COMMONWEALTH
OF THE BAHAMAS

THE BAHAMAS -

GOVERMENT GUARANTEE POLICY FRAMEWORK

- DEBT MANAGEMENT OFFICE, MINISTRY OF FINANCE -

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Abbreviations

DMC	Debt Management Committee
DMO	Debt Management Office
DOG	Deed of Guarantee
DSA	Debt Sustainability Analysis
FRA	Fiscal Responsibility Act
GBE	Government Business Enterprise
GOB	Government of The Bahamas
IMF	International Monetary Fund
MDA	Ministries, Departments and Agencies
MOF	Ministry of Finance
PDMA	Public Debt Management Act
PFMA	Public Finance Management Act

Definitions

Agency	An entity of the Government that is not a Ministry or a Department and is not a Government Business Enterprise and is listed in the Fourth Schedule of the Public Finance Management Act, 2023 (the "PFMA").
Budget Call Circular	Document issued by the Ministry of Finance requesting the submission, in a prescribed form, of the revenue and expenditure estimates of MDAs, for the next financial year.
Deed of Guarantee (DoG)	Formal documentation of the guarantee arrangement.
Government Business Enterprise (GBE)	An entity owned or controlled by the Government that provides services in the market or undertakes commercial activities and is listed in the Fifth Schedule of the PFMA.
Guarantee	A commitment by the Government to repay the financial liabilities of another entity, should that entity default.
Guarantor	The Government of the Commonwealth of The Bahamas, as the entity providing the guarantee.
Guarantee Beneficiary	The lender, provider of the loan to be guaranteed.
Guaranteed Entity	The entity whose debt the Guarantor is guaranteeing.
Guarantee call	The occurrence of a trigger event under the Deed of Guarantee that gives the Guarantee Beneficiary the right to request payments under the loan from the Guarantor.

Section 1: Introduction

1.1. Purpose

Over the years, the government has guaranteed the debt of state-owned and private sector entities, to enable the achievement of priority development goals, at reasonable costs and risks. However, failure on the part of these entities to honour their obligations can create significant fiscal and reputation risk to the government's operations.

In keeping with the requirements under section 42 of the Public Debt Management Act, 2021 ("the PDMA"), the Government Guarantee Policy Framework (the "GG Policy Framework") provides coherent guidelines to govern arrangements involving the issuance of government guarantees to in-scope entities. By managing the fiscal risks associated with guarantees, these guidelines contribute to the achievement of the government's overarching goal of fiscal and public debt sustainability.[1]

The GG Policy Framework is to be read in conjunction with the relevant governing legislation cited in Section 2.1 of this document.

1.2. Definition of Guarantee

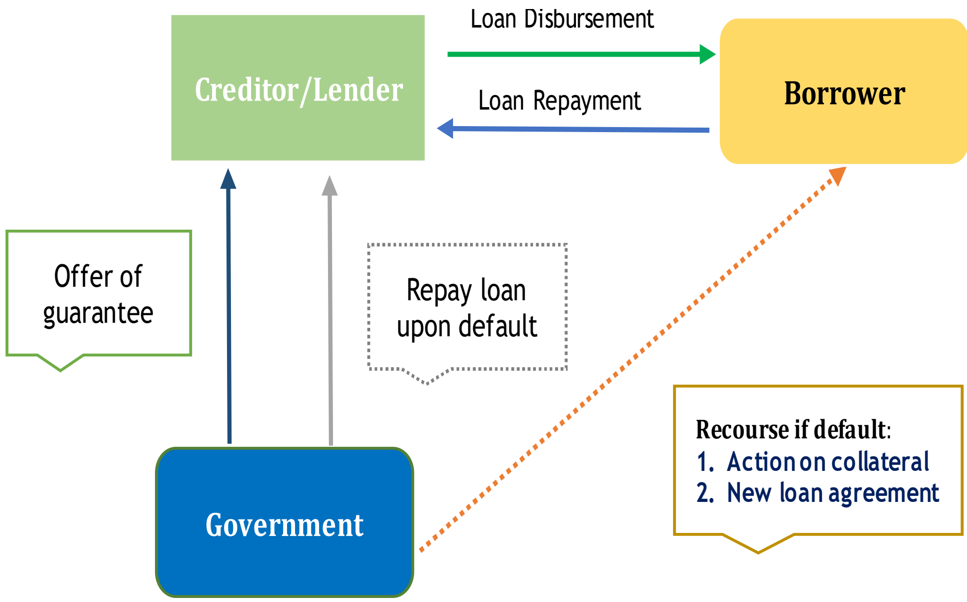
A guarantee is a legally binding undertaking given by a third party to assume responsibility for payment of a debt or performance of an obligation on behalf of a borrower to a lender under certain conditions—typically a default by the borrower. Where the borrower defaults on a financial or legal obligation, the lender has the right to "call" or "invoke" the guarantee, thereby requesting the third party to settle all outstanding financial obligations (e.g., payment of principal, interest and other fees that are outstanding or in arrears). A sovereign guarantee, therefore, is an explicit contingent liability where the government is obligated under a legal agreement to make repayments and payments to the lender in the event of a loan default.

