullet Repayment	The settlement of a security at maturity in a single principal repayment.
Callable	A provision that allows an Issuer the right, not the obligation, to repurchase a security before its maturity at an agreed price. The seller has the obligation to sell the security if the call option holder exercises the option.
Capacity	The largest amount of insurance available from a company. In a broader sense, it can refer to the largest amount of insurance available in the marketplace.
Capital Adequacy	A measure of the adequacy of an entity's capital resources in relation to its risks.
Capital	The sum of money that is invested to generate proceeds.
Cash	Funds that can be readily spent or used to meet current obligations.
Cede	To transfer all or part of a risk written by an insurer (the cedant or primary company) to a reinsurer.
Cedent	The party that transfers it's right in a cession.
Cession	Amount of the insurance ceded to a reinsurer by the original insuring company (cedant) in a reinsurance transaction.
Claim	1. A request for payment of a loss, which may come under the terms of an insurance contract (insurance). 2. A formal request or demand (corporate finance).
Collateral	Asset provided to a creditor as security for a loan or performance.
Concentrations	A high degree of positive correlation between factors or excessive exposure to a single factor that share similar demographics or financial instrument or specific sector or specific industry or specific markets.
Conditions	Provisions inserted in an insurance contract that qualify or place limitations on the insurer's promise to perform.
Contract	An agreement by which an insurer agrees, for a consideration, to provide benefits, reimburse losses or provide services for an insured. A 'policy' is the written statement of the terms of the contract.
Correlation	A term that describes the degree to which two variables move together. A correlation of 1 means that they move together exactly, while a correlation of minus 1 means that they move in exactly the opposite direction from each other.
Country Risk	The range of risks emerging from the political, legal, economic and social conditions of a country that have adverse consequences affecting investors and creditors with exposure to the country, and may also include negative effects on financial institutions and borrowers in the country.
Covenant	A provision that is indicative of performance. Covenants are either positive or negative. Positive covenants are activities that the borrower commits to, typically in its normal course of business. Negative covenants are certain limits and restrictions on the borrowers' activities.

Coverage	The scope of the protection provided under a contract of insurance.
Credit Assessment	See GCR Rating Scales, Symbols and Definitions.
Credit Default Swap	A form of insurance against non-performance of a third party's obligations.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
Credit Risk	The possibility that a bond issuer or any other borrowers (including debtors/creditors) will default and fail to pay the principal and interest when due.
Credit	A contractual agreement in which a borrower receives something of value now, and agrees to repay the lender at some date in the future, generally with interest. The term also refers to the borrowing capacity of an individual or company
Creditor	A credit provider that is owed debt obligations by a debtor.
Creditworthiness	An assessment of a debtor's ability to meet debt obligations.
Currency Risk	The potential for losses arising from adverse movements in exchange rates.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Default	A default occurs when: 1.) The Borrower is unable to repay its debt obligations in full; 2.) A credit-loss event such as charge-off, specific provision or distressed restructuring involving the forgiveness or postponement of obligations; 3.) The borrower is past due more than X days on any debt obligations as defined in the transaction documents; 4.) The obligor has filed for bankruptcy or similar protection from creditors.
Derivative	A financial instrument that offers a return based on the return of another underlying asset.
Diversification	Spreading risk by constructing a portfolio that contains different exposures whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Environment	The surroundings or conditions in which an entity operates (Economic, Financial, Natural).
Equity Investment	An instrument that signifies an ownership position of shares of stock in a company that is either listed or traded on a stock exchange (also known as a counter) or are unlisted.
Equity	Equity is the holding or stake that shareholders have in a company. Equity capital is raised by the issue of new shares or by retaining profit.
Exchange Rate	The value of one country's currency expressed in terms of another.
Expected Loss	Losses that a bank expects to bear over a certain period (generally a year). These losses are a consequence of doing business, namely the bank's role as financial intermediary.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding. In insurance, it refers to an indvdual or company's vulnerability to varous risks
Financial Institution	An entity that focuses on dealing with financial transactions, such as investments, loans and deposits.
Financial Leverage	The degree to which a company uses debt and equity in its capital structure.
Fix	The setting of a currency or commodity price for trade at a future date.
Fixed Assets	Assets of a company that will be used or held for longer than a year. They include tangible assets, such as land and equipment, stake in subsidiaries and other investments, as well as intangible assets such as goodwill, information technology or a company's logo and brand.
Forecast	A calculation or estimate of future financial events.
Going Concern	An accounting convention that assumes a company will continue to exist and trade normally for the foreseeable future. In practice this is likely to mean at least for the next 12 months.
Guarantee	An undertaking in writing by one person (the guarantor) given to another, usually a bank (the creditor) to be answerable for the debt of a third person (the debtor) to the creditor, upon default of the debtor.
Hybrid	A form of security that has characteristics of various types of transaction or product.
Income	Money received, especially on a regular basis, for work or through investments.

