EU 2020 And Long Term Financing

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Agenda

- New Sources of Finance And New Risks to Mitigate
- Impact of Basel III and Solvency II
- Credit Enhancements For Project Financing
- S&P's Assessment of Counterparty Risk In Infrastructure Projects

New Sources of Funding and New Risks to Mitigate

- Basel III and Solvency II aim to enhance regulation of the banking and insurance sectors, respectively, starting in 2013
- Higher costs to obtain project finance loans
- Ongoing changes related to which banks offer project loans
- A change in how banks structure such loans
- More refinancing risk for some bank loan financings
- A shift to more capital-market funding of project finance transactions
- The creation of innovative financing solutions such as effective targeted risk transfer techniques to improve projects’ credit quality

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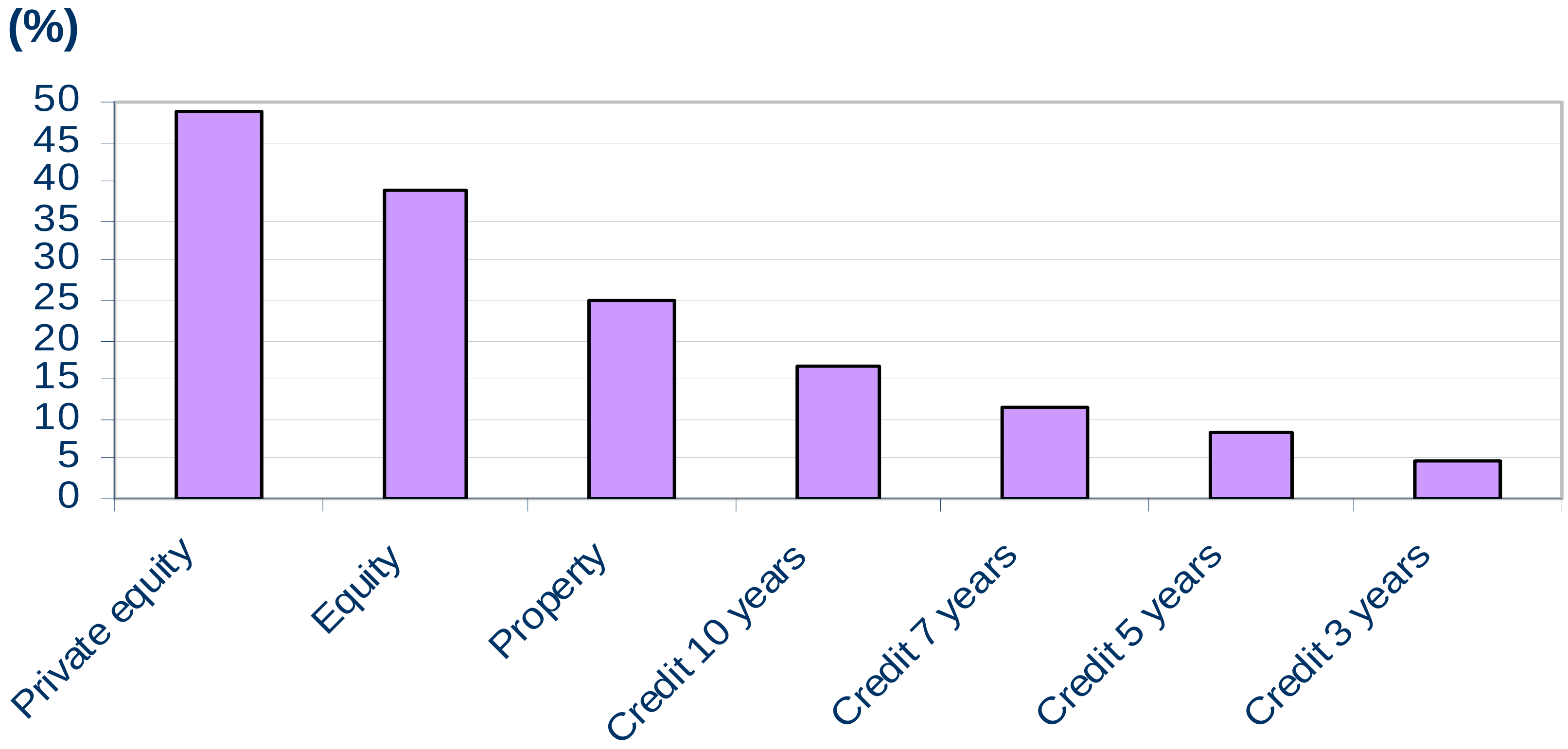
Capital Requirements For Lending By Asset Classes Under Basel III & Solvency II



Source: Oliver Wyman, Morgan Stanley: Insurance: Solvency II, Quantitative & Strategic Impact: The Tide is Going Out, September 2010.