In line with the activities/roles described above:

- the **Guarantor** is the Government;
- the **Guaranteed Entity** is the borrower (e.g., a public entity) whose financial obligations are covered by the Guarantor;
- the **Guarantee Beneficiary** is the creditor/lending institution (e.g., an investment bank or an international financial institution); and
- the **Deed of Guarantee** ("the DoG") is the legal document executed between the Guarantor, the Guaranteed Entity and the Guarantee Beneficiary.

[1] This document was drafted under the Commonwealth Secretariat's debt reform project entitled, 'Strengthening Public Debt Management Framework and Developing Government Bond Market in The Bahamas,' with the funding support of the India UN Partnership Development Fund and the Government of The Bahamas.

Figure 1: Typical Loan Guarantee Flow Diagram



1.3. Policy Objectives

The principal objectives of the GG Policy Framework are to:

- operationalize the legal provisions contained in section 42 of the PDMA relating to the provision of guarantees by the government;
- provide operational clarity to all stakeholders involved in government guarantee activities;
- ensure judicious evaluation, monitoring and management of costs and risks associated with guarantees on the government's fiscal position;
- uphold the key principles of transparency and accountability in government decision making related to the issuance of sovereign guarantees; and
- promote effective and efficient use and management of public resources.

1.4. Scope

The scope of the GG Policy Framework is to provide evaluation and decision-making guidance for prospective Guarantee Beneficiaries, Guaranteed Entities, the Debt Management Office (the "DMO") and the Ministry of Finance (the "MOF") regarding requests for sovereign guarantees.

The GG Policy Framework only governs legally binding sovereign guarantees that are provided to cover a Guarantee Beneficiary's unpaid financial obligations that arise from the crystallization of specified trigger events.

The GG Policy Framework shall apply to guarantees provided by the government on loans to Agencies and Government Business Enterprises (GBEs), as defined in the Public Finance Management Act, 2023 ("the

PFMA"), and private domestic companies and foreign entities—the latter two groupings on an exceptional basis, only.

Exclusions to the GG Policy Framework are:

- ***Guarantees for the benefit of private individuals***—covering educational loans, housing loans, and loans to small- and medium-sized enterprises. The government will rely on the accountability, transparency and risk assessment mechanisms within existing guarantee programmes governing these activities to assess the creditworthiness of individuals and ensure prudent use of public resources.
- ***Guarantees for Foreign Governments—***Decisions will be made upon the recommendation of the Cabinet, with input from the MOF, to Parliament.
- ***Guarantees for Public Private Partnerships (PPPs)—***Where guarantees are to be issued as part of a risk sharing arrangement, with the objective of improving the viability and sustainability of a project, decisions will be addressed within the context of the government's PPP policy.

1.5. Administration and Review

The DMO is to:

- administer the GG Policy Framework.
- maintain a comprehensive database to record, manage, monitor and report on all government guarantees and related activities, in accordance with the requirements of the PDMA.
- review the GG Policy Framework at least once every five years, to ensure ongoing relevance and alignment with applicable standards and legislation. Reviews should include, ***inter alia***, historical performance/compliance of Guaranteed Entities with respect to their guaranteed facilities and the different types of guarantees provided. However, the DMO may have cause to modify the GG Policy Framework prior to this timeline—based on the experience gained in implementing the framework.

Any amendments recommended by the Director, DMO (the "Director"), after consultation with the Debt Management Committee (the "DMC"), are to be provided to the Minister of Finance (the "Minister") for Cabinet's approval. Thereafter, the amended GG Policy Framework is to be published before coming into effect.

Section 2: Legal and Institutional Framework

2.1. Legal Framework & Requirements

The GG Policy Framework forms a part of the government's broader debt management arrangements and is anchored in a sound legal architecture based on the:

- Public Debt Management Act, 2021 (the "PDMA"); and the
- Public Financial Management Act, 2023 (the "PFMA").

2.2. Reason for Issuance of Guarantees

As outlined in section 45 of the PDMA, the Minister must be satisfied that the guarantee is necessary or expedient in the public interest to be issued; the guarantee must be consistent with the fiscal strategy report and the terms and conditions of the GG Policy framework and it must be within the permissible level of risk, as determined within a prudent risk assessment exercise

Government guarantees will normally be extended for the purpose of achieving the following objectives:

- To improve flexibility of borrowing options.
- To improve the viability of public sector investment projects that confer significant social and economic benefits.
- To enhance opportunities for the borrower to access lower cost financing that would otherwise be unavailable.
- To fulfil the requirement in cases where a sovereign guarantee is a precondition for semi-concessional loans from bilateral/multilateral agencies and commercial loan facilities to public sector entities.

2.3. Eligibility Criteria

The Minister will only consider applications for sovereign guarantees if the proposed investment meets one or more of the following principles:

- Constitutes a part of the government's investment plan.
- Contributes positively to the development priorities of the government.
- Has positive economic returns.
- Undergoes a rigorous credit risk assessment and scores an acceptable rating (i.e., low to medium)—as outlined in **Section 6**. Where this rating is not achieved, the government will reserve the right to determine whether to approve or deny an application, based on the project's ability to generate positive financial and economic benefits for the country.

