

Unclassified

TAD/PG(2010)10

Organisation de Coopération et de Développement Économiques
Organisation for Economic Co-operation and Development

03-Jun-2010

English - Or. English

**TRADE AND AGRICULTURE DIRECTORATE
PARTICIPANTS TO THE ARRANGEMENT ON OFFICIALLY SUPPORTED EXPORT CREDITS**

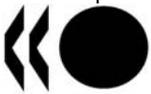
**INFORMATION NOTE ON THE RECENTLY AGREED CHANGES TO THE RULES ON MINIMUM
PREMIUM FOR OFFICIALLY SUPPORTED EXPORT CREDITS**

This note has been prepared in order to provide an explanation and summary of the changes that will take effect on 1 September 2011 to the premium-related rules of the Arrangement.

Contact: Mr. Michael GONTER, Export Credits Division, Trade and Agriculture Directorate, OECD.
Tel: + 33 (0)1 45 18 22 10; Fax: + 33 (0)1 44 30 61 58; Email: michael.gonter@oecd.org
(cc: xcred.secretariat@oecd.org)

JT03284779

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INFORMATION NOTE ON THE RECENTLY AGREED CHANGES TO THE RULES ON MINIMUM PREMIUM FOR OFFICIALLY SUPPORTED EXPORT CREDITS

I. Introduction

1. After two years of intensive negotiations, the Participants to the Arrangement on Officially Supported export Credits, at their 112th Meeting held on 3 February 2010, concluded the details of an agreement to revise and expand the premium-related rules of the Arrangement. The agreement (the Malzkuhn-Drysdale Package) is comprised on two basic components:¹ (1) a common framework for the pricing of buyer credit risk; and (2) new minimum premium rates for country credit risk that had remained unchanged since the first rules on risk premium (the Knaepen Package) came into effect in 1999.

2. This note has been prepared in order to provide an explanation and summary of the changes that will take effect on 1 September 2011, in advance of the formal amendment of the official text of the Arrangement.

II. The New System of Minimum Premium Rates for Country and Buyer Credit Risk

3. As stated in Article 23 of the Arrangement, Participants are currently obliged to:

“...charge premium, in addition to interest charges, to cover the risk of non-repayment of export credits. The premium rates shall be risk-based, shall converge and shall not be inadequate to cover long-term operating costs and losses.”

4. Although this requirement in principle is not limited to country credit risk, the concrete obligations in respect of premium which follow in Arrangement Articles 24-29 only provide for floor premium rates corresponding, in principle, to the country risk portion of credit risk. Nonetheless, the current floor premium rates apply to all officially supported export credits², irrespective of the type of buyer/borrower (*i.e.* private, public or sovereign risk).

5. In effect, the new rules of the Malzkuhn-Drysdale Package expand the coverage of the concrete premium-related obligations of the Arrangement to match the coverage of the existing “in principle” obligations by establishing minimum premium rates that are a function of both country and buyer risk.

¹ In addition to these two basic areas, a number of other changes were agreed in order to provide for a coherent, comprehensive set of rules addressing country and buyer credit risk (*i.e.* it was not possible to simply add the new rules related to buyer risk to the existing rules).

² Except for officially supported export credits supported according to the terms and conditions of the Ship Sector Understanding (Annex I) which does not currently contain disciplines related to premium for credit risk, and the Aircraft Sector Understanding (Annex III), which has its own specific rules on premium for credit risk.

(a) Comparison of Current and New Premium Rules*Basic Framework*

6. In terms of structure, the basic framework and mechanisms of the revised premium disciplines remain unchanged, *i.e.* minimum premium rates (MPRs) for official export credits that are determined by certain characteristics of each credit, along with transparency obligations when risk mitigation is applied to reduce the applicable MPR. As is the case at present, there is no obligation for any participant to charge a specified premium rate (*e.g.* they may wish to charge a higher premium rate than the MPR) or to modify the basic parameters of vehicles by which they provide official export credits³.

7. As far as the current rules are concerned, applicable MPRs are determined according to the following six factors⁴:

- The country risk classification of the buyer's country;
- The horizon of risk (HOR);
- The percentage of cover (POC) provided for country credit risk;
- The "quality" of the cover provided⁵;
- The application of agreed country risk mitigation techniques, or a third country guarantee; and
- Whether or not cover for buyer risk has been excluded.

8. The new agreement provides for MPRs that are determined by the above factors, and two new ones:

- The risk category of the buyer; and
- The percentage of cover provided for buyer credit risk.

9. In effect, where there was one MPR for a given credit in the past, there will now be four to seven MPRs (depending on the country risk category) according to the risk classification of the buyer, with one buyer risk category (SOV/CC0) corresponding to what had been the MPRs (although these rates have been adjusted as part of the new system as seen when comparing the current MPRs with the new rates for SOV/CC0)⁶. The following table and graph provide an example showing the MPRs for an official export

³. However, it is logical that some participants may choose to modify the structure of their system in the event that the premium rates generated by their system are systematically below or out of synchronization with the applicable MPRs due to structural issues, *e.g.* due to the use of fewer buyer risk categories in comparison to the number of buyer risk categories for which MPRs have been established.

