EBA/Op/2020/06

27 March 2020

Opinion of the European Banking Authority on the European Commission's amendments relating to the final draft Regulatory Technical Standards on Assigning Risk Weights to Specialised Lending Exposures under Article 153(9) of Regulation (EU) No 575/2013

Introduction and legal basis

The EBA competence to deliver an opinion is based on the sixth subparagraph of Article 10(1) of Regulation (EU) No 1093/2010[1], as the assignment of risk weights to specialised lending exposures relates to the EBA's area of competence and indeed is an area where the EBA has been entrusted to develop draft regulatory technical standards.

In accordance with Article 14(7) of the Rules of Procedure of the Board of Supervisors[2], the Board of Supervisors has adopted this opinion which is addressed to the European Commission.

General comments

1. On 13 June 2016, the EBA submitted the final draft regulatory technical standards (RTS) on assigning risk weights to specialised lending exposures under Article 153(9) of Regulation (EU) No 575/2013. With its letter of 9 March 2020, the European Commission informed the EBA of its intention to endorse the draft RTS with amendments and

[1] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

[2] Decision adopting the Rules of Procedure of the European Banking Authority Board of Supervisors of 22 January 2020 (EBA/DC/2020/307).

submitted to the EBA a modified version of the RTS with its envisaged changes.

2. With regard to those amendments envisaged by the European Commission which are of a substantive nature, the EBA views that they do not alter the draft RTS in a significant manner and that the draft RTS, despite these changes, maintain a good balance between the flexibility and risk sensitivity required for the IRB approach and the need for a harmonised regulatory framework.

3. The EBA agrees also with the remaining changes summarised in the subsection 'Non-substantive changes', due to their nature as non-substantive and given their usefulness in clarifying the text.

Specific comments

Substantive changes

Substantive change 1 – possibility of not applying a sub-factor or sub-factor component

4. Article 3(4) of the European Commission's envisaged version of the draft RTS introduces the possibility for institutions to consider a sub-factor or a sub-factor component as irrelevant for all specialised lending exposures belonging to a certain type of specialised lending exposures. The EBA notes the following limits of this flexibility:

    (a) this flexibility is at the sub-factor and sub-factor component level, and not at the higher level of factors; hence, there is no contradiction between this amendment and the 5% floor applied on the weight of the factors;

    (b) any potential arbitrage possibilities are limited as the article limits the application of this flexibility to exceptional cases, thereby rendering it an exemption. In addition, the treatment is required to be applied consistently for all exposures within a given type of specialised lending exposures;

    (c) this exemption is required to be appropriately justified and documented, as specified in the new paragraph (1)(c) of Article 6 in the European Commission's envisaged version of the RTS.

5. Therefore, the EBA believes that this additional flexibility will diminish only marginally the harmonisation across institutions, but will avoid the unnecessary burden of assessing a non-relevant sub-factor or sub-factor component. In addition, a similar flexibility was already mentioned in recital 8 of the RTS in the version in which it was submitted by the EBA to the European Commission. Consequently, the EBA agrees with this envisaged change.

Substantive change 2 – incorporation of additional information in the closest sub-factor

6. The European Commission added in Article 3(3) of the RTS the requirement for institutions to consider additional relevant information (an 'additional risk driver') for a type of specialised lending exposures jointly with the sub-factor which most closely corresponds to that additional risk driver. The EBA notes that this change is subject to similar limitations as the one discussed above:

    (a) this flexibility is at the sub-factor and sub-factor component level, and not at the higher level of factors; hence, this additional information is indirectly subject to the cap of 60% applied on the weight of the factors;

    (b) the provision is required to be applied consistently for all exposures within a given type of specialised lending exposures;

    (c) this additional risk driver is required to be appropriately justified and documented, as specified in the new paragraph (1)(b) of Article 6 of the European Commission's version of the RTS.

7. In addition, a similar flexibility was already mentioned in recital 9 of the RTS in the version in which it was submitted by the EBA to the European Commission. Consequently, the EBA agrees with this envisaged change.

Substantive change 3 – overlapping criteria for several categories

8. The European Commission's version of the draft RTS contains simplified rules on overlapping criteria at the level of the sub-factor or of the sub-factor components. Article 1(4) of the RTS in the version submitted to the European Commission by the EBA contained a general principle, with a reliance of sub-factor with no overlapping criteria and the overlapping criteria used for conservative adjustment only. Article 4 of the European Commission's version of the draft RTS now prescribes a specific treatment: in case of overlapping criteria for two categories, the higher of the categories needs to be selected; in case of overlapping criteria for three categories, the intermediate category needs to be selected. The EBA notes that this treatment is prudent in the case of criteria overlapping over two categories.

9. The EBA does not believe this change impedes significantly the risk sensitivity of the approach; instead it views that there is merit in it as it simplifies the treatment of overlapping criteria and, therefore simplifies and harmonises the regulatory framework. Consequently, the EBA agrees with this envisaged change.

Non substantive changes

10. In addition to the specific comments on substantive changes introduced by the Commission, the EBA notes a series of further modifications to the draft RTS it submitted to the European Commission, such as changes in the recitals (deletion of recital 7 and

clarification of the applicability of certain requirements by explanations in recitals 1, 8 and 9); adaptations to the structure of the draft RTS (with the requirements split into seven articles in the European Commission's envisaged version of the RTS, reflecting different stages of the application of the slotting approach); and other small changes in wording, without the intention of changing the meaning of the provisions included in the RTS submitted by the EBA. The EBA agrees with all of these envisaged changes, given that they improve the clarity of the text while not changing in substance the proposed provisions.

This opinion will be published on the EBA's website.

Done at Paris, 17 April 2020

[Signed]

José Manuel Campa

Chairperson
For the Board of Supervisors

Annex 1 (Draft RTS on the criteria for assigning risk weights to specialised lending exposures under Art 153(3)_amended text)
Annex 2 (Annexes Draft RTS on the criteria for assigning risk weights to specialised lending exposures under Art 153(3)_amended text)

EUROPEAN
COMMISSION

Brussels, XXX
[…](2020) XXX draft

COMMISSION DELEGATED REGULATION (EU) …/...

of XXX

on supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for assigning risk weights to specialised lending exposures in accordance with Article 153(5)

(Text with EEA relevance)

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EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Article 153(9) of Regulation (EU) No 575/2013 ('the Regulation') empowers the Commission to adopt, following submission of draft standards by the European Banking Authority (EBA), and in accordance with Articles 10 to 14 of Regulation No (EU) 1093/2010, delegated acts specifying the assignment of risk weights to specialised lending exposures.
In accordance with Article 10(1) of Regulation No (EU) 1093/2010 establishing the EBA, the Commission shall decide within three months of receipt of the draft standards whether to endorse the drafts submitted. The Commission may also endorse the draft standards in part only, or with amendments, where the Union's interests so require, having regard to the specific procedure laid down in those Articles.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

In accordance with the third subparagraph of Article 10(1) of Regulation No (EU) 1093/2010, the EBA has carried out a public consultation on the draft technical standards submitted to the Commission in accordance with Article 153(9) of Regulation (EU) No 575/2013 ('the Regulation'). A consultation paper was published on the EBA internet site on 11 May 2015, and the consultation closed on 11 August 2016. Moreover, the EBA invited the EBA's Banking Stakeholder Group set up in accordance with Article 37 of Regulation No (EU) 1093/2010 to provide advice on them. Together with the draft technical standards, the EBA has submitted an explanation on how the outcome of these consultations has been taken into account in the development of the final draft technical standards submitted to the Commission.
Together with the draft technical standards, and in accordance with the third subparagraph of Article 10(1) of Regulation No (EU) 1093/2010, the EBA has submitted its Impact Assessment, including its analysis of the costs and benefits, related to the draft technical standards submitted to the Commission. This analysis is available at https://www.eba.europa.eu/regulation-and-policy/credit-risk/regulatory-technical-standards-on-specialised-lending-exposures, pages 29-36 of the Final Draft Regulatory Technical Standards package.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

