

*The Ministry of Transportation, Ports and Civil Aviation has opened a public consultation on draft ordinance that presents a proposal for exchange rate protection policy for the partnership contracts in the airport sector.*

*The consultation began on Feb 10th and will last until the 20th. Interested parties may contribute throughout this period. The document and the form for submitting suggestions can be accessed through the link:*

<http://www.transportes.gov.br/cobertura-cambial.html>.

*To assist in understanding the main concepts and the operating logic of the Exchange Hedging Mechanism presented, a list of "questions and answers" was prepared, which is intended to encourage the participation of all stakeholders in bringing suggestions and improvements to the model.*

## **QUESTIONS AND ANSWERS ON THE EXCHANGE HEDGE MECHANISM**

### **1) Why provide exchange rate protection mechanism for concession contracts?**

The financing scenario for the country's partnership contracts has been characterized by a reduction in the participation of subsidized lines, as announced by the National Bank for Economic and Social Development (BNDES) in its new infrastructure credit policy. In this context, it is very important to explore new sources of funding for projects, including foreign ones. The adoption of an exchange hedging policy would facilitate the raising of funds in different currencies and would strengthen the financiability of the various projects that the Federal Government has either already launched or is planning to launch.

### **2) Regarding the draft ordinance issued by the Ministry of Transportation, what does it specifically address?**

The draft ordinance, which is under public consultation, contains the guidelines to be observed by the Ministry and the National Civil Aviation Agency (ANAC) in the application of the exchange hedging mechanism for airport concessions. It is a way to standardize practices and concepts and to signal to stakeholders the Government's intention to implement a policy aimed at broadening the range of options and strengthening the financiability of its partnership contracts.

### **3) What is the objective of the policy contained in the draft ordinance issued by the Ministry of Transportation?**

The objective of the proposed policy is to foster new sources of financing for the airport infrastructure sector in Brazil, through a mechanism that facilitates the raising of funds abroad.

It is worth noting that the proposed mechanism will affect only the financing taken by the concessionaire (debt), and will not affect the equity of its shareholders.

#### **4) How does the exchange hedging mechanism work?**

The mechanism, as indicated in the draft ordinance, works in three stages:

- a) **Activation:** it is when the mechanism becomes effective on a financing taken by the concessionaire in foreign currency;
- b) **Calculation and offsetting:** it is when the exchange rate variations are calculated versus a benchmark and the resulting amount (positive or negative) begins to be offset. This happens by the time the concessionaire should pay the variable grant contribution to the FNAC, and the amounts are reduced or increased according to the amount calculated in the mechanism;
- c) **Depletion:** it is when the exchange rate variation cease to be computed (but the compensations remain) to exhaust any remaining balance credited to any of the parties.

#### **5) How much foreign funding may the mechanism be applied to?**

The maximum amount that can be covered by the exchange mechanism will vary according to each project, and will be determined by the Ministry of Transportation and by the National Civil Aviation Agency (ANAC). For example, for the four airports of the current concession round, the proposed amounts would be:

- a) \$ 150,000,000.00 (one hundred and fifty million dollars) to Salgado Filho Airport – Porto Alegre/RS;
- b) \$ 180,000,000.00 (one hundred and eighty million dollars) to Deputado Luís Eduardo Magalhães Airport – Salvador/BA;
- c) \$ 75,000,000.00 (seventy-five million dollars) to Hercílio Luz Airport – Florianópolis/SC; and
- d) \$ 110,000,000.00 (one hundred and ten million dollars) to Pinto Martins Airport - Fortaleza/CE.

#### **6) Is the exchange hedging mechanism mandatory?**

No. The mechanism reflects only a policy designed to expand the potential sources of project funding, so that the concessionaire may, at its discretion, activate it or not.

**7) When can the concessionaire activate the mechanism?**

The activation of the mechanism depends on a concessionaire's request, which can be made, according to the draft ordinance submitted to the public consultation, only within the first seven years from the signing of the concession contract.

