OFFICIAL INFORMATION
OF THE CZECH NATIONAL BANK

of 27 May 2011

regarding the prudential rules for banks, credit unions and investment firms

Specialised Lending Exposures When Calculating the Capital Requirement for Credit Risk

The Czech National Bank hereby provides the following information with regard to Article 97, 6, Annex 11, 3, c), Annex 12, 2, d) and Annex 1, 1, B. to Decree No. 123/2007 Coll., stipulating the prudential rules for banks, credit unions and investment firms, as amended (hereinafter the "Decree"):

I. IRB Approach: Categories of corporate exposures – specialised lending exposures

1. Specialised lending exposures in respect of which the liable entity is not able to demonstrate that its PD estimates meet the requirements for the use of the IRB Approach (hereinafter the "regulatory approach"), shall be further structured by the liable entity as follows:
   a) project financing;
   b) income-producing real estate financing;
   c) object financing;
   d) commodity financing.

2. The structuring under paragraph 1 above may be expanded by the liable entity, as long as this corresponds to the nature of its exposures.

3. 'Project financing' is understood to mean a lending method whereby the lender primarily takes into account the income generated by a single project which is the source of repayment and also serves as protection of the exposure. As a rule, it is used for large, complex and costly investments such as power stations, chemicals processing plants, mines, transport infrastructure, telecommunications infrastructure and environmental infrastructure. Project financing may take the form of the construction of a new plant unit or the refinancing of an existing unit for renovation, reconstruction or modernisation purposes. As a rule, the borrower is a special purpose vehicle (SPV) which is not authorised to perform any other activities than to create, own and operate the given project. As a consequence, the source of repayment of the loan is primarily dependent (exclusively or almost exclusively) on cash flows generated by the project and on the value of the project assets which serve as funded credit protection. The risk of project financing is reduced if repayment is dependent primarily on well-established, diversified, creditworthy and contractually bound end users.

4. 'Income-producing real estate financing' is understood to mean a lending method for real estate (such as office buildings for rent, retail premises, residential rental housing with a

large number of dwelling units, industrial or warehouse buildings, hotels) where both the exposure's repayment and the recovery rate are primarily dependent on cash flows generated by this real estate or by a given set of real estate assets. The primary source of these cash flows is income from lettings or sale of real estate. For example, the borrower may be, but need not be exclusively, a special purpose vehicle, a company specialising in real estate construction and tenure, or a company that may have other income besides real estate income. A pronounced feature that distinguishes this type of exposure from other corporate exposures protected by real estate is the strong positive correlation between the borrower's ability to repay and the potential recovery rate in the case of default; both of these depend primarily on the cash flow generated by the given real estate.

5. 'Object financing' is understood to mean a lending method for the acquisition of physical assets (e.g. ships, aircraft, satellites, railway vehicles or vehicle fleets) where repayment of the exposure depends on cash flows generated by this specific asset that is financed (for which a loan is granted) and the lender has a lien on this specific asset. The primary source of cash flows is income from lettings from one or more third parties. If, however, the borrower's financial situation and debt capacity enable it to repay the debt without an exclusive dependency on the given specific asset, this is a corporate exposure with funded credit protection.

6. 'Commodity financing' is understood to mean a structured short-term lending method for financial requirements, i.e. inventories, receivables or commodities traded on public markets (e.g. oil, metals, certain agricultural commodities) where the source of repayment of the exposure is income from the sale of these assets and the borrower has no capability for independent repayment, i.e. has no other activities or balance-sheet assets. The structured nature of the lending is conceived in a way that compensates the borrower's poor credit quality. The exposure rating reflects the nature of the exposure and the lender's ability to appropriately structure the exposure rather than the borrower's credit quality. However, this is not a merely standard operational lending method for a borrower whose activity is more diversified and whose credit quality can be assessed according to ongoing operations where the asset that could otherwise become the subject of commodity financing may serve as a protection of the exposure rather than the source of repayment of the loan.

7. It is expected that the liable entity will assess the individual categories of specialized lending exposures according to the criteria set out in the annex to this Official Information. The liable entity may adjust these criteria so that they reflect as plausibly as possible the assessment of the risk corresponding to the nature of its provided exposures and so that no important aspect of assessment is overlooked.

8. If the liable entity has expanded its range of categories of specialised lending exposures with additional categories, it must define the criteria for assessing them in a way that ensures that they reflect as plausibly as possible the risks corresponding to the nature of the exposures provided by such liable entity and so that no important aspect of assessment is overlooked. At the same time, the liable entity shall adjust the characteristics for mapping exposures to regulatory rating grades in the equivalent manner as in the case of the specialised lending exposures mentioned in the annex to this Official Information.

9. For the purposes of the annex to this Official Information 'sponsor' is understood to mean a legal or natural person that supports or otherwise contributes to the completion or

operation of the project or asset that is being financed. The support or contribution may be financial or non-financial in nature.

