



Summary of 2011 Sector Understanding on Export Credits for Civil Aircraft

February 2011

Background

With effect from 1 February 2011, the OECD countries plus Brazil (*'Participants'*) have agreed to a new Aircraft Sector Understanding (*'2011 ASU'*). The 2011 ASU supersedes the 2007 Aircraft Sector Understanding (*'2007 ASU'*), which superseded the prior agreement that has governed export credit since 1986 (to the extent addressing large aircraft, *'LASU'* focused on large aircraft).

Unlike the 2007 ASU, which made a distinction between aircraft models,¹ the 2011 ASU establishes a *single system*, that is, the same terms and conditions apply regardless of the aircraft model.

Grandfathered Transactions

The 2011 ASU does not govern export credit for either (i) grandfathered transactions, which are governed by the 2007 ASU, or (ii) great-grandfathered transactions, which are governed by LASU (save that the premiums applicable thereto may not be lower than 3%). That includes premium, structures, and discounts.

'Grandfathered transactions' are deliveries that occur, in the case of Category 1 aircraft, by 31 December 2012, and, in the case of Category 2 / 3 aircraft, by 31 December 2013,² in either case where the financed aircraft was subject to a firm contract concluded not later than 31 December 2010. A 'firm contract' means a binding commitment between the manufacturer and the person taking delivery (including under a sale-leaseback with a lease term of at least 5 years). A commitment fee (with different starting times) of 20 basis points per annum is payable.

'Great-grandfathered transactions' are a subset of deliveries, previously notified (30 June 2007) to the OECD Secretariat, scheduled to occur on or prior to 31 December 2010 in accordance with firm contracts concluded not later than 30 April 2007. The subset is 69 aircraft per each Participant

¹ All Airbus and Boeing commercial aircraft in production, except the A318 and B737-600 were designated as **'Category 1 aircraft'**, and all other commercial and executive aircraft, including the A318 and the B737-600, all aircraft manufactured by ATR, Bombardier, Embraer, and MJET and all helicopters in production were designated as **'Category 2 aircraft'** or **'Category 3 aircraft'**.
These terms will be used in this summary as and when necessary.

² Each Participant that supports Category 2 aircraft is permitted an additional 92 aircraft with no delivery date limitation.

that supports Category 1 aircraft. Such country must submit a transition list of 69 selected aircraft by 31 January 2011. A commitment fee of 35 basis points per annum is payable, accruing from the earlier date of the final commitment or 31 March 2011. There is no delivery date limitation.

The identity of the borrowers on the transition list will be managed exclusively by the Secretariat and not shared with Participants.

Financial Terms and Conditions under the new ASU

Generally

The new ASU sets out the most favourable terms and conditions on which officially supported export credit may be provided. In other words, the new ASU sets minimum rather than mandatory rates to be charged by the Export Credit Agencies (**ECAs**).

There are a number of eligible currencies: euro, Japanese yen, UK pound sterling, US dollar, and other fully convertible currencies.

Export credit may take the form of pure cover (guarantees) or direct lending.

Where direct lending is provided, a minimum interest rate shall be charged (LIBOR, for floating rate loans, and 7-year swap rate, for 12-year fixed rate loans).³ In addition, margin benchmark (liquidity premium) will be charged. That will be set on a monthly basis.

The maximum repayment term is 12 years for all new aircraft. A 15-year term may be offered on an exceptional basis, with prior notification, and with a 35% surcharge on the MPR, described below. The term may not be extended through *pari passu* sharing of security rights.

Repayment is to be made on a quarterly basis. Semi-annual repayment may be offered with a 15% surcharge on the MPR.

Minimum Premium Rates

A minimum premium rate (**'MPR'**) shall be charged. The MPR is equal to the sum of the applicable (i) risk-based rate (**'RBR'**), which is meant to reflect and price risk, viewed through the business cycle, and (ii) market reflective surcharge (**'MRS'**), which is meant to balance export credit pricing with commercial market pricing at any point time.

A maximum reduction of 10% off the MPR (**'Cape Town Discount'**) is available if the operator⁴ is based in a country that ratified the Cape Town Convention, made the qualifying declarations,⁵ and properly implemented the treaty. A list of States whose borrowers are eligible will be maintained by the OECD Secretariat.

³ For aircraft with a net price of at least USD 35 Million, CIRR rates may be offered but only on an exceptional basis. All Participants shall be notified.