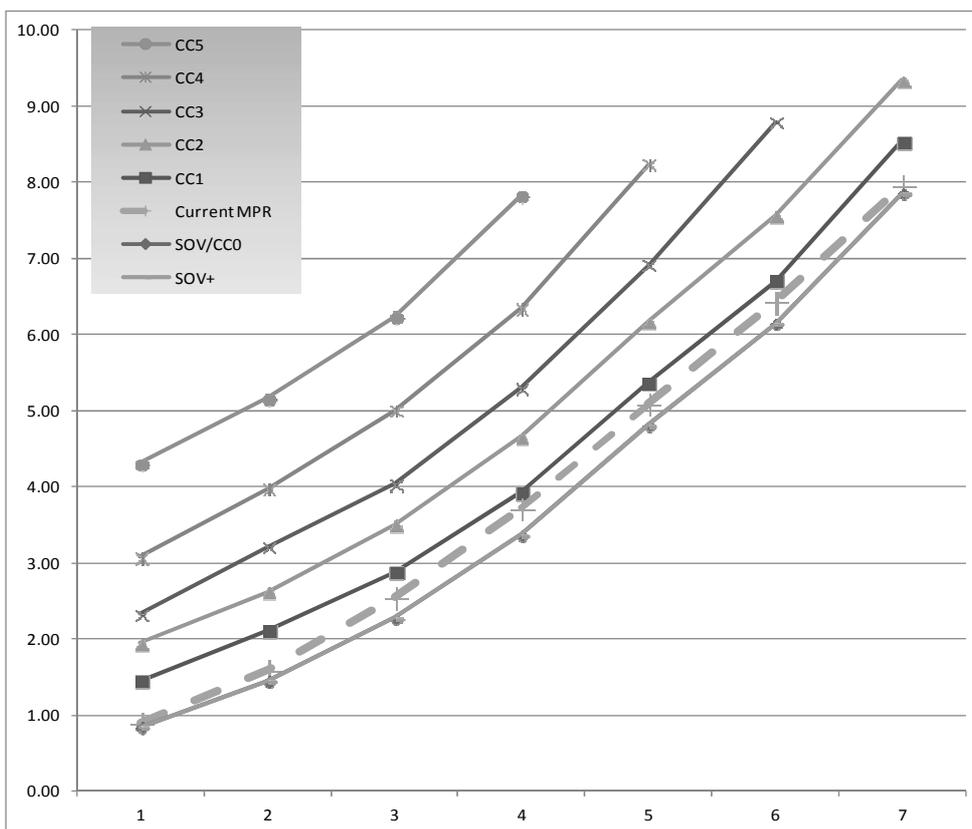
⁴. For further information on the role of these factors in the MPR calculation, please refer to Annex VI of the Arrangement.

⁵. This relates to the conditionality and scope of the official export credit instrument, *i.e.* from more conditional insurance to an unconditional guarantee.

⁶. Under the new agreement, the MPRs for transactions benefiting only from political risk cover (*i.e.* the percentage of cover for commercial risk is 0%) are the same as the SOV/CC0 MPRs.

credit with a HOR of 5.5 years, 95% POC for country and buyer credit risk, a “standard” product and involving no risk mitigation.

New MPRs		Country Risk Category						
		1	2	3	4	5	6	7
Buyer Risk Category	BTS	0.76	1.31	2.05	3.04	4.34	5.54	7.07
	SOV/CC0	0.85	1.45	2.28	3.38	4.82	6.15	7.85
	CC1	1.45	2.11	2.88	3.93	5.37	6.70	8.54
	CC2	1.95	2.62	3.50	4.66	6.17	7.57	9.34
	CC3	2.33	3.21	4.04	5.30	6.91	8.79	
	CC4	3.07	3.97	5.00	6.35	8.24		
	CC5	4.31	5.16	6.24	7.83			
Current MPRs		0.90	1.59	2.56	3.72	5.09	6.43	7.96



Determination of the Applicable Buyer Risk Category

10. Under the new system, participants retain the right to assess the risk of a buyer/borrower according to their own system; however, they are also obliged to assign a common buyer classification which, in combination with the buyer/borrower’s country classification (and other factors), determines the applicable MPR.

11. The following table shows the possible combinations of country and buyer risk categories that have been established under the new rules and the agreed concordance between buyer risk categories CC1-CC5 and the classifications of accredited private credit rating agencies (PCRA)⁷.

