

Rating Action: Moody's assigns a Baa1 IFS rating to Frontier Clearing Corporation B.V.

24 January 2023

NOTE: On January 26, 2023, the press release was corrected as follows: In the first sentence of the fourth paragraph of Ratings Rationale section, the date was corrected to 30 September 2026. Revised release follows

Paris, January 24, 2023– Moody's Investors Service (Moody's) has today assigned a Baa1 insurance financial strength rating (IFSR) to Frontier Clearing Corporation B.V. (Frontclear). The outlook is stable.

Frontclear is a financial markets development company focused on catalyzing more stable and inclusive financial markets in emerging and developing countries. Its primary operations include providing guarantees on swap and repo transactions, and providing capacity building technical assistance services.

Frontclear is a limited liability company incorporated in the Netherlands and is a wholly owned subsidiary of Frontclear Management B.V. It is the active company of the group issuing guarantees. Frontclear is funded through the issuance of profit participating notes to the different Frontier Clearing Funds, and ultimately to external development-focused investors.

RATINGS RATIONALE

Frontclear's Baa1 IFSR, with a stable outlook, reflects its continued growth and unique market position as a guarantor of inter-bank trades in emerging and frontier markets. The company has a low operating leverage - gross guaranteed exposure representing 1.4x the sum of paid in and callable capital as well as available insurance protection as at YE2022 - that leads to strong capitalization, a demonstrated ability to select and manage underwriting risks, as well as investment and technical support from several large European development finance institutions.

These strengths are offset by limited business diversification and a relatively high level of concentration in its guaranteed portfolio (with the two largest countries where Frontclear operates representing around 30% of the company's net maximum exposure as at YE2022), Frontclear's modest size (\$3.1 million revenues in 2021 and \$93.0 million of total assets as at YE2021) and profitability (-\$0.9 million net result in 2021) as well as moderate liquidity risk.

Frontclear's value proposition consists in providing frontier market banks the ability to trade hard currency swap and repos with international banks by posting local currency collateral as security. In fact Frontclear acts as a guarantor by providing the beneficiary banks a hard currency guarantee on the early termination amount (the difference between the mark-to-market amount on the trade and the value of the collateral) of a trade; as a result the beneficiary banks are comfortable with holding local currency collateral instead of hard currency collateral. In managing the risk of depreciation of the local currency collateral, Frontclear requires that all trades are supported by overcollateralization, with haircuts typically ranging from 20% to 50%. In addition, weekly or daily margining is required on all guaranteed transactions, often in USD, which reduces the risks associated with deterioration in the value of local currency collateral. If Frontclear has to pay the guarantee, it may take over the collateral. However, because Frontclear may not be able to liquidate the collateral immediately, it

runs liquidity risk. This risk is managed by the company through the holding of high amount of cash as well as additional liquidity lines.

Beneficiaries of Frontclear's guarantees are further protected by a counter-guarantee from Kreditanstalt fuer Wiederaufbau (KfW, Aaa stable), the German Development Bank, extended until 30 September 2026. However, in assigning its IFSR, Moody's does not consider this counter-guarantee to support Frontclear's own capital adequacy, or lower its default probability, because it is only available in the event Frontclear defaults on a guarantee obligation, and is paid directly to the beneficiary.

In the second half of 2022, Frontclear launched a new product in Uganda, the Tradeclear platform, which is an umbrella guarantee facility to facilitate interbank trading and market liquidity in the country. This solution, which enables Frontclear to guarantee bilateral transactions between nearly half of the banking system in the country, is a key milestone for the company and an important step to demonstrate that it can support the development of an inter-bank market in an emerging market.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATING

Moody's mentions that Frontclear's rating could be upgraded in case of: (1) continued growth and diversification of the guaranteed portfolio and further demonstration of ability to fulfill mandate for example through a successful execution of the Tradeclear platform in Uganda and replication in other countries, (2) improvement in capital and liquidity relative to risk, (3) improved generation of recurring revenues and profits; and (4) continued strong track record in managing its risks in stressed scenarios.

Conversely, Frontclear's rating could be downgraded in case of: (1) unexpected portfolio losses that result in capital erosion, or (2) a significant increase in guaranteed portfolio leverage relative to paid-in and unconditionally committed capital, notably in case of increase of exposures in low-rated countries, or (3) an increase in uncovered liquidity risk in excess of Frontclear's current internal liquidity buffers, or (4) recurring material operational losses, or (5) failure to increase the number of countries and institutions using Frontclear's guarantees and platforms, thereby limiting the company's development impact and success in fulfilling mandate.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was Financial Guarantors Methodology published in August 2022 and available at <https://ratings.moodys.com/api/rmc-documents/391810>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

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For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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