II. Fulfilment of criteria and assigning risk weights for specialised lending exposures under the IRB Approach

10. When assessing whether an exposure essentially fulfils the criteria for mapping to specialised lending exposures, the liable entity shall take into account:

    a) The possibility of the diversification of the borrower's activities – e.g. if the nature of the borrower's activity corresponds to specialised lending exposures, but the borrower is implementing several diversified projects (in practice three or more) and, if one of the projects fails, it is able to independently substitute the ceased cash flows with other projects, this does not constitute specialised lending exposure;

    b) The materiality of the specialised lending exposure in the borrower's cash flows – e.g. if the borrower, besides having activities related to the given exposure, has other diversified activities, but these other activities are not significant and cannot, if the exposure fails, sufficiently substitute any ceased cash flows that were used as a source of repayment (e.g. less than 30% coverage), this constitutes a specialised lending exposure;

    c) The materiality of the specialised lending exposure that the liable entity is financing – e.g. if the borrower uses more than one credit product from the same liable entity (e.g. operational financing and specialised lending exposures), the predominant nature of the borrower's financing is decisive.

    The borrower can be assigned to just one exposure category, i.e. either to ordinary corporate exposures or to specialised lending exposures. The liable entity shall proceed in the equivalent manner, unless it finances all of a given borrower's specialised lending exposures.

11. The risk weights for specialised lending exposures under the regulatory approach shall be determined according to the resulting regulatory grade, which results from the assessment of the risk factors as per the enclosed table, and according to the residual maturity of the exposure. Exposures for which a balloon or one-off payment of the exposure is assumed at the end of the maturity, but for which it is not assumed or it cannot be assumed that the resources to cover this repayment have been generated by the asset being financed, may not be classified under the residual maturity of the exposure of 'less than 2.5 years'. 'Exposure with a balloon or one-off payment' is understood to mean an exposure where the expected payment in the last year of the maturity accounts for 25 or more percent of the principal provided at the beginning.

III. Management of risks for exposures that are specialised lending exposures in their nature

12. The liable entity that uses the standardised approach (hereinafter the "STA Approach") for the calculation of capital requirements for credit risk in the investment portfolio shall, for

the purposes of this calculation, classify exposures that are specialised lending exposures in their nature, upon the commencement of such exposures, into the category of corporate exposures or into the category of exposures secured by real estate and shall not put them into a separate category or subcategory. However, with regard to the specific nature of exposures described in paragraph 10 and the risks related to these exposures, the Czech National Bank expects that the liable entity is able to distinguish these exposures in its internal systems and manage the related risks (including their monitoring and measurement). For the purposes of their management, the liable entity using the STA Approach can analogically use the criteria for the regulatory approach for specialised lending exposures mentioned in the annex.

13. If in the management of specialised lending exposures or exposures that are of this nature under the STA Approach the liable entity discovers that the regulatory risk weights (under the STA Approach or by using the regulatory approach under the IRB Approach) undervalue their actual risk, the liable entity shall allocate against them a sufficient amount of internally determined capital.

14. The risks related to specialised lending exposures or exposures that are of this nature under the STA Approach that may not be sufficiently covered by capital requirements include, among other items, the risk of a high correlation between the probability of default (PD) and the loss given default (LGD) and the risk of concentration, especially if these exposures are concentrated in one or several sectors or projects (e.g. development and related activities, photovoltaic power plants). In the event that specialised lending exposures or exposures that are of this nature exceed 10% of the investment portfolio or 15% of the amount of corporate exposures or exposures secured by real estate and are not sufficiently diversified, this may be generally regarded as a signal of an increased risk of concentration. It is also necessary to take into account exposures to the same sectors, if they are classified under ordinary corporate exposures. The Czech National Bank expects that the liable entity manages the risk of exposure concentration and that it allocates a sufficient amount of internally determined capital, if this risk increases.

15. As part of the criterion 'Stress analysis, economic cycle', the liable entity shall take into account potential financial and economic stresses with regard to the maturity of the exposure. When determining the regulatory rating grades according to the annexed tables or when using an analogical approach set directly by the liable entity, the liable entity shall ensure that the overall grade of the given exposure or the given borrower is distinguished with sufficient prudence. For this purpose, the liable entity, as part of its methodology for the assessment of specialised lending exposures shall take into account the significance of the individual criteria under review. For example, the mode of the ratings reached in the individual criteria may not be regarded as the resulting overall rating grade and the liable entity shall consider to what extent e.g. the rating grade 'weak' in certain criteria can be compensated by a better rating grade in other criteria. The liable entity must be able to document and justify its decision on any offset between the criteria.

IV. Final Provisions

16. The Official Information of the Czech National Bank of 18 July 2007 regarding the prudential rules for banks, credit unions and investment firms: Specialised Lending

Exposures when Calculating the Capital Requirement for Credit Risk, published in the CNB Bulletin under number 18/2007, is hereby repealed.