		Participants Country Risk Category						
		1	2	3	4	5	6	7
Buyer Risk Categories	Participants	SOV+	SOV+	SOV+	SOV+	SOV+	SOV+	SOV+
	Participants	SOV/CC0	SOV/CC0	SOV/CC0	SOV/CC0	SOV/CC0	SOV/CC0	SOV/CC0
	Participants	CC1	CC1	CC1	CC1	CC1	CC1	CC1
	S&P / Fitch IBCA	AAA to AA-	A+to A-	BBB+to BBB-	BB+to BB	BB-	B+	B
	Moody's	Aaa to Aa3	A1to A3	Baa1to Baa3	Ba1to Ba2	Ba3	B1	B2
	Participants	CC2	CC2	CC2	CC2	CC2	CC2	CC2
	S&P / Fitch IBCA	A+to A-	BBB+to BBB-	BB+to BB	BB-	B+	B	B- or worse
	Moody's	A1to A3	Baa1to Baa3	Ba1to Ba2	Ba3	B1	B2	B3 or worse
Participants	CC3	CC3	CC3	CC3	CC3	CC3		
S&P / Fitch IBCA	BBB+to BBB-	BB+to BB	BB-	B+	B	B- or worse		
Moody's	Baa1to Baa3	Ba1to Ba2	Ba3	B1	B2	B3 or worse		
Participants	CC4	CC4	CC4	CC4	CC4			
S&P / Fitch IBCA	BB+to BB	BB-	B+	B	B- or worse			
Moody's	Ba1to Ba2	Ba3	B1	B2	B3 or worse			
Participants	CC5	CC5	CC5	CC5				
S&P / Fitch IBCA	BB- or worse	B+ or worse	B or worse	B- or worse				
Moody's	Ba3 or worse	B1 or worse	B2 or worse	B3 or worse				

12. In the first instance, the selection of an appropriate buyer risk classification for a given transaction is based on the senior unsecured credit rating of the obligor as determined by the Participant; however, there are several exceptions:

- For transactions supported according to the terms and conditions of Annex X of the Arrangement (Project Finance) and any transaction with a credit value of five million SDRs or less, the selection of the appropriate buyer risk classification is undertaken on a transaction basis, *i.e.* after the application of any buyer risk credit enhancements⁸.
- Where a third party in the same country as the obligor provides a guarantee for the total amount at risk, the buyer risk classification may reflect the better-rated of the two entities. In the case of a

⁷. For illustrative purpose, the ratings of only three PCRA's (Moody's, S&P and Fitch IBCA) are shown in the table, however, the ratings of other PCRA's may also be used (a formal list will be compiled and maintained). In general, the role of PCRA classifications is limited, insofar as a participant may be required to prior-notify support for certain transactions when the participant's risk assessment of a non-sovereign borrower that is rated by an accredited PCRA is more favourable than the PCRA rating; this is explained in more detail later in this paper.

⁸. Such transactions are not eligible for any discounts for the application of buyer risk enhancements that are described later in this paper.

guarantee from a third party outside of the obligor's country that may reflect a better risk, the applicable country and buyer risk classification is that of the guarantor⁹.

13. In order to assist participants in classifying buyers according to the established categories, qualitative descriptions of each buyer risk category (SOV+ to CC5) have been established, as shown in the following table.

Buyer Risk Category	Qualitative Definition
SOV+	<p>Better than Sovereign</p> <p>This is an exceptional classification. The obligor achieving such a classification is one with an exceptionally strong credit profile which could be expected to fulfil its payment obligations during a period of sovereign debt distress or even default.</p> <p>International Credit Rating Agencies issue regular reports listing Corporate and Counterparty Ratings that exceed the Sovereign's Foreign Currency Rating. Participants proposing that buyers be classified as better than sovereign shall reference such better than sovereign ratings in support of their recommendation</p> <p>In order to be classified as better than its host sovereign, a company would be expected to display several or normally a majority of the following characteristics or equivalents:</p> <ul style="list-style-type: none"> • A strong credit profile for the company; • Substantial foreign exchange earnings relative to a company's foreign currency debt burden; • Production facilities and cash generation ability from subsidiaries or operations offshore, especially those domiciled in highly rated sovereigns i.e. multinational enterprises; • A foreign owner or a strategic partner which could be relied on as a source of financial support in the absence of a formal guarantee; • A history of preferential treatment of the company by the sovereign, including exemption from transfer and convertibility constraints and surrender requirements for export proceeds, and favourable tax treatment; • Committed credit lines from highly rated international banks, especially credit lines without a material adverse change (MAC) clause which enable banks to withdraw committed facilities in the event of a sovereign crisis or other risk events; and • Assets held offshore, especially liquid assets, often as a result of rules allowing exporters to trap and maintain cash balances offshore that are available for debt service. <p>Normally this category is <i>not</i> applicable to:</p> <ul style="list-style-type: none"> • Publicly owned entities and utilities, sub-sovereigns as line ministries, regional governments, etc; • Financial institutions domiciled in the sovereign's jurisdiction; and • Entities primarily selling to the domestic market in local currency
SOV	<p>Sovereign Buyer</p> <p>Obligors explicitly legally mandated to enter into a debt payment obligation on the behalf of the Sovereign State, typically Ministry of Finance or Central bank.</p> <p>A risk designated as sovereign is one where the obligor (or guarantor) is one legally mandated to enter into a debt payment obligation on behalf of the Sovereign and thereby commits the full faith and credit of the sovereign. Most typically this would be a risk on the central bank or Ministry of Finance. For other central government entities than the finance ministry, some due diligence would be required to affirm that this is the case.</p> <p>There would be a corresponding assumption that in the event of rescheduling of sovereign risk, the debt in question would be included in the rescheduling and payment obligations acquired by the sovereign by virtue of the rescheduling.</p>

⁹. As is the case for third country guarantees, a guarantee involving a buyer and guarantor in the same country must meet all of the conditions listed in Annex VII of the current Arrangement text in relation to "Country Risk Classification Reflecting a Third Country Guarantor, Case 1", with the exception of the condition that the guarantor be from a third country.

