



What the Luxembourg Rail Protocol means for the Finance Industry

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FINANCIAL INSTITUTIONS

- Regulated by Basle Committee on Banking Supervision
 - developing a more robust banking system
 - developing resilient banking institutions
- Determinants of Capital held on a portfolio requires an estimation of :
 - PD (Probability of Default) – average percentage of obligors that may default in a rating grade in any one year.
 - EAD (Exposure at Default) – estimate of the outstanding amounts at the point of default
 - LGD (Loss Given Default) – percentage exposure a bank/financier may lose if the obligor defaults
- Interaction between ratings of a client and the LGD impacts differently on the pricing of a client
 - investment grade versus non investment grade
 - very few investment grade rail operators
 - impact on pricing from an LGD perspective is far more beneficial

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- FOCUS ON LGDS
 - secured interest in assets will help reduce this factor
 - reduced capital to be held against the obligor by the Bank
 - positive impact on the pricing
- CERTAIN REQUIREMENTS
 - Legal enforceability
 - in all jurisdictions, reflect a perfected lien over the asset, should also be realisable within a reasonable time
 - Objective Market Value
 - reflect the value of a willing seller – willing buyer within a reasonable market
 - Frequent Valuation
 - valuation to be monitored frequently (at least annually)
 - significant changes in value should be verified by an expert or professional valuator.

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- CERTAIN REQUIREMENTS (cont'd)
 - Insurance
 - against deterioration or damage of the asset.
 - Environmental
 - liability against the asset for environmental liability
 - Maintenance
 - asset should be maintained in good condition

LUXEMBOURG RAIL PROTOCOL

- Security over movable assets is challenging; more so when the assets cross jurisdictional borders
- The Aircraft Protocol to the Cape Town Convention created a central registry; provided protection of international interests which is recognised by all ratifying states/jurisdictions
- When the Luxembourg Rail Protocol was adopted,
 - it created a legal framework;
 - recognised and regulated the security interests of financiers as well as lessors and other interested parties;
 - are secured by rolling stock.
- Protocol provides a central registry
 - all parties register their interests;
 - creditors can check rival claims to related rail equipment
- Enables creditors to enforce security in default and insolvency situations

LUXEMBOURG RAIL PROTOCOL

- Unique new identification numbering system for rolling stock
 - rolling stock is defined very broadly;
 - includes both above and beneath the ground systems, light rail to high speed, freight and passenger rail, trams and subways, gantries and cranes and even airport shuttles
- When ratified by a country, state or jurisdiction;
 - protocol will govern that country, state or jurisdiction and all debtors therein;
 - does not differentiate on the type of financing structures.
- Protocol should secure cheaper financing;
 - by securing the financier/creditor;
 - cheaper financing from the private sector;
 - result in more competitive rail sector and industry

LUXEMBOURG RAIL PROTOCOL

- Sector previously funded by Governments;
 - strain an available funding resources;
 - networks and fleets deteriorated
 - shift to more private sector appetite with more access to funding;
 - improvement in networks and the state of the rolling stock;
 - apparent in SA a few years back when Transnet's average fleet age was over 30 years;
 - governments can start focussing on funding, repairing and maintaining the infrastructure.
- Foster cross border trade corridors;
 - improve access
 - improve trade flows
 - where there are traversing rights / access rights to networks, even greater benefits

LUXEMBOURG RAIL PROTOCOL

- All parties will benefit;
 - whether funding originates from the banking sector or capital markets;
 - whether parties are financiers, lessors, lessees, or users
 - from the secured interest in the underlying rolling stock
- In certain circumstances funders may rely more on underlying secured interest in asset as opposed to the underlying obligor/credit counterpart
- ECA institutions
 - monitoring the position with regard to ratifying countries
 - make premium concessions, as they do in aircraft finance transactions, to countries that ratify the protocol.

LUXEMBOURG RAIL PROTOCOL

- Domestic transactions
 - Benefits for transactions where all parties and rolling stock are in the same jurisdiction
 - What might be initiated as a Domestic transaction, may change during the term;
 - the Lessor or Lessee 's domicile may change
 - financiers to the transaction may change
 - subleases to other counterparts whose principle place of business is in another jurisdiction
 - rolling stock may be manufactured in another jurisdiction and have a security interest created before it is imported to the jurisdiction of use
 - rolling stock may be transported to another jurisdiction (during or after primary transaction) during its lifetime
 - Common registry
 - facilitate Local recording, international interests and universal numbering system
 - provide for real time monitoring of rolling stock for tracking, maintenance and insurance
 - provides for clear creditor rights on termination, defaults, insolvency and other
 - registry clearly publishes priorities between interested parties
 - prevents unnecessary restructures in security interests as transactions change

LUXEMBOURG RAIL PROTOCOL

- BENEFITS
 - Reduce financing costs to operators
 - Facilitate lending to customers with poor credit ratings or infrastructure
 - Attract more private sector funding into this industry
 - Facilitate the leasing industry

- FINANCIAL (over five years)
 - Investment Grade approx 45 bps
 - Sub Investment Grade approx 90 bps
 - Weak Credit approx 190 bps