17. This Official Information shall apply from the date of its publication.

Vice-Governor

prof. PhDr. Ing. Vladimír Tomšík, Ph.D. v.r.

Annex
Criteria for the regulatory approach to specialised lending exposures

Financial Market Regulation and Analysis Department
Responsible:
Ing. Sůvová, CSc., tel.: 224 412 702

Criteria for the regulatory approach to specialised lending exposures

Table 1 – Regulatory rating grades for project financing

	Very good	Good	Sufficient	Poor
Financial strength				
Market conditions	Several competing suppliers or substantial and durable competitive advantage in terms of location, costs or technology. Demand is strong and growing.	Several competing suppliers or location, costs or technology on an above average level; this situation need not last, however. Demand is strong and stable.	The project does not have a competitive advantage of location, costs or technology. Demand is adequate and stable.	The project has a below average standard in terms of location, costs or technology. Demand is weak and falling.
Financial indicators (e.g. debt service coverage ratio, loan life coverage ratio, project life coverage ratio, and debt-to-equity ratio)	Very strong financial ratios relative to the project's risk level; very stable (robust) economic assumptions.	Strong to acceptable financial ratios relative to the project's risk level; stable economic assumptions.	Average financial ratios relative to the project's risk level.	Weak level of financial ratios, or aggressive financial policy relative to the project's risk level.
Stress analysis, economic cycle	The project can meet its financial commitments in the event of major stress in the given economy or sector.	The project can meet its financial commitments in the event of long-lasting stress in the given economy or sector. It is probable that the project will only default under unfavourable economic conditions.	The project is sensitive to stress that is not exceptional through an economic cycle and may default in a normal economic downturn.	It is probable that the project will default, if conditions do not improve soon.

	Very good	Good	Sufficient	Poor
Financial structure				
Duration of the loan compared to the duration of the project	The project's lifespan substantially exceeds the loan's maturity.	The project's lifespan sufficiently exceeds the loan's maturity.	The project's lifespan slightly exceeds or is equal to the loan's maturity.	The project's lifespan probably does not exceed the loan's maturity.
Repayment scheme	Regular repayment schedule, repayments copy the debtor's income.	Unequal repayments, copying the debtor's income.	Unequal repayments with limited one-off repayment *(bullet payment)*.	One-off repayment *(bullet payment)* or amortisation repayments with a high bullet payment.
Political and legal environment				
Political risk, including transfer of risk, relative to the type of project and risk mitigation instruments	Very low risk; if necessary effective mitigation instruments are available.	Low risk; if necessary, sufficient mitigation instruments are available.	Slight risk; if necessary satisfactory mitigation instruments are available.	High risk; mitigation instruments are absent or relatively ineffective.
Risk of *force majeure* (war, civil unrest, etc.)	Very low risk.	Low and acceptable risk.	Partial risk.	Significant risk, not fully mitigated.
Government support and the project's significance for the country from the long-term point of view	Project of strategic importance for the given country (usually export-oriented). Strong government support.	The project is regarded as important for the country. Good standard of government support.	The project is not necessarily strategic or important, but brings the country indisputable benefits. Government support	The project is not key for the country. Government support is absent or weak.
Stability of the legal and regulatory environment (risk of new legislation)	Favourable and stable regulatory environment from the long-term point of view.	Favourable and stable regulatory environment from the medium-term point of view.	It is probable that there will be regulatory changes negatively influencing the project.	The project will be negatively influenced by current or future changes in regulatory environment.
Acquisition of all necessary support or relief from local authorities	Excellent standard	Sufficient standard	Satisfactory	Poor

	Very good	Good	Sufficient	Poor
Enforceability of contracts and protection	Contracts and protection can be enforced quickly and effectively.	Contracts and protection can be enforced.	Contracts and protection are regarded as enforceable, yet certain problems, not deemed significant, may exist.	Key problems remain unresolved with regard to the actual enforceability of contracts and protection.
Characteristics of the				
Project design[1] *and technology risk*	Technology and design fully proven.	Technology and design fully proven.	Proven technology and design – problems on launch are alleviated by a strong set of measures aimed at completion.	Technology and design unproven; there are technological problems or complicated construction.
Risk associated with construction				
Permits associated with construction and its location	All permits have been obtained.	Certain permits have not yet been awarded, but are highly likely to be.	Some permits have not yet been awarded, but the award process is well defined and regarded as routine.	Key permits that are not considered routine still need to be awarded. These may be associated with significant conditions.
Type of construction contract	EPC – Engineering and Procurement Contract, turnkey construction projects with a fixed price and precise completion deadline with a highly reliable contractor.	EPC – Engineering and Procurement Contract, turnkey construction projects with a fixed price and precise completion deadline.	Contract with one or several contractors for a turnkey construction project with a fixed price and precise completion deadline.	Turnkey contract without a fixed price or with a partially fixed price, or problems in collaboration with various contractors.