<p>CC0</p>	<p>Buyer Equivalent to the Sovereign: Exceptionally Good Credit Quality</p> <p>Buyer equivalent to sovereign embraces two situations.</p> <p>Firstly it includes non-sovereign public entities where due diligence serves to satisfy the participant that either the buyer has the implicit full faith and credit/support of the sovereign or of the likelihood of sovereign liquidity and solvency support is very high. That view would need to hold good for recovery as well as default risk. Non-sovereign public entities equivalent to the sovereign would also include companies owned by the government with a monopoly or near monopoly on operations in a sector (e.g. power, oil, gas).</p> <p>Secondly it may also apply to corporate risks with an exceptionally strong credit profile, displaying features warranting the view being taken that in terms of both default and recovery prospects, the risk could be seen as equivalent to sovereign. Candidates could include strong blue chip corporates or vital banks with a likelihood of sovereign liquidity and solvency support.</p> <p>Exceptionally good credit quality implies that the risk of payment interruption is expected to be negligible. The obligor has an exceptionally strong capacity for repayment and this capacity is not likely to be affected by foreseeable events.</p> <p>The credit quality is typically manifested in a combination of some, if not all, of the following characteristics of the business and financial profile:</p> <ul style="list-style-type: none"> • exceptionally good to very good cash and income generation • exceptionally good to very good liquidity levels • exceptionally low to very low leverage • excellent to very strong business profile with proven and very strong management abilities <p>High quality of financial and ownership disclosure unless there is a very high likelihood of support from a parent (or sovereign) with a buyer risk classification equal or stronger than what corresponds to this buyer risk category.</p> <p>Dependent on the classification of the country the obligor is domiciled in, it is likely that such an obligor would be rated between AAA (Country Category 1) and B (Country Category 7).</p>
<p>CC1</p>	<p>Very Good Credit Quality.</p> <p>The risk of payment interruption is expected to be low or very low. The obligor has a very strong capacity for repayment and this capacity is not likely to be affected by foreseeable events. The obligor has a limited or very limited susceptibility to adverse effects of changes in circumstances and economic conditions.</p> <p>The credit quality is typically manifested in a combination of some, if not all, of the following characteristics of the business and financial profile:</p> <ul style="list-style-type: none"> • very good to good cash and income generation • very good to good liquidity levels • very low to low leverage • very strong business profile with proven management abilities and very strong business profile <p>High quality of financial and ownership disclosure unless there is a very high likelihood of support from a parent (or sovereign) with a buyer risk classification equal or stronger than what corresponds to this buyer risk category.</p> <p>Dependent on the classification of the country the obligor is domiciled in, it is likely that such an obligor would be rated between AAA (Country Category 1) and B (Country Category 7).</p>

<p>CC2</p>	<p>Good to Moderately Good Credit Quality, Above Average</p> <p>The risk of payment interruption is expected to be low. The obligor has a good to moderately good capacity for repayment and this capacity is not likely to be affected by foreseeable events. The obligor has a limited susceptibility to adverse effects of changes in circumstances and economic conditions.</p> <p>The credit quality is typically manifested in a combination of some, if not all, of the following characteristics of the business and financial profile:</p> <ul style="list-style-type: none"> • good to moderately good cash and income generation • good to moderately good liquidity levels • low to moderately low leverage • moderately strong business profile with proven management abilities and very strong business profile <p>High quality of financial and ownership disclosure unless there is a very high likelihood of support from a parent (or sovereign) with a buyer risk classification equal or stronger than what corresponds to this buyer risk category.</p> <p>Dependent on the classification of the country the obligor is domiciled in, it is likely that such an obligor would be rated between A+ (Country Category 1) and B- or worse (Country Category 7).</p>
<p>CC3</p>	<p>Moderate Credit Quality, Average</p> <p>The risk of payment interruption is expected to be moderate or moderately low. The obligor has a moderate or moderately good capacity for repayment. There is a possibility of credit risk developing as the obligor faces major ongoing uncertainties or exposure to adverse business, financial or economic conditions which could lead to inadequate capacity to meet timely payments. However, business or financial alternatives may be available to allow financial commitments to be met.</p> <p>The credit quality is typically manifested in a combination of some, if not all, of the following characteristics of the business and financial profile:</p> <ul style="list-style-type: none"> • moderately good to moderate cash and income generation • moderately good to moderate liquidity levels • moderately low to moderate leverage • moderate business profile with proven management abilities <p>Adequate quality of financial and ownership disclosure unless there is a very high likelihood of support from a parent (or sovereign) with a buyer risk classification equal or stronger than what corresponds to this buyer risk category.</p> <p>Dependent on the classification of the country the obligor is domiciled in, it is likely that such an obligor would be rated between BBB+ (Country Category 1) and B- or worse (Country Category 6).</p>
<p>CC4</p>	<p>Moderately Weak Credit Quality, Below Average</p> <p>The risk of payment interruption is expected to be moderately weak. The obligor has a moderate to moderately weak capacity for repayment. There is a possibility of credit risk developing as the obligor faces major ongoing uncertainties or exposure to adverse business, financial or economic conditions which could lead to inadequate capacity to meet timely payments. However, business or financial alternatives may be available to allow financial commitments to be met.</p> <p>The credit quality is typically manifested in a combination of some, if not all, of the following characteristics of the business and financial profile:</p> <ul style="list-style-type: none"> • moderate to moderately weak cash and income generation • moderate to moderately weak liquidity levels • moderate to moderately high leverage • moderately weak business profile with limited track record of management abilities <p>Adequate quality of financial and ownership disclosure unless there is a very high likelihood of support from a parent (or sovereign) with a buyer risk classification equal or stronger than what corresponds to this buyer risk category.</p> <p>Dependent on the classification of the country the obligor is domiciled in, it is likely that such an obligor would be rated between BB+ (Country Category 1) and B- or worse (Country Category 5).</p>