Furthermore, the prospective lender must be an approved financial institution[2], and the request must fall with the government's limits for outstanding guarantees and not have an adverse impact on the government's debt sustainability indicators.

[2] Official multilateral and bilateral organizations; and financial institutions licensed to conduct banking or other financial institution business under the laws of any state, country or territory and which meet other criteria as may be prescribed by the relevant regulatory authority.

2.3.1. Entity-specific Eligibility Requirements

a. Agencies/GBEs:

- Be compliant with all provision of the PFMA—including reporting requirements.
- Have no National Insurance Board (NIB) contribution arrears.
- Have no other tax or debt arrears.

In cases where there are records of default or arrears, the guarantee request may be considered if formal arrangements are in place to settle the arrears and where the underlying project will produce positive financial returns and confer economic and social benefits to the country.

b. Private domestic companies:

- Have no debt arrears.
- Have no NIB or other government tax arrears or, where they exist, formal arrangements are in place to settle.

c. Foreign entities

- Projects expected to deliver a net economic return to The Bahamas and would not otherwise be developed by an Agency/GBE or domestic private company.
- Have no formal debt arrears.
- Have no tax arrears, including NIB contributions and government taxes.
- Projects that have commercial characteristics and can generate income by charging market prices to compensate for costs ***will not*** be considered.

2.4. Governance and Institutional Framework

The governance and institutional arrangements for guarantees will typically involve one of more of the following government entities.

- Parliament
- Cabinet
- Ministry of Finance—the Minister and the Financial Secretary
- Debt Management Office
- Debt Management Committee
- Office of the Attorney General
- Treasury Department
- Parent/Responsible Ministries/Departments

2.4.1. Roles and Responsibilities

a. Parliament (House of Assembly)

Approve resolutions for guarantees issued on behalf or in the name of the government.

b. Cabinet

Approve, on behalf of the Executive, the policy framework for the granting of government guarantees.

c. Debt Management Office (DMO)

Under Section 7 the PDMA, the DMO is to:

- manage the public debt portfolio, including government guarantees, in accordance with the public debt management objectives.
- assess the risks in issuing any guarantees; prepare reports on the method used for each assessment and submit the results to the Financial Secretary for transmission to the Minister.
- facilitate the recovery of any payment, including interest and other costs incurred by government, due to the honouring of outstanding guarantees.
- prepare annual reports on outstanding guarantees.
- keep timely, comprehensive and accurate records of outstanding government guarantees in an appropriate database.
- submit to the DMC, for review, proposals for issuance of guarantees.

d. Director, DMO

Under section 42 of the PDMA, the Director is to:

- prepare/amend the policy framework for the issuance of guarantees by government in consultation with the DMC, and publish the policy framework after approval by Cabinet.

e. Debt Management Committee (DMC)

Under Section 8 of the PDMA, the DMC is to:

- assist and advise the Minister on matters relating to guarantees.
- provide overall guidance to the DMO on guarantees.
- review proposals for issuance of guarantees, as may be submitted to it by the DMO for consideration or for obtaining the approval of the Minister.

f. Ministry of Finance (MOF)

The Minister has the power to issue sovereign guarantees and is required to table, in Parliament, reports relative to guarantees.

The Financial Secretary is to:

- review risk assessment reports on guarantee proposals submitted to the Minister by the DMO.
- oversee and monitor guarantees and their aggregate limits, consistent with the fiscal strategy report and the annual budget.
- apply a sanction, as deemed necessary, to an Agency or GBE which has issued a guarantee without the appropriate authorization.

- ensure that the annual budget includes plans for issuance of guarantees to public or private entities, together with annexes denoting any limits for issuing guarantees.

g. Office of the Attorney General

- Assist with the review of all draft loan documents for which guarantees are requested.
- Draft the DoG, in consultation with the Ministry and other relevant parties.

h. Parent/Responsible Ministries/Departments

- Conduct initial reviews of all applications for guarantees from Agencies and GBE, as applicable.
- Assist with the overall monitoring and reporting requirements for guarantees.

i. Treasurer

Under the PFMA, the Treasurer is to:

- prepare, sign and transmit to the Auditor-General, for auditing, statements of contingent liabilities of the government, including any government guarantees.

j. Technical Committee (TC)

A technical team, led by the Director, will be appointed to carry out credit risk assessments—and is to be constituted as follows:

- Director of the DMO
- Debt Officer/Analyst, (Policy and Risk Management, DMO),
- Staff from the Treasurer Department
- Parent/Responsible Ministry or Department staff
- Consultant, as deemed necessary

The TC will meet as and when a guarantee assessment needs to be carried out. It will also meet half-yearly to discuss the management status of guarantees, payments due, prospective guarantees and reporting.

Section 3: Guarantee Risk Mitigation Measures and Considerations

3.1. Guarantee Limits

In keeping with prudential norms, the government will impose the following limits.