⁴ Or the borrower/buyer or lessor, if in the view of the Participant providing official support, the structure of the transaction so warrants. That is a more flexible standard for lessor/borrowers than in the 2007 ASU.

⁵ As defined in Annex 1 of the 2011 ASU ('qualifying declarations' means (i) insolvency (Protocol, art X, Alternative A (with no more than a 60 calendar day period), (ii) deregistration and export (Protocol, art XIII), (iii) choice of law (Protocol, art VIII), and (iv) either (a) non-judicial remedies (Convention, art 54(2), or (b) expedited court remedies, Protocol, art X). Certain other declarations would be disqualifying.

The initial MPRs, with and without the Cape Town Discount, are set out in the **Annex 1**. The premium may be paid either upfront or, over the life of the facility, as spreads expressed in basis points *per annum*. In the case of pure cover, MPR shall be charged as an upfront fee, or if financed, as a *per annum* spread. In the case of direct lending, it shall be embedded in the overall interest rate.

Annex 1 also lists the system of borrower classification, which determines, among other things, the applicable MPR.⁶ All borrowers are placed in one of the eight (8) risk categories ('**RC**') set out in the **Annex 1**.

Periodic Premium Adjustments

There is a complex system for adjustments to the MPR. It has the potential for volatility. The RBR, initially fixed with reference to historical (non-aircraft) secured bank debt rates, is reset annually based on a 4-year moving average of the annual Moody's index of loss given default data on senior unsecured bank loans in Moody's data base. The first reset is scheduled for the 1st quarter of 2012 and the resulting RBRs will become effective as of 15 April 2012. The RBRs resulting from subsequent reset processes will be effective as of 15 April of each following year. The MPR (which result from the RBR and MRS) shall not exceed the RBR by more than 100%.

For each risk category, a MRS shall be calculated. The MRS are based on 90 day moving averages of Moody's Median Credit Spreads ('**MCS**'). The MCS spreads (which are unsecured rates) are discounted by 50% to account for the asset-security and subject to different 'blend coefficients' depending on the risk category. The MRS will be updated quarterly with the first reset for the 1st quarter of 2011 and effective 15 April 2011.⁷ No increase in the MPR resulting from the MRS update shall exceed 10% of the previous quarterly MPR.

Maximum Advance Rate and Risk Mitigants

Official support for borrowers in Risk Category 1 (BBB- and higher) cannot exceed 80% of the net price⁸ of the aircraft. For borrowers in RCs 2 to 8, official support cannot exceed 85% of the net price of the aircraft. RCs are based on the risk classification process described below.

The transaction must also be structured to include, as a minimum, the number and type of '**risk mitigants**' in **Annex 2** applicable to each risk category.

Risk Mitigants are divided into two categories: "A" and "B".

"A" risk mitigants are

⁶ The classification of the 'primary source of repayment', if different from the borrower, shall determine the applicable MPR.

⁷ Until 15 April 2012, the outcome of the updates of the MRS applying to Risk Category 1 shall become effective only if they result in an increase of such MRS.

⁸ Net Price: The price for an item invoiced by the manufacturer or supplier, after accounting for all price discounts and other cash credits, less all other credits or concessions of any kind related or fairly allocable thereto. All import duties and taxes (e.g. VAT) are not included in the net price.

- (a) each 5% reduction from the permitted 85% of net price advance rate (e.g., a 75% advance rate would count as 2 such risk mitigants);
- (b) a straight-line amortization profile (repayment of principal in equal installments); and/or
- (c) a reduced repayment term, not exceeding 10 years.

NB.: With prior notification, one of the above risk mitigants may be replaced by a 15% surcharge on the applicable MPR.

“B” risk mitigants include:

- (a) each security deposit equal to one quarterly installment of principle and interest;
- (b) lease payments in advance equal to one quarterly installment of principal and interest, paid one quarter in advance of each repayment date; and/or
- (c) Maintenance reserves in a form and amount reflective of market best practices.

Security Package

Official support at or above the MPR must be supported by an asset-backed transaction⁹ that satisfies the following criteria: (i) a first-priority security interest in the aircraft and engines; (ii) in a lease structure, assignment and/or first priority security interest of or in the lease payments; and (iii) cross-default and cross-collateralization, when permitted under applicable law (this last element not required in the 2007 ASU). In addition and as noted above and in **Annex 2**, risk mitigants also apply, save only in respect of borrowers in RC 1 or 2.