CC5	<p>Weak Credit Quality</p> <p>The risk of payment interruption is expected to be high to very high. The obligor has a moderately weak to weak capacity for repayment. The obligor currently has the capacity to meet repayments but a limited margin of safety remains. However, there is a likelihood of developing payment problems as the capacity for continued payment is contingent upon a sustained, favorable business and economic environment. Adverse business, financial, or economic conditions will likely impair capacity or willingness to repay.</p> <p>The credit quality is typically manifested in a combination of some, if not all, of the following characteristics of the business and financial profile.</p> <ul style="list-style-type: none"> • moderately weak to weak to very weak cash and income generation • moderately weak to weak liquidity levels • moderately high to high leverage • weak business profile with limited or no track record of management abilities <p>Poor quality of financial and ownership disclosure unless there is a very high likelihood of support from a parent (or sovereign) with a buyer risk classification equal or stronger than what corresponds to this buyer risk category.</p> <p>Dependent on the classification of the country the obligor is domiciled in, it is likely that such an obligor would be rated between BB- (Country Category 1) and B- or worse (Country Category 4).</p>
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14. With respect to the SOV+ buyer risk category (for which the MPRs are set at 90% of the corresponding MPRs for Buyer Risk Category SOV/CC0), it should be noted that it is only possible for an obligor to achieve this classification if its foreign currency rating¹⁰ is better than the foreign currency rating of its respective sovereign.

Revised MPR Formula

15. As mentioned previously, the MPRs of the new premium agreement are influenced by all of the factors taken into consideration under the current rules (but not necessarily in the same way), as well as two additional ones; the risk category of the buyer and the percentage of cover provided for commercial risk. The following formula¹¹ is currently used to determine the applicable MPR for transactions subject to the premium rules in Country Risk Categories 1-7:

$$\text{MPR} = [(a * \text{HOR}) + b] * (\text{PCP}/0.95) * \text{QPF} * \text{PCF} * (1 - \text{MEF}) * \text{BRF}$$

16. The new MPR formula¹² (applicable to the same transactions) is as follows:

$$\text{MPR} = \{ [a_i * (\max (\text{PCC}, \text{PCP}) / 0.95 * \text{HOR} + b_i) * (1 - \text{LCF})] + [c_{in} * \text{PCC}/0.95 * \text{HOR} * (1 - \text{CEF})] \} * \text{QPF}_i * \text{PCF}_i * \text{BTSF}$$

where:

- a_i = country risk coefficient in country risk category i ($i = 1-7$)
- c_{in} = buyer risk coefficient for buyer category n ($n = \text{SOV+}, \text{SOV/CCO}, \text{CC1-CC5}$) in country risk category i ($i = 1-7$)
- b_i = constant for country category risk category i ($i = 1-7$)

¹⁰. According to an accredited PCRA that is on the list maintained by the Participants.

¹¹. Please see Annex VI of the Arrangement for further information on the current MPR formula, including an explanation of the variables, coefficients and constants used.

¹². The Participants agree to resolve the issue of term adjusted fee levels as part of the current package of work on the Sector Understandings on Export Credits for Renewable Energies and Water Projects and Nuclear Power Plants (*i.e.* formally added to the future work of the two sector understandings).

- HOR = horizon of risk
- PCC = buyer risk percentage of cover
- PCP = political risk percentage of cover
- CEF = credit enhancements factor
- QPF_{*i*} = quality of product factor in country risk category *i* (*i* = 1-7)
- PCF_{*i*} = percentage of cover factor in country risk category *i* (*i* = 1-7)
- BTSF = better than sovereign factor
- LCF = local currency factor

17. Annex I provides further details on the variables, coefficients and constants used in the new MPR equation.

Country Risk Mitigation

18. Although the current premium rules provide for eight country risk mitigation techniques (as listed in Article 28b of the Arrangement) and the possibility of excluding selected country risk elements¹³, an examination of actual experience for the period 1999-2008 revealed that some techniques were used very infrequently, with some having never been used. Accordingly, only two of them have been retained under the new Agreement:

- Offshore Future Flow Structure Combined with Offshore Escrow Account (Technique 1); and
- Local Currency Financing (Technique 6).