- The optimal stock of government guaranteed obligations shall be a percentage of GDP, as stipulated in the annual fiscal strategy framework.
- The maximum limit of guarantees as a percentage of the total underlying loan amount that could be extended to any entity, at each point in time, is to be based on the entity's creditworthiness and the government's shareholding in the entity.
- For a new company/private sector firm, Agency or GBE, which has no historical reference, the financial and economic viability of the investment will be used to assess the entity's eligibility.

3.2. Partial Guarantee

To safeguard the government against moral hazard and reduce costs in the event that the risk of a default materializes, the MOF may recommend that the government grant a partial guarantee with less than 100 percent coverage of the underlying loan. The MOF will utilize the outcome of the risk assessment exercise and particulars of the guarantee application in determining the recommended guarantee coverage.

3.3. Guarantee Conditions

The government may impose certain conditions on the grant of a guarantee—to include, ***inter alia***:

- The posting of collateral—in the case of non-public sector entities and public sector entities having less than 100% ownership by the government.
- Use of loan proceeds restricted to the investment project only.
- Submission of regular reporting on the investment project, along with audited financials and ad hoc financial reports.
- Restrictions on future borrowings—depending on the outcome of the credit risk assessment exercise.
- Restrictions on the validity of the guarantee, if the borrower's ownership changes.
- Restrictions on the offering as security any asset/security for the purpose of obtaining any other loan guarantee.
- Execution of a counter guarantee that would convert the guarantee to a loan, where the guarantee is invoked.

3.4. Guarantee & Administrative Fees

3.4.1. Guarantee fees

As a norm, a guarantee fee is a prerequisite for availing of a government guarantee, and is to cover the administrative cost of processing and monitoring the guarantee and the risk of default of the loan. Formal requests for exemption from the payment of the guarantee fee will only be considered by the Minster, for final approval of the Cabinet, upon the recommendation of the Ministry of Finance following its analysis of the request.

The annual guarantee fee is charged as a constant percentage of the guaranteed debt outstanding and disbursed every year until the guaranteed loan is paid-off. The constant percentage is based on the credit score obtained in the initial credit risk assessment.

Constant Fee determined after credit risk assessment	0.5 % of DOD	Score of between 1 and 1.5
	1.0 % of DOD	Score of greater than 1.5 and 2

3.4.2. Administration fee

The management/administration fee is a one-off fee of 0.25% of the total guaranteed amount—to be charged at the signing of the guaranteed loan facility and is to cover costs relative to its arrangement and monitoring.

Both the Administration and the Guarantee Fee are to be deposited into the Consolidated Fund.

3.5. Collateral

Where applicable, the acceptable collateral for a guarantee will include cash; stocks and negotiable bonds; irrevocable letters of credit; certificates of deposit; assignment of receivables (e.g., export earnings, electricity generation charges, road tolls, and telecom receipts); and physical assets such as buildings, ports, and industrial plants—including the project assets.

In accordance with section 41 of the PDMA, collaterals are to be in the name of the Treasurer.

The Minister will exercise powers to realize the collateral in accordance with the terms of the guarantee agreement executed with the Guaranteed Entity.

3.6. Deed of Guarantee

Following Cabinet's approval of an affirmative guarantee application, the DMO will provide the Office of the Attorney General (OAG) with the necessary details to prepare a DoG. At this stage in the guarantee application process, the prospective Guaranteed Entity can commence activities to finalize the underlying loan agreement.

The DoG, which is to be executed between the Guaranteed Entity, the Guarantee Beneficiary and the government, should clearly state all the procedures related to the issuance of the guarantee. General conditions of the DoG should, *inter alia*:

- follow a standard format and must be endorsed by the Attorney General's Office.
- outline the responsibilities of all parties (i.e., the Guarantor, the Guarantee Beneficiary and the Guaranteed Entity) and the terms and conditions.
- specify whether the guarantee is partial or 100 percent.
- include other conditions necessary and appropriate to reduce the risk of the guarantee being invoked.

- provide for the Ministry of Finance to be the receiver, on behalf of the Minister, of any notices or other documents related to the DoG.
- be issued for the period of the guaranteed loan, with the termination or end date of the guarantee clearly outlined in the guarantee letter.
- stipulate any guarantee fee charged.
- specify all reporting requirements of the Guaranteed Entity that would allow the government to monitor, in a timely manner, the risk of the guarantee being called.
- include any other conditions and criteria the government may, at its discretion, deem fit to be included in the DoG.

Adjustments to the terms and conditions of the DoG, to be outlined in a variation agreement, are to be submitted to the Minister, for the approval of the Cabinet.

3.7. Parliamentary Requirements for Guarantees

All guarantee activities must be reported to Parliament, as specified in section 50 of the PDMA.

Section 4: Guidelines for Issuing Government Guarantees

4.1. Introduction

The need for a government guarantee by potential borrowers is typically identified during multilateral country assistance strategy meetings, or during financing discussion with bilateral/export creditor agency meetings and commercial lenders.

