Research Update:

International Finance Facility for Education Assigned 'AA+/A-1+' Ratings; Outlook Stable

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Overview

- The International Finance Facility for Education (IFFEd) is an innovative financing mechanism that will provide portfolio support and concessional financing through its partnerships with multilateral lending institutions (MLIs) to encourage investments in education in lower-middle-income countries (LMIC).
- Our prospective view for the next few years factors in IFFEd's unique role, as well as our expectations that it will execute on its mandate and initial contributors will remain supportive, balanced by its short track record and evolving operational functions.
- IFFEd's financial risk profile of extremely strong captures robust capital and liquidity metrics, reflecting its start-up nature and no leverage.
- We assigned our 'AA+/A-1+' long- and short-term issuer credit ratings to IFFEd.
- The outlook is stable, based on our expectation that the organization will expand its activities and contributors will remain supportive of the facility, allowing it to continue apace with its policy mandate while managing capital and liquidity prudently.

Rating Action

On Sept. 12, 2024, S&P Global Ratings assigned its 'AA+' long-term and 'A-1+' short-term issuer credit ratings to the International Finance Facility for Education (IFFEd). The outlook is stable.

Rationale

The ratings on IFFEd reflect our assessment of the entity's strong enterprise risk profile and extremely strong financial risk profile. IFFEd was established in 2023 as a crucial provider of financing products to support education lending in LMICs through MLI partners. It will provide portfolio guarantees to support MLIs' capital optimization efforts as eligible education loans are approved, complemented by grants to improve the terms of MLI education loans in LMICs. We view this policy mandate as both important and niche, particularly against the backdrop of the 2030

Sustainable Development Goals, with a stronger focus on the education sector and limited financing alternatives that encourage education spending in LMICs. At the same time, the scheme furthers the G20's objectives of scaling MLIs' balance-sheet optimization to unlock additional lending, which we think enhances IFFEd's value proposition.

The entity has no track record of fulfilling its policy mandate, which is partly counterbalanced by IFFEd relying on four strong deliverers of financial and technical services for education in developing countries. We view the relationship with the largest MLIs (the Asian Development Bank, the African Development Bank, the Inter-American Development Bank, and the International Bank for Reconstruction and Development), as augmenting IFFEd's policy importance and developmental impact. The organization has entered a formalized partnership with the Asian Development Bank and expects to commit a portfolio guarantee and release grant financing on a qualifying education loan by year-end. The engagement with additional participating MLIs is ongoing.

While IFFEd is not established by treaty, it will operate through treaty-funded MLIs, it will be tax exempt, and we expect contributors to be supportive. The three initial contributors--the U.K., Canada and Sweden (through the Swedish International Development Cooperation Agency [Sida])--have demonstrated timely and robust support to the facility. The entity's paid-in capital contributors, namely the U.K. and Canada, have now fully released total paid-in capital of $40.25 million. Legal agreements are signed for $200 million in contingent capital from Sida and the U.K. parliament has approved $102 million in contingent capital. We consider these locked-in contributions as partly mitigating the lack of demonstrable continuous shareholder support. Also, we take the prospective view that IFFEd will be able to lock in additional contributor support, which is a necessary element to scale its developmental reach.

IFFEd will be exposed to sovereign loans and guarantees comprising the covered portfolios of participating MLIs, which will remain the lenders of record for these loans and guarantees and effectively benefit from the robust Preferred Creditor Treatment (PCT) these institutions receive. The portfolio support that IFFEd provides to MLIs is designed to cover losses in interest and principal on any loan and guarantee of the entire sovereign portfolio in the event of nonaccrual, while its pro rata share of these payments depends on the overall share of IFFEd-supported education loans in the MLI's portfolio. Countries in nonaccrual status at the beginning of the replenishment cycle will be excluded from receiving portfolio support for the rest of the cycle, which in our view further strengthens the PCT benefit IFFEd receives and translates into an initial arrears ratio of 0%. The facility will recover its full guarantee payment when the MLI fully recovers the loans.

Credit risk is closely linked to the afforded PCT for the implementing MLI, and the MLI's chosen leverage ratio. The leverage used drives the overall share of IFFEd-supported education loans and, in effect, the share it would be responsible in paying out in the event of nonaccrual in the MLI sovereign portfolios. Furthermore, IFFEd's policy of applying no leverage in its existing portfolio support (that is, the total amount of guarantees outstanding will not exceed the amount of paid-in capital plus contingent capital) is, in our view, an important backstop to credit risk.

