



RATING ACTION COMMENTARY

Fitch Affirms Construction Guarantee's IFS at 'A'; Outlook Stable

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Fitch Ratings - Singapore - 24 Nov 2022: Fitch Ratings has affirmed South Korea-based Construction Guarantee's (CG) Insurer Financial Strength (IFS) Rating at 'A' (Strong). The Outlook is Stable.

The rating takes into consideration the company's 'Very Strong' capitalisation with a 'Moderate' company profile. It also incorporates the strong state support that CG continues to enjoy. This also factors in CG's 'Moderate' financial performance and high business concentration risk in the niche domestic construction sector.

KEY RATING DRIVERS

Ratings Reflect Franchise, Support: CG's rating reflects its established market franchise, sound capital commensurate with its company profile, and generally consistent, albeit modest, financial performance for its niche business focus.

CG, established under the Korea Construction Financial Cooperative Law, was set up to promote the development of the local construction industry by providing guarantees and financing loans to construction firms. Its business conduct is influenced heavily by the Ministry of Land, Infrastructure and Transport, which also supervises and regulates it. Accordingly, CG benefits from a one-notch uplift from Fitch's standalone credit quality due to the potential state support.

Strong Capital Buffer: CG operates under a regulatory capital regime modelled on the Basel III capital framework. Its regulatory capital ratio was above 200% for 2021 and end-June 2022, well in excess of the 100% regulatory minimum, providing an appropriate capital cushion for its potentially volatile business portfolio, particularly against the backdrop of economic volatility and challenges from the overall operating environment due to the lingering pandemic.

Its capitalisation, measured by the Fitch Prism Model score, was well into the 'Very Strong' level in 2021. We do not expect this to change materially in 2022. Net premiums written/total capital was below 0.5x at end-2021 and end-June 2022. CG's capital quality is sound, consisting only of ordinary equity and retained profit. The company does not issue corporate debt and has no plans to do so in the short to medium term. Accordingly, we do not expect any constraint on its financial or operational flexibility from interest servicing or debt repayments.

Modest Profitability for Niche Segment: CG's return on equity remained modest, amounting to 2.5% in 2021, similar to 2020, with a 2.5% three-year average. It reduced marginally to 2.1% for 1H22 on an annualised basis. We believe that CG faces potential volatility in its financial performance, as it still focuses mainly on the specialised business segment of guarantee insurance that is limited to the domestic construction industry. This niche segment is vulnerable to economic volatility from the South Korean economy, which affects the overall performance and business cycles of the construction sector.

Business Concentration Risk: The company faces challenges in appropriately managing business risk associated with the cyclical nature of guarantee insurance. It also has high geographical business concentration risk, as it sources almost all of its revenue from the domestic market. CG has taken a measured approach to overseas expansion in the past few years, in a bid to widen its limited business and geographical diversification. Fitch expects its proportion of overseas business to remain immaterial in the short to medium term.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Sustained improvement in the company profile; for instance, better operating scale as well as successful and profitable business diversification in terms of business class and geographical spread.
- Return on equity improving to above 7% on a prolonged basis, while maintaining its Fitch Prism Model score at well into 'Strong'.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Perceived weakening of state support for CG.
- Persistent weakening in the company profile in terms of business franchise and operating scale.
- Consistently lower capitalisation, such as a Fitch Prism Model score below 'Strong'.
- Persistent, substantial declining trend in profitability.

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>

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

RATING ACTIONS

ENTITY / DEBT ⇄

RATING ⇄

PRIOR ⇄

Construction
Guarantee

Ins Fin Str A Rating Outlook Stable

Affirmed

A Rating
Outlook
Stable

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APPLICABLE CRITERIA

[Insurance Rating Criteria \(pub. 16 Jul 2022\) \(including rating assumption sensitivity\)](#)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Prism Factor-Based Capital Model, v1.8.0 (1)

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Construction Guarantee

EU Endorsed, UK Endorsed

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Insurance Asia-Pacific South Korea
