MOODY'S INVESTORS SERVICE

Credit Opinion: International Finance Facility for Immunisation

Global Credit Research - 07 Aug 2014

Supranational

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Aa1
Senior Unsecured	Aa1
ST Issuer Rating	P-1
Other Short Term	(P)P-1

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Key Indicators

International Finance Facility for Immunisation

	2007	2008	2009	2010	2011	2012	2013
Total Assets (US$ Millions)	3,074	2,928	4,292	5,200	4,525	4,243	4,443
Return on Average Assets (%)	19.4	-10.7	-13.4	0.3	-3.9	-8.2	3.2
ST Debt + CMLTD/Liquid Assets (%) [1]	2.8	8.7	24.7	68.9	90.0	76.9	70.9
Gearing Ratio [2]	35.5	33.1	40.9	40.6	44.0	43.2	44.7

[1] Short-term debt and currently-maturing long-term debt [2] Net debt as percent of the present value of scheduled donor pledge payments

Opinion

Credit Strengths

IFFIm has the following credit strengths:

Strong commitment from donor governments to support programs financed by IFFIm, reinforced by legally binding Grant Agreements

Gearing ratio and liquidity policies that provide a financial cushion against adverse developments in the full and timely receipt of donor's scheduled payments

Financial and risk management by the World Bank

Credit Challenges

IFFIm faces the following credit challenges:

Concentration of donor pledges

High correlation in credit risk among euro area donors

The possibility of a large number of recipient countries going into arrears with the IMF causing material reductions in donor payments via the high-level financing condition

Rating Rationale

IFFIm's Aa1 issuer rating is based on the firm commitment of the donor governments to make payments to IFFIm on specified dates over periods of around 20 years, on adherence to its gearing and liquidity policies, and on the involvement of the International Bank for Reconstruction and Development (IBRD or World Bank) as Treasury Manager. IFFIm was established as a charity in the United Kingdom in 2006 with the purpose of accelerating and facilitating funding for immunization programs in the world's poorest countries. The programs are carried out by the GAVI Alliance, a public/private entity that is active in such immunization programs. IFFIm issues bonds to finance GAVI programs, and the donor payments will be used to repay the bonds. As such, IFFIm's rating is closely linked to the creditworthiness of its sovereign donors because its revenue structure is reliant on the receipt of donors' pledges. Although the amount and timing of donor payments is predetermined at the time they are pledged, the amounts and maturities of debt issuance are determined on the recommendation of the Treasury Manager.

Six donor governments founded IFFIm - France, Italy, Norway, Spain, Sweden, and the United Kingdom. Australia, the Netherlands, and South Africa subsequently joined. Other governments may join in the future, such as Brazil, which has a pending grant agreement. The UK is the single largest donor to IFFIm, pledging around 50% of remaining donor payments. Further significant concentration results from our belief that there is correlation between three of IFFIm's euro area donors. France, Italy, and Spain pledge 26.8%, 8.6%, and 3.0%, respectively, of remaining donor payments. As a result of the correlation assumption, we consider these three sovereigns' combined 38.4% of remaining pledges to be a concentration risk. Therefore, IFFIm's donor structure is 89.7% concentrated around two donors, the UK and France, both rated Aa1. This donor concentration allows for a low-probability, but high-severity event risk in IFFIm's credit profile. Nevertheless, we believe that all donors have the capacity and willingness to meet their commitments on a timely basis. Supporting this assessment is the very high Aa1 weighted median government bond rating of the donors and the very small size of the scheduled annual payments relative to the donors' annual budgets.

IFFIm has four donors with a Aaa rating (the Netherlands, Australia, Norway, and Sweden) and there is an exceptionally low chance that these four sovereigns would renege on their commitments to IFFIm. While each sovereign donors' pledge to IFFIm is legally binding, there is no additional legal requirement for the donors to support IFFIm above and beyond their individual contractual commitments. Therefore, we do not consider the strength of the four remaining Aaa-rated donors as a rationale for IFFIm's rating exceeding those of the UK and France.

A reduction in the amount of donor pledges paid in could result from either a donor breaking its pledge or recipient countries going into arrears with the International Monetary Fund (IMF) causing reductions in donor payments via the high-level financing condition. The high-level financing condition reduces donors' scheduled payments if any of the 71 recipient countries are in protracted arrears to the IMF. For all but ten of the countries, the reduction in payment amount from the donors would be 1% during the period the country is in arrears. Of the ten that are not 1%, for two countries the reduction would be 0.5%, for one country 3%, and for seven 5%. Currently three of the 71 eligible recipient countries are in protracted arrears with the IMF, all at the 1% level.

To ensure that there are sufficient funds to repay bondholders despite the risk of reductions in donors' scheduled payments, IFFIm has two key risk management policies. The first one is a solvency policy over the remaining life of IFFIm - a gearing ratio limit that restricts net debt to around 57% of the present value of remaining donor payment amounts. In our view, the strength of the gearing ratio limit is not only a function of how well the risks are modeled in order to set the limit, but a function of the flexibility of the limit to account for increasing risks; and, more importantly, the flexibility for the Treasury Manager to delay grant commitments and disbursements to GAVI in respect of the gearing ratio limit. The actual gearing ratio level is currently around 45%, pointing to a large-enough solvency buffer that would allow IFFIm to expand its operations, but nevertheless not fully accounting for the increased event risk represented by a downgrade of IFFIm's largest donors. The second policy is the liquidity policy, which requires a prudential minimum level of liquid assets to be held equal to at least one year's debt service (both interest and principal). Since inception, IFFIm has consistently over complied with the liquidity policy.