[1] Refers to the project's appearance, structure and functionality.

	Very good	Good	Sufficient	Poor
Guarantees of proper performance and completion	Compensation for damage incurred during implementation is almost fully guaranteed and is supported by the debtor's financial situation or strong support from sponsors with an excellent financial situation.	Compensation for damage incurred during implementation is to a significant degree guaranteed and supported by the debtor's financial situation or strong support from sponsors with a good financial situation.	Compensation for damage incurred during Implementation is to a reasonable degree guaranteed and supported by the debtor's financial situation or strong support from sponsors with a good financial situation.	Compensation for damage incurred during implementation is not guaranteed to a reasonable degree guaranteed and is not supported by the debtor's financial situation or by appropriate sponsors.
Contractor's track record and financial strength in constructing similar projects	Excellent	Good	Sufficient	Poor
Operational risk				
Scope and nature of operational and service contracts	Very high-quality long-term operational and service contract, ideally with performance incentives, or reserve accounts for operation and maintenance	Long-term operational and service contract or reserve accounts for operation and maintenance.	Limited operational and service contract or reserve account for operation and maintenance.	No operational and service contract: risk of high operating costs is greater than the capabilities of risk mitigation instruments.
Operator's know-how, track record and financial strength	Excellent standard, or sponsors' commitment to provide technical assistance.	Very good	Acceptable	Limited to poor, or local operator dependent on local authorities.
Buyer risk				
(a) In the case of a contract with a buyer in the "*take-or-pay*"[2] regime or with a fixed price:	Buyer has excellent creditworthiness; tough contract termination clauses; contract's duration far exceeds the debt's maturity.	Buyer has good creditworthiness; tough contract termination clauses; contract's duration exceeds the debt's maturity.	Buyer has acceptable financial situation; standard contract termination clauses; contract's duration roughly the same as the	Weak buyer; insufficient contract termination clauses; contract's duration does not exceed the debt's maturity.

[2] In this regime, the volume agreed in the contract must be paid for regardless of whether it is consumed (e.g. supplies of gas or electricity).

	Very good	Good	Sufficient	Poor
(b) In the event of no contract with the buyer in the ”*take-or-pay*“ regime or with a fixed price:	The project produces essential services or a commodity generally sold on a world market; the output can be easily absorbed at the planned prices, even if the market growth slows down.	The project produces essential services or a commodity generally sold on a regional market, which can absorb it at the planned prices at historical growth rates.	The commodity is sold on a limited market that can absorb it only at lower prices than planned.	The project's output is required just by one buyer or several buyers or is not generally sold on an organized market.
Supplier risk				
Risk associated with the price, volume and shipping of raw materials; supplier's track record and financial strength	Long-term supply contract with a supplier with an excellent financial situation.	Long-term supply contract with a supplier with a good financial situation.	Long-term supply contract with a supplier with a good financial situation – some degree of price risk may persist.	Short-term or long-term supply contract with a financially weak supplier – some degree of price risk may persist certainly persists.
Risks associated with reserves (e.g. development of natural resources)	Independently verified, proven and developed reserves sufficiently exceeding requirements over the lifetime of the project.	Independently verified, proven and developed reserves exceeding requirements over the lifetime of the project.	Verified reserves may adequately provide for the project's requirements until the debt's maturity.	The project is to some degree reliant on potential and undeveloped reserves.
Sponsor's strength				
Sponsor's track record, financial strength and experience with the country or sector	Strong sponsor with excellent track record and excellent financial situation.	Good sponsor with sufficient track record and good financial situation.	Adequate sponsor with reasonable track record and good financial situation.	Weak sponsor with no or questionable track record or financial weaknesses.

	Very good	Good	Sufficient	Poor
Sponsor support reflected in equity, a ban on change in ownership structure without lender's approval and motivation to supply further financing if necessary	Strong. The project is highly strategic for the sponsor (principal activity – long-term strategy).	Good. The project is strategic for the sponsor (principal activity – medium-term strategy).	Acceptable. The project is considered important for the sponsor (principal activity).	Limited. The project is not key to the sponsor's long-term strategy or principal activity.
Set of protection instruments				
Assignment of receivables from contracts and accounts	Exhaustive	Covering most receivables	Acceptable	Poor
Line on property with regard to its scope and sequence	First perfected security interest on all things, rights and other assets essential to the conduct of the project.	First perfected security interest on almost all things, rights and other assets essential to the conduct of the project.	Acceptable degree of protection for all things, rights and other assets essential to the conduct of the project.	Insufficient degree of protection for all things, rights and other assets essential to the conduct of the project.
Lender's control over cash flows (e.g. automatic term deposits /*sweeps*/, independent escrow accounts)	Strong	Satisfactory	Sufficient	Poor
Standard of implementation of financial conditions (e.g. obligatory cash advance facilities, deferred payments, sequence of drawing of funds, restriction of dividends)	High Additional debt service is not expected.	Satisfactory Very restricted possibility of additional debt service.	Sufficient Partial possibility of additional debt service.	Poor Possibility of additional debt service is unlimited.