Other Applicable Fees

Pure Cover: In the case of pure cover, premium holding fees on the undrawn portion of the official support are as follows: (i) no fee is charged for the first six months; (ii) for the months 7-12, a holding fee of 12.5 basis points *per annum*; and (iii) for months 13-18, a holding fee of 25 basis points *per annum*.

Direct Lending: Fees are as follows for direct lending: (i) arrangement/structuring fee of 25 basis points; (ii) commitment and premium holding fee of 20 basis points *per annum* on the undrawn portion; and (iii) administration fee of 5 basis points *per annum* on the amount outstanding, or, alternatively, an equivalent up-front fee.

Co-financing: A Participant can provide direct credit on the same financial terms and conditions, including fees, as those provided by the financial institution under pure cover, to generate an all-in cost equivalence between the pure cover provider and the direct lender. However, pure cover must represent at least 35% of the officially supported amount.

Spare Engines and Spare Parts

⁹ Non-asset backed transactions are permitted in certain cases, often at a significant premium, the exception being to sovereign borrowers in RCs 1-3.

Export credit for spare engines may be provided on the same terms and conditions as for aircraft, except that, if spare engines are not ordered in connection with the aircraft or its initial engines, the maximum repayment term will be 8 or 10 years, the latter permitted for engines with a unit value exceeding USD 10 million, provided the above-described security package is available. Export credit may be provided for contracts for cargo conversion/major modification/refurbishing, maintenance and service contracts, and engine kits, though the terms are more restrictive.

Risk Classification System

Minimum premium rates are based on the RC of borrowers reflecting the senior unsecured credit rating. The 8 rating categories are set out in **Annex 1** hereto.

The Participants shall develop and agree to a common list (*'List'*) prior to the entry into force of ASU 2011. The OECD Secretariat will maintain the List, which will be available to all the Participants on a confidential basis. A borrower's RC, at any point in time and until formally updated, is binding at any stage of the transaction (*e.g.* campaign and delivery).

RCs have a 12-month maximum validity period absent a material change (*e.g.* modification of rating delivered by a Credit Rating Agency (*'CRA'*)). The rating applicable to a specific transaction may be extended by an additional 18 months once a commitment or a final commitment has occurred and the premium holding fee is charged.

The List may be updated on an *ad hoc* basis. There is a mandatory process for establishing a borrower's RC in the case of disagreement among the Participants. In the absence of an agreement between the Participants, a Credit Rating Agency may be used to settle the RC (unless otherwise agreed, the cost of CRA shall be the borrower's responsibility).

A borrower that is not on the List can request an indicative risk classification from the CRA at its own expense. However, the result does not bind the Participants.

Review

The 2011 ASU is meant to be dynamic. In addition to the adjustments described above, there will be period reviews. The first review is scheduled to occur in the fourth calendar year (2015) following the effective date of the 2011 ASU (1 February 2011). Participants may request an earlier review, with three months prior notice and a written explanation and documentation supporting the request. Finally, each Participant reserves the right to withdraw from the 2011 ASU by notifying the Secretariat.

END OF SUMMARY

NOTE: THIS SUMMARY PROVIDES NEITHER LEGAL ADVICE ON NOR AN INTERPRETATION OF THE 2011 ASU. IT MAY NOT BE RELIED UPON FOR ANY PURPOSE.

Annex 1

to AWG Summary of 2011 ASU

Minimum Premium Rates as of entry into force 1 February 2011

(12-year repayment term, asset-backed transactions)

Risk Category	Risk Classification	Minimum Premium Rates			
		Per Annum Spreads (bps) (without CTD^{*/})	Up-Front (%) (without CTD)	Per Annum Spreads (bps) (<u>with CTD</u>)	Up-Front (%) (<u>with CTD</u>)
1	AAA to BBB-	137	7.72	123	6.95
2	BB+ and BB	184	10.44	166	9.40
3	BB-	194	11.03	175	9.93
4	B+	208	11.85	187	10.67
5	B	234	13.38	211	12.04
6	B-	236	13.50	212	12.15
7	CCC	252	14.45	227	13.01
8	CC to C	257	14.74	231	13.27

^{*/} Cape Town Convention Discount

Annex 2

to AWG Summary of 2011 ASU

Risk Mitigants

ASU Risk Category	Risk Ratings	Risk Mitigants		
		A+B	Of which at least A	And at least B
1	AAA to BBB-	0	0	0
2	BB+ and BB	0	0	0
3	BB-	1	1	0
4	B+	2	1	1
5	B	2	1	1
6	B-	3	2	1
7	CCC	4	3	1
8	CC to C	4	3	1