These draft 'regulatory technical standards' ('RTS') specify how institutions should take into account the factors of financial strength, political and legal environment, transaction and/or asset characteristics, strength of the sponsor and developer, and security package when assigning risk weights to specialised lending exposures in respect of which an institution is not able to estimate PDs or the institutions' PD estimates do not meet the requirements set out in Section 6 of Chapter 3 of Title II of Part Three of Regulation (EU) No 575/2013. Those factors are further specified in the form of sub-factors, which provide further clarification about the assessment criteria for each of them, and for some sub-factors, these sub-factors are further specified in sub-factor components. These draft RTS specify how institutions should assign each specialised lending exposure to one of the categories listed in Table 1 of Article 153(5) of Regulation (EU) No 575/2013.
Institutions are required to classify each specialised lending exposure in one of the four specified classes, project finance, real estate, object finance and commodities finance. For specialised lending exposures that are not in default, institutions should apply the assessment criteria associated with the relevant class in the Annexes of these RTS. For specialised lending exposures that are identified as in default, the institution should assign the exposure to category 5.
In addition to this, in exceptional situations, the institutions should be allowed not to apply a certain sub-factor or sub factor component for an individual specialised lending exposure, where they find it

not to be relevant. Insitutions should also be allowed not to apply a certain sub-factor or sub-factor component to all specialised lending exposures belonging to a type of exposures when that sub-factor or sub-factor component is not a relevant risk driver for that type of specialized lending exposures.

Institutions should specify for each type of exposure how the different factors are combined in the final assignment of the specialised lending exposure to one of the categories. The final assignment to a category should be done on the basis of the weighted average of the cardinal numbers of the categories to which the exposure has been assigned, for each factor. The weight that institutions assign to each factor should not be lower than that 5% and not be higher than 60%.

COMMISSION DELEGATED REGULATION (EU) …/...

of XXX

on supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for assigning risk weights to specialised lending exposures in accordance with Article 153(5)

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,
Having regard to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012[3], and in particular the third subparagraph of Article 153(9) thereof[4],
Whereas:

(1) Under the Internal Ratings Based Approach ('IRB Approach'), for specialised lending exposures in respect of which an institution is not able to estimate PDs or the institutions' PD estimates do not meet certain requirements institutions are to assign risk weights to specialised lending exposures in accordance with Article 153(5) of Regulation (EU) No 575/2013, by attributing them to one of the categories in Table 1 set out in the first subparagraph of Article 153(5) based on their assessment of the specialised lending exposure against each of the factors referred to in its second subparagraph. In order to ensure a harmonised approach to the assignment of the specialised lending exposures to categories, it should be laid down how those factors are to be taken into account by providing for a calculation of values on the basis of which the factors can be linked to the risk categories of that Table. As the specialised lending exposures belong to the corporate exposure class within the IRB Approach and the method for assigning risk weights to such exposures specified in Article 153(5) of Regulation (EU) No 575/2013 is a form of rating system, the regulatory technical standards for assigning risk weights to specialised lending exposures set by this Regulation apply in addition to the general rules concerning the assignment of risk weights and other requirements with regard to rating systems under the IRB Approach.

(2) In order for the institutions to adequately apply each of those factors, they should be further specified in the form of sub-factors with a view to clarifying the assessment criteria for each situation. In order to adequately assess the sub-factors, it is necessary to further specify some sub-factors in sub-factor components.

(3) In order to reflect the internationally agreed standards on assigning risk weights to specialised lending exposures, as specified by the Basel Committee on Banking Supervision in the Basel II framework[5], and take into account the large number of variations in specialised lending exposures, such as project finance, real estate, object

[3] OJ L 176, 27.6.2013, p. 1.

[4] OJ L […], […], p. […].

[5] International Convergence of Capital Measurement and Capital Standards, A Revised Framework, Comprehensive Version, June 2006.

finance and commodities finance, with regard to their purpose and the origin of the income generated by the assets, different assessment criteria should be applied to each of those classes of specialised lending exposures when applying the factors. Before assigning a risk weight to a specialised lending exposure, institutions should determine to which of those classes the specialised lending exposure most closely corresponds.

(4) Where an obligor is in default, institutions should assign the risk weight category 5 in Table 1 of Article 153(5) and the highest expected loss category, i.e. category 5 in Table 2 of Article 158(6) of Regulation (EU) No 575/2013, to the specialised lending exposure in line with the Basel II framework.

(5) The attribution by the institutions of a category to each factor should be done on the basis of an overall assessment taking into consideration the categories attributed to the sub-factors of the factor as well as the relative importance which each sub-factor has for the type of specialised lending exposure. The same procedure should be followed when attributing a category to sub-factors where a sub-factor is further specified in sub-factor components.

(6) In order to achieve the greatest possible accuracy and consistency in the assignment of specialised lending exposures to categories, the institutions should attribute a weight to each factor having regard to its relative importance for the type of specialised lending exposures and determine the weighted average of the values of the categories which have been attributed to the factors. In order to ensure that the institutions assign these weights in a sufficiently prudent way, a lower and an upper limit should be set for the weight that can be assigned to each factor.

(7) Under Regulation (EU) No 575/2013 institutions are required to document the assignment of risk weights under the IRB Approach in general. In order to facilitate the verification by the competent authorities of the correct application of the rules on the assignment of risk weights to specialised lending exposures as referred to in the second subparagraph of Article 153(5) of Regulation (EU) No 575/2013, certain specific documentation requirements should be laid down for the assignment of risk weights to those exposures.

(8) This Regulation is largely based on the internationally agreed standards on assigning risk weights to specialised lending exposures. Given the breadth and variety of specialised lending exposures and given the specificities of such exposures, it may not capture all risk drivers which institutions identify in their daily business, either for particular types of exposures within the meaning of point 2 of Article 142(1) of Regulation (EU) No 575/2013 or for individual specialised lending exposures. Given that the institutions are required by Article 171(2) of Regulation (EU) No 575/2013 to take into account all relevant information for assignment of obligors and facilities to grades or pools, the institutions should be required to take into account additional risk drivers and consider them jointly with the sub-factor which most closely corresponds to that risk driver of the specialised lending exposure framework. Where this is done for an individual specialised lending exposure, it is considered an override for the purposes of Article 172(3) of Regulation (EU) No 575/2013. The institution should document why it was appropriate to take into account additional risk drivers and to provide a justification for it.

(9) The provisions on the application of overrides in the IRB Approach also apply to specialised lending exposures. Therefore, the institutions are allowed, exceptionally, not to apply a certain sub-factor or sub-factor component, for an individual specialised

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lending exposure, where they find it not to be relevant. Institutions should also be allowed, exceptionally, not to apply a certain sub-factor or sub-factor component, for all specialised lending exposures belonging to a type of exposures within the meaning of the definition in point (2) of Article 142(1)(2) of Regulation (EU) No 575/2013 when that sub-factor or sub-factor component is not a relevant risk driver for that type of specialised lending exposures. The institutions should be required to document the decision not to apply a sub-factor or a sub-factor component and to provide a justification for it.

(10) The institutions should be allowed a sufficient period of time to adapt their rating systems for assigning risk weights to specialised lending exposures in order to comply with the rules laid down in this Regulation.

(11) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.