	Very good	Good	Sufficient	Poor
Reserve funds (debt service, operation and maintenance, renewal and replacement, unforeseen events, including cost overruns, etc.)	Highly above average coverage period, all reserve funds are fully covered by cash, letters of credit or guarantees from a bank with a high rating or by other highly liquid assets.	Slightly above average coverage period, all reserve funds are fully covered.	Average coverage period, all reserve funds are fully covered.	Short coverage period, reserve funds financed from operational cash flows.

Table 2 – Regulatory rating grades for exposures in the field of income-producing real estate financing

	Very good	Good	Sufficient	Poor
Financial strength				
Market conditions	Supply and demand for this type of project and location are currently in equilibrium. The number of competitive properties coming to the market is equal to or lower than forecasted demand.	Supply and demand for this type of project and location are currently in equilibrium. The number of competitive properties coming to the market is roughly equal to forecasted demand.	Market conditions are roughly in equilibrium. Competitive properties are coming to the market and others are in the planning phase. The project's design and capabilities need not be as up-to-date as new projects.	Market conditions are poor. It is uncertain when they will improve and return to a state of equilibrium. After expiry of the lease period the project loses tenants. New lease terms are less favourable than in the previous tenancy period.
Financial indicators	The property's debt service coverage ratio is considered strong (not relevant for the construction phase however) and the loan-to-value ratio (LTV) is considered low for the type of property.	The debt service coverage ratio (not relevant for development projects) and LTV ratio are satisfactory and correspond to ordinary market conditions.	The property's debt service coverage ratio has deteriorated and its value has fallen, thus increasing the LTV ratio.	The property's debt service coverage ratio has deteriorated markedly and its LTV is well above underwriting standards for new loans.
Stress analysis, economic cycle	The structure of the property's resources, contingencies and liabilities generally makes it possible to honour financial commitments at a time of serious financial or economic stress (e.g. interest rate changes, economic decline).	The property is able to honour its financial commitments under a sustained period of financial or economic stress (e.g. interest rate changes, economic decline). Default is probable only in the event of adverse economic conditions.	Revenue generated by the property would fall during an economic downturn, which would in turn limit its ability to finance capital expenditure and would substantially increase the risk of default.	The property's financial condition is strained and it is likely that there will be a default, unless conditions improve quickly.

	Very good	Good	Sufficient	Poor
Predictability of cash flows				
(a) for complete and stabilized property	Leases are long-term, tenants are creditworthy and lease periods end at different times. In the past, the property retained its tenants even after the lease period ended. The vacancy rate is low. Expenditure (maintenance, insurance, security and real estate taxes) is predictable.	Most leases are long-term, tenants' creditworthiness differs. The property experiences a standard degree of tenant fluctuation upon lease expiration. The vacancy rate is low. Expenditure is predictable.	Most leases are medium-term rather long-term, tenants' creditworthiness differs. The property experiences a reasonable degree of tenant fluctuation upon lease expiration. The vacancy rate is reasonable. Expenditure is relatively predictable, but variable in relation to income.	Lease durations differ, tenants' creditworthiness differs. The property experiences a very high degree of tenant fluctuation upon lease expiration. The vacancy rate is high. Considerable expenditure is associated with preparing space for new tenants.
(b) for complete but not stabilised property	Income from leases meets or exceeds forecasts. The project should become stable in the near future.	Income from leases meets forecasts. The project should become stable in the near future.	The majority of the income from leases corresponds to forecasts, but stabilisation will not be achieved in the immediate future.	Income from leases does not meet expectations. Despite the occupancy target being achieved, the coverage of cash flows is tight because of unsatisfactory income.

	Very good	Good	Sufficient	Poor
(c) for the construction phase	The property is entirely pre-leased for the entire tenor of the loan or pre-sold to a tenant or a buyer with an investment grade rating or equivalent internal rating grade or the liable entity has a refinancing commitment from an investment grade lender.	The property is almost entirely pre-leased or pre-sold to a tenant or a buyer with an investment grade rating or equivalent internal rating grade or the liable entity has a permanent financing commitment from a creditworthy lender.	Concluded lease agreements correspond to the plan, but the building is not necessarily pre-leased and refinancing need not exist. The liable entity may be the permanent lender.	The property's situation is worsening because planned expenditure has been exceeded, the market situation is deteriorating, tenants or buyers are repudiating the contract or because of other factors. A dispute may arise with the contractual party providing permanent financing.

