

THE KNAEPEN PACKAGE : GUIDING PRINCIPLES FOR SETTING PREMIA FEES UNDER THE ARRANGEMENT ON GUIDELINES FOR OFFICIALLY SUPPORTED EXPORT CREDITS

I. PREMIUM CONVERGENCE

1. The aim of the Knaepen Package, concluded on the 20 June 1997 by the Participants to the Arrangement on Guidelines for Officially Supported Export Credits, is to seek convergence on the pricing of officially supported medium and long term export credits by means of Guiding Principles for setting premium fees.

2. The Premium Guiding Principles have been established with the perspective of the exporter in mind. This means that the Guiding Principles are designed to provide a level playing field with regard to the cost of official support for exporters from OECD Member countries that participate in the Arrangement on Guidelines for Officially Supported Export Credits. Hence, a system of minimum premium benchmarks (MPBs) is in force effective from 1 April 1999.

3. The Participants include insurers, guarantors and direct lenders. Accordingly, these different systems are taken into account in the Guiding Principles, mainly through differentials in the pricing of various types of products (so-called “related conditions”).

4. The Guiding Principles set minimum premium rates for sovereign and country credit risks, irrespective of whether the buyer/borrower is a private or public entity, that:

- are risk based/risk reflective
- eliminate distortion of competition and thus create a level playing field, taking into account different qualities of cover
- are not inadequate to cover long term operating costs and losses
- are transparent among export credit agencies (ECAs) of the Participants to the Arrangement on Guidelines for Officially Supported Export Credits
- apply to medium/long term business with a repayment term of two years and over (exclusive of Agricultural Products and Military Sales).

II. KEY ELEMENTS

5. The key elements of the Knaepen Package are:

- a system for assessing country credit risk and classification of the countries into seven categories
- MPB rates for each category of risk
- the application of surcharges or discounts to the MPB rates for the qualitative differences between ECA products, including percentage of cover

- Permitted Exceptions with appropriate levels of discount against the MPBs in the case of risk externalisation/mitigation
- an Electronic Exchange of Information among ECAs on all aspects of the Guiding Principles
- a regular review process to allow for adjustments and enhancements in the light of experience.

NOTES: Transactions of large aircraft and ships are not subject to the Premium Guiding Principles since they require separate negotiations under Part 1 of the Aircraft Sector Understanding (LASU) and under the Ships Understanding which is for the competence of WP6, respectively.

The Guiding Principles do not encompass cover policy, including capacity, which remains the competence of each Participant.

III. COUNTRY RISK CLASSIFICATION METHOD

6. The Country Risk Classification Method:

- measures the country credit risk, i.e. the likelihood that a country will service its external debt;
- uses an econometric Model based on quantitative indicators, e.g. the financial and the economic situation and the payment experience of the countries;
- takes account of possible qualitative factors, e.g. political and other economic and financial factors not included in the quantitative Econometric Model;
- combines the quantitative and qualitative factors;
- results in countries being classified into seven premium categories.

a) *Elements of Country Credit Risk*

7. There are five elements of country credit risk:

- general moratorium on repayments decreed by the buyer's/borrower's/guarantor's government or by that agency of a country through which repayment is effected;
- political events and/or economic difficulties arising outside the country of the notifying Participant or legislative/administrative measures taken outside the country of the notifying Participant which prevent or delay the transfer of funds paid over in respect of the credit;
- legal provisions adopted in the buyer's/borrower's country declaring repayments made in local currency to be a valid discharge of the debt, notwithstanding that, as a result of fluctuations in exchange rates, such repayments, when converted into the currency of the credit, no longer covers the amount of the debt at the date of the transfer of funds;

- any other measure or decision of the government of a foreign country which prevents repayment under a credit; and
- cases of force majeure occurring outside the country of the notifying Participant, i.e. war (including civil war), expropriation, revolution, riot, civil disturbances, cyclones, floods, earthquakes, eruptions, tidal waves and nuclear accidents.

b) *The Country Risk Assessment Model*

8. To guide the common classification of countries, a quantitative Country Risk Assessment Model (CRAM) has been developed. The aim of the CRAM is to assess the likelihood that a country will service its external debts. The selection and the weighting of the indicators in the CRAM have been based on economic theory, econometric research and judgements of experienced country risk experts. The predictive value of the CRAM has been successfully tested with historical simulations. The validity of the CRAM is monitored and, if appropriate, the CRAM may be further enhanced.

