MPG

Guarantee-backed Lines of Credit

ASEAN PPP Summit

Mahanakorn Partners Group

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Mahanakorn Partners Group

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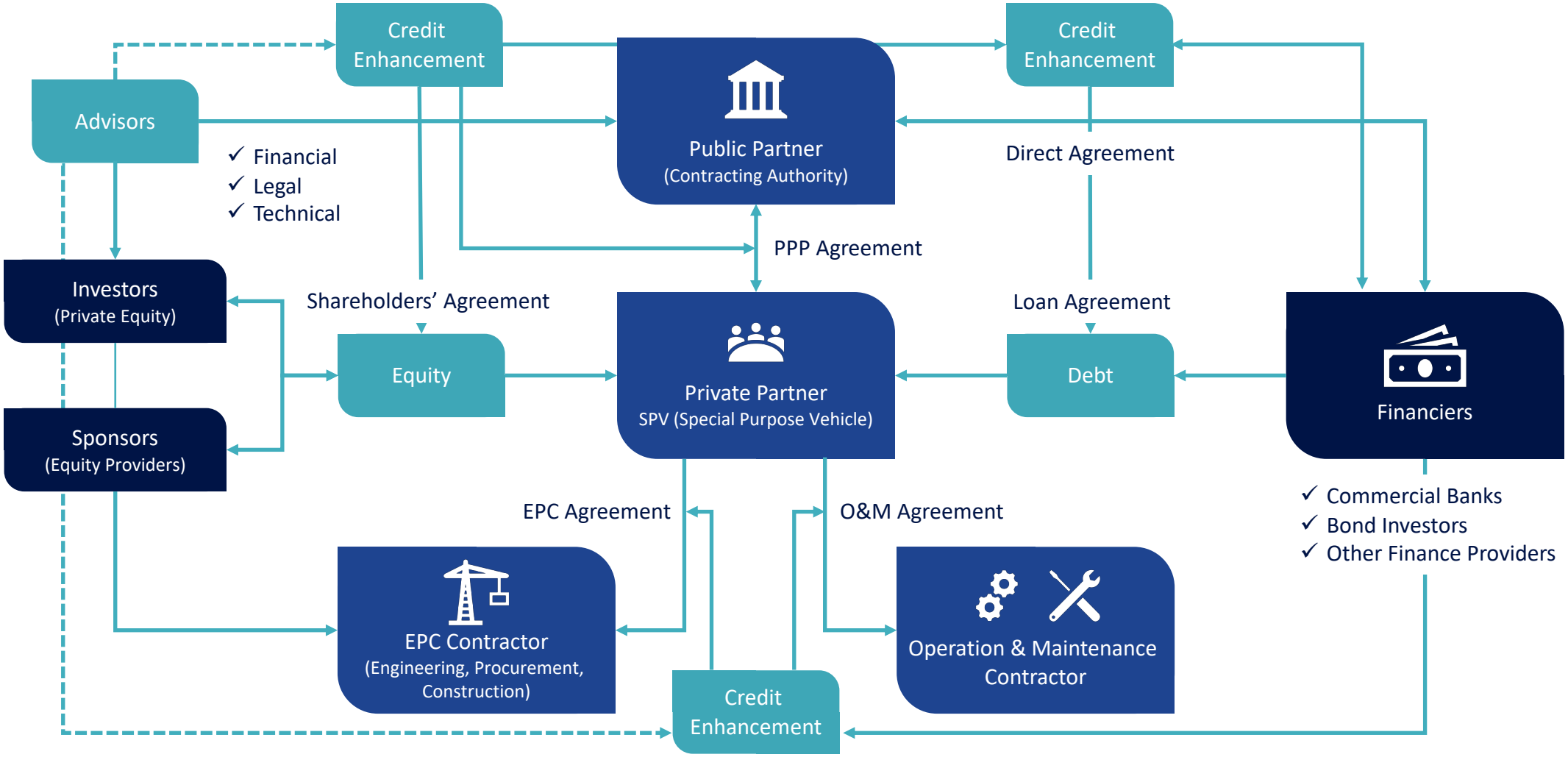


Demand Guarantees

A guarantee is a legally enforceable promise whereby the guarantor agrees to fulfill the principal obligor's obligations, should the principal obligor fail to pay or perform. In project finance transactions, lines of credit are structured so as to be underpinned by several credit enhancement mechanisms. These are contingent liabilities for the issuer, which cover the insured in the event of principal obligor's failure to perform under any circumstances.