All requests for government guarantees will be subject to the government's credit risk assessment. To align this evaluation process as closely as possible to the annual budget process, and to allow for early input from the MOF, in-scope entities are expected to submit their requests during the time of the annual ***Budget Call Circular*** exercise, which usually commences in February each year. However, the government recognizes that there may be exceptions to this timeframe, in which case these requests will be considered on this basis—subject to conformance with the established guarantee limit.

4.2. Guarantee Application Procedures

All applications for government guarantees should be submitted to the MOF to the attention of the Financial Secretary.

- Applications for Agencies and GBEs must be submitted through the Parent/Responsible Ministry or Department, where is expected to confirm, before forwarding to the MOF, whether:
  - the loan for which the guarantee is requested satisfies national priorities—in keeping with the objectives outlined in sections 2.2 and 2.3, above.
  - all other potential funding opportunities were well examined before selecting the guarantee option.
  - the prospective loan is within the government's overall guarantee limit.
  - terms and conditions of the loan appear satisfactory and in accordance with the borrower's governing legislation.

4.2.1. Documentation requirements

To ensure a fully informed assessment, an application is deemed to have been made successfully only where the following documents/information have been submitted.

- Term sheet from the lending institution (specifying loan amount, currency, interest rate, maturity, grace period, other fees and conditions) of the loan to be guaranteed, draft loan agreement).
- All documents and details related to the proposed investment project to be financed—to include the business case (i.e., project outline, economic and financial impact, cash flow projections, scenario analysis and assumptions, project management and monitoring plans).
- Reason(s) for choosing the specific lending institution.
- Where applicable, board resolution clearly stating the board's decision and reasons for applying for a sovereign guarantee, and agreement to comply with the GG Policy Framework.
- Information on how risks affecting the guarantee would be monitored and mitigated throughout the life of the guarantee, including the role of the parent/responsible ministry.

- Details of all existing loans, overdrafts or any other financial exposure, and the security in place for those commitments.
- Annual Reports and audited financial statements for the past three years, and the pro forma financial statements showing forecasted figures for the current year and the next two years.
- Copy of business license, as applicable.
- A statement of money owed to the government.
- Stand-alone credit rating, where applicable.
- Financial forecasts of the borrower for the duration of the proposed guarantee—to include scenario analysis and assumptions.

The DMO also reserves the right to request additional information and, where deemed necessary, the applicant will be required to make a formal presentation to the TC.

4.3. Loan Evaluation and Credit Risk Assessment

The Financial Secretary, on behalf of the Minister, will forward the application to the Director for appropriate assessment and recommendation on whether or not to offer a guarantee.

4.3.1. Specific activities

a. DMO

- Ensures the completeness of the application and, where this is not the case, requests any missing information from the submitting entity.
- Ensures that the application is compliant with the eligibility requirements and can be offered without breaching the limit established for guarantees.
- Ensures, in consultation with responsible parties within the MoF, that the prospective loan is within debt sustainability considerations.

b. TC

- Once the application is deemed to be complete, the Director will convene the TC, which may require applicants to make formal presentations of their requests. The TC will, ***inter alia***,:
    - undertake the credit risk assessment of the application—based on a credit scoring model (see Annex 1) and produce estimates of the cost and risks of the proposed guarantee. Depending on the value and complexity of the underlying investment project, the TC reserves the right to have an independent analysis of the risks associated with accessing the guarantee undertaken, with cost to be borne by the applicant.
    - confirm the reasonableness of the financial forecasts provided by the applicants.
    - determine how the guarantee would affect the government's portfolio of outstanding guarantees and overall debt levels.
    - consider whether the timing and nature of the proposed guarantee borrowing would conflict with the government's own borrowing plan.
    - consider and recommend whether conditions should be attached to the proposed guarantee.

- Upon completion of its review process, the TC will prepare an assessment report (the Report), to include:
    - a summary of the results of the credit risk assessment, and the probability of default and expected loss estimate.
    - a recommendation on whether a guarantee should be offered; where an application is not successful, reasons for the decline and where a positive recommendation is advanced, any conditions to be considered.
    - details of the proposed guarantee fee and other charges.
- The TC, via the Director, will submit the Report to the DMC for its consideration.

c. DMC

- Before making a final recommendation to the Minister, the DMC will review the Report of the TC and ensure, ***inter alia,*** that:—
    - the cost-benefit assessment is based on national priorities outlined in the government's economic and development plans.
    - the terms and conditions of the underlying loan are competitive and alternative funding opportunities were appropriately considered.
    - the appropriate business and financial risk profile indicators are selected for carrying out the credit risk assessment.
    - the appropriate weights are used for the credit risk assessment and project feasibility (i.e., economic and financial returns, debt servicing capacity) are acceptable.
    - the proposed guarantee fee is appropriately calculated.
    - the request could be considered within the limit established for the overall stock of guarantees.

4.4. Final Approval of Guarantee Application

The Minister, after considering the recommendations for a guarantee made by the DMC, may approve or deny the issue of a guarantee and impose other conditions or requirements, as deemed necessary in the national interest.

The Minister's final decision will be communicated to the DMC, the TC and the DMO, via the Financial Secretary, who will request that the Director prepare a Cabinet Paper (with the Report of the TC as an attachment) to submit the Minister's decision (whether affirmative or negative) for Cabinet's no objection.