9. The CRAM integrates three groups of indicators (the list of mentioned individual indicators is not exhaustive):

- the payment experience of all the Participating Export Credit Agencies, whereby the indicators are differentiated according to the credit period; for debt rescheduling countries special attention is given to the experience under the rescheduling or refinancing agreements as well as on contracts concluded after the cutoff-date as determined by the Paris Club; the payment experience of the international financial institutions is also taken into account;
- the financial situation of the country, based on liquidity indicators such as total external short term debts and foreign exchange reserves, as well as on financial solvency indicators in a medium-term perspective such as total external debts and total external debt service, that are typically related to aggregates such as gross domestic product and/or foreign exchange revenues;
- the economic situation of the country, based on indicators for current policy performance (such as budgetary, monetary and balance of payments' aggregates) as well as on more structural indicators of a longer-term nature that measure growth potential (such as income level, savings rates or realised economic growth rates) and vulnerability (such as export diversification, aid dependency or smallness) of the economy.

10. Critical values have been determined for each individual indicator. The risk scorings for the different indicators are weighted to arrive at an aggregated assessment for each of the three groups of indicators. The risk scorings for these three separate groups are then combined to arrive at one scoring that is the outcome of the CRAM. The three groups of indicators are approximately attributed the same level of importance, meaning that a bad result on one of these groups is sufficient for a high-risk CRAM-outcome.

11. A certain hierarchy of data sources has been drawn up with regard to the financial and economic data-input in the CRAM. In general, data of official international institutions (like the IMF, World Bank, BIS and OECD) are used. Other sources may be useful to fill in lacking data or for comparison. Divergent data from different sources are critically and conservatively approached.

12. The details of the Country Risk Assessment Model are confidential and not published.

c) Final Country Risk Classification

13. The outcome of the CRAM is an objective starting point for the final assessment of the country risk. The CRAM outcome is transformed into a classification on a fixed scale of seven risk categories. Where appropriate, the resulting risk category is adjusted for qualitative risks related to the political situation and to other risk factors not included in the quantitative CRAM, in accordance with procedures agreed by the Participants. The final classification, based only on valid country risk elements, is a consensus decision of the sub-Group of Country Risk Experts, that involves the country risk experts of the Participating Export Credit Agencies.

d) Procedures

14. The common country risk classification takes into account the latest available information. To this end the CRAM, that is centrally run, is updated for each country each time important new information becomes available or when important sudden events may change the perceived country risk. New financial/economic data from the official international organisations become available for most countries in principle at least once a year. Payment experience data are reported by the Participating Export Credit Agencies every quarter. To verify the data-input and to be informed of the latest developments, the updated outcome of the CRAM for each country is made available to the sub-Group of Country Risk Experts.

15. The sub-Group of Country Risk Experts meets several times a year. These meetings are organised so as to guarantee that every country is reviewed each time a fundamental change is noticed and at least once a year. The meetings are confidential and no official reports of the deliberations are made.

IV. THE MINIMUM PREMIUM BENCHMARK SYSTEM

16. The Minimum Premium Benchmark System:

- sets MPBs for sovereign and country credit risk, irrespective of whether the buyer/borrower is a public or private entity
- the MPBs also apply to non-sovereign public and private debtors
- sovereign credit risk is the full faith and credit of the State, e.g. the Ministry of Finance or the Central Bank
- 90 per cent of the benchmark rate can be charged where only country credit risk is covered
- the MPBs are risk-reflective and based on the country classification and the horizon of risk
- the MPBs are expressed as an up-front rate applied to the principal amount of the credit
- ECAs can charge premium above the benchmark rates, e.g. following their own perceptions of the risk

- “High Income OECD countries” (as defined by the World Bank)¹ as well as other countries with similar risks shall not be subject to the application of MPBs with the understanding that the pricing of the private market shall not be undercut
- the “highest risk” countries in Category seven shall, in principle, be subject to appropriate premium surcharges to the MPBs established for that Category; any such surcharges shall be set by the Participant providing official support
- the MPBs are set to reflect differences of product type, i.e. “related conditions”, including percentage of cover and taking into account the country categorisation.