19. In comparison with the current rules, the application of these techniques has been modified significantly:

- The application of Technique 1 no longer results in variable percentage discounts to the applicable MPR on the basis of various criteria (*e.g.* the Loan Life Coverage Ratio), but rather yields a standardized improvement by one category in the applicable country risk classification (and, therefore, a lower applicable MPR). It should be noted, however, that Technique 1 will not be applicable to transactions in Country Risk Category 1.
- With respect to Technique 6, the requirement for crystallization has been removed and the maximum allowable discount will be 20% (now applicable to portion of the MPR that is related to country risk as shown in the new MPR formula).

¹³. The five elements of country risk are identified in Article 25a of the Arrangement. The first three elements taken together comprise “transfer risk”.

Buyer Risk Credit Enhancement

20. With buyer risk now being explicitly taken into consideration, the possibility to achieve lower MPRs through buyer risk credit enhancements has been introduced. Similar to the treatment of country risk mitigation, buyer risk credit enhancements have an impact on the portion of the MPR attributable to buyer risk, specifically via the Credit Enhancement Factor (CEF) in the new premium formula. In total, the new rules provide for four types of Buyer Risk Credit Enhancements (BRCEs) that may lead to a CEF value greater than zero:

BRCE	Defintion	Maximum CEF
Assignment of Contract Proceeds or Receivables	<p>In the event a Borrower has contracts with strong off-takers, whether offshore or local, a legally enforceable assignment of the contract provides rights to enforce the Borrower's contracts and/or make decisions under major contracts in the place of the Borrower after a default under the loan. A direct agreement with a third party in a transaction (a local government agency in a mining or energy transaction) allows Lenders to approach a government to seek remedies for expropriation or other violation of contractual obligations related to the transaction.</p> <p>An existing company operating in a difficult market or sector may have receivables related to the sale of production with a company or companies located in a more stable environment. Receivables would generally be in a hard currency but may not be the subject of a specific contractual relationship. Assignment of these receivables could provide asset security in the accounts of the Borrower, giving the Lender a preferential treatment in the cash flow generated by the Borrower.</p>	0.10
Asset Based Security	<p>Control of an asset shown by:</p> <ul style="list-style-type: none"> • Mortgage on very mobile and valuable piece of property • Property has entire value in itself <p>An asset based security is one that can be reacquired with relative ease such as a locomotive, medical equipment or construction equipment. In valuing such a security, the ECA should take into consideration the legal ease of recovery. In other words, there is more value when the security interest in the asset is perfected under an established legal regime and less value where the legal ability to recover the asset is questionable. The precise value of an asset-based security is set by the market, with the relevant "market" being deeper than a local market because the asset can be moved to another jurisdiction. NOTE: The application of an asset based security credit enhancement applies to the buyer risk, where the asset based security is held internally within the country in which the transaction is domiciled.</p>	0.25
Fixed Asset Security	<p>A fixed asset security is most typically component equipment which may be constrained by its physicality such as turbine or manufacturing machinery integrated into an assembly line. The intent and value of the fixed asset security is to provide the ECA with more leverage over the use of the asset in recouping losses in the event of default. The value of a fixed asset security varies dependant on economic, legal, market and other factors.</p>	0.15
Escrow Account	<p>Escrow accounts involve debt service reserve accounts held as security for the lenders or other forms of cash receivable accounts held as security for the lenders by a party not controlled or sharing common ownership with the buyer/obligor. The escrowed amount must be deposited or escrowed in advance. The value of such security is nearly always 100% of the U.S. dollar value of the amount in such cash accounts. Permits greater control over use of cash, ensures that debt is serviced before discretionary spending. NOTE: The application of an escrow account credit enhancement applies to the buyer risk, where the escrow account is held internally within the country in which the transaction is domiciled. Cash security significantly diminishes the risk of default for the covered instalments.</p>	escrowed amount as % of credit up to a maximum of 0.10

21. BRCEs may be used alone or in combinations, however the maximum CEF that can be achieved through the use of the BRCEs is 0.35. In addition, “Asset Based Security” and “Fixed Asset Security” cannot be used together in one transaction.

22. With respect to the interaction between buyer risk credit enhancements and the two remaining country risk mitigation techniques:

- In the event that the country risk classification has been improved through the use of “Offshore Future Flow Structure Combined with Offshore Escrow Account”, no BRCE may be applied.
- All BRCEs may be applied in combination with “Local Currency Financing” (as well as a third country guarantee).

Premium Rates for Transactions with Buyers in Country Risk Category Zero

23. In comparison with the current rules, whereby the only obligation is to “...not charge premium rates which undercut available private market financing” for transactions with buyers in Category Zero countries, the new rules provide more specific guidance and require additional *ex-post* transparency for these transactions that are not subject to pre-defined MPRs.