Characteristics of the property				
Location	Excellent, attractive location that has suitable infrastructure required by tenants or buyers and has no environmental defects.	Above average, attractive location that has suitable infrastructure required by tenants or buyers.	Average to below average location that lacks any competitive advantage.	Unsatisfactory location and insufficient infrastructure, high crime rate or environmental burden.
Appearance and condition	The property is preferred due to its appearance, arrangement and maintenance and is highly competitive with new properties.	The property has appropriate appearance, arrangement and maintenance. The property's appearance and possibilities are competitive with new properties.	The property's arrangement, appearance or maintenance are adequate.	There are shortcomings in the property's arrangement, appearance or maintenance.
Building risk (for property under construction)	The construction budget is conservative, is not expected to be exceeded and the technical risks are limited. Contractors are highly qualified, financially very strong; excellent contractual terms.	The construction budget is conservative, the technical risks are limited. Contractors are highly qualified, financially strong; standard contractual terms.	The construction budget is adequate and contractors have standard qualifications, their financial strength is average to below average, contractual terms do not contain fundamental parameters (time, price).	The project has exceeded the budget or is unrealistic because of technical risks. Contractors may be insufficiently qualified and are financially weak; contractual terms unknown.

	Very good	Good	Sufficient	Poor
Characteristics of the transaction				
Repayment scheme	A regular repayment schedule. No deferral period for a completed property.	Upon completion of the property, there is a regular repayment schedule or a very low balloon payment and a short deferral period. Possibly a larger balloon payment and no deferral period.	Significant balloon payment with potential deferral periods.	A bullet payment or a large balloon payment.
Debtor's or sponsor's strength				
Financial capacity and willingness to support the property financially	The sponsor or developer contributed a considerable amount of its own resources to build or buy the property. It has considerable resources and limited direct and contingent liabilities. Its properties are diversified geographically and by property type.	The sponsor or developer contributed its own resources to build or buy the property. Its financial conditions allow it to financially support the property in the event of insufficient cash flow. Its properties are located in several geographic regions.	The sponsor's or developer's contribution may be intangible or non-financial. Its financial resources are average to below average.	The sponsor or developer is not willing or able to financially support the property.
Reputation and track record concerning similar properties	Experienced management and high quality of sponsors. Good reputation and long and successful record with similar properties.	Sufficient management and sponsors' quality. The sponsor or management has a successful record with similar properties.	Ordinary management and sponsors' quality. Management or sponsor track record does not raise serious concerns.	Ineffective management and below average sponsors' quality. Management and sponsor difficulties contributed to difficulties in managing properties in the past.

Standard of project preparation	Very thorough project and financial plan *(feasibility study)*.	Thorough project and financial plan.	Project and financial plan sufficiently cover the basic points.	Insufficiently thorough project and financial plan.
Relations with relevant entities in the real estate market such as real estate vendors and administrators or leasing companies	Strong relations with leading entities in the market.	Established relations with leading entities in the market.	Standard commercial relations.	Poor relations.
Set of protection instruments				
Recovery rate from lien	Lender can be satisfied in full from the yield gained from realising the lien.	Lender can be satisfied in full or almost in full from the yield gained from realising the lien.	Lender can be satisfied in part from the yield gained from realising the lien.	Insufficient possibility of satisfying the lender from the yield gained from realising the lien.
Assignment of receivables from rent (for projects with long-term tenants)	Rent receivables have been assigned to the lender. The lender has information about current tenants, e.g. a list of tenants and copies of the project's lease contracts, information about payment history, and the assignor has notified tenants of the receivable assignment.	Rent receivables have been assigned to the lender. The lender has basic information about current tenants and the assignor has notified tenants of the receivable assignment.	Rent receivables have been assigned to the lender. The lender does not have sufficient information about current tenants and the assignor has notified tenants of the receivable assignment.	Rent receivables have not been assigned to the lender or the assignor has not notified tenants of the assignment.
Scope and quality of insurance coverage	Excellent, full scope of coverage for comprehensive risk with a highly sound insurance company.	Insurance coverage includes comprehensive coverage with a good insurance company, with a partial limit on the scope of indemnification.	Insurance coverage is sufficient and includes the most important risks with a good insurance company.	Unsatisfactory standard (important risks are not covered, limited indemnification or unsound insurance company).

	Very good	Good	Sufficient	Poor
Political and legal environment				
Political risk, including transfer of risk	Very low risk	Low risk	Moderate risk	High risk
Stability of the legal and regulatory environment (risk of legislative changes)	Favourable and stable regulatory environment from the long-term point of view.	Favourable and stable regulatory environment from the medium-term point of view.	Regulatory changes can be predicted with a considerable degree of certainty.	The project may be influenced by present-day or future regulatory issues.