17. To accommodate the differing quality of products provided by the Participants, the MPBs are adjusted to take account of “Related Conditions”, i.e. the differences in the quality of official support. The treatment of related conditions is based on the exporter’s perspective (i.e. to neutralise the competitive effect arising from the differing qualities of product provided to the exporter/financial institution); there are three types of product:

- the **Standard Product** is defined as an insurance product with cover of interest during the claims waiting period without premium surcharge; or direct loans: the standard Benchmark rate applies
- the **Below Standard Product** is defined as an insurance product with no cover of interest during the claims waiting period; or cover of interest during the claims waiting period with a premium surcharge: a discount applies
- the **Above Standard Product** is defined as unconditional guarantees: a surcharge applies.

a) *The Minimum Premium Benchmark Calculation*

18. Step 1: At the heart of the MPB system is the benchmark formula $ax+b$, with x being one half of the drawdown/disbursement period plus the repayment term measured in years. The coefficients a and b are used to establish the appropriate time function across the seven Country Risk Categories. The coefficients are as follows:

	Risk Category						
	1	2	3	4	5	6	7
Coefficient a:	0.100	0.225	0.392	0.585	0.780	0.950	1.120
Coefficient b:	0.350	0.350	0.400	0.500	0.800	1.200	1.800

19. The MPBs resulting from these coefficients using the benchmark formula are those for the 95% standard product.

¹. For example using 1997 data, those countries with a GNP per capita above \$ 9 656.

20. Step 2: In order to determine the MPB for the other products, the following surcharge/discount factors are applied depending on whether the product is above standard (surcharge) or below standard (discount):

	Risk Category						
Related Conditions	1	2	3	4	5	6	7
Surcharge/Discount:	0.0035	0.0065	0.0150	0.0175	0.0175	0.0200	0.0200

21. In the case of an above standard product, the standard MPB resulting from the benchmark formula (in Step 1 above) is multiplied by 1 + the surcharge, and in the case of a below standard product, the standard MPB resulting from the benchmark formula is multiplied by 1 - the discount. Thus, an above standard quality product in Risk Category 4 requires that the standard MPB be multiplied by 1.0175.

22. Step 3: For products providing a percentage cover that is more or less than the standard 95% cover, the MPB resulting from Step 2 is multiplied by the actual percentage of cover divided by 95, thus 100% cover requires the standard MPB to be multiplied by 100/95. This calculation is performed regardless of the risk category involved.

23. Step 4: Finally, for percentages of cover greater than 95%, a further Qualitative Surcharge is applied to the MPB.

	Risk Category						
	1	2	3	4	5	6	7
Qualitative Surcharge	0.00000	0.00337	0.00489	0.01639	0.03657	0.05878	0.08598

24. The application of the Qualitative Surcharge is as follows: for any amount of cover above 95%, the extra cover percentage is divided by 5% and the product is multiplied by the surcharge; the result plus 1 (one) is then multiplied by the result of Step 3 above. Thus, for example, in the case of 98% cover in Risk Category 5, the excess cover above 95% (i.e. 3%) is divided by 5% producing 0.6 which is then multiplied by 0.03657 which equals 0.021942; then this result is added to 1 (one) to obtain the surcharge multiplier of 1.021942. The equation would be as follows: $1 + (0.03657 * ((.98 - .95) / .05)) = 1.021942$.

b) *The Average Life Concept*

25. The repayment profile used for setting the MPBs is the one based on the standard Arrangement repayment profile, i.e. equal semi-annual payments of principal. Therefore, when any other repayment profile is used, it must be converted into an equivalent profile. This is accomplished by calculating the average weighted life (AWL) of the non-standard profile and inputting the result into the following formula:

$$Rp = \frac{AWL - 0,25}{0,5}$$

where: AWL = average weighted life of the actual repayment period
Rp = repayment period to be used for determining the MPB

c) *Different Patterns of Premium Payment*

26. The MPB are expressed as a percentage of the principal value of the credit as if the MPB were collected in full at the zero point. The zero point is the date of the first drawing in case of a buyer credit or the first delivery in case of a supply contract. In the case of deferred premium payments, they must equal, on a net present value (NPV) basis, the up-front MPB. A premium which is at risk, i.e. is financed, it must bear a separate premium for the portion at risk.