**8) How does the activation of the mechanism occur?**

In order to activate the mechanism, the concessionaire must submit to the Granting Authority, within the first seven years of the concession term, an indication that a foreign currency financing was taken. For instance, it should submit information regarding the amount of debt and interest, its payment schedule, etc. The concessionaire must also declare that the resources will be used exclusively for investments in reversible assets or grant payments defined in the concession contract. By properly submitting these documents, the mechanism is considered activated.

**9) For how long is the mechanism effective once it is activated?**

The maximum period in which the hedging mechanism will work varies according to each project. However, it is important to understand that the "calculation and offsetting" period finishes before the end of the concession term (for example, in the case of the four airports already in bidding process, this period would be 10 years earlier), in order to allow sufficient time for the "depletion" of any outstanding balances related to the application of the mechanism, over the remaining of the contractual term.

**10) Can the concessionaire take a loan for a period longer than the calculation period, i.e., into the depletion stage?**

Yes. However, according to the draft ordinance, the payments of principal and interest due after such period would be out of the mechanism coverage, therefore not considered for the calculation of any compensation.

**11) If the mechanism is activated once, can the concessionaire take additional financing?**

Yes. The concessionaire may enter into as many foreign financing agreements as they want. However, only the amounts up to the limits allowed for each project would be subject to the mechanism indicated in the draft ordinance.

**12) Do financing contracts need to be in any specific currency to activate the mechanism?**

No. The concessionaire may contract financing in any foreign currency. However, the mechanism only covers the exchange variation of the US Dollar (USD) against the Real (BRL).

**13) Does the mechanism affect the user tariffs?**

No. The mechanism does not affect users' tariffs, which remain unchanged. The compensation for the exchange rate variation – either positive or negative – will only affect the amount to be annually paid by the concessionaire to the FNAC. For instance, if the variable contribution is 5% of gross annual revenues, the maximum compensation would be +/- 5%, resulting in payments to FNAC ranging from zero to 10% of gross revenues every year, according to the amount to be compensated.

**14) Does the mechanism publication change the auction rules for the 4 airports to be auctioned?)**

No. The mechanism reflects a ministerial policy and sets up an option that the future airport concessionaires might use (or not), as long as they activate it.

**15) Illustrative example of the mechanism**

Consider an airport concession with variable contribution payment to the FNAC of 5% of the SPV's annual gross revenues.

The concessionaire takes a foreign financing line and activates the mechanism, with coverage up to the maximum amount allowed, for example, US\$ 100 Mi. Remember that, the concessionaire can even take more than that amount if foreign financing, but only US\$ 100 Mi would be subject to the effects of the mechanism.

Under the mechanism, every month is accounted the impact on the outstanding debt (US\$100 Mi) of the difference between the BRL/USD path and the evolution of a benchmark, consisting of inflation plus a % factor. These differences accumulate throughout the year, increasing or decreasing, until the payment date for the variable contribution arrives.

The accumulated balance will be then offset. If the concessionaire got a positive balance, on the one hand, they will discount that amount from the variable contribution due, up to the limit of paying zero. On the other hand, if the concessionaire got a negative balance in the mechanism, they will pay more to FNAC, up to the limit of 10% of gross revenues (double the variable contribution) in that year. This range of 0 to 10% of gross annual revenues would be the boundaries for FNAC payments throughout the “Calculation and Offsetting Period” to offset the exchange variation.

This interval may not be enough to offset a very large appreciation or depreciation. IN this case, if the accumulated balance exceeds the 5% of gross revenues in a year, the exceeding amount will be registered as a Future Compensation Balance called SMC.

Therefore, in the 10 last years until the concession expires – when the exchange variations cease to be calculated – the SMC continues to be yearly offset against the variable contribution payments. This is called the Depletion Period.

By the end of the Depletion Period, i.e., at the end of the concession, if there is any residual balance in SMC, either in favor of the concessionaire or of the FNAC, it will be extinguished.

A numeric example of the mechanism working can be found in this website ([www.projetocrescer.gov.br](http://www.projetocrescer.gov.br)).