(12) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council[6],

HAS ADOPTED THIS REGULATION:

Article 1

Applicable assessment criteria for different classes of specialised lending exposures

1. Where the purpose of a specialised lending exposure is to finance the development or acquisition of large, complex and expensive installations, including in particular power plants, chemical processing plants, mines, transportation infrastructure, environment, and telecommunications infrastructure, and the income to be generated by the assets is the money generated by the contracts for the output of the installation obtained from one or several parties which are not under management control of the sponsor ('project finance exposures'), institutions shall apply the assessment criteria set out in Annex I to this class of exposures when assigning risk weights in accordance with the second subparagraph of Article 153(5) of Regulation (EU) No 575/2013. …

2. Where the purpose of a specialised lending exposure is to finance the development or acquisition of real estate, including in particular office buildings to let, retail space, multifamily residential buildings, industrial or warehouse space, hotels and land, and the income to be generated by the real estate is lease or rental payments or the proceeds from the sale of such real estate obtained from one or several third parties ('real estate exposures'), institutions shall apply the assessment criteria set out in Annex II to this class of exposures when assigning risk weights in accordance with the second subparagraph of Article 153(5) of Regulation (EU) No 575/2013.

3. Where the purpose of a specialised lending exposure is to finance the acquisition of physical assets, including in particular ships, aircraft, satellites, railcars, and fleets, and the income to be generated by those assets is lease or rental payments obtained from

[6] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

one or several third parties ('object financing exposures'), institutions shall apply the assessment criteria set out in Annex III to this class of exposures when assigning risk weights in accordance with the second subparagraph of Article 153(5) of Regulation (EU) No 575/2013.

4. Where the purpose of a specialised lending exposure is to finance reserves, inventories or receivables of exchange-traded commodities, including in particular crude oil, metals, or crops, and the income to be generated by those reserves, inventories or receivables is to be the proceeds from the sale of the commodity ('commodities financing exposures'), institutions shall apply the assessment criteria set out in Annex IV to this class of exposures when assigning risk weights in accordance with the second subparagraph of Article 153(5) of Regulation (EU) No 575/2013.

Article 2

Assessment at factor level and risk weight assignment

1. Institutions shall, on the basis of an overall assessment, attribute a category to each factor set out in the annex which is applicable to the class of specialised lending exposures in accordance with Article 1. For each specialised lending exposure, the institution shall carry out this attribution taking into consideration the categories attributed to each applicable sub-factor in accordance with Articles 3 and 4, as well as the relative importance of each sub-factor for the type of specialised lending exposures as defined in point (2) of Article 142(1) of Regulation (EU) No 575/2013.

2. The institution shall assign a weight in percentage that is not lower than 5% and not higher than 60% to each factor having regard to its relative importance for the type of specialised lending exposures.

3. The institution shall determine the weighted average of the categories which have been attributed to the factors in accordance with paragraph 1, applying the weights assigned in accordance with paragraph 2. Where the weighted average is a decimal number, institutions shall round that number to the nearest cardinal number.

4. The institution shall assign the specialised lending exposure to the category set out in Table 1 of Article 153(5) of Regulation (EU) No 575/2013 for which the number corresponds to the weighted average calculated in accordance with paragraph 3.

Article 3

Assessment at sub-factor level

1. Where a sub-factor of a given factor listed in Annex I, II, III or IV is not further specified in sub-factor components, the institution shall attribute a category to the sub-factor on the basis of the assessment criteria set out for that sub-factor.

2. Where a sub-factor of a given factor listed in Annex I, II, III or IV is further specified in sub-factor components, the institution shall:

   (a) attribute a category to each sub-factor component on the basis of the assessment criteria set out for that sub-factor component;

   (b) attribute a category to the sub-factor on the basis of an overall assessment carried out taking into consideration the categories attributed in accordance with point (a) as well as the relative importance of each sub-factor component for the type of specialised lending exposure.

3. Where the institution takes into account additional relevant information (an ‘additional risk driver’) in accordance with Article 171(2) of Regulation (EU) No 575/2013 for a type of specialised lending exposures, it shall consider it jointly with the sub-factor, which most closely corresponds to that additional risk driver.

4. Where, exceptionally, a sub-factor or sub-factor component is irrelevant for all specialised lending exposures belonging to a certain type of specialised lending exposures, the institution may decide not to apply that sub-factor or sub-factor component for any of the specialised lending exposures belonging to that type.

Article 4

Overlapping criteria at sub-factor and sub-factor component levels

Where a sub-factor or a sub-factor component has identical assessment criteria in two or more categories (‘overlapping criteria’), and the specialised lending exposure conforms to those overlapping criteria, institutions shall attribute a category to the sub-factor or sub-factor component as follows:

(a) where overlapping criteria occur in two categories, institutions shall attribute the higher of the two categories;

(b) where overlapping criteria occur in three categories, institutions shall attribute the category between the lowest and the highest of the three categories.

Article 5

Obligor's default

By way of derogation from Articles 1 to 4, where the obligor is in default in the meaning of Article 178 of Regulation (EU) No 575/2013, the institution shall assign a risk weight of category 5 as set out in Table 1 of Article 153(5) of that Regulation to the specialised lending exposure.

Article 6

Documentation

1. Institutions shall document the following information for each type of specialised lending exposures for which they assign risk weights in accordance with this Regulation:

(a) the assignment of weights to each factor in accordance with Article 2(2) and the justification for that assignment;

(b) a description of additional risk drivers and a justification for taking them into account in accordance with Article 3(3), where applicable;

(c) the justification for deciding not to apply a certain sub-factor or sub-factor component in accordance with Article 3(4), where applicable.

2. Institutions shall document the following information for each specialised lending exposure for which they assign risk weights in accordance with this Regulation:

(a) the class of the specialised lending exposure as set out in Article 1;

(b) the category of Table 1 of the first subparagraph of Article 153(5) of Regulation (EU) No 575/2013 to which the specialised lending exposure has been assigned;

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(c) the remaining maturity as referred to in Table 1 of the first subparagraph of Article 153(5) of Regulation (EU) No 575/2013;

(d) the assessment of the specialised lending exposure at each step of the process laid down in Articles 2 to 5 that led to the assignment of the risk weight to the exposure.

Article 7
Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

It shall apply from [Instructions to the PO: insert a date one year after the date of publication].

This Regulation shall enter into force on the […] day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President
Ursula von der Leyen

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EUROPEAN
COMMISSION

Brussels, XXX
[…](2020) XXX draft

ANNEXES 1 to 4

ANNEXES

supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for assigning risk weights to specialised lending exposures

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ANNEX I
Assessment criteria for project finance exposures

	Category 1	Category 2	Category 3	Category 4
Factor: financial strength				
(a) Sub-factor: market conditions	Few competing suppliers or substantial and durable advantage in location, cost, or technology. Demand is strong and growing.	Few competing suppliers or better than average location, cost, or technology but this situation may not last. Demand is strong and stable.	Project has no advantage in location, cost, or technology. Demand is adequate and stable.	Project has worse than average location, cost, or technology. Demand is weak and declining.
(b) Sub-factor: financial ratios (e.g. debt service coverage ratio (DSCR[7]), Interest Coverage Ratio (ICR[8]), loan life coverage ratio (LLCR[9])and debt-to-equity ratio)	Strong financial ratios considering the level of project risk; very robust economic assumptions.	Strong to acceptable financial ratios considering the level of project risk; robust project economic assumptions.	Standard financial ratios considering the level of project risk	Aggressive financial ratios considering the level of project risk.
(c) Sub-factor: stress analysis on the basis of the income being generated during the tenor of the loan[10]	The project can meet its financial obligations under sustained, severely stressed economic or sectoral conditions.	The project can meet its financial obligations under normal stressed economic or sectoral conditions. The project is only likely to default under severe economic conditions.	The project is vulnerable to stresses that are not uncommon through an economic cycle, and may default in an economic downturn.	The project is likely to default unless conditions improve soon.
(d) Sub-factor: financial Structure				
• Amortisation schedule (sub-factor component)	Amortising debt without bullet repayment	Amortising debt with no or insignificant bullet repayment	Amortising debt repayments with limited bullet payment.	Bullet repayment or amortising debt repayments with high bullet repayment.
• Market/cycle and refinancing risk (sub-factor component)	There is no or very limited exposure to market or cycle risk since the expected cashflows cover all future loan repayments during the tenor of the loan and there are no significant delays between the cashflows and the loan repayments. There is no or very low refinancing risk.	The exposure to market or cycle risk is limited since the expected cashflows cover the majority of future loan repayments during the tenor of the loan and there are no significant delays between the cashflows and the loan repayments. There is low refinancing risk.	There is moderate exposure to market or cycle risk since the expected cashflows cover only a part of future loan repayments during the tenor of the loan or there are some significant delays between the cashflows and the loan repayments. Average refinancing risk.	There is significant exposure to market or cycle risk since the expected cashflows cover only a small part of future loan repayments during the tenor of the loan or there are some significant delays between the cashflows and the loan repayments. High refinancing risk.
(e) Sub-factor : foreign exchange risk	There is no foreign exchange risk because there is no difference in the currency of	There is no foreign exchange risk because there is no difference in the	There is a difference in the currency of the loan and the income of the	There is a difference in the currency of the loan and the income of the

