

Construction Guarantee Fund

An extract from Latest comments by Fitch Ratings on CGF Financial Status (up-to-date on July – 2023)

Company Profile

State Links Help Business Profile; Higher Risk Appetite

Fitch ranks CGF's business profile as 'Moderate' compared with that of other insurers in Sri Lanka because of the fund's adequate business franchise that is supported by full state ownership and its unique role in assisting the domestic construction industry. Some of these benefits are balanced by CGF's limited scale, inherent focus on a singular market, and a risk appetite that is higher than that of the industry.

CGF, a Trust established by Sri Lanka's Department of Treasury in 1999, was given legal status through the Trust Ordinance. The secretary to the Treasury has handed day-to-day decision-making authority to the Board of Trustees, which includes state and private-sector representatives.

The franchise is supported by its full state ownership and its unique role in assisting the Domestic Construction Industry, predominantly by supporting SME contractors. The state has directed all government organisations to treat the bonds issued by CGF on a par with guarantees provided by banks and insurance companies.

CGF's small scale, high risk appetite and limited diversification are factors that constrain our business profile assessment. Its operating scale, measured by its equity base, premiums and market position compared with conventional non-life insurers, is small. The domestic construction guarantee market is dominated by banks and some insurers, mostly catering to established contractors with proven records. CGF's risk appetite is high, given its mandate to support SME contractors without access to banks or a sufficient record and/or collateral to obtain guarantee services.

Its business risk has also increased, as Construction Industry Development Authority's contractor-grading thresholds have been made more lenient in recent years to allow several contractors to bid for high-value projects with the objective of boosting Domestic Construction. CIDA gradings are part of CGF's contractor evaluation process and, hence, we think these changes by the state will somewhat impair risk-management processes. This is because certain high-risk contractors are now eligible to bid for large Government contracts.

CGF mitigates some of these risks by conducting an evaluation of the contractor's past performance, financial standing and technical ability before issuing guarantees.

'Moderate/Favourable' Corporate Governance, 'Less Favourable' Financial Transparency

Fitch ranks CGF's corporate governance as 'Moderate/Favourable' against that of all other insurers in Sri Lanka. CGF is fully owned by the state. The Board of Trustees appointed by the Secretary to the Treasury consists of four from public-sector institutions and two from the private sector. There are a number of sub-committees to ensure effective conduct of its operations.

There are no current civil or criminal issues or uncertainties outside of anything customary to the market or CGF's business model.

Ownership

Neutral Ownership

(We consider the state ownership neutral for its rating, as CGF operates as an autonomous body with limited Government influence in its day-to-day operations.)

The government allocated a grant of LKR100 million to set up CGF through the 1999 National Budget. CGF has only drawn LKR55 million of the initial grant to date. The state has not infused any further capital into CGF. It does not make any contributions to the state's consolidated fund in the form of dividends or levies. However, the trust deed requires all assets of CGF to be vested with the state in the event of liquidation.

Benefits from state ownership to its franchise and competitive positioning are factored into its business profile assessment.

Ratings

Construction Guarantee Fund

National IFS Rating BB(lka)

Outlooks

National IFS Rating RWN

Financial Data

Construction Guarantee Fund

| | 2022 | 2021 |
|---|-------|-------|
| Gross written premiums (LKRm) | 102 | 274 |
| Total assets (LKRm) | 2,600 | 2,707 |
| Shareholder equity (LKRm) | 1,747 | 1,460 |
| Net premiums written (NPW) to capital (x) | 0.1 | 0.2 |
| Guarantee risk exposure to total equity (x) | 0.4 | 3.1 |
| Return on equity (%) ^a | 18 | 20 |

^a Net income is after factoring claim expenses.

Source: Fitch Ratings, Fitch Solutions, CGF

Applicable Criteria

[Insurance Rating Criteria \(July 2023\)](#)

[National Scale Rating Criteria \(December 2020\)](#)

Related Research

[Sri Lanka's Debt Restructuring to Ease Insurers' Investment, Liquidity Pressures \(July 2023\)](#)

[Sri Lankan Insurers' Operating Risks Intensify \(June 2023\)](#)

Rating Sensitivities

We expect to resolve the RWN once the impact of Sri Lanka's economic crisis on CGF's credit profile becomes more apparent. This may take longer than six months.

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

- Rising investment and asset risks, including a downgrade of the ratings of financial institutions or the sovereign
- Significant liquidity constraints that impede CGF's ability to service its guarantee obligations
- Sustained weakness in financial performance or weaker risk management practices
- A deterioration in CGF's company profile – for instance, due to significant weakening in its association with the government – or a deterioration in its business risk profile due to a decline in the country's economic conditions that affects the domestic construction sector

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

- There is limited scope for upward rating action given the RWN.