Bid Bond

An assurance issued by a guarantor (a bank) to warrant that the importer (tenderee or project owner) receives an agreed compensation if the exporter (tenderer or contractor) defaults on its obligations under an international tender. The presentation of a bid bond is virtually always an indispensable condition for a tender to even be considered.

Performance

A guarantee that indemnifies the importer, should the exporter fail to meet its contractual obligations (failure of performance) and complete a project in a timely and satisfactory manner. The guarantee can offer coverage against a number of issues, such as quality, function or delivery. A performance bond usually covers 10-20% of the contract value.

Advance Pmt

A type of guarantee that is commonly linked to a supply agreement for capital goods, wherein the importer has agreed to make a down payment, or in a service agreement, wherein a Contractor requires an advance payment to fund the preliminary costs and mobilization works of the contract. The advance payment is commonly between 10-30% of the contract value.

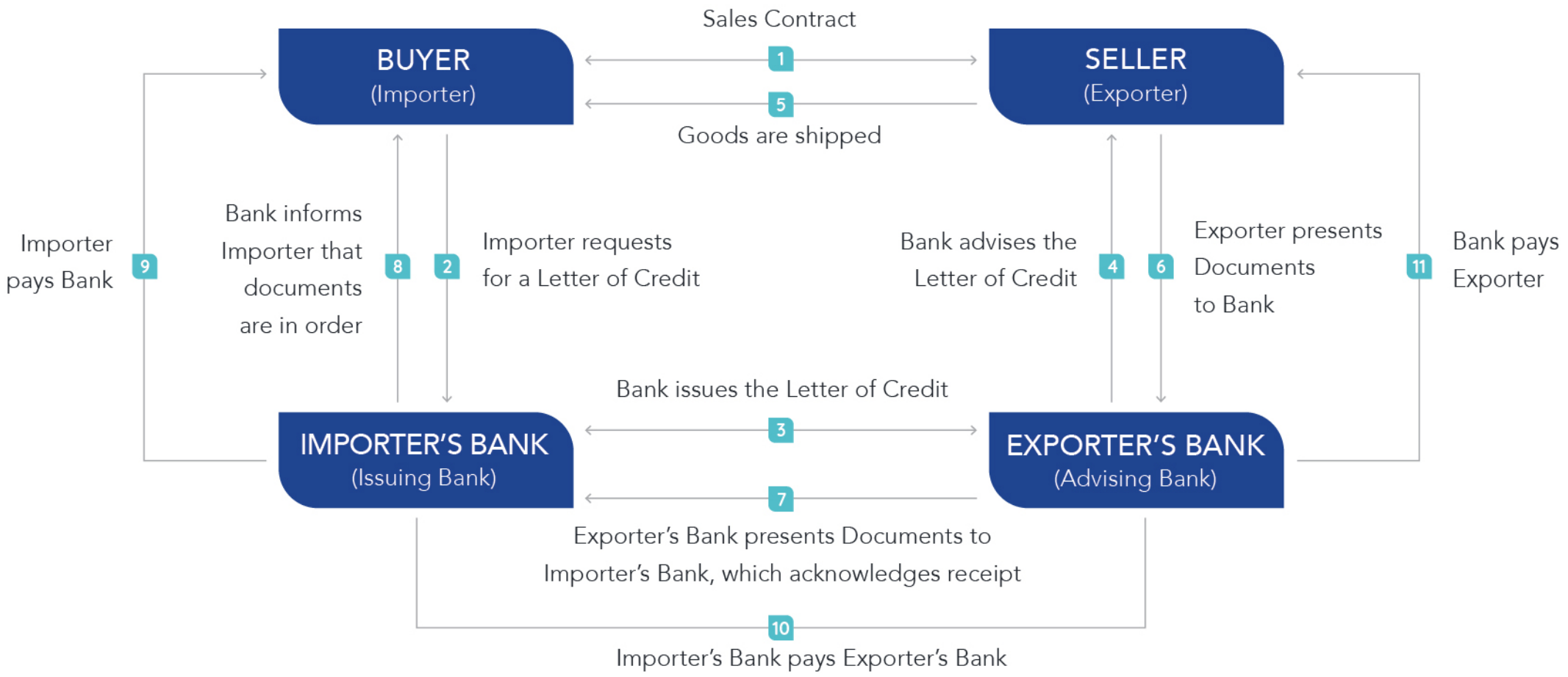
Retention

A Retention is a fraction of the amount due to a contractor on an interim certificate that is retained by the principal. The purpose of the retention is to ensure that the contractor honor their contractual obligations. A percentage of the amount retained is released upon completion of the contract and the remaining amount is paid upon issuance of a certificate of making good defects.

Payment

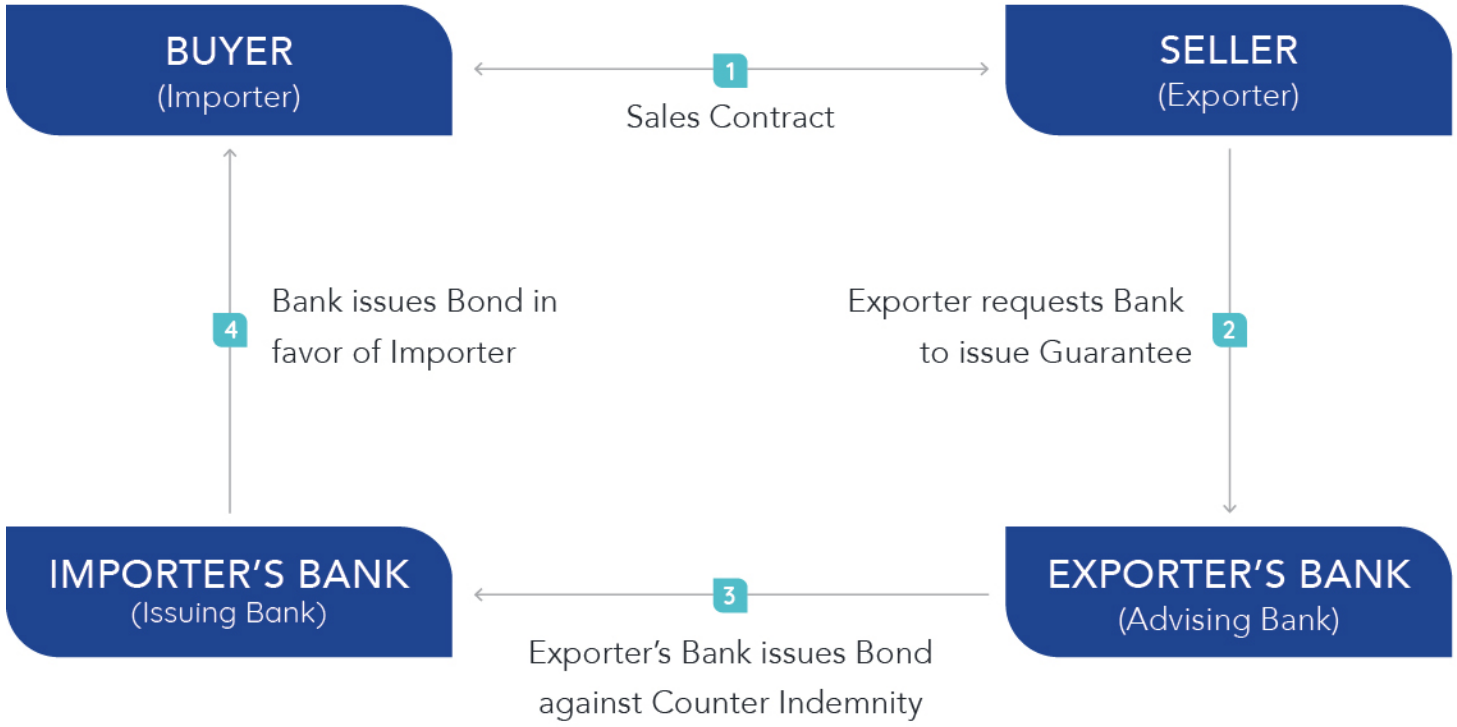
This surety is issued by a guarantor (commonly a bank or other financial institution) to underpin the performance of a construction contract. A payment guarantee can be issued as an endorsement on a bill of exchange, also known as a Per Aval (third party) endorsement. By means of a Per Aval endorsement, the exporter benefits from the credit substitution of the guarantor for the importer.