27. Should, for any reason, a disbursement fall into the repayment period (i.e. disbursements effected after the starting point of the credit), the part of the premium attributable to that disbursement will not be regarded as being at risk. Thus, only a simple discounting back to time zero will apply.

d) *The Applicable Discount Rate*

28. The calculation of the NPV requires the choice of a discount rate that defines the time value of money paid at any point during the disbursement/drawing period and the repayment period; in this connection the approach is discount rate-sensitive.

29. The following rules with respect to the definition of the discount rates:

- If any part of the premium is collected after the starting point of the credit, the discount rate applied to the whole flow of premium income shall be the prevailing CIRR base rate. For currencies with a three-tier CIRR system, the relevant (to the repayment term of the transaction) base rate shall be applied. The prevailing CIRR base rate shall be the CIRR base rate according to the Arrangement on Guidelines for Officially Supported Export Credits.
- For premium collected in full after the first drawing/disbursement but before the starting point of the credit, the discount rate applied to the flow of premium income shall be the six-month average of the CIRR base rate for the currency in question. This rate shall be calculated twice a year, in January and July, and remain in force for a six-month period. For currencies with a three-tier CIRR system, the 5-year base rate shall be applied.

30. Only one discount rate applies to any transaction and there is no scope for selection of the discount rate.

V. VALIDATING THE BENCHMARKS

31. Premium shall not be inadequate to cover long term operating costs and losses. To ensure the continuing adequacy of premium benchmarks and to allow, if necessary, for adjustments, either upwards or downwards:

- three premium feedback tools (PFTs), shall be used in parallel to monitor and adjust the MPBs
- the PFTs are the accruals and cashflow accounting approaches collated on an aggregate Participants' level and, where appropriate, private market indicators.

VI. PERMITTED EXCEPTIONS

32. Permitted Exceptions are circumstances under which the country credit risks are either externalised/removed or limited/excluded for the entire life of the debt repayment obligation and which may justify a discount with regard to MPBs, consistent with the level of risk.

33. For the purpose of applying Permitted Exceptions and the appropriate maximum levels of discount to the MPBs:

- the levels of discounts are maximums and must be justified on a case-by-case basis
- the application of a Permitted Exception will not be a precedent for any future transaction
- the Permitted Exception techniques must apply for the entire duration of the risk
- in the case of the exclusion of risks:
 - the first three country credit risks (see paragraph 8) are indivisible and their pricing is fixed at a maximum of 50 per cent; and
 - the fourth and fifth country credit risks (see paragraph 8) are indivisible and their pricing is fixed at a maximum of 20 per cent
- discounts may not be accumulated where two or more Permitted Exception Techniques overlap identical country credit risks
- for each Permitted Exception, the notifying Participant shall ascertain whether the security arrangements can be validly enforced in their legal/judicial environment
- the use of Permitted Exception techniques involving "High Income OECD countries" shall not lead to Participants undercutting the pricing of the private market in similar situations
- in cases where a transaction is financed in parallel by other sources of finance, any security retained by the Participant is treated, at least, *pari passu* with the same security held by the other sources of finance
- in the case a limitation in amount is permitted, i.e. techniques 1, 2, 4, 5, 6, 7 and 8:

the security must cover both the principal and the related interest

a pro-rata application of the discount may be applied provided that the guarantee or security is for not less than 10 per cent of the principal amount plus interest, or five million SDRs principal plus related interest in cases where the transaction exceeds 50 million SDRs.

34. The list of Permitted Exceptions to the MPBs is as follows:

1. Third Country Unconditional Guarantee
2. Multilateral or Regional Institutions' Intervention
3. Offshore Future Flow Structure Combined with Offshore Escrow Account
4. Offshore Hard Security
5. Offshore Asset-Based Security
6. Asset-Secured and Asset-Based Financing
7. Third Country Insurance or Conditional Guarantee
8. Debtor Representing a Better Risk than the Sovereign
9. Co-financing with International Financial Institutions (IFIs)
10. Local Currency Financing

35. The Secretariat shall maintain the applicability criteria that the Participants shall use in order to determine whether cases qualify for the appropriate maximum levels of discount to the MPBs.

36. Essential features of the Permitted Exception techniques, including the appropriate maximum level of discount, are in Annex I.