7 The Debt Service Coverage ratio ('DSCR') refers to the ratio of the cashflow available for debt service which can be generated from the asset to the required repayment of the principal and the interest payments during the life of the loan, where the cashflow available for debt service is calculated by subtracting operating expenditure, capital expenditure, debt and equity funding, taxes and working capital adjustments from the revenues generated by the project.

8 The Interest Coverage Ratio ('ICR') refers to the ratio of the cashflow available for debt service which can be generated from the asset to the required repayment of the interest payments during the life of the loan, where the cashflow available for debt service is calculated by subtracting operating expenditure, capital expenditure, debt and equity funding, taxes and working capital adjustments from the revenues generated by the project.

9 The Loan Life Coverage Ratio ('LLCR') refers to the ratio of the net present value of the cashflow available for debt service to the outstanding debt balance, and refers to the number of times the cashflow available for debt service which can be generated from the asset can repay the outstanding debt balance over the scheduled life of the loan, where the cashflow available for debt service calculated by subtracting operating expenditure, capital expenditure, debt and equity funding, taxes and working capital adjustments from the revenues generated by the project.

10 The tenor of a loan refers to the amount of time left for the repayment of a loan.

	the loan and the income of the project or because the foreign exchange risk is fully hedged.	currency of the loan and the income of the project or because the foreign exchange risk is fully hedged.	project, but the foreign exchange risk is considered low because the exchange rate is stable or because the foreign exchange risk is hedged to a large extent.	project, and the foreign exchange risk is considered high because the exchange rate is volatile and the foreign exchange risk is not hedged to a large extent.
Factor: political and legal environment				
(a) Sub-factor: political risk, including transfer risk, considering project type and mitigants	Very low exposure; strong mitigation instruments, if needed	Low exposure; satisfactory mitigation instruments, if needed	Moderate exposure; fair mitigation instruments	High exposure; no or weak mitigation instruments
(b) Sub-factor: force majeure risk (war, civil unrest, etc)	No or very low exposure to force majeure risk’	Limited exposure to force majeure risk	Significant exposure to force majeure risk which is not sufficiently mitigated	Significant exposure to force majeure risk which is not mitigated
(c) Sub-factor: government support and project’s importance for the country over the long term	Project of strategic importance for the country (preferably export-oriented). Strong support from Government	Project considered important for the country. Good level of support from Government	Project may not be strategic but brings unquestionable benefits for the country. Support from Government may not be explicit	Project not key to the country. No or weak support from Government
(d) Sub-factor: stability of legal and regulatory environment (risk of change in the law)	Favourable and stable regulatory environment over the long term	Favourable and stable regulatory environment over the medium term	Regulatory changes can be predicted with a fair level of certainty	Current or future regulatory issues may affect the project
(e) Sub-factor: acquisition of all necessary supports and approvals for such relief from local content laws	Strong	Satisfactory	Fair	Weak
(f) Sub-factor: enforceability of contracts, collateral and security	Contracts, collateral and security are enforceable	Contracts, collateral and security are enforceable	Contracts, collateral and security are considered enforceable even if certain non-key issues may exist	There are unresolved key issues in respect if actual enforcement of contracts, collateral and security
Factor: transaction characteristics				
(a) Sub-factor: design and technology risk	Fully proven technology and design	Fully proven technology and design	Proven technology and design — start-up issues are mitigated by a strong completion package	Unproven technology and design; technology issues exist and/or complex design.
(b) Sub-factor: construction risk				
• Permitting and siting (sub-factor component)	All permits have been obtained	Some permits are still outstanding but their receipt is considered very likely	Some permits are still outstanding but the permitting process is well defined and they are considered routine.	Key permits still need to be obtained and are not considered routine. Significant conditions may be attached.
• Type of construction contract (sub-factor component)	Fixed-price date-certain turnkey construction EPC[11] (engineering and procurement contract)	Fixed-price date-certain turnkey construction EPC	Fixed-price date-certain turnkey construction contract with one or several contractors	No or partial fixed-price turnkey contract and/or interfacing issues with multiple contractors
• Likelihood to finish the project at the agreed time and cost (sub-factor component)	It is almost certain that the project will be finished within the agreed time horizon and at the agreed cost.	It is very likely that the project will be finished within the agreed time horizon and at the agreed cost.	It is uncertain whether the project will be finished within the agreed time horizon and at the agreed cost.	There are indications that the project will not be finished within the agreed time horizon and at the agreed cost.

[11] An Engineering and Procurement Contract ('EPC') or 'turnkey contract' refers to an agreement between the engineering and procurement contractor ('EPC contractor) and the developer, whereby the EPC contractor agrees to develop the detailed engineering design of the project, procure all the equipment and materials necessary, construct and deliver a functioning facility or asset to the developer, usually within an agreed time and budget.

	• Completion guarantees [12] or liquidated damages [13] (sub-factor component)	Substantial liquidated damages supported by financial substance and/or strong completion guarantee from sponsors with excellent financial standing	Significant liquidated damages supported by financial substance and/or completion guarantee from sponsors with good financial standing	Adequate liquidated damages supported by financial substance and/or completion guarantee from sponsors with good financial standing	Inadequate liquidated damages or not supported by financial substance or weak completion guarantees
	• Track record and financial strength of contractor in constructing similar projects (sub-factor component)	Strong	Good	Satisfactory	Weak
(c)	Sub-factor: operating risk				
	• Scope , nature and complexity of operations and maintenance (O & M) contracts (sub-factor component)	Strong long-term O&M contract[14], preferably with contractual performance incentives[15], and/or O&M reserve accounts[16], although an O&M contract is not strictly necessary to perform the required maintenance because the O&M activities are straightforward and transparent	The O&M activities are relatively straightforward and transparent, and there is a long-term O&M contract, and/or O&M reserve account	The O&M activities are complex and an O&M contract is necessary. There is a limited long-term O&M contract and/or reserve account	The O&M activities are complex and an O&M contract is strictly necessary. There is no O&M contract. There is therefore the risk of high operational cost overruns beyond mitigants.
	• Operator's expertise, track record, and financial strength (sub-factor component)	Very strong, or committed technical assistance of the sponsors	Strong	Acceptable	Limited/weak, or local operator dependent on local authorities
(d)	Sub-factor: revenue assessment, including off –take risk[17]				
	• What is the robustness of the revenue contracts (e.g. off-take contracts [18], concession agreements, public private partnership income stream, and other revenue contracts)? What is the	Excellent robustness of the revenues	Good robustness of the revenues	Acceptable robustness of the revenues	The revenues of the project are not certain and there are indications that some of the revenues may not be obtained.

12 A completion guarantee refers to a guarantee provided by the contractor to the project's lenders to undertake to deliver the project within the specified timeframe, and to pay for the cost overruns, if any.

