FAQs on Agreement State – FMO 2023

Summary slide in Investor Presentation

Agreement State – FMO 2023 update

FMO
Entrepreneurial Development Bank

- The 1998 keep-well agreement was modernised in 2023 taking into account the Dutch State's guarantee framework, FMO's regulatory environment as a bank and the evolution of capital markets standards.
- The Agreement State - FMO 2023 reaffirms the vital role that FMO plays in Dutch government policy, the State's intention to ensure FMO's continuity in accordance with the Agreement and to facilitate FMO's stable access to capital market funding in order to effectively carry out its mandate.
- **Key principles of the Agreement remain unchanged or strengthened**:
  - **Maintenance obligation** (now Article 4, previously in Article 7) to ensure FMO is maintained as a financial undertaking remains in place with more clarity on what "maintenance" entails, a commitment from the State to provide "timely" support and a "direct, unconditional and irrevocable" payment obligation once triggered.
  - **Financial security obligation** (now Article 5, previously in Article 8) to prevent FMO from failing to meet its financial obligations remains in place with a commitment from the State to provide "timely" support and a "direct, unconditional and irrevocable" payment obligation once triggered. This provides a further level of comfort on an individual instrument level in addition to the Maintenance obligation.
  - The agreement remains **valid for an indefinite period** and can only be cancelled subject to a **12-year notice period**.
- **New components introduced in line with the Dutch State's guarantee framework**:
  - A **Debt Ceiling** implemented for the State's budgetary and planning process. The ceiling will be recalculated ever 5 years, taking into account 10 years of forecasted growth to ensure the ceiling does not constrain FMO's strategic ambitions. It has been set at **16 bln for the next 5 years**. An excess amount, which is a **highly unlikely** event, **does not void the guarantee**.
  - A **Premium** to compensate the State for the risk of providing support, which has an **immaterial financial impact** on FMO.

Statement from Dutch State	S&P's Ratings' commentary	Fitch Ratings' commentary
The Ministry of Finance states that the modernization of the Agreement is an affirmation of the importance of FMO's role in development cooperation on behalf of the Dutch State and shows the State's intention to consistently support FMO, maintain its continuity and ensure FMO's access to capital markets.	"The updated agreement formally codifies extraordinary sovereign support to FMO". "there is an almost certain likelihood that the government of the Netherlands would provide timely and sufficient extraordinary support to FMO" … "therefore affirmed our 'AAA/A-1+' ratings on FMO and maintained our stable outlook"	Update does not impact ratings: "The re-phrased keepwell agreement is conceptually unchanged, validating the current KRF (Key Risk Factors) assessments." "the key amended clauses will be accounted for in the Support Track Record KRF, which is currently assessed at 'Very Strong'." "the state will remain legally bound to enabling FMO to meet its financial obligations on time"

Rationale

1. **Why has the Agreement been updated?**
   - The last update to the Agreement was in 2009
   - The primary intention behind this review was to ensure that the Agreement aligns with the broader Dutch government support / framework policies, not to change its core principles

2. **What are the aims that the Dutch State and FMO wish to achieve through updating the Agreement?**
   - The objective of all parties (Dutch State and FMO) was to modernise the Agreement while ensuring that there is no weakening of FMO's ability to fulfil its mandate also ensuring that FMO's credit profile remains aligned to that of the state and the "AAA" rating is not impacted
   - The main goals were to:
     i. reemphasize the importance of FMO as a policy tool for the Dutch State and the strong government support for FMO
     ii. achieve closer alignment with the Dutch State guarantee framework
     iii. to create more transparency on the support mechanism
     iv. to facilitate investors assessment of FMO as being equal to Dutch State risk from the perspective of credit and regulatory qualifications such as risk weights and HQLA

3. **What impact does this have on the policy role of FMO?**
   - None; FMO will continue to carry out its policy role as the strategic government vehicle for promoting private sector growth in developing countries
   - FMO will also continue to manage public funds on behalf of the Dutch State

Impact on outstanding bonds

4. **What impact does this have on the credit rating of FMO?**
   - No impact on the credit rating –FMO's credit ratings did not change due to the updated Agreement.
     - Dutch Development Bank FMO 'AAA/A-1+' Ratings Aff | S&P Global Ratings (spglobal.com)
     - FMO's Strong State Integration Is Sustained in Revised Agreement (fitchratings.com)

- Continued alignment of FMO's credit rating with that of the Dutch State was a core objective of the updated Agreement

5. What does this mean for existing bond holders?
- Existing debt and obligations of FMO will be covered by the updated Agreement from the date it comes into effect
- We believe that the updated Agreement is an improvement for bondholders due to the additional transparency on the support mechanism included in Art 4 and Art 5. The additions of the Debt Ceiling and the Premium are of relevance to FMO rather than the bondholders.

6. What is the impact of the updated agreement on FMO's outstanding subordinated debt?
- No impact - the existing and updated agreement do not distinguish between different levels of debt classes

7. Does this have any impact on the Risk Weighting and HQLA status of the bonds?
- Aligning the Risk weighting and HQLA status of FMO with that of the Dutch State has been an explicit objective of the State and FMO with designing the updated Agreement
- The preambles of the updated Agreement state: 'the Parties aim to ensure that FMO can be assigned the same credit rating and regulatory classifications (including risk weighting and HQLA) as the State by creating a similar risk profile through a Maintenance Obligation (contained in Article 4 of this Agreement) and an explicit guarantee from the State to FMO (contained in Article 5 of this Agreement).'