Table 3 – Regulatory rating grades for object finance exposures

	Very good	Good	Sufficient	Poor
Financial strength				
Market conditions	Strong and growing demand, strong market entry barriers, low sensitivity to technological changes and changes in opinions on future economic development.	Demand is strong and stable. Some market entry barriers, some sensitivity to technological changes and changes in opinions on future economic development.	Adequate and stable demand, limited market entry barriers, considerable sensitivity to technological changes and changes in opinions on future economic development.	Falling demand easily influenced to technological changes and changes in opinions on future economic development, highly uncertain environment.
Financial indicators (debt service coverage ratio) and loan-to-value ratio (LTV)	Very strong financial indicators considering the type of object. Very stable economic assumptions.	Strong to acceptable financial indicators considering the type of object. Stable economic assumptions.	Average financial indicators considering the type of object.	Poor financial indicators considering the type of object, or aggressive financial policy.
Stress analysis, economic cycle	Stable long-term revenues, highly resistant to significant stress conditions in the economic cycle.	Satisfactory short-term revenues. Ability to resist to long-lasting financial or economic stress. Defaulting is likely only in adverse economic conditions.	Uncertain short-term revenues. Cash flows are sensitive to stresses that are common in the economic cycle. The loan may default in a normal period of downturn.	Revenues are highly uncertain; the debtor may default even in normal economic conditions, unless conditions improve.
Market liquidity	The market is structured on a worldwide basis; the object is highly liquid.	The market is worldwide or regional; the object is relatively liquid.	The given object's market is regional with limited short-term prospects causing lower liquidity.	Local market or poor visibility. Low or no liquidity, especially in uncovered or niche markets.

	Very good	Good	Sufficient	Poor
Political and legal environment				
Political risk, including risk of transfer	Very low; powerful instruments for mitigating risk if necessary.	Low; satisfactory instruments for mitigating risk	Moderate; standard instruments for mitigating risk.	High; no or weak instruments for mitigating risk.
Legal and regulatory risks	The legal system ensures a high degree of enforceability of the law and protection of ownership, including the enforceability of loan contracts.	The legal system ensures a sufficient degree of enforceability of the law and protection of ownership, including the enforceability of loan contracts.	The legal system generally ensures the enforceability of the law and protection of ownership, but the enforcement process may be lengthy or difficult.	Unstable or confused legal and regulatory environment. The legal system makes the process of enforcing the law or protection of ownership inordinately lengthy or makes it completely impossible.
Characteristics of the transaction				
Repayment period compared to the asset's (object's) economic lifespan	Repayment is on a regular basis or absolutely minimal balloon payment[3]. No deferral period.	Repayment is on a regular basis or absolutely minimal balloon payment, deferral period exists. Possibly a larger balloon payment and no deferral period.	Significant balloon payment with potential deferral periods.	Bullet repayment or a large balloon payment.
Operational risk				

[3] Balloon payment – a high payment at the end of the loan period.

	Very good	Good	Sufficient	Poor
Acquisition of permits or licences	All permits and licences have been obtained; the object satisfies the current and expected safety rules.	All permits and licences have been obtained or will be obtained very soon; the object satisfies the current and expected safety rules.	Most permits and licences have been obtained or the award process is ongoing, pending permits and licences are regarded as routine practice, the object satisfies the current safety rules.	Problems acquiring all required permits and licences; part of the planned configuration of the object or planned operations will probably have to be reassessed.
Scope and characteristics of operation and maintenance contracts	High-quality long-term contract on operation and maintenance, preferentially with contractual performance indicators, or sufficient resources to cover operation and maintenance	Long-term contract on operation and maintenance or sufficient resources to cover operation and maintenance (if necessary).	Limited contract on operation and maintenance or resources to cover part of operation and maintenance (if necessary).	No contract on operation and maintenance: there is a risk of exceeding high operational costs which is not under control.
Operator's financial strength, track record of management of the given type of object and ability to put the object back on the market when lease ends.	Excellent track record and strong ability to put it back on the market.	Satisfactory track record and ability to put it back on the market.	Poor or short track record and uncertain ability to put it back on the market.	No or unknown track record and inability to put it back on the market.
Characteristics of the asset (object)				
Configuration, size, appearance and maintenance (e.g. age, size of aircraft) compared to other objects in the same market	Marked advantage of appearance and maintenance. Configuration is standard, such that the object meets the requirements of a liquid market.	Above average appearance and maintenance. Standard configuration, with the possibility of very limited exceptions – such that the object meets the requirements of a liquid market.	Average appearance and maintenance. Configuration is somewhat specific; which may narrow the market for the given object.	Below average appearance and maintenance. The object is nearing the end of its economic lifespan. Configuration is highly specific; the market is very restricted.