37. The list of Permitted exceptions and their features are open to review in the light of experience.

VII. THE ELECTRONIC EXCHANGE OF INFORMATION (EEI)

38. The EEI facilitates the exchange of information, data and transparency among the ECAs.

VIII. REVIEW OF ALL ELEMENTS OF THE GUIDING PRINCIPLES

39. The Guiding Principles are subject to review to ensure their continuing validity in the light of experience and other developments.

ANNEX I

LIST OF PERMITTED EXCEPTIONS AND THE APPROPRIATE LEVELS OF DISCOUNT

1. THIRD COUNTRY UNCONDITIONAL GUARANTEE

Definition

Security in the form of an irrevocable, unconditional and on-demand guarantee of the debt repayment obligations of the buyer/borrower from a creditworthy entity classified in a better risk country than that of the buyer/borrower.

Pricing Implications / Discount

The MPB is determined by the country where the guarantor is located.

Specific considerations shall apply where the third country guarantor is a subsidiary/parent of an entity located in another third country.

This technique shall apply if the borrower is located in another third country.

A discount will not apply to guarantees limited in extent with regard to the five country credit risks on the buyer/borrower country.

2. MULTILATERAL OR REGIONAL INSTITUTIONS' INTERVENTION

Definition

A Multilateral or Regional Institution is acting either as borrower or guarantor (in which case, it must cover all of the five country credit risks and be irrevocable, unconditional, and on demand) for the project, the repayments being made directly to the creditor.

Pricing Implications / Discount

The Institutions will be classified by the Participants, in accordance with set criteria, either as similar to High-Income OECD country risk or in one of the seven country risk categories. This classification will determine the MPB.

The Institution acting as borrower or guarantor should be committed for the total amount of the credit.

3. OFFSHORE ESCROW ACCOUNT COMBINED WITH OFFSHORE FUTURE FLOW STRUCTURE

Definition

A document, such as a deed or a release or trustee arrangement, sealed and delivered to a third party, i.e. a person not party to the instrument, to be held by such third party until the fulfilment of certain conditions and then to be delivered by him to the other party to take effect.

Features

The escrow account is to be:

- related to a foreign exchange-earning project and the flows into the escrow account are generated by the project itself and/or by other offshore export receivables;
- held offshore i.e. located outside the buyer/borrower country where there are very limited, transfer or other country risks (i.e. High-Income OECD countries or countries classified as similar risks); and
- located in a first class bank, which is not directly or indirectly controlled by interests of the buyer/borrower or by the country of the buyer/borrower.

The funding of the account must be secured through long-term or other appropriate contracts.

The funds, which have to be kept within the account, must be equal to at least six, nine or twelve months of debt service according to the level of discount indicated below in Pricing Implications/Discount. Where flexible repayment terms are being applied under a project finance structure, an amount equivalent to the actual six, nine or twelve months debt service under such flexible terms must be kept within the account; this amount may vary over time depending on the debt service profile.

The combination of the sources of revenue (i.e. that generated by the project itself and/or the other sources) of the buyer/borrower flowing through the account:

- must be in hard currency;
- can reasonably be expected to be collectively sufficient for the service of the debt for the entire duration of the credit; and
- shall come from one or more creditworthy foreign customers located in better risk countries than the country of the buyer/borrower, normally High-Income OECD countries.

The buyer/borrower must irrevocably instruct the foreign customers to pay directly into the account (i.e. the payments are not forwarded through an account controlled by the buyer/borrower or through its country).

The buyer/borrower must have restricted access to the account (i.e. only after payment of the debt service under the credit).

The revenues deposited in the account must be assigned to the lender as direct beneficiary, for the entire life of the credit.

The opening of the account must have received all the necessary legal authorisations from the local and any other appropriate authorities.

The escrow account and contractual arrangements must be unconditional and irrevocable.

Case-by-case consideration shall also be given, inter alia, to:

- the country, the buyer/borrower (i.e. either public or private), the sector, the vulnerability in relation to the commodities or services involved, including their availability for the entire duration of the credit, the customers, and the contracts with the customers;
- the amount which will flow into the account, in relation to the total amount of the credit, and the mechanism for the continuation of appropriate provision;
- the legal structures e.g. whether the mechanism is sufficiently immune against the influence of the buyer/borrower or its country;
- the degree to which the technique remains subject to Government interference, renewal or withdrawal;
- whether the account would be sufficiently protected against project related risks and against the risks of the country where the account is located.