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Key Implementation Milestones Of Basel III And Solvency II

	2013	2015	2018
Basel III			
	The cost of over-the-counter derivatives will rise significantly for end users because of a steep increase in regulatory capital requirements for banks related to these transactions.	The introduction of the liquidity coverage ratio assumes that liquidity facilities (use without conditions) be 100% drawn, versus 10% drawn within one month for credit facilities with a dedicated use.	The introduction of the net stable funding ratio will require banks to provide 50% stable funding requirements for loans below one year, 100% for loans above one year. Also, corporate bonds rated 'AA-' and above need only 20% stable funding, corporate bonds rated between 'A' and 'AA-' 50%, and below 'A' 100%.
	A sharp increase in market risk requirements for proprietary trading will increase the incentive for banks to lend to corporates.	Deposits of small and midsize enterprises (SMEs) will be assumed to be as stable as retail deposits. The regulation assumes an outflow of 5% / regulation assumes an outflow of 5% / one-month horizon compared with an outflow of 75% for large corporates.	
Solvency II			
	Until 2013 (the earliest possible implementation date) there are no regulatory capital requirements for asset risk.	**--Various transitional positions over a period of up to 10 years--**	
	The most recent potential calibration of Solvency II (Quantitative Impact Study 5; QIS 5) introduces risk-based capital requirements for asset risk. Lighter risk weights on short-dated highly rated corporate bonds and high weights on equities, private equities and long-dated lowly rated corporate bonds.		

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Incremental Borrowing Costs Due To Increased Capital Requirements*

(Bps)	Return on equity threshold target		
	8%	10%	5%
Investment grade	20	25	40
Mid 'BB' to mid 'BBB'	39	51	80
Speculative grade	70	91	142

(Bps)	Return on equity threshold target**		
	8%	10%	5%
Investment grade	50	56	70
Mid 'BB' to mid 'BBB'	66	78	107
Speculative grade	92	112	164

Source: Standard & Poor's calculations. *Assumes regulatory risk weights of 35% of investment grade, 70% for 'BB' and 'BBB' categories, and 125% below; core Equity of 9.5%; Hybrid Tier 1 of 1%; funding costs over LIBOR of 30 bps for senior debt, 500 bps for Tier 1 and 0 bp on deposits; Loan to deposit ratio of 150%; and tax rate of 33%. ** Assumes 100 bps liquidity charge for the introduction of the Net Stable Funding Ratio.

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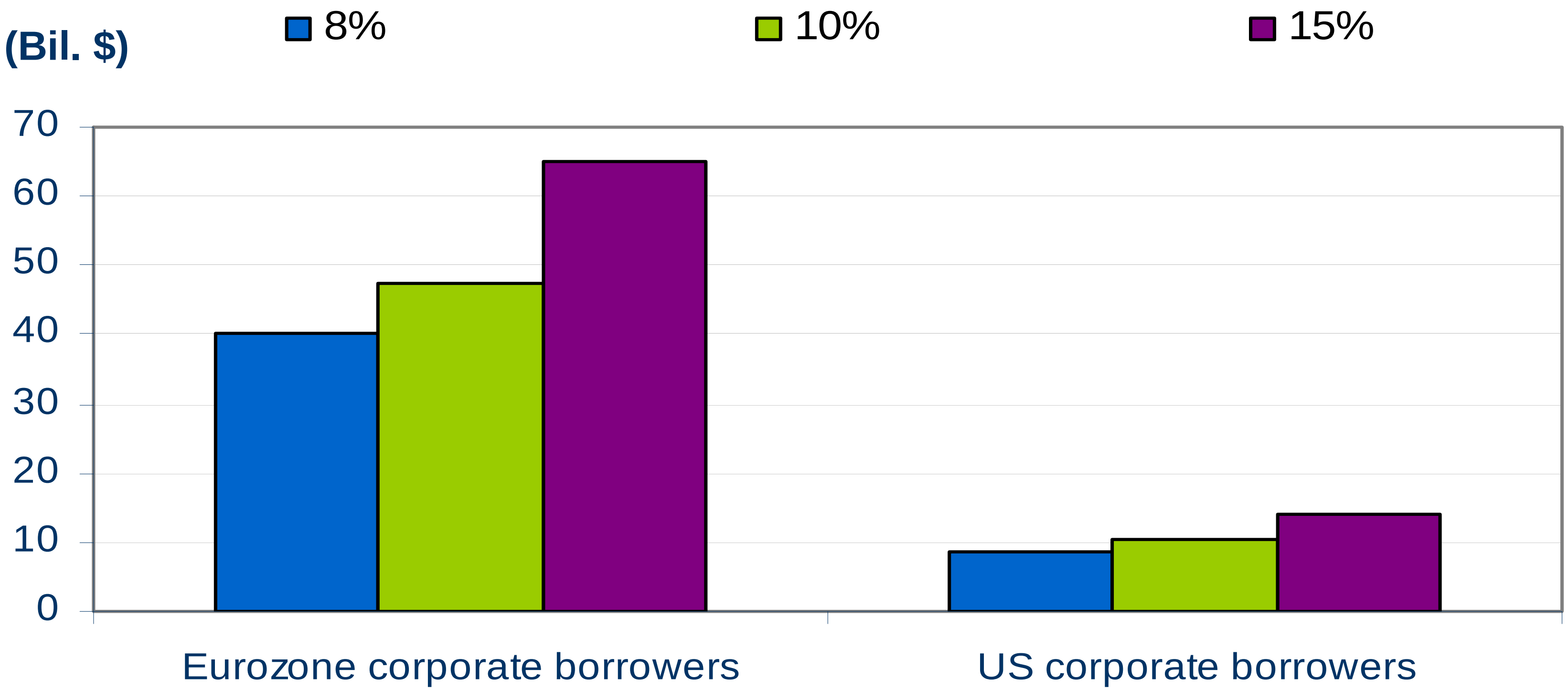
Annual Additional Interest Costs For U.S. And Eurozone Corporate Borrowers Under Basel III Depending On Banks' ROE Targets*