	Very good	Good	Sufficient	Poor
Resale value	The current resale value is considerably higher than the value of the debt.	The resale value sufficiently exceeds the value of the debt.	The resale value je is slightly higher than or equal to the value of the debt.	The resale value is lower than the value of the debt.
Sensitivity of the object's value and liquidity to economic cycles	The object's value and liquidity are relatively insensitive to economic cycles.	The object's value and liquidity are sensitive to economic cycles.	The object's value and liquidity are rather sensitive to economic cycles.	The object's value and liquidity are very sensitive to economic cycles.
Sponsor's strength				
Sponsor's 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 or weak financial standing.
Set of protection instruments				
Control over the object	Legal documentation gives the lender very effective control (e.g. the oldest lien in terms of age */first perfected security interest/* or leasing contract that contains this right) over the given object or over the entity that owns it.	Legal documentation gives the lender effective control (e.g. lien */perfected security interest/* or leasing framework that contains this right) over the given object or over the entity that owns it.	Legal documentation gives the lender some control (e.g. lien */perfected security interest/* or leasing framework that contains this right) over the given object or over the entity that owns it.	The contract gives the lender little certainty and leaves room for loss of control over the given object.
Rights and means the lender possesses for monitoring the location and condition of the given object.	The lender may monitor the location and condition of the object at any time and place (regular reports, option of conducting inspections).	The lender may monitor the location and condition of the object at almost any time and place.	The lender may monitor the location and condition of the object.	The lender's possibilities for monitoring the object's location and condition are restricted.

	Very good	Good	Sufficient	Poor
Scope and quality of insurance coverage	Strong insurance coverage including secondary (indirect) damages with highly sound insurance companies.	Satisfactory insurance coverage (not including secondary damages) with good insurance companies.	Adequate insurance coverage (not including secondary damages) with acceptably sound insurance companies.	Poor insurance coverage (not including secondary damages) or with unsound insurance companies.

Table 4 – Regulatory rating grades for commodities financing exposures

	Very good	Good	Sufficient	Poor
Financial strength				
Exposure protection standard	Strong (the value of the collateral far exceeds the value of the exposure)	Good (the value of the collateral sufficiently exceeds the value of the exposure; the risk volatility in the value of the protection and, where appropriate, the currency risk are covered by a	Satisfactory (the value of the collateral exceeds the value of the exposure; the risk of volatility in the value of the protection and, where appropriate, the currency risk are covered)	Poor (the value of the collateral does not necessarily exceed the value of the exposure)
Political and legal environment				
Country risk	Zero country risk	Low country risk (in particular placement of reserves abroad /offshore/ in a transforming country)	Average country risk (partial placement of reserves abroad /offshore/ in a transforming country)	Strong country risk (in particular reserves placed in a transforming country)
Mitigation of country risk	Very strong: Strong risk mitigation mechanisms via a third country (offshore mechanisms) Strategic commodity First-class buyer	Strong: Offshore mechanisms Strategic commodity Strong buyer	Acceptable: Offshore mechanisms Less strategic commodity Acceptable buyer	Only partial: No offshore mechanisms Non-strategic commodity Weak buyer
Characteristics of the asset (commodity)				

	Very good	Good	Sufficient	Poor
Liquidity and vulnerability to damage	The commodity is quoted and can be hedged through futures or OTC instruments. The commodity is not susceptible to damage.	The commodity is quoted and can be hedged through OTC instruments. The commodity is not susceptible to damage.	The commodity is not quoted but is liquid There is uncertainty about the possibility of hedging. The commodity is not susceptible to damage.	The commodity is not quoted. Liquidity is limited according to the size and depth of the market. No hedging instruments. The commodity is susceptible to damage.
Sponsor's strength				
Trader's financial strength	Very high with regard to trading philosophy and risks.	High	Average	Poor
Track record, including ability to manage a logistical process	Extensive experience with the given type of transaction. High success rate in the field of operations and cost efficiency.	Adequate experience with the given type of transaction. Above average success rate in the field of operations and cost efficiency.	Limited experience with the given type of transaction. Average success rate in the field of operations and cost efficiency.	Limited or uncertain track record. Volatile c costs and profits.
Regulation of trading and hedging strategy	Tough standards for the selection of a counterparty, protection and monitoring.	Adequate standards for the selection of a counterparty, protection and monitoring.	Transactions in the past were not marked by any or any major problems.	Traders registered considerable losses in the past.
Quality of disclosure of financial information	Excellent	Good	Satisfactory	Information unreliable or insufficient.

Set of protection instruments				
	Very good	**Good**	**Sufficient**	**Poor**
Control over the commodity	The oldest lien in terms of age *(first perfected security interest)* gives the lender very effective control over the commodity at any time if necessary.	The oldest lien in terms of age *(first perfected security interest)* gives the lender control over the commodity if necessary.	At a certain point in the process of the lender's control over the commodity will be disrupted. The disruption is mitigated by knowledge of the transaction process or a possible third-party intervention.	The contract leaves room for a certain risk of loss of control over the commodity. Regaining control may be jeopardized.
Scope and quality of insurance coverage	Strong insurance coverage including secondary damages with highly sound insurance companies.	Satisfactory insurance coverage (not including secondary damages) with good insurance companies.	Sufficient insurance coverage (not including secondary damages) with acceptably sound insurance companies.	Poor insurance coverage (not including secondary damages) or with unsound insurance companies.