Latest Developments

- CGF's net profit fell to LKR285 million in 2022 from LKR310 million in 2021 due to a 63% yoy drop in premium income.
- Guarantee exposure fell to LKR1.2 billion in 2022 from LKR7.0 billion in 2021 and net guarantee exposure declined to LKR772 million from LKR4.4 billion due the drop in new guarantee volume and expiration of existing contracts.
- Earnings are likely to be under pressure as premium income is falling while most of CGF's expenses are fixed, resulting increased dependence on investment income.

Appendix A: Peer Analysis

CGF does not have similar peers in the domestic market, given its unique business model and focus on serving a niche customer segment. Fitch compares it with much larger and more established South Korean guarantee companies – Construction Guarantee (A/Stable) and Seoul Guarantee Insurance Company (AA-/Stable) – that offer similar services in the Korean construction market.

| Peer Comparison | | | | | | | | | |
|--|------------|---------------------|-------------------------|----------------------|------------------|----------------------|-------------------------------------|-------------------------------------|--|
| | IFS Rating | National IFS Rating | Premiums income (LKRbn) | Total assets (LKRbn) | Net leverage (x) | Return on equity (%) | Total exposure to total capital (x) | Net premiums written to capital (x) | |
| Construction Guarantee Fund ^a | n.a | BB(Ika) | 0.1 | 2.6 | 01 | 17 | 0.4 | 0.1 | |
| Construction Guarantee ^b | A | n.a. | 49 | 1281 | 0.1 | 3 | 21.5 | 0 | |
| Seoul Guarantee Insurance Company ^b | AA- | n.a. | 337 | 1635 | 1.0 | 9 | 76 | 0.3 | |

^a CGF's data are as of end 2022
^b Data as of end 2021
Source: Fitch Ratings, Fitch Solutions, companies

Peer Comparison 2021

| | IFS Rating ^a | National IFS Rating ^a | Non-life market share (%) | | Life market share (%) | | Return on equity (%) | | Non-life combined ratio (%) | | Risk-based capital (RBC) non-life (%) | | RBC life (%) | |
|--|-------------------------|----------------------------------|-----------------------------|-------------------|-----------------------|------|----------------------|------|-----------------------------|------|---------------------------------------|------|--------------|------|
| | | | 2021 | 2020 | 2021 | 2020 | 2021 | 2020 | 2021 | 2020 | 2021 | 2020 | 2021 | 2020 |
| | | | Construction Guarantee Fund | n.a | BB(Ika)/RWN | 0.3 | 0.3 | n.a. | n.a. | 20 | 25 | 26 | 24 | n.a. |
| Continental Insurance Lanka Limited | n.a. | A-(Ika)/RWN | 4.5 | 4.6 | n.a. | n.a. | 26 | 33 | 88 | 84 | 320 | 291 | n.a. | n.a. |
| Sri Lanka Insurance Corporation Limited ^b | CC/RWN | A(Ika)/RWN | 18.7 | 18.4 | 17.6 | 18.7 | 15 | 9 | 96 | 88 | 244 | 223 | 501 | 459 |
| HNB Assurance PLC ^b | n.a. | A-(Ika)/RWN | 4.7 | 4.3 | 5.7 | 5.3 | 15 | 16 | 101 | 95 | 260 | 255 | 277 | 338 |
| National Insurance Trust Fund Board | n.a. | A-(Ika)/RWN | 12.3 ^c | 11.4 ^c | n.a. | n.a. | 32 | 71 | 75 | 57 | 600 | 562 | n.a. | n.a. |
| People's Insurance PLC | n.a. | A-(Ika)/RWN | 5.2 | 5.4 | n.a. | n.a. | 20 | 29 | 91 | 83 | 317 | 304 | n.a. | n.a. |
| Co-operative Insurance Company PLC | n.a. | BB(Ika)/RWN | 4.0 | 4.0 | n.a. | n.a. | 16 | 21 | 92 | 88 | 292 | 249 | n.a. | n.a. |

^a Ratings are as of publication date of this report

^b Composite insurer; HNB Assurance PLC includes the consolidated performance of HNB General Insurance Limited

^c Fitch has added CGF's premium volume to the industry non-life premiums published by the regulator in order to calculate market share. National Insurance Trust Fund Board's non-life market share calculation excludes reinsurance premiums and crop levy

Source: Fitch Ratings, Fitch Solutions, companies, Insurance Regulatory Commission of Sri Lanka