Pricing Implications/Discount

The maximum discount in the best circumstances is 20 per cent of the MPB applicable to the buyer/borrower.

However, when the creditor has a first priority interest in the escrow account and the long term contracts, and the buyer/borrower is a private entity being more than 80 per cent privately owned a maximum discount of:

- up to 40 per cent applies to the minimum premium benchmarks if the following enhanced criteria are met:
 - a) either the projected Loan Life Coverage Ratio (LLCR) averages at least 2.5:1 OR the projected LLCR averages at least 2.0:1 and the projected Annual Debt Service Coverage Ratio (ADSCR) is not less than 1.0 at all times after the starting point of credit; and
 - b) there is at least 12 months of debt service pre-funding in escrow, which should be replenished after each call on the pre-funded amount; or
- up to 30 per cent applies to the minimum premium benchmarks if the following enhanced criteria are met:

- a) either the LLCR averages at least 1.75:1; or
- b) where there is at least 9 months of debt service pre-funding in escrow, which should be replenished after each call on the pre-funded amount.

APPENDIX - COMMON UNDERSTANDINGS ON TECHNIQUE 3 RATIO DEFINITIONS

1. The reference to “**Loan Life Coverage Ratio (LLCR)**” is intended to mean, with respect to the period over which senior debt is being amortised, the ratio of (a) the net present value of the net forecasted cash flows, including the amount of any debt service reserve, available for payment of senior debt service discounted by the weighted average interest rate of the senior debt to (b) the total senior debt outstanding.
2. The LLCR allows banks and ECAs to take a risk-adjusted, long-term view of the adequacy of cashflow to service debt (principal and interest) throughout the life of the loan.
3. The reference to “**Annual Debt Service Cover Ratio (ADSCR)**” is intended to mean, as at any forecast date, the ratio of: (i) projected net cash flow available for payment of senior debt service for the relevant period to (ii) amount of interest, financing costs and principal of senior debt payable by the borrower for such period. The ADSCR mentioned in paragraph 6.1.1a) should be understood to be a minimum DSCR of 1.0 and shall be calculated on a projected basis.
4. The ADSCR allows banks and ECAs to determine the adequacy of cashflow to service debt (principal and interest) at any particular repayment date (which sets a point in time for determining the beginning or end of a particular 12-month period).
5. The objective in using ADSCR and LLCR ratios in Technique 3 is to provide a measure of the cashflow available for debt service which is included within the security package of lenders through any offshore account.
6. The calculations of LLCR and ADSCR shall be made in accordance with the conventions normally applied by prudent lenders to establish an agreed (central scenario) banking case at or near financial close (after completion of full technical and economic due diligence) and from time to time during the life of the project to monitor, in accordance with prudent banking practice, compliance with covenants relating to these ratios.
7. The debt service pre-funding requirement can be funded in cash or in other forms equivalent to cash (e.g. through the issuance of an irrevocable, unconditional and payable at first demand L/C by a highly creditworthy international bank, acceptable to the ECAs and the international lenders involved in the transaction).
8. A transaction seeking a discount under this technique should not achieve its viability through the granting of a discount on premia. A discount shall only be granted on the basis of the project’s economic viability and soundness, and when the transaction fulfils the requirements set out in the specification form. This check should be done at financial close when all of the relevant information is available on a reliable basis.

4. OFFSHORE HARD SECURITY

Definition

Unconditional and irrevocable security in the form of offshore first or second priority pledges or assignments of securities held offshore by a shareholder of the buyer/borrower or by the buyer/borrower itself, or cash on deposit in an offshore account.

Features

The securities are defined as publicly-listed stocks and bonds issued by entities located in a better risk country located outside the buyer/borrower country and traded on Exchanges in High-Income OECD countries.

The cash is defined as deposits in hard currencies of High-Income OECD countries or treasuries in such hard currencies issued by High-Income OECD countries.

The country where the security is located must represent a better risk than the buyer/borrower country and would normally be a High-Income OECD Country.

The security must be beyond the reach and jurisdiction of the buyer/borrower.

The prudently-assessed projected market value of the securities should correspond throughout the repayment period to the amount of the outstanding debt covered by the security.