13 A liquidated damage refers to a monetary compensation for a loss, detriment or injury to a person's rights or property, awarded by a court judgment or by a contract stipulation regarding breach of contract.

14 An Operation and Maintenance ('O&M') contract refers to a contract between the developer and the operator. The developer delegates the operation, maintenance and often performance management of the project to an operator with expertise in the industry under the terms of the O&M contract (i.e. scope, term, operator responsibility, fees, and liquidated damages).

15 Performance incentives or performance based contracting refer to strategic performance metrics which directly relate contracting payment to these performance metrics. Performance metrics may measure availability, reliability, maintainability, supportability.

16 An O&M reserve account refers to a fund into which money is deposited to be used for the purpose of meeting the costs of operation and maintenance of the project.

17 Off-take risk refers to the risk that the demand for the output or service does not exist at the price at which it is provided or the off-taker is unable or refuses to honour his commitment to purchase the output or service.

18 An off-take contract refers to a contract between a producer of a resource/product/service and a buyer ('off-taker') of a resource to purchase/sell portions of the producer's future production. An off-take contract is normally negotiated prior to the construction of a facility in order to secure a market for the future output of the facility. The purpose is to provide the producer with stable and sufficient revenue to pay its debt obligation, cover the operating costs and provide certain required return.

quality of the termination clauses[19]? (sub-factor component)				
• If there is a take-or-pay[20] or fixed-price off-take contract (sub-factor component)	Excellent creditworthiness of off-taker; strong termination clauses; tenor of contract comfortably exceeds the maturity of the debt.	Good creditworthiness of off-taker; strong termination clauses; tenor of contract exceeds the maturity of the debt	Acceptable financial standing of off-taker; normal termination clauses; tenor of contract generally matches the maturity of the debt.	Weak off-taker; weak termination clauses; tenor of contract does not exceed the maturity of the debt.
• If there is no take-or-pay or fixed-price off-take contract (sub-factor component)	Project produces essential services or a commodity sold widely on a world market; output can readily be absorbed at projected prices even at lower than historic market growth rates.	Project produces essential services or a commodity sold widely on a regional market that will absorb it at projected prices at historical growth rates	Commodity is sold on a limited market that may absorb it only at lower than projected prices	Project output is demanded by only one or a few buyers or is not generally sold on an organised market.
(e) Sub-factor: supply risk				
• Price, volume and transportation risk of feed-stocks; supplier's track record and financial strength (sub-factor component)	Long-term supply contract with supplier of excellent financial standing.	Long-term supply contract with supplier of good financial standing.	Long-term supply contract with supplier of good financial standing — a degree of price risk may remain.	Short-term supply contract or long-term supply contract with financially weak supplier — a degree of price risk definitely remains.
• Reserve risks[21] (e.g. natural resource development) (sub-factor component)	Independently audited, proven and developed reserves well in excess of requirements over lifetime of the project.	Independently audited, proven and developed reserves in excess of requirements over lifetime of the project	Proven reserves can supply the project adequately through the maturity of the debt.	Project relies to some extent on potential and undeveloped reserves.
Factor: strength of sponsor (including any public private partnership)				
(a) Sub-factor: financial strength of the sponsor	Strong sponsor with high financial standing	Good sponsor with good financial standing	Sponsor with adequate financial standing	Weak sponsor with clear financial weaknesses
(b) Sub-factor: track record of the sponsor and its country/sector experience	Sponsor with excellent track record and country/sector experience	Sponsor with satisfactory track record and country/sector experience	Sponsor with adequate track record and country/sector experience	Sponsor with no or questionable track record or country/sector experience
(c) Sub-factor: sponsor support, as evidenced by equity, ownership clause[22] and incentive to inject additional cash if necessary	Strong. Project is highly strategic for the sponsor (core business — long term strategy)	Good. Project is strategic for the sponsor (core business — long term strategy)	Acceptable. Project is considered important for the sponsor (core business)	Limited. Project is not key to sponsor's long term strategy or core business
Factor: security package				
(a) Sub-factor: assignment of contracts and accounts	Fully comprehensive	Comprehensive	Acceptable	Weak

[19] A termination clause refers to a provision in a contract which allows for its termination under specified circumstances.

[20] A take-or-pay contract refers to a contract in which it is agreed that a client buys the output or service from the supplier or the client pays the supplier a penalty. Both the price and the penalty are fixed in the contract.

[21] Reserve risk refers to the risk that the accessible reserves are smaller than estimated.

[22] An ownership clause refers to a provision that states that a project cannot be owned by a different entity than the actual owner (sponsor).

(b)	Sub-factor: pledge of assets, taking into account quality, value and liquidity of assets	First perfected security interest[23] in all project assets, contracts, permits and accounts necessary to run the project	Perfected security interest in all project assets, contracts, permits and accounts necessary to run the project	Acceptable security interest in all project assets, contracts, permits and accounts necessary to run the project	Little security or collateral for lenders; weak negative pledge clause[24]
(c)	Sub-factor: lender's control over cash flow (e.g. cash sweeps[25], independent escrow accounts[26])	Strong	Satisfactory	Fair	Weak
(d)	Sub-factor: strength of the covenant package(mandatory prepayments [27], payment deferrals[28], payment cascade[29], dividend restrictions[30] …)	Covenant package is strong for this type of project Project may issue no additional debt	Covenant package is satisfactory for this type of project Project may issue extremely limited additional debt	Covenant package is fair for this type of project Project may issue limited additional debt	Covenant package is Insufficient for this type of project Project may issue unlimited additional debt
(e)	Sub-factor: reserve funds (debt service, O&M, renewal and replacement, unforeseen events, etc)	Longer than average coverage period, all reserve funds fully funded in cash or letters of credit from highly rated bank	Average coverage period, all reserve funds fully funded	Average coverage period, all reserve funds fully funded	Shorter than average coverage period, reserve funds funded from operating cash flows.

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23 First perfected security interest refers to a security interest in an asset (mortgaged as a collateral) protected from claims by other parties. A lien is perfected by registering it with appropriate statutory authority so that it is made legally enforceable and any subsequent claim on that asset is given a junior status.

24 A negative pledge clause refers to a provision that indicates that the institution will not pledge any of its assets if doing so gives the lenders less security.

25 A cash sweep refers to the mandatory use of excess free cash flows to pay down outstanding debt rather than distribute it to shareholders.

26 An independent escrow account refers to an account held in the sponsor's name by a bank under the support of an escrow account agreement between the lender and borrower providing for irrevocable instructions from the borrower to the effect that all operational revenue or proceeds from sale of assets of the project will be paid into this account, and where the bank is authorised to make payments from available funds only as agreed in the project financing documents.

27 A mandatory prepayment refers to a provision that requires the borrower to prepay a portion of the debt with certain proceeds if and when received before the maturity date.

28 A payment deferral refers to a provision that indicates that the borrower is allowed to start making payments at some specified time in the future.

29 A payment cascade refers to a provision whereby the project's cash flows are summarised using a cash flow waterfall, which shows the priority of each cash inflow and outflow.

30 A dividend restriction refers to a provision that defines the circumstances in which the lender is able to prevent equity distributions.