24. Specifically, the premium rates applied to transactions with buyers in Country Risk Category Zero are to be determined on a case-by-case basis, depending on the available market information and the characteristics of the underlying transaction; this is to be achieved through benchmarking against market pricing that is deemed appropriate for the specific transaction. The specific market benchmarks that are to be used are provided in Annex 2.

25. As a practical measure, if the relevance of the market information is limited due to *e.g.* lack of liquidity, or if the transaction is small (below SDR 10 million), the MPRs applicable to buyers in Country Risk Category 1 are to be used as reference; in practical terms this means that the premium rates charged may not be lower than the Country Risk Category 1 MPRs for similar buyers.

26. As far as transparency is concerned, *ex-post* transaction reporting involving buyers in Category Zero (currently provided via Form 1C) must indicate the market benchmark(s) used, or, in the case of transactions for which no market benchmarks were found, the buyer risk category applied.

Prior Notification Requirements

27. Current prior notification requirements related to the premium rules of the Arrangement exist in relation to the following scenarios whereby the applicable MPR has been reduced through the:

- application of a third country guarantee;
- application of the risk classification of a classified multilateral or regional institution;
- use of a country risk mitigation technique;
- exclusion of cover for buyer risk; or
- exclusion of selected country risk elements (*e.g.* transfer risk).

28. Under the new rules, prior notification¹⁴ is required in relation to the remaining vehicles for country risk mitigation (*i.e.* Country Risk Mitigation Techniques 1 and 6 under the current rules, third country guarantees and the guarantee of a classified multilateral/regional institution) and when support is provided for a transaction involving a non-sovereign obligor under the following circumstances:

- The premium charged is below the corresponding premium rates for Buyer Risk Category CC1, *e.g.* the rates corresponding to CC0 and SOV+, or
- The credit value exceeds SDR 5 million; and
 - Buyer risk credit enhancements lead to a reduction in the MPR (through the application of a CEF greater than zero) and a premium rate below the unadjusted MPR is charged.
 - The obligor is rated by an accredited PCRA and the participant's assessment of the risk (according to the agreed relationship that has been provided earlier in this paper) is more favourable, leading to a premium rate being charged that is below the MPR corresponding to the PCRA buyer risk classification¹⁵.

Monitoring and Review

29. Although agreement does not require any changes to the text of the current rules in relation to monitoring and review, it will be necessary to modify current reporting vehicles and some of the tools used to review the validity of the system and the MPRs. In concrete terms, this will involve adding new data elements to the two *ex-post* reporting vehicles used in this area (Form 1C transaction reporting and Premium Feedback Tool [PFT] annual reporting) as well as modifying the reporting template used to communicate prior-notifications. It will also be necessary to modify the mechanics of the PFTs in light of *e.g.* the addition of disciplines related to buyer risk.

30. With respect to reviewing the provisions of the premium rules in the Arrangement, the Agreement stipulates that regular reviews should be undertaken, and that the first review should take place no later than the fourth calendar year following implementation in September 2011. In terms of substance, the review will address the level of the MPRs (using the PFT result to determine if they remain an accurate measure of risk) and consider whether any amendments to any aspect of the premium rules would be justified.

(b) *Competitive Situations*

31. As mentioned above, the new premium rules allow for each individual participant to determine the appropriate buyer risk category to be applied. This means that the possibility of divergent classifications and premium rates for the same buyer exists in respect of competition on a specific transaction. In such cases, it is expected that effort should be made to arrive at a common buyer classification through informal discussions. If a common classification cannot be achieved, a participant may choose to charge a premium rate that allows it to remain competitive (*i.e.* the rate reflecting the more optimistic rating).

^{14.} Ten calendar days prior to commitment, without discussion (*i.e.* in line with Article 45 of the Arrangement).

^{15.} If the obligor is rated by more than one accredited PCRA, only the most favourable rating need be taken into consideration (*i.e.* the notification requirement only applies if the participant's risk assessment is more favourable than all PCRA ratings).

(c) Implementation

32. The new rules will be implemented by 1 September 2011, with all new commitments after that date being subject to the agreement. All commitments issued under the current premium rules prior to 1 September 2011 must become final no later than 31 March 2012; otherwise the new rules will apply. Revised Arrangement text reflecting the new premium rules will be available well in advance of the implementation date.