L/C-backed Transaction



Credit Substitution

The success of project finance transactions may be undermined by a number of factors and unforeseen circumstances. In order to secure their investment, the parties to an equity financing or debt financing contract often seek guarantees that serve as a contingency mechanism to sidestep unpleasant surprises.



Credit Substitution Principles

Irrevocable and unconditional. A guarantee that is offered as a substitute of the guarantor's credit rating for that of the project owner would create an unconditional payment obligation on the part of the guarantor. The guarantee, such as a letter of credit or bond insurance policy, is called a first demand instrument where the credit enhancer must simply pay without recourse to any defenses.

Full and timely payment. The timing of payment specified by the terms of both the underlying obligation and the guarantee must assure that the guarantor must pay no later than when the guaranteed obligation is contractually due. A guarantee that achieves credit substitution also covers the full amount of the principal and interest due on the debt obligation as well as any other amounts that are contractually owed to the MLA, such as a redemption premium or penalty interest.

Covers payment, not just collection. Guarantees of collection require that the creditor first exhaust all judicial remedies against the principal obligor before demanding payment from the guarantor. Such guarantees do not provide credit substitution; they merely provide a possible recovery at the end of two litigations (first against the principal obligor, then against the guarantor). Guarantees of payment, in contrast, require the guarantor to pay upon demand from a beneficiary or automatically pay when payment becomes contractually due according to the terms of the underlying obligation.

Exemption. The guarantee covers preference payments, fraudulent conveyance charges, or other payments that have been rescinded, repudiated, or "clawed back.". A guarantee that achieves credit substitution covers any payment from the principal obligor that a court rescinded, or required noteholders to give back (i.e., "disgorge") either as a result of the principal obligor's bankruptcy or otherwise. While claw-back or disgorgement most typically occurs as the result of a judicial order from a bankruptcy court, a regulatory agency will sometimes have similar statutory powers.

Waiver of defenses. A guarantor can invoke various defenses to payment (so-called suretyship defenses). In addition, the guarantor may have the benefit of virtually all the principal obligor's defenses under the guarantee-backed loan agreement. In order to avoid complex fact-based litigation, thus increasing the risk that debt service payments may not be made on a timely basis, all suretyship defenses must be expressly waived.

Source: Moody's Investors Service

Credit Substitution Principles

Term as per underlying obligation. The term of the guarantee extends as long as the term of the underlying obligation, as the guarantee must remain in force for the entire life of the guaranteed obligation, including any bankruptcy or other regulatory preference periods. The guarantee cannot be terminated prematurely at the guarantor's sole option. The guarantee also remains in force if there is a partial settlement or intermediate payment, and terminates only after the final payment due under the guaranteed obligation has been received.

Enforceable. The guarantee is enforceable against the guarantor. Many transaction structures, including those for which the rights under the guarantee are to serve as collateral for the noteholders, may not achieve credit substitution without the acknowledgment and agreement of the guarantor that the benefit of the guarantee may be assigned or transferred and may be granted as security.

Unimpaired credit. The transfer, assignment or amendment of the guarantee by the guarantor does not release the guarantor from the obligation, thus does not result in a deterioration of the credit support provided by the guarantee. However, it is not uncommon for the guaranteeing assignor to also provide written confirmation of retaining its liability, notwithstanding the guarantee assignment, so as to preserve credit substitution. Likewise, it is common for SBLCs to be expressly issued as irrevocable, non-transferable.

Governing law. The guarantee is governed by the law of a jurisdiction that is hospitable to the enforcement of guarantees. Some jurisdictions give guarantors a wide range of rights and defenses, which may result in a deterioration of the credit of the guarantee and negatively affect credit substitution. It is common, to avoid unnecessary risk, that international guarantees be governed by ICC Uniform Rules for Demand Guarantees (URDG)758

Source: Moody's Investors Service

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Thank You!

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