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All Change for ECA Aircraft Financings

Following negotiations by OECD Participants[1], the OECD has published the text of a new Aircraft Sector Understanding[2] (the "**2011 ASU**"), which has an effective date of 1 February 2011. We summarise the key amendments made to the terms on which export credit agencies in the participating countries will provide official support going forward, for new large civil aircraft.

Uniform terms apply to all aircraft

The distinction between Categories 1, 2 and 3 aircraft no longer applies and accordingly the new text does not include any aircraft lists. Instead, the same 2011 terms apply to new civil aircraft, which in some cases means a less advantageous financing profile for certain aircraft models. For example, under 2011 ASU, the standard maximum repayment term for support of new aircraft is 12 years whereas under 2007 ASU, the maximum term was 15 years for Category 2 new aircraft.

Significant increase in premiums

Probably the most significant change is the increase in the minimum premium rate to be charged for any supported financing. While the applicable rate is still based on the Participants' risk rating of the borrower (or buyer), in most cases, the minimum premium chargeable has more than doubled. The table below summarises the minimum premiums payable upfront for aircraft under 2011 ASU, compared against the minimum upfront premiums for Category 1 (large) aircraft under 2007 ASU, in each case as a percentage of the supported amount.

Borrower/Buyer Risk Rating		Minimum premium under 2007 ASU	Minimum premium under 2011 ASU
Risk Category	**Risk Classification**	***(Category 1 aircraft, 12 year repayment term, asset backed transaction)***	***(All aircraft, 12 year repayment term, asset backed transaction)***
1	AAA to BBB-	4.00	7.72
2	BB+ and BB	4.75	10.44
3	BB-	5.50	11.03
4	B+	5.50	11.85
5	B	6.25	13.38
6	B-	6.25	13.50
7	CCC	7.50	14.45
8	CC to C	7.50	14.74

Key Issues

Uniform rules for new large and regional aircraft

Higher premiums

80% maximum support for investment grade borrowers

Stricter repayment profile

Additional risk requirements for lower rated borrowers

Grandfathering rules including cap on each ECA's support levels

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[1] The 2011 ASU participating countries are Australia, Brazil, Canada, the EU, Japan, Korea, New Zealand, Norway, Switzerland and the US.

[2] The Sector Understanding on Export Credits for Civil Aircraft is part of the OECD's Arrangement on Officially Supported Export Credits and will replace the previous version of the Aircraft Sector Understanding published in July 2007 (see our client briefing on the 2007 ASU).

Maximum support for investment grade borrowers capped at 80%

Borrowers risk rated "1" (corresponding to AAA to BBB-) will no longer be able to obtain 85% export credit financing; official support to such entities is capped at 80% of the net price of the aircraft (less any discounts and credits).

Repayment profile

As mentioned, the standard maximum repayment term is 12 years for all new aircraft and while the repayment profile may still be either "mortgage-style" (equal instalments of principal and interest) or "straight-line" (equal principal instalments, with interest payable on a declining basis) amortisation, under the 2011 ASU, the standard requirement is that payments must be quarterly for all aircraft (a change for Categories 2 and 3 aircraft from the 2007 ASU). Borrowers[3] may seek more attractive terms but at a cost: a 35% surcharge to the minimum premium rate will be applied for a 15 year financing and a 15% surcharge for a semi-annual repayment profile.

The revised text includes a new provision stating that "repayment of principal may be structured to include a final payment of all outstanding amounts on a specified date", subject to the maximum repayment term allowed and with prior repayments structured in accordance with the amortisation profile described above. It appears that this provision may allow a balloon repayment at lease end.

However, the prohibition introduced under the 2007 ASU against extension of the repayment term by sharing of security rights on a *pari passu* basis with commercial lenders (which limits the utilisation of mismatch or "SOAR" loans other than on a subordinated basis) has been retained.

Risk Requirements

The 2011 ASU imposes stricter structural requirements upon any ECA supported financing, focusing on the risk profile of the borrower. The requirement that there must be a first priority security interest on the aircraft is maintained, although the relevant provision has been amended to allow such an interest to be "in connection with" the aircraft; this wording would seem to support structures which utilise a share charge or other security interest over the aircraft owning entity, rather than having asset specific security.

In addition, the new text provides that "in the case of a lease structure", an assignment and/or first priority security interest in connection with the lease payments is required. The application of this condition to transactions with multiple lease chains needs to be considered. Further, whenever possible under the applicable legal regime, there must be "cross default and cross collateralisation of all aircraft and engines owned legally and beneficially by the same parties" in the relevant financing. This requirement will need to be analysed in the context of multiple or portfolio financings and in structures with complicated ownership elements.