The prospective continuing value of the securities and the likelihood of realisation in relation to the entity, the sector and the country from which they originate shall be assessed.

The security must be legally and unconditionally realisable in any event of default (i.e. of country credit risks in the buyer/borrower country); its proceeds must be freely convertible into the currency of the credit or in another hard currency, and transferable or payable directly to the creditor for the appropriate amount.

Pricing Implications / Discount

The maximum level of discount will be derived from the application of the MPB of the country where the security is located and enforceable to either 80 per cent of the cash deposit or 35 per cent of the prudential valuation of the securities.

5. OFFSHORE ASSET-BASED SECURITY

Definition

Unconditional and irrevocable security in the form of first priority mortgages on real (i.e. immovable) assets which are held offshore.

Features

The assets must have a prudently-assessed projected continuing market value and should represent for the owner a substantial equity stake. This projected value should correspond throughout the repayment period with the amount of the outstanding debt covered by the security.

The nature of the assets (e.g. sector) and their ownership will have an impact on the assessment of the continuity in their value and on the likelihood time and costs of realisation.

The security must be legally and unconditionally realisable in any event of default (e.g. of country credit risks in the buyer/borrower country); its proceeds must be convertible into the currency of the credit or in another hard currency and payable or assignable directly to the creditor for the appropriate amount.

The country where the security can be enforced must represent a better risk than the buyer/borrower country; i.e. it is normally ranked in the best risk categories.

Pricing Implications / Discount

The maximum level of discount is 15 per cent of the difference between the MPB on the buyer/borrower country and the MPB resulting from using the classification of the country where the security is located and enforceable.

6. ASSET SECURED AND ASSET-BASED FINANCING

Definition

Unconditional and irrevocable security in the form of an offshore lease or a first priority mortgage on movable assets, which are typically directly related to the transaction.

Features

The assets must be identifiable and mobile or portable and which can therefore be physically as well as legally repossessed/seized by the creditor, its agent or nominee outside the country of the buyer/borrower or lessee.

In the first instance, it is expected that the technique will apply to e.g. aircraft, ships and oil platforms, primarily intended to be used outside the country of the buyer/borrower or lessee.

The nature of the assets may impact on their complete mobility, the possibility to repossess them outside the country of the buyer/borrower or lessee and their projected commercial market value, including the costs of seizing, transporting, refurbishing and re-selling them, as well as the interest costs accruing until re-sale.

The assets must have a prudently-assessed projected market value, which, taking into account an evaluation of the above costs, corresponds throughout the repayment period to the amount of the outstanding debt.

The security must be registered offshore in an acceptable jurisdiction.

The assets should be capable of being freely sold and offer opportunities for their use outside the country of the buyer/borrower or lessee; its proceeds must be able to be converted into the currency of the credit or in any other hard currency, and payable directly to the creditor.

Pricing Implications / Discount

The maximum level of discount is 10 per cent, or 20 per cent in the case of aircraft, of the MPB applicable to the buyer/borrower or lessor.

It is not expected that a discount would apply if the technique is essentially used to make the country credit risks acceptable (e.g. in category 7 countries), or is mainly related to the buyer/borrower or the lessor risks.

7. THIRD COUNTRY INSURANCE OR CONDITIONAL GUARANTEE

Definition

Security in the form of an irrevocable insurance or conditional guarantee, from an Export Credit Agency (ECA) in a better risk country than that of the buyer/borrower, against risks, which are, included in the five elements of the country credit risks.

Features

Specific considerations shall apply where the third country insurer or guarantor is a subsidiary/parent of an entity located in another third country.

The insurance or guarantee must be legally valid and capable of being enforced in the third country jurisdiction and its proceeds assigned to the creditor.

The wording of the insurance or guarantee must make the link with the five country credit risks clear and indisputable.

Pricing Implications / Discount

The discount is the result of adding 50 per cent of the MPB relating to the insurer's or guarantor's country and 50 per cent of the MPB relating to the buyers/borrower's or guarantor's country.

In the case where the insurance or guarantee is limited in extent, i.e. with regard to the five country credit risks :

- only 50 per cent of 50/70th (i.e., 35.71%) of the MPB of the guarantor shall apply if the insurance/guarantee applies to the first three country credit risks only; and
- only 50 per cent of 20/70th (i.e., 14.29%) of the MPB of the guarantor shall apply if the insurance/guarantee applies to the last two country credit risks only.