Annex 2
Assessment criteria for real estate exposures

	Category 1	Category 2	Category 3	Category 4
Factor: financial strength				
(a) Sub-factor: market conditions	The supply and demand for the project's type and location are currently in equilibrium. The number of competitive properties coming to market is equal or lower than forecasted demand	The supply and demand for the project's type and location are currently in equilibrium. The number of competitive properties coming to market is roughly equal to forecasted demand	Market conditions are roughly in equilibrium. Competitive properties are coming on the market and others are in the planning stages. The design and capabilities of existing comparable properties are not state of the art as compared to new projects	Market conditions are weak. It is uncertain when conditions will improve and return to equilibrium. Comparable properties in the market are losing tenants at lease expiration. New lease terms of comparable properties are less favourable compared to those existing
(b) Sub-factor: financial ratios, i.e. Indicators of the borrower's ability to repay	The property's financial ratios, measured by the property's debt service coverage ratio (DSCR[31]) or interest coverage ratio (ICR[32]), are considered strong and are expected to remain strong taking into account the past evolution in financial ratios. DSCR or ICR is not relevant and should not be calculated for properties that are in the construction phase.	The property's financial ratios, measured by the property's DSCR or ICR, are considered good and are expected to remain good taking into account the past evolution in financial ratios. The DSCR or ICR is not relevant and should not be calculated for properties that are in the construction phase.	The property's financial ratios measured by the property's DSCR or ICR are satisfactory and are expected to remain satisfactory taking into account the past evolution in financial ratios. The DSCR or ICR is not relevant and should not be calculated for properties that are in the construction phase.	The property's financial ratios, measured by the property's DSCR or ICR are weak and are expected to remain weak taking into account the past evolution in financial ratios. The DSCR or ICR is not relevant and should not be calculated for properties that are in the construction phase.
(c) Sub-factor: advance ratio, i.e. the loan-to-value (LTV[33]) ratio as an indicators of the borrower's willingness to repay	The property's loan to value ratio (LTV) is considered low given its property type. Where a secondary market exists, the transaction is underwritten to market standards.	The property's LTV is considered satisfactory given its property type. Where a secondary market exists, the transaction is underwritten to market standards.	The property's LTV is considered relatively high given its property type	The property's LTV ratio is well above underwriting standards for new loans.
(d) Sub-factor: stress analysis on the basis of the income being generated during the tenor of the loan[34]	The property's resources, contingencies and liability structure allow it to meet its financial obligations during a period of severe financial stress (e.g. interest rates, economic growth)	The property can meet its financial obligations under a sustained period of financial stress (e.g. interest rates, economic growth). The property is likely to default only under severe economic conditions	During an economic downturn, the property would suffer a decline in revenue that significantly increase the risk of default	The property's financial condition is strained and is likely to default unless conditions improve in the near term
(e) Sub-factor: cash-flow predictability				

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[31] The Debt Service Coverage ratio ('DSCR') refers to the ratio of the cashflow available for debt service which can be generated from the asset to the required repayment of the principal and the interest payments during the life of the loan, where the cashflow available for debt service is calculated by subtracting operating expenditure, capital expenditure, debt and equity funding, taxes and working capital adjustments from the revenues generated by the project.

[32] The Interest Coverage Ratio ('ICR') refers to the ratio of the cashflow available for debt service which can be generated from the asset to the required repayment of the interest payments during the life of the loan, where the cashflow available for debt service is calculated by subtracting operating expenditure, capital expenditure, debt and equity funding, taxes and working capital adjustments from the revenues generated by the project.

[33] The Loan-to-Value ratio ('LTV') refers to the ratio of the loan amount to the value of the pledged assets.

[34] The tenor of a loan refers to the amount of time left for the repayment of a loan.

• For complete and stabilized property (sub-factor component)	The property's leases are long-term with creditworthy tenants and their maturity dates are scattered, or a public private partnership guarantees a considerable part of the tenancy contracts. The property has a track record of tenant retention upon lease expiration. Its vacancy rate is low. Expenses (maintenance, insurance, security, and property taxes) are predictable	The majority of the property has several tenant lease contracts that are long-term, and with tenants that have on average a high creditworthiness, and with scattered maturity dates. A public private partnership may guarantee part of the tenancy contracts. Where the property has only one lease contract or one tenant has a very significant share in the income generated by the property, this tenant is of excellent creditworthiness and the contract includes covenants that ensure lease payments until the end of the project life or beyond. The property experiences a normal level of tenant turnover upon lease expiration. Its vacancy rate is low. Expenses are predictable	Most of the property's leases are medium rather than long-term with tenants that range in creditworthiness. A public private partnership may guarantee only a minor part of the tenancy contracts. Where the property has only one lease contract or one tenant has a very significant share in the income generated by the property, this one tenant, the contract includes covenants that ensure lease payments until the end of the project life or beyond but the tenant has moderate creditworthiness. The property experiences a moderate level of tenant turnover upon lease expiration. Its vacancy rate is moderate. Expenses are relatively predictable but vary in relation to revenue	The proportion of short term leases is significant with tenants that range in creditworthiness, or the property has only one lease contract, or one tenant has a very significant share in the income generated by the property, where that tenant has a low creditworthiness and/or the contract does not include the necessary covenants that ensure lease payments until the end of the project life or beyond. The property experiences a very high level of tenant turnover upon lease expiration. Its vacancy rate is high. Significant expenses are incurred preparing space for new tenants
• For complete but not stabilized property (sub-factor component)	The cashflows obtained from the leasing activity, for instance obtained from a public private partnership, meet or exceed the expected cashflows used in the valuation of the property. The project should achieve stabilization in the near future	The cashflows obtained from the leasing activity, for instance obtained from a public private partnership, meet or exceed the expected cashflows used in the valuation of the property. The project should achieve stabilization in the near future	Most of the cashflows obtained from the leasing activity meet the expected cashflows used in the valuation of the property however, stabilization will not occur for some time	The cashflows obtained from the leasing activity do not meet the expected cashflows used in the valuation of the property. Despite achieving target occupancy rate, cash flow coverage is tight due to disappointing revenue
• For construction phase (sub-factor component)	The property is entirely preleased through the tenor of the loan[35] or pre-sold to a tenant or buyer of high creditworthiness, or the bank has a binding commitment for take-out financing from a tenant or buyer of high creditworthiness, for instance through a public private partnership.	The property is entirely pre-leased or pre-sold to a creditworthy tenant or buyer, or the bank has a binding commitment for permanent financing from a creditworthy lender, for instance through a public private partnership.	Leasing activity is within projections but the building may not be pre-leased and there may not exist a take-out financing. The bank may be the permanent lender	The property is deteriorating due to cost overruns, market deterioration, tenant cancellations or other factors. There may be a dispute with the party providing the permanent financing
Factor: political and legal environment				
(a) Sub-factor: legal and regulatory risks	Jurisdiction is very favourable to repossession and enforcement of contracts	Jurisdiction is generally favourable to repossession and enforcement of contracts	Jurisdiction is generally favourable to repossession and enforcement of contracts, but repossession might be long and/or difficult	Poor or unstable legal and regulatory environment. Jurisdiction may make repossession and enforcement of contracts lengthy or impossible
(b) Sub-factor: political risk, including transfer risk, considering property type and mitigants	Very low exposure; strong mitigation instruments, if needed	Low exposure; satisfactory mitigation instruments, if needed	Moderate exposure; fair mitigation instruments	High exposure; no or weak mitigation instruments
Factor: asset/transaction characteristics				