The risk mitigants which were introduced under the 2007 ASU are retained as "A risk mitigants": as a borrower's risk rating decreases (below BB), it is subject to an increasing number of risk mitigants, consisting of straight-line amortisation, a reduction in the repayment term to 10 years and 5% reductions in the amount of the loan advance. The 2011 ASU allows qualifying borrowers to avoid one of these "A risk mitigants" by paying a 15% surcharge on the minimum premium.

In addition, a new matrix of "B risk mitigants" applies, including a security deposit equivalent to 3 months of principal and interest (by cash or standby letter of credit), 3 months' advance lease payments and maintenance reserves in a "form and amount reflective of market best practices." Borrowers rated B+ or lower need to provide at least one of these new "B risk mitigants"; again, the number increases as the rating decreases.

The table below summarises the A and B risk mitigants under 2011 ASU, compared with 2007 ASU.

Borrower/Buyer Risk Rating		Risk Mitigants under 2007 ASU	Risk Mitigants under 2011 ASU	
Risk Category	Risk Classification	(Equivalent to 2011 ASU A Risk Mitigants only, no B Risk Mitigants applied)	A Risk Mitigants	B Risk Mitigants
1	AAA to BBB-	0	0	0
2	BB+ and BB	1	0	0
3	BB-	1	1	0
4	B+	1	1	1
5	B	2	1	1
6	B-	2	2	1
7	CCC	3	3	1
8	CC to C	3	3	1

[3] "Borrower" refers to the buyer or borrower or, if different, the primary source of repayment, which would include the airline lessee under a lease financing

Although 2011 ASU imposes additional risk mitigants, borrowers rated BB+ and BB may find themselves in a better position under the new terms in terms of risk requirements.

Home Country Rule

An issue that has raised much debate in the aviation industry relates to the future of the so-called "Home Country Rule", whereby US EX-IM Bank, the ECA of Boeing's jurisdiction, and COFACE, Euler Hermes and ECGD, the European ECAs which support financings for Airbus aircraft, have traditionally refrained from providing support to customers of Boeing or Airbus based in the US or the main Airbus manufacturing countries of the UK, France and Germany (subject to certain exceptions for operating lessors based on such countries). The 2011 ASU text is silent on this rule, which we note was the case in respect of the texts of both the 2007 ASU and the previous 1986 Large Aircraft Sector Understanding ("**LASU**") however it is understood that in practice the Home Country Rule will continue to be observed. It should be noted that Canada and Brazil do not consider their respective countries are bound by the Home Country Rule.

Transitional rules

Another controversial issue has been a "cap" on the level of export credit a Participant can provide going forward. Under the transitional provisions, the 2007 ASU terms will still apply to aircraft subject to a firm contract concluded no later than 31 December 2010 and physically delivered by 31 December 2012 for Category 1 aircraft and 31 December 2013 for Categories 2 and 3 aircraft.

However, the text states that official support may be provided on terms applicable prior to the effective date of the 2011 ASU (i.e. 1 February 2011) for aircraft under a firm contract concluded no later than 31 December 2010 and subject to an aircraft cap of 69 Category 1 aircraft and 92 Category 2 aircraft per Participant. Although the text of the 20ll ASU expressly provides that such caps are total numbers applicable both to aircraft otherwise eligible for support under the 1986 LASU and aircraft otherwise eligible for support under the 2007 ASU we understand it was intended that the 69 Category 1 aircraft cap apply only to aircraft otherwise eligible for support under the 1986 LASU and that in practice it will be so applied.

Great-grandfathered and grandfathered aircraft were required to be identified on confidential "transition lists" provided to the OECD Secretariat. We assume such lists have been so provided but we have no information as to the contents of the same.

Even if aircraft qualify for these more attractive support terms, there will be an extra cost payable in the form of a commitment fee of 20 b.ps per annum chargeable from the earlier of (a) the commitment date and (b) (i) 31 January 2011 for Category 1 or (ii) 30 June 2011 for Category 2 aircraft until the delivery date for 2007 ASU terms; for LASU terms the commitment fee is 35 b.ps per annum from the earlier of the commitment date or 31 March 2011 until the delivery date.

Cape Town Discount Conditions

A new condition for the Cape Town discount requires the relevant contracting state to have implemented the treaty into national law, supported by a detailed analysis and ultimately, if there is a dispute, a report from an independent law firm. Any Cape Town discount is capped at a 10% reduction of the applicable minimum premium.