



State Guarantee Policy

Prepared by the Department of Treasury

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1. Objective

- 1.1. The overall objective of this policy is to make sure that all requests received by Government to guarantee debts, meet the following key criteria:
 - a) To protect the public finances whilst also supporting economic development.
 - b) To ensure transparency and accountability in the analytical and decision making process.
 - c) Any debt guarantees that are issued, and any applications that are rejected, are done so for sound reasons.
 - d) The justification and documentation for the original guarantee and application is available for review and evaluation.
- 1.2. The intention of this policy is to develop a set of standardised operating procedures governing the application to the State for debt guarantees.

2. Legal Basis

- 2.1. The legal basis for guarantees to debts by the State is provided by Article 37 of the Public Finances (Management) Act 1995 which states the following:

"37. Guarantees by the State

(1) The Minister may, for and on behalf of the State, guarantee the repayment of a debt (including interest and associated charges) made to any person, where the debt was made for purposes approved by the Head of State, acting on advice."

3. Scope

- 3.1. For the purposes of this policy a guarantee is defined as the following:

"A PNG Government guarantee is a promise whereby the Government of PNG assumes the responsibility for the payment of the debt of another party should that party default in some way".

- 3.2. Only the Minister of Treasury may issue a guarantee on behalf of the Government of Papua New Guinea.
- 3.3. All guarantees must be non-transferable.
- 3.4. The State will guarantee debt issued by a commercial bank or financial institution that is licensed to operate in Papua New Guinea. The State will only guarantee a debt issued by a commercial bank or financial institution that does not have a license to operate in Papua New Guinea with a minimum credit rating of A-.

3.5. The State will only issue guarantee for a debt whose purpose has been explicitly approved by the Head of State, acting on advice. According to the Constitution the Head of State is the Governor General.

3.5.1. The Minister may guarantee the repayment of a loan (including interest and associated charges) made to any party if the purpose of the loan has been approved in accordance with clause 3.5.

3.6. The Government can issue a guarantee to any party other than itself.

3.7. Government owned entities and statutory authorities cannot on-sell or in any way create a lien against State guarantees.

4. The Application Process for State Guarantees

4.1. The Minister for Treasury

4.1.1. All requests for State debt guarantees are to be submitted to the Minister for Treasury.

4.1.2. The Minister will forward these submissions to the Department of Treasury for their subsequent advice and guidance.

4.1.3. All guarantees that are approved by the Minister for Treasury must follow a formal advice from the Department of Treasury.

4.2. The Department of Treasury

4.2.1. The Department of Treasury through the Financial Management Division will liaise with the party seeking a guarantee to ensure that all the required documentation for analysis of the request have been provided.

4.2.1.1. Requests without the complete set of documentation will not be considered.

4.2.2. The Department of Treasury through the Financial Management Division will prepare a guidance note to assist the requesting parties with their application for a guarantee, reporting requirements and the process for calling on a guarantee. The guidance note will set out how the credit risk assessment will be conducted. It will also provide a Master Guarantee Agreement that will be used for State debt guarantees.

4.2.3. The Department of Treasury's advice to the Minister will be delivered within 30 days of receipt of full and complete documentation from the requesting party.

4.3. The Requesting Party

4.3.1. Any party requesting consideration of a guarantee must supply the following information in their application to the Minister:

- a) Previous three years audited financial statements of the party.
- b) Financial details of the debt.
- c) A cost benefit analysis of the purpose of the debt.
- d) The detailed investment analysis of the debt undertaken by a commercial bank or financial institution supplying the debt, this should include analysis on the probability of default.
- e) A detailed risk analysis of the purpose of the debt and the party requesting the debt which should at a minimum cover the following:
 - o A justification as to why the State should accept such risks.
 - o A justification of what other alternatives (such as commercial insurance) are available and why they are not suitable.
 - o The price of the risk being taken by the Government.
 - o An appropriate risk management strategy which should include the following elements.
 - Clearly identify all of the risks to be managed.
 - Clarify the possible consequences of the risk and the likelihood that those consequences may occur.
 - Clarify how the risk is going to be managed or treated (i.e. retained, reduced, eliminated, controlled or transferred).
 - Demonstrate a system for monitoring and reviewing the risks.
 - o Arrangements for monitoring the risks before and after the approval for the duration of the arrangement.
 - o Legal advice from the State Solicitor clarifying that the party and the debt are eligible for such a guarantee.