*Source: Standard & Poor's calculations, ECB, FED. RCE – return on equity.

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The Infrastructure Funding Challenge – Bridging the Gap

- **Demand for infrastructure is strong <u>but</u> the supply side is absent**
- **Investor sentiment to infrastructure remains broadly positive, given the track record of credit stability and long dated nature**

EMEA Market needs to 'bridge' from the current "BBB Category" ratings

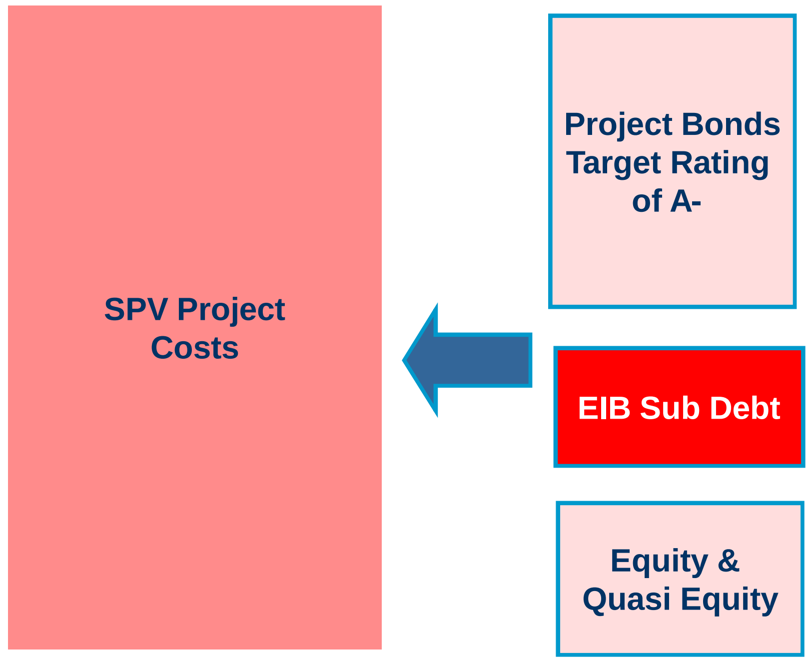
To achieving ratings in the 'A Category' to potentially meet this demand

EU Project Bond Initiative – Moving the Market Forward?

- **EU Project Bond Proposal**
  - Funded or Unfunded Sub-debt for up to 20% of the Total Project Debt issuance financed by the European Investment Bank
  - Funded is permanent sub-debt loan day one
  - Unfunded is on demand liquidity facility
- **S&P's View:**
  - devil is in the detail but,
  - It cannot make a weak project good and
  - has the capacity to enhance the debt rating

- **EU Project Bond Proposal**

Funded or Unfunded Sub-Debt for up to 20% of the total debt issue used in conjunction with bond or bank debt



Sovereign Credit Quality and Projects – Standard & Poor's Criteria

- **Sovereign credit quality plays a key role in determining project ratings**

The Transfer and Convertibility (T&C) Assessment of a Sovereign Is Generally a Cap to a Project's Rating