4.5. Notification of Decision(s) to Applicants

The Financial Secretary will communicate, in writing, Cabinet's decision on the guarantee application.

- For an Agency or GBE, decisions will be forwarded directly to the Parent/Responsible Ministry or Department.
- For all other entities, the decision will be forwarded to the requesting entity.

Section 5: Recording, Monitoring and Reporting of Guarantees

5.1. Recording, Monitoring and Reporting

All guarantees are to be recorded and monitored in the government's debt recording and analysis system to ensure that conditions are being met and to manage any potential risk. These responsibilities are to be achieved through the collective activities of the various entities involved in the guarantee process.

a. DMO/Ministry of Finance:

- Record the qualitative descriptions and quantitative information (actual and forecast) of the guaranteed loan in the Commonwealth Secretariat Meridian debt recording and analysis programme ("Meridian").
- Ensure that electronic versions of all executed loan/guarantee documents are securely stored in Meridian.
- Monitor the progress on loan payment transactions (i.e., principal, interest and any fees) in a prompt manner and detect any sign of payment difficulties, well in advance.
- Ensure that the annual guarantee fee is collected by issuing invoices for payment on the anniversary of the agreement being executed.
- Prepare half-yearly reports (end-June and end-December) on guarantees (any guarantee given, and called, any payments on guarantees and an assessment of the risk of a guarantee being invoked and the estimated cost of honoring the guarantee) for the Minister to present to Parliament—within three months after the respective periods.
- Publish information on guarantees as part of the government's quarterly Public Debt Statistical Bulletins and annual financial statements.
- In the case of default, the MOF should decide what recourse action should be taken.

Figure 2: DMO's Responsibilities for Loan Guarantee Management

Portfolio Management

- Receiving applications
- Assessing applications against pre-set criteria
- Presenting applications to the Technical Committee for risk assessment
- Drafting guarantee letters
- Evaluating loans for which guarantees are requested

Policy & Risk Management

- Conducting credit risk assessment for applications
- Conducting credit risk assessments for portfolio of loan guarantees
- Estimating guarantee fee.

Debt Operations

- Recording guarantees
- Monitoring loan disbursements
- Monitoring repayments
- Advising on payments for guarantee calls
- Reconciling and sharing of guarantee data
- Reporting and disclosure

b. Guarantee beneficiaries

- Provide to the Guarantor, via the DMO, the status on the loan disbursements, repayment schedules and actuals, and any other foreseen event, on a quarterly basis. The Guarantee Beneficiary must also notify the DMO immediately of any developments that significantly increase the risk of default.

c. Guaranteed entities

- Submit copies of the annual report and audited financial statements to the DMO during the entire duration of guarantees
- Provide relevant information on the use of funds, disbursements, accounting and degree of implementation of the project funded by the guarantee and conduct regular consultations with the DMO.
- Ensure that all guarantees are reviewed annually, and copies of reviews forwarded to the DMO, via the Parent/Responsible Ministry or Department, by July 31.

d. Parent/Responsible Ministry or Department

- Monitor whether the Agency/GBE is discharging debt service obligations as per the terms of the loan agreement, whether the repayment capacity for the loan and guarantee amount is impaired in any manner and whether covenants and conditions are being upheld. Copies of these reviews should be forwarded to the DMO annually, by July 31.

Section 6: Call of Guarantee

6.1. Events of Default

In the event of default by the borrower, the Guarantee Beneficiary may invoke the guarantee.

- As a first step, the Guaranteed Entity should inform any case of impending/likely invocation, well in advance, to the DMO, along with corrective time limit—and not to exceed sixty days from the date of default.
- Upon receipt of the report from the Guaranteed Entity, the Director shall refer the document to the DMC to verify whether the default in question is covered by the guarantee and the claim is validly made in terms of the guarantee.
- Simultaneously, the Director will write to the Guaranteed Entity demanding immediate payment of the amount due to the Guarantee Beneficiary, seek an explanation of the default and outline measures (e.g., realization of the collateral) that will apply should the default not be rectified. Both the Minister and the Cabinet will be made aware of the default situation.
- Where recommended by the DMC, the government will honor the guarantee and make payment to the lender from the Consolidated Fund—without need for any appropriation.
- Any amount paid by the government as a result of the guarantee being called will become a loan between the government and the Guaranteed Entity, and fall under the government's Policy Framework for Lending. Where this is the case, the MOF, with the assistance of the Office of the Attorney General, will prepare a loan agreement for execution between the parties, and the performance of the agreement will be monitored by the MOF, with regular reporting in the government's fiscal accounts.
- The Director will prepare a report for the Minister, for presentation to Cabinet and submission to the Parliament, on all guarantee calls--providing details on payments made by the government and an estimate of the associated costs.

Section 7: Credit Risk Assessment and Expected Loss

7.1. Credit Risk Assessment

Credit risk assessments help to evaluate the creditworthiness of the prospective Guaranteed Entity, in terms of repayment of the guaranteed loan. The selected methodology, termed the `credit scoring model, contains a number of features and steps.