8. DEBTOR REPRESENTING A BETTER RISK THAN THE SOVEREIGN

Definition

A Debtor, which has the ability to generate foreign exchange earnings in hard currencies, and which is likely to represent a better risk than the Sovereign credit risk. The Debtor can be either the buyer/borrower or a guarantor providing an unconditional and irrevocable on demand guarantee.

Features

The Debtor must be acting in a durable and essential sector of basic export-oriented resources generating substantial foreign exchange returns in hard currencies, which are critical for the financial health of the Debtor's country and which the Debtor has the legal ability to freely generate and use.

Specific consideration shall apply where a guarantor is a subsidiary/parent of an entity located in another third country.

The preferred status of the Debtor, which must apply equally to all its external creditors and its strategic and economic value, must be recognised by its Government/by the Sovereign.

Following a set of criteria and on the basis of a strict assessment of each Debtor on its own merits, the Participants will develop, review and, where appropriate, adjust a list of such Debtors.

Pricing Implications / Discount

The maximum discount in the best circumstances is 10 per cent of the MPB for sovereign credit risks.

A discount will not apply to guarantees limited in extent with regard to the five country credit risks on the buyer/borrower country.

In the case of combination with other risk externalisation/mitigating techniques, the possible overlaps will be carefully considered before deciding on the global pricing implication.

9. CO-FINANCING WITH INTERNATIONAL FINANCIAL INSTITUTIONS (IFIS)

Definition

The export credit (i.e. insurance/guarantee/loan) is co-financed with an IFI retained in the list of Multilateral Institutions enjoying a pricing status equivalent to the High- Income OECD countries.

Features

The IFI must have a preferred creditor status.

The ECA and the IFI should have developed close exchanges during the evaluation and setting-up process of the project and of its financing.

The ECA should have obtained from the IFI the benefit of pari passu and cross-default clauses for the entire amount of the credit.

The same IFI arrangements should apply to any competing ECA.

Pricing Implications / Discount

The maximum level of discount is 5 per cent of the MPB applicable to the buyer/borrower country.

10. LOCAL CURRENCY FINANCING

Definition

Contract and financing negotiated in convertible and available local, other than hard, currencies; and financed locally.

Features

The liability of and any claims payment by, an Export Credit Insurer/Guarantor or the payment to an Export Credit Direct Lender must be expressed/made throughout in local currency and should normally not be exposed to the transfer risk.

There shall be no requirement for local currency deposits to be converted into hard currency.

The buyer's/borrower's repayment in his own currency and in his own country must be a valid discharge of the loan obligation.

If a borrower's income is in local currency the borrower is protected against adverse exchange rate movements.

Transfer regulations in the borrower's country should not affect the borrower's repayment obligations, which would remain in local currency.

Subsequent to an event of default leading to a claims payment in local currency, the value of that claim must be translated, as explicitly set out in the loan agreement, into an equivalent hard currency amount. Recovery of the claims payment should be in local currency as a counter value of the hard currency value of the claims payment at the time of the claims payment.

Responsibility for conversion of local currency repayments by the buyer/borrower must be borne by the insured party who should also carry the exchange risk of devaluation or appreciation of local currency receipts. Whilst a Direct Lender may have a direct exposure to currency fluctuations this shall not be related to country risks or buyer/borrower risks.

The technique will normally apply to all currencies of countries outside the High-Income OECD countries, and to all buyers/borrowers and sectors.

This technique shall be considered only on a selective basis in respect of convertible and transferable currencies, where the underlying economy is sound. The Export Credit Insurer/Guarantor should be in a position to meet its obligations to pay claims expressed in its own currency in the event that the local currency becomes either 'non-transferable' or 'non-convertible' after the Export Credit Insurer/Guarantor takes on liability. An Export Credit Direct lender would however carry this exposure.

Pricing Implications / Discount

In cases where the first three country credit risks are specifically excluded, the maximum discount is 50 per cent of the minimum premium benchmark applicable to the buyer/borrower. Where the risk is only mitigated, i.e. not explicitly excluded, the discount is 35 per cent of the MPB applicable to the buyer/borrower.