4.3.2. Failure to supply this information will result in the application being returned to the party without being processed further.

4.3.3. The party may supply additional information to support their application.

4.3.4. The Department of Treasury through the Financial Management Division may request for additional information to assist in their analysis.

5. The Approval Process for State Guarantees

5.1. The Minister for Treasury

- 5.1.1. The Minister for Treasury may only approve and sign a guarantee on the advice of the Department of Treasury.
- 5.1.2. In the event that the Minister accepts the advice of the Department of Treasury the necessary legal documents shall be signed and dispatched by the Office of the Minister with a copy to the Department of Treasury.
- 5.1.3. In the event the Minister rejects the advice of the Department of Treasury this shall be conveyed in writing to the Secretary of Treasury.

5.2. The Department of Treasury

- 5.2.1. The Department of Treasury through the Financial Management Division will draft the advice to the Minister in regard to all applications for a guarantee.
- 5.2.2. In their advice the Department of Treasury Financial Management Division will, at a minimum, provide the Minister with the following information:
 - a) Have potential losses been independently assessed and verified?
 - b) Have all the risks been explicitly identified?
 - c) Do the identified benefits outweigh the costs?
 - d) A justification as to why the State should accept such risks?
 - e) The price of the risk incorporating a credit risk assessment being taken by the Government and how this has been factored into the proposal.
 - f) A recommendation on an appropriate service fee based on the probability of default.
 - g) The appropriateness of the risk management strategy?
 - h) The arrangements for monitoring the risks before and after the approval for the duration of the arrangement.
 - i) The legal provisions that will enable the Government to seek to recover some or all the defaulting payments when the guaranteed is claimed.
- 5.2.3. The advice of the Department of Treasury Financial Management Division should also include drafting guidelines for the State Solicitor for the guarantee agreement which should include the following:
 - a) The time limit on the guarantee.
 - b) A termination clause to enable the Government to terminate the agreement when there is no longer a need?
 - c) Maximum financial limits on the claims which can be made?
 - d) Subrogation clauses i.e. things that would allow the Government to participate in or take over any litigation related to the contingent liability provided to State owned entities.
 - e) Clauses that clarify that these guarantees cannot be transferred in any way.

5.2.4. The advice of the Department of Treasury Financial Management Division should also include a formal correspondence from the State Solicitor, which confirms the following:

- a) The legislative requirements have been met.
- b) The contract does not duplicate protections already available under common law.
- c) Confirmation if payable amounts under these guarantees need a vote (or appropriation) in the budget.

5.2.5. Where the terms of the guarantee deviate or differ from the standard terms described above and as set out in the master guarantee agreement, the reasons should be recorded in writing.

6. The Rejection Process for State Guarantees

6.1. The Minister for Treasury

6.1.1. The Minister for Treasury may only reject a guarantee on the advice of Treasury.

6.1.2. In the event that the Minister agrees to reject an application, the necessary documents shall be signed and dispatched by the Office of the Minister with a copy to the Department of Treasury.

6.1.3. In the event the Minister rejects the advice of the Department of Treasury Financial Management Division, this shall be conveyed in writing to the Head of Treasury.

6.2. The Department of Treasury

6.2.1. The Department of Treasury through the Financial Management Division may recommend to the Minister rejecting an application for a guarantee.

6.2.2. The Department of Treasury Financial Management Division may also return all incomplete applications to the party.

6.2.3. The Department of Treasury Financial Management Division may also return any application to the party if it has failed to pay the application fee.