35 The tenor of a loan refers to the amount of time left for the repayment of a loan.

(a) Sub-factor: location	Property is located in highly desirable location that is convenient to services that tenants desire	Property is located in desirable location that is convenient to services that tenants desire	The property location lacks a competitive advantage	The property is located in an undesirable location
(c) Sub-factor: design and condition	Property is favoured due to its design, configuration, and maintenance, and is highly competitive with new properties	Property is appropriate in terms of its design, configuration and maintenance. The property's design and capabilities are competitive with new properties	Property is adequate in terms of its configuration, design and maintenance	The property's configuration, design and maintenance have contributed to the property's difficulties. Weaknesses exist in the property's configuration, design or maintenance.
(d) Sub-factor: property is under construction	Construction budget is conservative and technical hazards are limited. Contractors are highly qualified and have high credit standing	Construction budget is conservative and technical hazards are limited. Contractors are highly qualified and have good credit standing	Construction budget is adequate and contractors are ordinarily qualified and have average credit standing	Project is over budget or unrealistic given its technical hazards. Contractors may be under qualified and have low credit standing
(e) Sub-factor: financial structure:				
• Amortisation schedule (sub-factor component)	Amortising debt without bullet repayment	Amortising debt with no or insignificant bullet repayment	Amortising debt repayments with limited bullet payment	Bullet repayment or amortising debt repayments with high bullet repayment
• Market/cycle and refinancing risk (sub-factor component)	There is no or very limited exposure to market or cycle risk since the expected cashflows cover all future loan repayments during the tenor of the loan and there are no significant delays between the cashflows and the loan repayments. There is no or very low refinancing risk.	The exposure to market or cycle risk is limited since the expected cashflows cover the majority of future loan repayments during the tenor of the loan and there are no significant delays between the cashflows and the loan repayments. There is low refinancing risk.	There is moderate exposure to market or cycle risk since the expected cashflows cover only a part of future loan repayments during the tenor of the loan or there are some significant delays between the cashflows and the loan repayments. Average refinancing risk.	There is significant exposure to market or cycle risk since the expected cashflows cover only a small part of future loan repayments during the tenor of the loan or there are some significant delays between the cashflows and the loan repayments. High refinancing risk.
Factor: strength of sponsor/developer (including any public private partnership)				
(a) Sub-factor: financial capacity and willingness to support the property.	The sponsor/ developer made a substantial cash contribution to the construction or purchase of the property. The sponsor/developer has substantial resources and limited direct and contingent liabilities. The sponsor/developer's properties are diversified geographically and by property type	The sponsor/ developer made a material cash contribution to the construction or purchase of the property. The sponsor/developer's financial condition allows it to support the property in the event of a cash flow shortfall. The sponsor/developer's properties are located in several geographic regions	The sponsor/ developer's contribution may be immaterial or non-cash. The sponsor/developer is average to below average in financial resources	The sponsor/ developer lacks capacity or willingness to support the property
(b) Sub-factor: reputation and track record with similar properties.	Experienced management and high sponsors' quality. Strong reputation and lengthy and successful record with similar properties	Appropriate management and sponsors' quality. The sponsor or management has a successful record with similar properties	Moderate management and sponsors' quality. Management or sponsor track record does not raise serious concerns	Ineffective management and substandard sponsors' quality. Management and sponsor difficulties have contributed to difficulties in managing properties in the past
(c) Sub-factor: relationships with relevant real estate actors	Strong relationships with leading actors such as leasing agents	Proven relationships with leading actors such as leasing agents	Adequate relationships with leasing agents and other parties providing important real estate services	Poor relationships with leasing agents and/or other parties providing important real estate services

Factor: security package				
(a) Sub-factor: nature of lien	Perfected first lien[36]	Perfected first lien	Perfected first lien	Ability of lender to foreclose is constrained
(b) Sub-factor: assignment of rents	The lender has obtained an assignment for the majority of the rents. They maintain current tenant information that would facilitate providing notice to remit rents directly to the lender, such as a current rent roll and copies of the project's leases	The lender has obtained an assignment for a significant part of the rents. They maintain current tenant information that would facilitate providing notice to the tenants to remit rents directly to the lender, such as current rent roll and copies of the project's leases	The lender has obtained an assignment for a relatively small part of the rent. The lender has not maintained current tenant information that would facilitate providing notice to the tenants to remit rents directly to the lender, such as current rent roll and copies of the project's leases	The lender has not obtained an assignment of the leases
(c) Sub-factor: quality of the insurance coverage	Very good quality	Good quality	Appropriate quality	Substandard quality

36 Lenders in some markets exclusively use loan structures that include junior liens. Junior liens may be indicative of this level of risk if the total LTV inclusive of all senior positions does not exceed a typical first loan LTV.

Annex 3
Assessment criteria for object finance exposures

	Category 1	Category 2	Category 3	Category 4
Factor: financial strength				
(a) Sub-factor: market conditions	Demand is strong and growing, strong entry barriers, low sensitivity to changes in technology and economic outlook	Demand is strong and stable. Some entry barriers, some sensitivity to changes in technology and economic outlook	Demand is adequate and stable, limited entry barriers, significant sensitivity to changes in technology and economic outlook	Demand is weak and declining, vulnerable to changes in technology and economic outlook, highly uncertain environment
(b) Sub-factor: financial ratios, i.e. DSCR[37] or ICR[38]	Strong financial ratios considering the type of asset. Very robust economic assumptions	Strong / acceptable financial ratios considering the type of asset. Robust project economic assumptions	Standard financial ratios for the asset type	Aggressive financial ratios considering the type of asset
(c) Sub-factor: advance ratio, i.e. loan-to-value (LTV[39]) ratio	Strong LTV ratio considering the type of asset.	Strong/good LTV ratio considering the type of asset.	Standard LTV ratio for the asset type	Aggressive LTV ratio considering the type of asset
(d) Sub-factor: stress analysis on the basis of the income being generated during the tenor of the loan[40]	Stable long-term revenues, capable of withstanding severely stressed conditions through an economic cycle	Satisfactory short-term revenues. Loan can withstand some financial adversity. Default is only likely under severe economic conditions	Uncertain short-term revenues. Cash flows are vulnerable to stresses that are not uncommon through an economic cycle. The loan may default in an economic downturn	Revenues subject to strong uncertainties; even in normal economic conditions the asset may default, unless conditions improve
(e) Sub-factor: market liquidity	Market is structured on a worldwide basis; assets are highly liquid	Market is worldwide or regional; assets are relatively liquid	Market is regional with limited prospects in the short term, implying lower liquidity	Local market and/or poor visibility. Low or no liquidity, particularly on niche markets
Factor: political and legal environment				
(a) Sub-factor: legal and regulatory risks	Jurisdiction is favourable to repossession and enforcement of contracts	Jurisdiction is favourable to repossession and enforcement of contracts	Jurisdiction is generally favourable to repossession and enforcement of contracts, even if repossession might be long and/or difficult	Poor or unstable legal and regulatory environment. Jurisdiction may make repossession and enforcement of contracts lengthy or impossible
(b) Sub-factor: political risk, including transfer risk, considering object type and mitigants	Very low exposure; strong mitigation instruments, if needed	Low exposure; satisfactory mitigation instruments, if needed	Moderate exposure; fair mitigation instruments	High exposure; no or weak mitigation instruments
Factor: transaction characteristics				

[37] The Debt Service Coverage ratio ('DSCR') refers to the ratio of the cashflow available for debt service which can be generated from the asset to the required repayment of the principal and the interest payments during the life of the loan, where the cashflow available for debt service shall be calculated by subtracting operating expenditure, capital expenditure, debt and equity funding, taxes and working capital adjustments from the revenues generated by the project.

[38] The Interest Coverage Ratio ('ICR') refers to the ratio of the cashflow available for debt service which can be generated from the asset to the required repayment of the interest payments during the life of the loan, where the cashflow available for debt service shall be calculated by subtracting operating expenditure, capital expenditure, debt and equity funding, taxes and working capital adjustments from the revenues generated by the project.

[39] The Loan-to-Value ratio ('LTV') refers to the ratio of the loan amount to the value of the pledged assets.

[40] The tenor of a loan refers to the amount of time left for the repayment of a loan.