We base our view of the entity's governance and management expertise on a small subset of contributor governments, with one of the highest rankings in governance. We think agency risk is limited given that IFFEd's contributors are not recipients, combined with highly conservative financial policies. The unique mechanism embedded into the IFFEd structure--providing clear, automatic, and preemptive triggers to increase the share of paid-in capital under certain conditions--reflects our view of contributors' commitment to the facility's financial sustainability. IFFEd has been recently incorporated and is ramping up its activities, so it could be subject to general related start-up risks, although we think this is partly mitigated by its more streamlined business model as a guarantee provider to MLIs. At the same time, the entity is planning to employ the World Bank as an asset manager for its general liquidity, which we think will minimize some execution risks.

IFFEd's financial risk profile will stand extremely strong at inception, and only decline as its guarantee service operations expand. Still, we would attribute any lackluster operational evolution as suggesting issues with its overall policy relevance, despite this scenario likely resulting in a smaller reduction in IFFEd's financial metrics. We base this view on our assessment of general start-up-related risks in which an inability to gain sufficient momentum in its initial phase--particularly if developments remain muted--could, in our view, constrain IFFEd's relevance as a viable instrument through which sovereign partners could execute their developmental policy ambitions.

We expect our risk-adjusted capital (RAC) ratio after incorporating adjustments specific to MLIs to well exceed the 23% threshold for extremely strong based on year-end financial information for 2024. IFFEd assets consist of cash balances from paid-in capital and no guarantee issuances as of today. Nevertheless, as the entity begins issuing portfolio guarantees and becomes exposed to MLI sovereign portfolios, we expect the RAC ratio to decline meaningfully but remain above the 23% threshold over the next three years. In the event that the ratio falls below 23%, we would incorporate the committed contingent capital from the highly rated contributors as a form of extraordinary support into our financial analysis.

IFFEd does not borrow, instead obtaining funding solely through retained earnings and contributors' funding. We assign a neutral funding score because we think the positive factor of the entity's paid-in capital base is counterbalanced by the lack of access to the wholesale market, which limits its size and scale to provide portfolio support to MLIs. We assess IFFEd's liquidity position as robust. Currently, the organization does not have any guarantee liabilities, although as it ramps up, we expect it should comfortably pay out on its guarantees for at least a year under stressed market conditions, without recourse to liquidity facilities from contributors or from the market.

Outlook

The stable outlook reflects our view that, over the next two years, IFFEd will develop a track record of delivering on its mandate by expanding its guarantee operations and solidifying its policy relevance, and expect the initial contributors to remain supportive. We also expect the institution to strengthen its operations, risk management, staff, and IT systems to support execution and limit start-up-related risks. We assume it will adhere strongly to what we consider sound policies in governance and risk. While we expect IFFEd's capital and liquidity positions to fall from extremely strong levels as it proceeds with its mandate, we expect the entity to manage this to high levels commensurate with an extremely strong financial risk profile.

Upside scenario

We could take a positive rating action over the next 24 months if IFFEd incorporates a meaningful number of new and highly rated contributors, which will both cement its policy relevance and diversify its governance structure in addition to a superior execution of its mandate through the issuance of its guarantee instrument.

Downside scenario

We could lower the ratings if IFFEd fails to expand its business, signaling that more widespread recognition of the instrument is lackluster, or if contingent capital contributors failed to convert their contingent contributions to cash and in a timely manner in the event of a trigger event as per the contingent contributions.

Ratings Score Snapshot

Issuer credit rating	AA+/Stable/A-1+
Stand-alone credit profile	aa+
Enterprise risk profile:	Strong
Policy importance	Strong
Governance and management expertise	Adequate
Financial risk profile:	Extremely strong
Capital adequacy	Extremely strong
Funding and liquidity	Strong
Extraordinary support	0
Callable capital:	0
Group support:	N/A
Holistic approach	N/A

Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, July 26, 2024
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

New Rating;	
International Finance Facility for Education	
Sovereign Credit Rating	
Foreign Currency	AA+/Stable/A-1+