- An assessment is undertaken of the financial and business risk indicators of the beneficiary over the past 3 years and the forecasted figures are for the current year and the next two years
- Financial risk indicators are based on typical financial ratios that represent profitability, liquidity, solvency, debt structure and performance in meeting financial obligations to Government.
- Business risk indicators are categorized under 'regulatory environment', 'sector risk and competitive position' and, 'governance and management'.
- Risk range can vary from low risk (1) to `distress' (5).

7.2. Weighting and Average Weighted Score

- The individual scores assigned to each indicator are multiplied by corresponding weights determined by its priority.
- After obtaining a weighted score for each indicator, an overall average score is estimated.
- Average weighted scores are used in assessing creditworthiness, probability of default and the guarantee fee.

7.3. Probability of Default

- The weighted average scores are converted through the use of sovereign credit rating scores assigned by the credit rating agencies.
- Rating agencies usually have a numerical value of probability of default attached to their alphabetic grading structure.

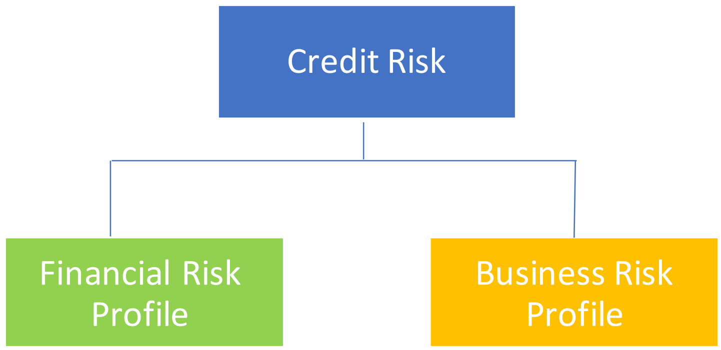
7.4. Expected Loss

- Expected loss estimations are to be jointly carried out by staff of the DMO and the Treasury Department. The methodology for estimating Expected Loss is provided in ***Annex 1***.
- Although section 48 (3) makes provision for the government to settle all liabilities incurred under a guarantee out of the Consolidated Fund, expected loss estimates may be used for budget provisioning and for estimating contingency reserves, where deemed appropriate.

Annex 1: Credit Risk Assessment: A Credit Scoring Approach[3]

1.1 Risk Indicators

Guaranteed debt of Agencies, GBEs and other approved entities expose the government to credit risk. The credit risk, in turn, depends upon two major underlying factors, viz., the business risk profile and the financial risk profile. The business risk profile factors are generally qualitative while financial risk profile factors are quantifiable.



The credit scoring method is used to assess and quantify credit risk, as it is simple, user-friendly and allows use of both quantitative and qualitative information. The application of this method, however, involves a number of steps, viz.,

(i) identify the business and financial risk indicators;

(ii) assign weights to each risk indicator, depending upon the influence of these indicators on determining the level of government's exposure;

(iii) assign scores to each risk indicators, based on the entity's performance;

(iv) calculate the weighted score of each risk indicator; and

(v) sum these weighted scores to obtain the overall risk rating of the entity.

As a starting point, the methodology begins with selected business and financial risk indicators which would be increased over time as the assessment process matures. Selection of business and financial risk indicators will depend upon the sector/area of operation of the prospective Guaranteed Entity. Availability of data, information, resources, and capacity of the staff to carry out this exercise will also influence application of the model.

1.1.1 Business risk factors

The Business Risk Profile of a Guaranteed Entity is determined based on an assessment of a combination of factors (e.g., the regulatory environment, sector risk and competitive position, and governance and management) as outlined in ***Table 1*.**

[3] The methodology is adopted from `Credit Rating Tool to Assess and Quantify Credit Risk from Public Corporations' Guidance Note, The World Bank, 2022. The World Bank acknowledges in its Guidance Note (pages 1,2) that the application of the model should consider the country context in terms of the availability of data and information, resources available and staff capacity to carry out this exercise.

Table 1: Business Risk Factors and Assessment Considerations

Categories	Assessment (based on questions/responses)
Regulatory Environment	▪ Is there relevant laws and regulations with regard to the industry and enterprise?
	▪ Does the legal environment allow for recovery of running cost, capital cost and new investment programmes?
	▪ Is the legal framework consistent with other laws and regulatory authorities?
Sector Risk and competitive position	▪ Is the industry affected by macroeconomic factors? What is the proportional impact for the Agency/GBE?
	▪ What is the competitive position of the entity (past and future prospects)?
	▪ What is the entity's growth prospects?
Governance and Management	▪ Does the governing board act independently and has members who are competent and qualified?
	▪ How well does the entity enforce legal, regulatory and policy reforms?
	▪ Are the financial and other reports submitted on a timely basis?