The IBRD's role as the Treasury Manager in helping to manage these prudent financial policies, monitor the underlying risks, and make adjustments when necessary, is a key factor in IFFIm's rating. As an innovation in financing, IFFIm started as an untested structure. The World Bank's capacity, experience, and proven track record of timely debt servicing adds necessary institutional strength to the structure.

Rating Outlook

The outlook on IFFIM's ratings was changed to stable from negative on 6 August 2014, to reflect the improvement in the creditworthiness among IFFIm's major sovereign donors and Moody's view that the default correlation between the euro area donor states might be lower than previously assumed, although still considered to be high. This has been reflected in the improvement of several European sovereigns' creditworthiness, which supports their ability to meet their financial obligations with IFFIm. As a consequence, we expect IFFIm's market access to remain strong.

The stable outlook also captures Moody's expectation that IFFIm's conservative liquidity and gearing policies will continue to partially mitigate concentration risk among donors.

What Could Change the Rating - Up

Given that IFFIm's rating is closely tied to that of its donors, positive ratings momentum would only emerge if the creditworthiness of its largest donors, the UK and France, were to improve. A significant decrease in the concentration of sovereign donors' pledges could also support upward ratings momentum.

What Could Change the Rating - Down

A deterioration in the creditworthiness of its sovereign donors is the most likely possible cause of downward pressure on IFFIm's rating, particularly if the deterioration led to a downgrade of the UK or a multi-notch downgrade of France. A negative rating action could also be triggered by a weakening of the gearing ratio limit mandate or a change in treasury manager, neither of which Moody's considers likely.

Recent Developments

Over the past year, the credit standing of several of IFFIm's European sovereign donors has improved as conditions in the euro area have stabilised. This is reflected by the rating actions taken on Italy (Baa2 rating affirmed and outlook changed to stable from negative in February 2014), Netherlands (Aaa rating affirmed and outlook changed to stable from negative in March 2014) and Spain (upgraded to Baa2 with a positive outlook in February 2014). Additionally, Moody's has lowered its assessment of default correlation among euro area states even in the event of a very severe crisis involving the defaults of even the strongest member states of the monetary union. Taking these factors together - the improvement in and greater stability of donor creditworthiness and the lower default correlation assumption - Moody's believes that IFFIm's rating would be less immediately affected were any one of its euro area donors to be downgraded, supporting the stable outlook on IFFIm's rating.

Sudan has been in the reference portfolio of countries of the high-level financing condition since IFFIm's inception. After seceding from Sudan, South Sudan joined the IMF in April 2012. While Sudan is in protracted arrears with the IMF, and therefore was causing a 1% reduction in donors' payments to IFFIm, South Sudan is not in protracted arrears. Therefore, when the reference portfolio of countries was updated in February 2013, the newly included South Sudan was given a 0.5% weight and Sudan's weight was reduced from 1.0% to 0.5%. This caused 0.5% of the donor payments that were being withheld under the high-level financing condition as a result of Sudan's IMF arrears, to be released. We view this to be a positive development because it increases IFFIm's cash inflow, however, the small scale is not materially beneficial.

IFFIm enters into foreign exchange and interest rate swap contracts with the IBRD as a part of its asset/liability management. According to the swap agreement between IFFIm and the IBRD, after IFFIm's rating was changed from Aaa to Aa1 the IBRD has the right to call collateral above a threshold. However, and despite surpassing the threshold, the IBRD has not called collateral and has committed to not call if it would constrain IFFIm's ability to meets its debt obligations. The IBRD made this commitment in line with its responsibilities as Treasury Manager to ensure that IFFIm has the funding to fulfil its debt obligations. The commitment which first became effective from July 2013 through June 2014, in line with the IBRD's current fiscal year, can be renewed annually, and was extended in June of this year until May 2015.

The IBRD's commitment to not call collateral comes in tandem with a structural change to the limits of IFFIm's indebtedness. A "Risk Management" buffer of 12% has been added to the gearing ratio limit. The gearing limit model itself (neither the inputs nor the parameters) has not changed. The IBRD will run the model in the same manner and set a gearing limit to absorb risks from the two main sources of risk (i.e. donor default on grant payments and the high-level financing condition). On top of that limit, an additional 12% will now be added which will result in an effective gearing ratio limit lower than that output by the model. The IBRD has sole discretion to adjust the Risk Management buffer.

We view this structural change positively as it reduces the overall risk taken on by the structure (i.e. a lower leverage level) and enables IFFIm to maintain regular financial operations. The structural change also displays the non-contractual support that IFFIm receives from the IBRD. The financial and institutional strength of the IBRD allows it to innovate solutions like this that ultimately benefit IFFIm. A weaker organization or an organization whose own mandate does not align with IFFIm's would be less able or willing to support IFFIm in this manner. This development supports our assessment that having the IBRD as Treasury Manager is a significant source of credit strength for IFFIm.

Rating Factors

International Finance Facility for Immunisation

Rating Factors	**Factor Weight**	**Factor Score**
Factor 1: Capital Adequacy	0%	--
Factor 2: Liquidity	100%	Very High
Intrinsic Financial Strength (F1 + F2)	+2, +1, 0, -1 notches	Very High
Factor 3: Strength of Member Support	Preliminary Rating Range	High
Rating Range (F1 + F2 + F3)		**Aaa-Aa2**
Assigned Rating		**Aa1**

Note: While the information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the rating range. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the indicative rating range.
For more information please see our Multilateral Development Banks and Other Supranational Entities rating methodology.

Footnotes:(1) Rating Range: Factor 1, Capital Adequacy, and Factor 2, Liquidity, combine according to the weights indicated into a construct we designate as Intrinsic Financial Strength (IFS). A notching system combines IFS and Factor 3, Strength of Member Support. (2) 5 Ranking Categories: Very High, High, Medium, Low, Very Low.

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