Annex 1 - Premium Calculation

→ The values for the a coefficient and the b constant are obtained from the following table:

	Country Risk Category							
	0	1	2	3	4	5	6	7
a	n/a	0.090	0.200	0.350	0.550	0.740	0.900	1.100
b	n/a	0.350	0.350	0.350	0.350	0.750	1.200	1.800

→ The value for the c coefficient is obtained from the following table:

Buyer Risk Category	Country Risk Category						
	1	2	3	4	5	6	7
SOV+	0.000	0.000	0.000	0.000	0.000	0.000	0.000
SOV/CC0	0.000	0.000	0.000	0.000	0.000	0.000	0.000
CC1	0.110	0.120	0.110	0.100	0.100	0.100	0.125
CC2	0.200	0.212	0.223	0.234	0.246	0.258	0.271
CC3	0.270	0.320	0.320	0.350	0.380	0.480	n/a
CC4	0.405	0.459	0.495	0.540	0.621	n/a	n/a
CC5	0.630	0.675	0.720	0.810	n/a	n/a	n/a

→ The Horizon of Risk (HOR) is calculated as follows (in years):

- for standard (*i.e.* equal semi-annual repayments of principal) repayment profiles:

$$\text{HOR} = (\text{length of the disbursement period} * 0.5) + \text{the length of the repayment period}$$

- for non-standard repayment profiles:

$$\text{HOR} = (\text{length of the disbursement period} * 0.5) + [(\text{weighted average life of the repayment period} - 0.25) / 0.5]$$

→ The percentages of cover for commercial risk (PCC) and political risk (PCP) are expressed as a decimal value (*i.e.* 95% is expressed as 0.95).

→ The Credit Enhancement Factor (CEF) is determined according to Part IV (Buyer Risk Mitigation).

→ The Local Currency Factor (LCF) shall not be more than 0.20.

→ The Quality of Product Factor (QPF) is obtained from the following table:

Product Quality	Country Risk Category						
	1	2	3	4	5	6	7
Below Standard	0.9965	0.9935	0.9850	0.9825	0.9825	0.9800	0.9800
Standard	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000
Above Standard	1.0035	1.0065	1.0150	1.0175	1.0175	1.0200	1.0200

→ The Percentage of Cover Factor (PCF) is determined as follows:

for ($\max(\text{PCC}, \text{PCP}) \leq 0.95$, $\text{PCF} = 1$)

for ($\max(\text{PCC}, \text{PCP}) > 0.95$, $\text{PCF} = 1 + ((\max(\text{PCC}, \text{PCP}) - 0.95) / 0.05) * (\text{percentage of cover coefficient})$)

Percentage of Cover Coefficient	Country Risk Category						
	1	2	3	4	5	6	7
	0.00000	0.00337	0.00489	0.01639	0.03657	0.05878	0.08598

→ When a buyer is rated better than sovereign, then $\text{BTSF} = 0.9$, otherwise $\text{BTSF} = 1$.

Annex 2 - Market Benchmarks

- a. Un-covered portion of export credits in question or the non-ECA covered part of a syndicated loan: The price indicated by private banks/institutions with respect to the uncovered portion of export credits (or sometimes as the non-ECA covered part of a syndicated loan) may represent the best match to ECA cover. Pricing on such un-covered portions or non-covered parts should only be used if provided on commercial terms (*e.g.* this would exclude IFI funded portions).
- b. Name-specific corporate bonds: Corporate bonds reflect name specific credit risk. Care should be used in matching in terms of the ECA contract characteristics, such as term of maturity, and currency denomination, and any credit enhancements. If primary corporate bonds (*i.e.* all-in yield upon issuance) or secondary corporate bonds (*i.e.* the OAS spread over the appropriate curve - usually the relevant currency swap curve) are used, those for the obligor should be used in the first instance; if not available, primary or secondary corporate bonds for comparable borrowers and comparable transactions should be used.
- c. Name-specific Credit Default Swaps: Credit Default Swaps (CDS) are a form of protection against default. The CDS spread is the amount paid per period by the buyer of the CDS as a percentage of notional principal, and is usually expressed in basis points. The CDS buyer effectively buys insurance against default by making payments to the seller of the CDS for the life of the swap, or until the credit event occurs. A CDS curve for the obligor should be used in the first instance; if not available, CDs curves for comparable borrowers and comparable transactions should be used.
- d. Indexed Credit Default Swaps: An indexed Credit Default Swap is a compilation of registered CDS for an industry sector, or part of it, or for a geographical area. The CDS spreads thus compiled reflects the credit risk of the particular market segment that the index is capturing. Its relevance may be greatest in cases where no name-specific CDS is available or when the market for a name-specific CD is illiquid.
- e. Loan Benchmarks: Primary loan benchmarks (*i.e.* pricing upon issuance) or secondary loan benchmarks (*i.e.* the current yield on the loan expected by the financial institution purchasing the loan from another financial institution). All fees must be known for primary loan benchmarks so that the all-in yield can be calculated. If loan benchmarks are used, those for the obligor should be used in the first instance; if not available, those for comparable borrowers and comparable transactions should be used.
- f. Benchmark market curves: Benchmark market curves reflect the credit risk of a whole sector or class of buyers. This market information may be relevant when name specific information is not available. In general, the quality of the information inherent to these markets depends upon their liquidity. In any case, one should look for market instruments that provide the closest match in terms of the ECA contract characteristics, such as date, credit rating, term of maturity, and currency denomination.
- g. Weighted Average Cost of Financing Resources (WACFR): From the buyer's financial statements it may be possible to gauge the WACFR. Care must be taken when using this method to ensure that the average cost of finance resources of a company reflects the real conditions under which the finance has been provided.