(a) Sub-factor: amortisation schedule	Amortising debt without bullet repayment	Amortising debt with no or insignificant bullet repayment	Amortising debt repayments with limited bullet payment	Bullet repayment or amortising debt repayments with high bullet repayment
(b) Sub-factor: market/cycle and refinancing risk	There is no or very limited exposure to market or cycle risk since the expected cashflows cover all future loan repayments during the tenor of the loan[41] and there are no significant delays between the cashflows and the loan repayments. There is no or very low refinancing risk.	The exposure to market or cycle risk is limited since the expected cashflows cover the majority of future loan repayments during the tenor of the loan and there are no significant delays between the cashflows and the loan repayments. There is low refinancing risk.	There is moderate exposure to market or cycle risk since the expected cashflows cover only a part of future loan repayments during the tenor of the loan or there are some significant delays between the cashflows and the loan repayments. Average refinancing risk.	There is significant exposure to market or cycle risk since the expected cashflows cover only a small part of future loan repayments during the tenor of the loan or there are some significant delays between the cashflows and the loan repayments. High refinancing risk.
(c) Sub-factor: operating risk				
• Permits / licensing (sub-factor component)	All permits have been obtained; asset meets current and foreseeable safety regulations	All permits obtained or in the process of being obtained; asset meets current and foreseeable safety regulations	Most permits obtained or in process of being obtained, outstanding ones considered routine, asset meets current safety regulations	Problems in obtaining all required permits, part of the planned configuration and/or planned operations might need to be revised
• Scope and nature of O & M contracts (sub-factor component)	Strong long-term O&M contract[42], preferably with contractual performance incentives, and/or O&M reserve accounts (if needed)	Long-term O&M contract, and/or O&M reserve accounts[43] (if needed)	Limited O&M contract or O&M reserve account (if needed)	No O&M contract: risk of high operational cost overruns beyond mitigants
• Operator's financial strength, track record in managing the asset type and capability to re-market asset when it comes off-lease (sub-factor component)	Excellent track record and strong re-marketing capability	Satisfactory track record and re-marketing capability	Weak or short track record and uncertain re-marketing capability	No or unknown track record and inability to re-market the asset
Factor: asset characteristics				
(a) Sub-factor: configuration, size, design and maintenance (i.e. age, size for a plane) compared to other assets on the same market	Strong advantage in design and maintenance. Configuration is standard such that the object meets a liquid market	Above average design and maintenance. Standard configuration, maybe with very limited exceptions — such that the object meets a liquid market	Average design and maintenance. Configuration is somewhat specific, and thus might cause a narrower market for the object	Below average design and maintenance. Asset is near the end of its economic life. Configuration is very specific; the market for the object is very narrow
(b) Sub-factor: resale value	Current resale value is well above debt value	Resale value is moderately above debt value	Resale value is slightly above debt value	Resale value is below debt value
(c) Sub-factor: sensitivity of the asset value and liquidity to economic cycles	Asset value and liquidity are relatively insensitive to economic cycles	Asset value and liquidity are sensitive to economic cycles	Asset value and liquidity are quite sensitive to economic cycles	Asset value and liquidity are highly sensitive to economic cycles
Factor: strength of sponsor (including public private partnership)				

[41] The tenor of a loan refers to the amount of time left for the repayment of a loan.

[42] An Operation and Maintenance ('O&M') contract refers to a contract between the developer and the operator. The developer delegates the operation, maintenance and often performance management of the project to an operator with expertise in the industry under the terms of the O&M contract (i.e. scope, term, operator responsibility, fees, and liquidated damages).

[43] An O&M reserve account refers to a fund into which money is deposited to be used for the purpose of meeting the costs of operation and maintenance of the project.

(a) Sub-factor: sponsors' track record and financial strength	Sponsors with excellent track record and high financial standing	Sponsors with good track record and good financial standing	Sponsors with adequate track record and good financial standing	Sponsors with no or questionable track record and/or financial weaknesses
Factor: security package				
(a) Sub-factor: asset control	Legal documentation provides the lender effective control (e.g. a first perfected security interest[44], or a leasing structure including such security) on the asset, or on the company owning it	Legal documentation provides the lender effective control (e.g. a perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it	Legal documentation provides the lender effective control (e.g. a perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it	The contract provides little security to the lender and leaves room to some risk of losing control on the asset
(b) Sub-factor: rights and means at the lender's disposal to monitor the location and condition of the asset	The lender is able to monitor the location and condition of the asset, at any time and place (regular reports, possibility to lead inspections)	The lender is able to monitor the location and condition of the asset, almost at any time and place	The lender is able to monitor the location and condition of the asset, almost at any time and place	The lender is able to monitor the location and condition of the asset are limited
(c) Sub-factor: insurance against damages	Strong insurance coverage including collateral damages with top quality insurance companies	Satisfactory insurance coverage (not including collateral damages) with good quality insurance companies	Fair insurance coverage (not including collateral damages) with acceptable quality insurance	Weak insurance coverage (not including collateral damages) or with weak quality insurance

[44] First perfected security interest refers to a security interest in an asset (mortgaged as a collateral) protected from claims by other parties. A lien is perfected by registering it with appropriate statutory authority so that it is made legally enforceable and any subsequent claim on that asset is given a junior status.

Annex 4
Assessment criteria for commodities finance exposures

	Category 1	Category 2	Category 3	Category 4
Factor: financial strength				
(a) Sub-factor: degree of over-collateralisation of trade	Strong	Good	Satisfactory	Weak
Factor: political and legal environment				
(a) Sub-factor: country risk	No country risk	Limited exposure to country risk (in particular, offshore location of reserves in an emerging country)	Exposure to country risk (in particular, offshore location of reserves in an emerging country)	Strong exposure to country risk (in particular, inland reserves in an emerging country)
(b) Sub-factor: mitigation of country risks	Very strong mitigation: Strong offshore mechanisms Strategic commodity 1st class buyer	Strong mitigation: Offshore mechanisms Strategic commodity Strong buyer	Acceptable mitigation: Offshore mechanisms Less strategic commodity Acceptable buyer	Only partial mitigation: No offshore mechanisms Non-strategic commodity Weak buyer
Factor: asset characteristics				
(a) Sub-factor: liquidity and susceptibility to damage	Commodity is quoted and can be hedged through futures or OTC instruments. Commodity is not susceptible to damage	Commodity is quoted and can be hedged through OTC instruments. Commodity is not susceptible to damage	Commodity is not quoted but is liquid. There is uncertainty about the possibility of hedging. Commodity is not susceptible to damage	Commodity is not quoted. Liquidity is limited given the size and depth of the market. No appropriate hedging instruments. Commodity is susceptible to damage
Factor: strength of sponsor (including public private partnership)				
(a) Sub-factor: financial strength of trader	Very strong, relative to trading philosophy and risks	Strong	Adequate	Weak
(b) Sub-factor: track record, including ability to manage the logistic process	Extensive experience with the type of transaction in question. Strong record of operating success and cost efficiency	Sufficient experience with the type of transaction in question. Above average record of operating success and cost efficiency	Limited experience with the type of transaction in question. Average record of operating success and cost efficiency	Limited or uncertain track record in general. Volatile costs and profits
(c) Sub-factor: trading controls and hedging policies	Strong standards for counterparty selection, hedging, and monitoring	Adequate standards for counterparty selection, hedging, and monitoring	Past deals have experienced no or minor problems	Trader has experienced significant losses on past deals
(d) Sub-factor: quality of financial disclosure	Excellent	Good	Satisfactory	Financial disclosure contains some uncertainties or is insufficient
Factor: security package				
(a) Sub-factor: asset control	First perfected security interest [45] provides the lender legal control of the assets at any time if needed	First perfected security interest provides the lender legal control of the assets at any time if needed	At some point in the process, there is a rupture in the control of the assets by the lender. The rupture is mitigated by knowledge of the trade process or a third party undertaking as the case may be	Contract leaves room for some risk of losing control over the assets. Recovery could be jeopardised

[45] First perfected security interest refers to a security interest in an asset (mortgaged as a collateral) protected from claims by other parties. A lien is perfected by registering it with appropriate statutory authority so that it is made legally enforceable and any subsequent claim on that asset is given a junior status.

(b) Sub-factor: insurance against damages	Strong insurance coverage including collateral damages with top quality insurance companies	Satisfactory insurance coverage (not including collateral damages) with good quality insurance companies	Fair insurance coverage (not including collateral damages) with acceptable quality insurance companies	Weak insurance coverage (not including collateral damages) or with weak quality insurance companies

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