

19 JUL 2023

Fitch Rates Frontier Clearing Corporation IFS 'A-'; Outlook Stable

Fitch Ratings - Frankfurt am Main - 19 Jul 2023: Fitch Ratings has assigned Frontier Clearing Corporation B.V. (FCC) an Insurer Financial Strength Rating (IFS) of 'A-' with Stable Outlook.

The rating reflects FCC's 'Very Strong' capitalisation and leverage, its 'Less Favourable' company profile as a financial guarantor with a single product focus still in its growth phase, as well as 'Somewhat Weak' profitability.

Key Rating Drivers

'Very Strong' Capitalisation: Capitalisation and leverage is 'Very Strong', underpinned by a low net par/capital ratio of 1.5x at end-2022 for a high-risk (with currency risk) guarantee portfolio. FCC is not subject to externally imposed minimum capital requirements, but calculates its capital needs based on an internal capital model that primarily determines the amount of guarantees FCC underwrites. The capital leverage restriction imposed by this capital model is expected to replace the current internally set leverage cap of 2x as FCC's business grows.

Although FCC is primarily debt-funded through profit participating notes (PPN) Fitch treats all classes of these capital instruments as equity, based on their equity-like features. Accordingly, FCC has no financial leverage.

'Less Favourable' Company Profile: FCC's company profile is 'Less Favourable' compared with that of other financial guarantors that cover lower-risk exposures on more developed markets. FCC provides guarantees for counterparty credit risk and general country (transfer and convertibility) risk of financial institutions in emerging markets. Fitch views FCC's business as high risk based on its emerging market focus and potential exposure to emerging market debt securities of weak credit quality as part of its normal operations. FCC has no direct competitors. Fitch expects ongoing demand to facilitate financial transactions in emerging markets to support FCC's business over the long run, which we view positively.

Strong Policyholder Protection: Excess of loss (XoL) reinsurance adequately protects FCC against large losses, and per risk reinsurance on individual risks is used to manage country or counterparty exposure limits. At end-2022 reinsurance from Lloyd's of London syndicates (Fitch: AA-/Stable) covered USD34 million (end-2021: USD51.1 million) of FCC's gross notional exposure. The USD75 million Lloyd's XoL portfolio reinsurance policy pays based on liquidity triggers. An additional USD100 million counter-guarantee provided by KfW (Fitch: AAA/Stable) gives further protection to FCC's beneficiaries in case of FCC's insolvency. The facility, however, does not affect FCC's credit rating as it pays out only after the

insolvency of FCC.

'Somewhat Weak' Profitability: As a government and supranational-backed financial guarantor, the level of profitability has lower importance for FCC than for commercial guarantors and is limited to returns that are sufficient to sustain its activities. FCC is in a growth phase and accordingly its profitability has been 'Somewhat Weak' with a five-year average return on equity (ROE) of -1.3% (PPNs included as equity) and a five-year average combined ratio of 128%. FCC is unlikely to achieve significant positive technical results and, therefore, investments and revaluations remain the key drivers of its profitability.

Low Investment and Liquidity Risk: FCC's investment portfolio is conservative and includes very high credit quality short- to medium- term bonds rated 'AA-' or higher, 'AAA' rated money market funds and cash at highly rated financial institutions. At end-2022, FCC had no assets subject to significant market risk. FCC evaluates its liquidity needs by testing the adequacy of its liquidity buffer under stress scenarios. At end-2022 stress test results indicated ample liquidity under each stress scenario.

Ownership Neutral to Rating: FCC's only shareholder is Frontclear Management B.V. (FCM). FCM is the statutory director of FCC and is 100% ultimately owned by Stichting Cardano Development, a Dutch foundation. Key investors in FCC's PPNs are governments, supranationals, development finance institutions, and other private-sector entities. Fitch does not view PPN investors as owners of FCC, therefore their credit profiles have no impact on FCC's rating. Nevertheless, Fitch views the presence of financially strong investors favourably for FCC's financial flexibility.

RATING SENSITIVITIES

Factors That Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

- Seasoning of the business profile including but not limited to guarantee portfolio growth and diversification, and ability to attract new capital investments
- Positive financial performance on a sustained basis

Factors That Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

- Par/capital above 2.9x, for example, as a result of portfolio growth or capital depletion due to loss-making operations

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-

specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>

Date of Relevant Committee

06 July 2023

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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Rating Actions

ENTITY/DEBT	RATING	RECOVERY	PRIOR
Frontier Clearing Corporation B.V.	LT IFS	A- 	New Rating

RATINGS KEY OUTLOOK WATCH

POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

[Insurance Rating Criteria \(pub.15 Jul 2022\) \(including rating assumption sensitivity\)](#)

Additional Disclosures

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