
Proposed Credit Guarantee and Investment Mechanism (CGIM)

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The opinion expressed in the presentation is that of my own and does not necessarily reflect that of the Asian Development Bank

Outline of the Presentation

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- Participants and Capital
- How CGIM could ease the impact of the financial crisis
- Timeline and next steps

Background (1)

- The concept of credit guarantee and investment mechanism came about as the result of from the 1997 Asian financial crisis.
- It is one of key elements of the Bond Market Initiative (ABMI) promoted by Association of Southeast Asian Nations (ASEAN) and the People's Republic of China (PRC), Japan, and Republic of Korea (Korea)—or ASEAN+3—to develop local currency bond markets as an alternative source of funding to bank loans.

Background (2)

To promote local current bond markets, ASEAN+3 initially aimed to

- (i) facilitate a wide variety of issuers' access to the bond market; and
- (ii) remove policy and regulatory impediments environment to foster the development of the markets.

Background (3)

Subsequently, ASEAN+3 focused support on:

- (1) the creation of new securitized debt instruments;
- (2) the enhancement of credit rating;
- (3) the establishment of a regional settlement and clearance system; and
- (4) the establishment credit guarantee and investment mechanism.

Rationale for the Establishment of CGIM (1)

- ABMI has achieved much. Local currency denominated bonds outstanding in ASEAN+2 grew from under \$1 trillion in 2001 to almost \$4 trillion in the end of 2008.
- However, much more needs to be done to give corporations better access to the region's bond markets and to offer a variety of maturities to meet issuers' financing needs.
- For example, regulators normally prescribe minimum ratings for bond investments for the companies they supervise—generally A for banks and AA for insurance companies.
- The risk-return properties of these markets have not yet developed to the point where lower-rated companies can sell bonds—at any price.

Rationale for the Establishment of CGIM (2)

- This market failure is compounded by the lack of insurance or other credit guarantee agencies for local currency bonds to gain full market access.
- Credit protection is available through derivatives (largely credit default swaps) only in developed and liquid bond markets.

Rationale for the Establishment of CGIM (3)

- Mono-line insurers provide credit guarantees, but essentially only for investment-grade bonds denominated in G3 currencies.
- Another difficulty issuers face is limited bond maturities, particularly for infrastructure projects. For example, in Korea, while BBB-rated companies can issue bonds, the maximum maturity tends to be 3 years.
- Maturities of bonds issued by AAA-rated companies are not much longer, although government bonds can have maturities up to 20 years.

Rationale for the Establishment of CGIM (4)

- ASEAN+3 has agreed in 2008 to establish a credit guarantee and investment mechanism (CGIM) to provide credit guarantees for bonds issued in the region and investments in domestic credit guarantee companies.
- CGIM will be an ADB trust fund, with capital from ASEAN+3 and ADB. It will carry an AAA rating.

Potential Issuers

- Issuers with higher rating seeking to lengthen the maturity of their debt issuance
- Lower rated issuers seeking to issue bonds
- Special purpose vehicles used for securitization transactions (they often require a guarantee for the securitization exercise to work)

Participants and Capital of CGIM

- **Participants:**
 - ASEAN + 3 Governments and/or Government-designated financial institutions and
 - ADB
- **Capital:**
 - Precise proportion of individual contributions by ASEAN + 3 and ADB to be determined following multilateral discussions.

Current Financial Market Turmoil

- With global credit tightened, dollar illiquidity has reached Asian shores, despite the large build-up of foreign exchange reserves across the region.
- Major international banks have drastically reduced lending to Asian banks.
- This does not only hurt Asian exporters, where dollar supply is an essential element for trade finance, but also SMEs.

Current Financial Market Turmoil (2)

- As the financial turmoil deepens, offshore bond issuance dropped by more than half and credit default swap spreads for Asian sovereign and corporate issuers have widened with the global trend.
- External borrowing costs have thus risen and many of the region's economies have trouble accessing dollars.
- Cross-currency swap basis spreads increased sharply in several economies, both from rising counterparty risk and dollar funding demand.

Current Financial Market Turmoil (3)

- Banking systems with relatively large short-term external debt face further stress with heightened concerns about rollover risk.
- Global liquidity and pricing strains have already transmitted to domestic inter-bank and local currency bond markets.
- Should this continue, the high cost of capital would severely dampen investment and economic growth in the region.

How CGIM could ease the impact of the credit crunch (1)

- In light of the financial turmoil, ASEAN+3 and ADB have agreed to fast-track the establishment of CGIM.
- Depending on the timing of its establishment, it could be used to provide credit guarantee for bonds issued by the corporate sector and selected ADB member countries seeking external funding for fiscal purposes.
- CGIM could be built on the agreed ASEAN+3 framework for the CGIM, however, with a provision to expand availability to other ADB member countries.

How CGIM could ease the impact of the credit crunch (2)

- CGIM could be built on the agreed ASEAN+3 framework for the CGIM, however, with a provision to expand availability to other ADB member countries.
- It could be extended to bonds issued in both local currencies and US dollars to ease access to both international and domestic bond markets.
- Credit guarantees for bonds would help reverse capital outflows and make it possible for financial institutions to continue lending to exporters and SMEs.

How CGIM could ease the impact of the credit crunch (3)

- CGIM would help make the region's financial systems more sound and resilient.
- CGIM would serve to promote regional public goods through promoting the financial integration, and allow companies in the region to more effectively tap regional savings for financing regional investment and economic growth.

Timeline and Next Steps

- Most key elements of CGIM have been discussed and agreed upon with ASEAN+3.
- ADB has already prepared most of the work required for the establishment of CGIM.
- Subject to agreement among ASEAN+3 and ADB, CGIM could be ready for operations by late 2009 or in 2010.