Table 2: Typical Financial Risk Indicators

Categories	Specific Variables and Indicators	Definition/Assessment
Liquidity	*Current Ratio*	Current assets to current liabilities
	Quick Ratio	Current assets (excluding inventory) to current liabilities
Profitability	*EBITDA margin*	Earnings before Interest, Taxes, Depreciation and Amortization as a percentage of Revenue
	RoA	Rate of Return on Assets
Solvency	*Debt to Equity*	Assess leverage of corporation's funding and dependence on liabilities
	Debt Coverage Ratio	EBIDTA divided by the sum of short-term debt, long term debt and financial leases
Debt Structure	*Currency risk*	
	Interest rate risk	Exposure to these three risks
	Re-financing risk	
Performance in meeting financial obligations to government	*Timeliness in Meeting Repayments due*	In Distress or Not in Distress

1.1.2 Financial risk factors

The Financial Risk Profile assessment of the Guaranteed Entities is based on a number of financial ratios such as:

1. Liquidity
2. Profitability
3. Solvency
4. Debt Structure
5. Performance in Meeting Financial Obligations to Government

The first three factors (i.e., Liquidity, Profitability and Solvency) are measured quantitatively, while the remaining two (i.e., Debt structure and Performance in Meeting Government Obligations) are qualitative measures (see ***Table 2***).

1.2 Information Requirements

Potential Guaranteed Entity should submit financial performance data (i.e., cash flow statements, profit and loss accounts, balance sheet and annual report) for the past 3 years and a forecast of 3 years, together with economic and financial feasibility analysis of the project loan for which a guarantee is requested.

1.3 Scoring and Weighting the Indicators

1.3.1 Scoring

The financial risk indicators assume a score range between 1 and 5, whereas the business risk indicators assume a range between 1 and 4.

Rating/Scores	Risk Level
1	Low Risk
2	Moderate Risk
3	Elevated Risk
4	High Risk
5	In Distress

The total weighted score obtained is used in assessing credit worthiness of an entity and to make a decision on whether or not to offer a guarantee.

1.3.2 Weighting

The weighting shows the priority ranking of the indicator. For example, if liquidity indicators are deemed to be more important than solvency indicators, a greater weight should be assigned to the liquidity indicators. All weights must add up to 100 per cent. In the absence of a predetermined priority, weights can be assigned in an equal proportion. Correspondingly, if financial indicators are judged to be more important than business indicators then financial indicators will be assigned a greater weight.

To illustrate, assume the World Bank's Guidance Note ratios for business risk and financial risk of 45%: 55%, respectively, to derive a weighted scoring—as shown in ***Table 3***.

Table 3: Illustration of Risk Weighting

Factors	Weights	Individual score	Weighted score
Business Risk (45%)			
Regulatory Environment	15%	1	0.15
Sector Risk and competitive position	15%	2	0.30
Governance and Management	15%	2	0.30
Financial Risk (55%)			
Liquidity	10%	1	0.10
Profitability	10%	2	0.20
Solvency	15%	2	0.30
Debt Structure	10%	1	0.10
Meeting Government Obligations	10%	1	0.10
Total Risk	**100%**	**Overall weighted Score**	**1.55**

1.4 Decision on Guarantee offer

Having obtained the overall weighted score, the following numeric scales are used in deciding whether or not to offer guarantee.

Low Probability of default	**Moderate Probability of Default**	**High Probability of Default**
`Offer Guarantee'	`Re-assess Credit Risk and Re-consider'	'Do not offer Guarantee'
1 ↔ 2	2 ↔ 3	3 ↔ 5

The above example with the overall weighted score of 1.55 falls under the category of `Offer Guarantee'.

1.5 Risk quantification - Probability of Default (PD)

After obtaining an overall weighted score, the next step is to convert the score to a Probability of Default. This can be done in several ways, e.g., using statistical methods, through domestic or international rating agencies [e.g., Standard & Poor's (S&P), Moody's Investor Service (Moody's), and Fitch) etc.

- Where the country does not regularly carry out international rating exercises, statistical methods or domestic rating could be used.
- For countries that regularly carry out international rating agency exercises, the overall weighted score is to be converted into an equivalent rating grade and the applicable probability of default for that rating grade is to be applied, as shown in the following example.

For example, the Risk Ratings for GBEs by S&P are provided in Table 4.

Table 4: Estimating PDs Using S& P Credit Ratings

Risk Rating Scores	S&P Rating	Probability of Default
1	BBB	0.15%
2	BB	0.5%
3	B	3%
4	CCC	28%
5	D	100%

1.6 Expected Losses

Expected Losses can be estimated at the initial assessment stage for the guarantee or during every repayment due date of the loan.

1.6.1 Expected loss given default

Expected Loss (EL) is determined by the following equation:

Expected Loss Given Default = Total Exposure x Probability of Default x (1-Recovery Rate)
Where:
Total Exposure = Guaranteed Loan Outstanding
Probability of Default = a numerical probability value between 0 and 1
Recovery Rate = Percentage of amount that can be recovered of the total expected loss

1.6.2 Annual risk status

The annual risk status provides information on whether the guaranteed loan repayments are under stress. This is represented by 'Net Present Value of Expected losses' (applied to all payments due each year)

Net Present Value of EL at each year = Σ Discounted Expected Losses each year

1.7 Project related financial forecasts

Reviewing the financial and economic feasibility studies that contain forecasts can add value to the credit risk assessment exercise.

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