Agreement Specifics

8. What are the main features in the updated agreement?
- Article 4: Maintenance Obligation remains:
  - The State will provide support to FMO before it would be declared failing or likely to fail by the regulator, maintaining FMO as a going-concern entity
  - The State will provide sufficient support to allow FMO to meet is prudential requirements
  - The State and FMO will discuss conditions that may be attached to the support, such discussion and conditions not preventing the support to be provided in a timely manner
  - Legal enforceability by FMO is strengthened

- Article 5: Guarantee, financial security obligation
  - The 'explicit' guarantee from the State to FMO remains
  - Increased list of obligations covered by the Agreement, such as securities financing transactions
  - The State and FMO will discuss conditions that may be attached to the support, such discussion and conditions not preventing the support to be provided in a timely manner
  - Legal enforceability by FMO is strengthened

- Debt Ceiling is introduced to provide the State with guidance on the potential maximum amount of support that could be envisaged. It does not limit the Guarantee directly as all outstanding obligations are always guaranteed

- Fee: FMO will pay an annual premium to the state for the guarantee which reflects the risk for the State

9. Will the government remain a majority shareholder? / Does the updated agreement change in any way FMO's control, governance and / or risk arrangements?
- The shareholding structure, control framework and governance of FMO are not amended with this modernization of the Agreement
- The Dutch State will continue to be the majority shareholder in FMO and the Ministry of Finance and Ministry of Foreign Affairs will continue to jointly oversee FMO's activity and accounts
- The arrangements regarding the support that the state will provide to FMO under the Maintenance Obligation and Financial Security Obligation are conceptually retained, but modernized and clarified

10. When will the updated agreement be effective from?
- The updated Agreement will enter into force on 01 July 2023

11. What is the termination notice period of the Agreement?
- The tenor of the Agreement will be indefinite
- The current Agreement's 12-year notice period should either party want to cancel the Agreement has not been changed

12. How often will the Agreement be reviewed?
- While the existence of the Agreement remains indefinite, parties have agreed to a regular review (every 5 years) of the performance of the Agreement. This is an unchanged element of the current Agreement

- We believe the modernisation process we have gone through means the Agreement in its current shape should remain suitable for the foreseeable future

13. How do you see the new maintenance obligation working out in practice? Is this process different to what you would expect under the current Agreement?

- This will be very situationally dependent. In practise, the State and FMO have regular update meetings on all aspects of FMO, including financial performance. If there is an expectation that FMO's financial situation will deteriorate drastically, there will be early interactions to discuss potential support provision
- It is the expectation that the State would provide support as a shareholder even before the Agreement would be called upon
- Sequence of the maintenance obligation is clarified in the updated Agreement

a. When the situation becomes so urgent that the Agreement needs to be called upon, because it becomes reasonably foreseeable that DNB will declare FMO failing or likely to fail, FMO can through a written communication call upon the Agreement

b. The State and FMO will discuss the most suitable type of support and accompanying conditions, though these discussions will never prevent the support from being provided in a timely manner

c. After these discussions, the State will have a direct, unconditional and irrevocable obligation to provide the support to FMO in a timely manner

Debt Ceiling

14. Why has a debt ceiling been imposed and what happens if FMO breaches it?

- In line with the Dutch State's guarantee framework, the ceiling provides long-term visibility for the State on the potential size of the contingent obligations that may arise under the Agreement
- In any situation, all financial obligations of FMO will always be covered under the guarantee as described in the Agreement. A breach of the ceiling may be a trigger for the State to issue reasonable instructions to FMO on the direction of its financial and economic policy.
- It is nonetheless worth highlighting the State is the majority shareholder of FMO and it is therefore an inconceivable scenario whereby FMO issues debt in excess of the ceiling without prior consultation with the Dutch State.
- At $16bn, the ceiling is currently set at almost 3x FMO's current debt outstanding

15. How do you calculate the debt ceiling?

- The debt ceiling will be sufficient to always facilitate growth
- The debt ceiling is recalculated every 5 years based on a fixed formula to estimate FMO's needs over 10 years based on i) realistic growth forecasts; ii) FMO long term strategy; iii) expected economic growth of FMO's client countries; iv) FMO development objectives
- A buffer of 10% has been factored in for FX implications
- Please see art 7.1 for more details on the methodology

Fee

16. FMO will pay a fee to the government under the updated Agreement, how is the fee calculated?

- The Dutch State's guarantee framework requires the payment of a premium to compensate for the risk taken. The premium is therefore calculated as the sum of both the expected and unexpected loss for the State. The formula has been validated by the Ministry of Finance
- Key parameters:

- Probability of Default = Dutch State's view on FMO's implied rating without the Agreement (one notch below the State).
- Estimated level of support needed to meet Prudential Requirements post shock.
- Fixed annual fee recalculated every 5 years

17. What is the impact of annual premium payments on FMO's financials?

- Immaterial impact, < 1% of FMO's historical average net profit