- **This may result in the project being rated higher than the Sovereign's Foreign currency rating if the project's characteristics support it**
- **However, there maybe cases where a project's debt issue rating could be higher than the T&C based on the transaction structure such as a via offshore structuring or a guarantee**

	Sovereign LC/FC T&C	Project LC/FC	Potential Project Debt Rating	Potential Project Debt Rating With "Structure"
Wastewater Plant	A-/BBB A	BB/BB	BB	Higher than BB
"Strong" Wastewater Plant	A-/BBB A	BBB/BBB	BBB	Higher than BBB
LNG Plant	A-/BBB A	A-/BBB	A-/BBB	Higher than A-/BBB
"Strong" LNG Plant	A-/BBB A	A-/A-	A	Higher than A

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Sovereign Credit Quality and Projects – T&C and Sovereign Ratings in the EU

Sample Sovereign Ratings	Long Term Rating (as at 6/4/12)	Transfer & Convertibility Assessment
U.K	AAA//Stable	AAA
Federal Republic of Germany	AAA/Stable	AAA
Republic of France	AA+/Negative	AAA
Kingdom of Spain	BBB+/Negative	AAA
Republic of Italy	BBB+/Negative	AAA
State of The Netherlands	AAA/Negative	AAA
Republic of Ireland	BBB+/Negative	AAA
Hungary	BB+/Negative	BBB
Republic of Portugal	BB/Negative	AAA
Hellenic Republic of Greece	CCC/Stable	AAA

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Sovereign Credit Quality and Projects – New Concerns and Opportunities

- **Counterparty Credit Quality Evolving – Sovereign, Sub-Sovereign**

- **Likely Increased Interface Risk in Existing Projects**

- **Review of value for money of proposed projects and uncertainty over financing availability – including market access**

- **But also effective means of financing infrastructure development whilst Government balance sheets are stretched**

Project Finance Criteria Update

- **Construction and Operations Counterparty established as criteria for project finance in December 2011**
- **Request for Comment (RfC) issued on Transaction Structure in November 2011**
- **Further RfCs on Construction, Operations and Overall Project Framework will follow.**

Aim to deliver greater transparency to the project finance ratings process

Not anticipating significant ratings changes based on the experience to date, but there maybe modest adjustments

Project Finance Criteria Update: Counterparty Risk in Projects

Counterparty risk results from reliance on suppliers, construction companies, operators and concession grantors

Summary Of Counterparty Dependency Assessments (CDA) Relative To Contract Type

	Type of Contract Obligation				
Counterparty	Revenue (concession or offtaker)	Construction	Equipment supplier	Operations and maintenance	Raw material supply
Irreplaceable	CDA is equated to counterparties' ICRs or credit estimates				
Replaceable (Subpart VI.C)	CDA is linked to basket of offtake counterparties (Subpart VII.A.1)	CDA uplifted by up to two categories from counterparty ICR, reflecting credit enhancement and type of construction (Subpart VII.B & table 3)	CDA uplifted by up to two categories from counterparty ICR, reflecting credit enhancement and availability of viable alternate suppliers (Subpart VII.C & table 5)	No CDA assigned, as de-linked subject to number of alternate parties and credit support equal to one month's fees (Subpart VII. D)	CDA is de-linked or uplifted by up to two notches from counterparty ICR, reflecting availability of viable alternate suppliers (Subpart VII.E & table 6)
EXCEPTIONS					
Counterparty with regulatory or legal support	CDAs may be raised for counterparties rated 'BB' and lower (¶39 & table 2)	N/A	N/A	N/A	N/A
Unwilling counterparty	CDA capped at one category lower than the counterparty ICR, subject to a maximum 'bb+' (Subpart VII.A.3)	N/A	N/A	N/A	N/A

CDA--Counterparty Dependency Assessment. ICR--Issuer Credit Rating. N/A--Not applicable.

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The Project Finance Funding Landscape Is Going To Change

- **“How Europe’s Initiative To Stimulate Infrastructure Project Bond Financing Could Affect Ratings,” May 16, 2011**
- **“Basel III and Solvency II Regulations Could Bring A Sea Change In Global Project Finance Funding,” October 14, 2011**
- **“Why Basel III and Solvency II Will Hurt Corporate Borrowing In Europe More Than In The U.S.,” September 27, 2011**
- **“Solvency II Implementation Looks, But European Insurers Face Uncertainty After Fifth Quantitative Impact Study,” April 6, 2011**
- **“Basel III Proposals Could Strengthen Bank’s Liquidity, But May Have Unintended Consequences,” April 15, 2010**

Source: Standard & Poor’s Global Credit Portal.

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