Insurance	Provides protection against a possible eventuality.
Interest Rate Risk	The potential for losses or reduced income arising from adverse movements in interest rates.
Interest Rate	The charge or the return on an asset or debt expressed as a percentage of the price or size of the asset or debt. It is usually expressed on an annual basis.
Interest	Scheduled payments made to a creditor in return for the use of borrowed money. The size of the payments will be determined by the interest rate, the amount borrowed or principal and the duration of the loan.
International Scale Rating.	An opinion of creditworthiness relative to a global pool of issuers and issues.
Issuer	The party indebted or the person making repayments for its borrowings.
LC	An LC is a guarantee by a bank on behalf of a corporate customer that payment will be made if that entity cannot to meet its obligations.
Leverage	With regard to corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
Liabilities	All financial claims, debts or potential losses incurred by an individual or an organisation.
Liability	All financial claims, debts or potential losses incurred by an individual or an organisation.
Liquid Assets	Assets, generally of a short term, that can be converted into cash.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Loan	A sum of money borrowed by a debtor that is expected to be paid back with interest to the creditor. A debt instrument where immovable property is the collateral for the loan. A mortgage gives the lender a right to take possession of the property if the borrower fails to repay the loan. Registration is a prerequisite for the existence of any mortgage loan. A mortgage can be registered over either a corporeal or incorporeal property, even if it does not belong to the mortgagee. Also called a Mortgage bond.
Long-Term Rating	A long term rating reflects an issuer's ability to meet its financial obligations over the following three to five year period, including interest payments and debt redemptions. This encompasses an evaluation of the organisation's current financial position, as well as how the position may change in the future with regard to meeting longer term financial obligations.
Long-Term	Not current; ordinarily more than one year.
Loss Given Default	This is an estimate of the amount of the exposure at default that will not be recovered. It also includes other costs such as legal costs.
Loss	1. A tangible or intangible, financial or non-financial loss of economic value. 2. The happening of the event for which insurance pays (insurance).
Mandate	Authorisation or instruction to proceed with an undertaking or to take a course of action. A borrower, for example, might instruct the lead manager of a bond issue to proceed on the terms agreed.
Market Risk	Volatility in the value of a security/asset due to movements in share prices, interest rates, currencies, commodities or wider economic factors.
Market	An assessment of the property value, with the value being compared to similar properties in the area.
National Scale Rating	National scale ratings measure creditworthiness relative to issuers and issues within one country.
Notching	A movement in ratings.
Obligation	The title given to the legal relationship that exists between parties to an agreement when they acquire personal rights against each other for entitlement to perform.
Obligor	The party indebted or the person making repayments for its borrowings.
Off Balance Sheet	Off balance sheet items are assets or liabilities that are not shown on a company's balance sheet. They are usually referred to in the notes to a company's accounts.
Operational Risk	The risk of loss resulting from inadequate or failed internal processes, people or systems or from external events. This includes legal risk, but excludes strategic risk and reputational risk.
Option	An option gives the buyer or holder the right, but not the obligation, to buy or sell an underlying financial asset at a pre-determined price.

Performing Loan	A loan is said to be performing if the borrower is paying the interest on it on a timely basis.
Performing	An obligation that performs according to its contractual obligations.
Policy	The legal document issued by the company to the policyholder, which outlines the conditions and terms of the insurance.
Premium	The price of insurance protection for a specified risk for a specified period of time.
Private	An issuance of securities without market participation, however, with a select few investors. Placed on a private basis and not in the open market.
Probability	The likelihood or relative frequency of an event expressed in a number between zero and one. The throw of a die is an example. The probability of throwing five is found by dividing the number of faces that have a five (1) by the total number of faces (6). That is a probability of one-sixth or one divided by six, which is .17. See also Degree of Risk, Law of Large Numbers, and Odds.
Refinancing	The issue of new debt to replace maturing debt. New debt may be provided by existing or new lenders, with a new set of terms in place.
Release	An agreement between the creditor and debtor, in terms of which the creditor release the debtor from its obligations.
Repayment	Payment made to honour obligations in regards to a credit agreement in the following credited order: 3.) Satisfy the due or unpaid interest charges; 4.) Satisfy the due or unpaid fees or charges; and 5.) To reduce the amount of the principal debt.
Reserve	(1) An amount representing actual or potential liabilities kept by an insurer to cover debts to policyholders. (2) An amount allocated for a special purpose. Note that a reserve is usually a liability and not an extra fund. On occasion a reserve may be an asset, such as a reserve for taxes not yet due.
Reserves	A portion of funds allocated for an eventuality.
Risk Management	Process of identifying and monitoring business risks in a manner that offers a risk/return relationship that is acceptable to an entity's operating philosophy.
Risk Weighting	A weighting allocated to certain assets or obligations that have higher amount of risk attached to it than another.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Seasoning	The age of an asset, the time period passed since origination.
Senior	A security that has a higher repayment priority than junior securities.
Shareholder	An individual, entity or financial institution that holds shares or stock in an organisation or company.
Short Term	Current; ordinarily less than one year.
Sovereign Debt	A bond issued by a government or a government-backed agency.
Spread	The interest rate that is paid in addition to the reference rate for debt securities.
Subordinated Debt	Debt that in the event of a default is repaid only after senior obligations have been repaid. It is higher risk than senior debt.
Surveillance	Process of monitoring a transaction according to triggers, covenants and key performance indicators.
Swap	An exchange of payment streams between two parties for their mutual benefit. Swaps can involve an exchange of debt obligations, interest payments or currencies, with a commitment to re-exchange them at a specified time.
Tenor	The time from the value date until the expiry date of an instrument, typically a loan or option.
Total Capital	The sum of owner’s equity and admissible supplementary capital.
Underwriting	The process of selecting risks and classifying them according to their degrees of insurability so that the appropriate rates may be assigned. The process also includes rejection of those risks that do not qualify.
Valuation	An assessment of the property value, with the value being compared to similar properties in the area.
Weighted Average	An average resulting from the multiplication of each component by a factor reflecting its importance or, relative size to a pool of assets or liabilities.
Weighted	The weight that a single obligation has in relation to the aggregated pool of obligations. For example, a single mortgage principal balance divided by the aggregated mortgage pool principal balance.