6.3. The Party Applying for the Guarantee

6.3.1. In the event of a rejection of an application for a guarantee the party may request the Department of Treasury to provide a written explanation as to why the request was rejected.

6.3.2. If the party wishes the Government to re-consider its rejection of the guarantee this must be done as a new submission following all of the previous procedural steps outlined above.

7. Fees

7.1. The legal basis for charging a fee for a guarantee is provided by Article 37 of the Public Finances (Management) Act 1995 which states the following:

"37. Guarantees by the State

.. (2) The Minister may, on behalf of the State, charge such fee in respect of a guarantee made under Subsection (1) as he considers appropriate in relation to that guarantee."

7.2. All parties including State owned entities requesting a guarantee shall be subject to the fees as set out in Annex 1 of these guidelines. The Service Fee will be determined according to the credit rating assessment as set out in the guidelines under clause 4.2.2.

8. Monitoring of Guarantees

8.1. The Department of Treasury through the Financial Management Division will maintain a record of all State guarantees in Meridian, as provided and supported by the Commonwealth Secretariat (or any system that may replace this in the future), and monitor the risk of each guarantee in accordance with the guidelines. Should the guaranteed entity fail to comply with all requirements set out in the guarantee agreement or directives issued by Department of Treasury Financial Management Division, the Minister for Treasury will be notified along with the steps for compliance. No further guarantees will be permitted until the guaranteed entity fully complies.

8.2. The guaranteed entity shall monitor the risk during the life of the loan guarantee in accordance with the guidelines set by the Department of Treasury through the Financial Management Division. The guaranteed entity shall notify the Department of Treasury immediately of any developments that significantly increase the risk of default.

9. Reporting Requirements

9.1. The legal basis for reporting guarantees and contingent liabilities is contained in Article 37 of the Public Finances (Management) Act of 1995 which states the following:

"37. Guarantees by the State

.. (3) Where the Minister has guaranteed the repayment of a debt under Subsection (1), he shall, at the first sitting of the Parliament following the giving of the guarantee, table the documents relating to the guarantee."

9.2. The Department of Treasury through the Financial Management Division shall report the guarantees under the category of Publicly Guaranteed Debt on a semi-annual basis at the end of June and December. These will be reported in the Financial Budget Outcome (at the end of March), the Mid-Year Economic and Fiscal Outlook (MYEFO) (at the end of July), and the Budget under the Chapter on Financing and Debt Management Strategy (in November).

10. Registration and Documentation

10.1. The Department of Treasury through the Financial Management Division must maintain an official register of all guarantees to ensure accurate reporting in both financial statements and budget papers. The register should contain details of the guarantees as well as the scope and nature of the risks involved including the probability of default necessitating invocation of the guarantee.

10.2. The register, which could be part of the same database that is used to record direct government debt (i.e. Meridian as provided and supported by the Commonwealth Secretariat), should include the details of each guarantee, the schedule of guaranteed payments, the results of monitoring, and any payments that have been made to meet or prevent guarantee calls. It should include all the details of the original loan agreements. Guarantee and loan agreements need also to be stored securely.

10.3. All documentation associated with each guarantee should be stored and filed electronically and physically in a secure location for up to ten years. This is because these records will be required in the event of future claims or litigation which may even occur after the period of indemnification has lapsed.

11. Calling on the Guarantee

11.1. If the guaranteed entity is unable to make a loan payment due, in full or in part, to the lender, the guaranteed entity shall submit in writing a request to the Department of Treasury to make the payment on behalf of the guaranteed party at least thirty (30) days prior to the payment date. The guaranteed party shall state the reasons for not being able to meet the payment obligation and commit to repaying the debt amount to be paid by the Department of Treasury on its behalf plus all expenses arising from the debt payment. If the guaranteed entity fails to notify in advance to the Department of Treasury of the difficulties in meeting its debt payment obligations, thereby impacting directly on the government budget, the guaranteed entity shall compensate all related expenses to the government budget.

11.2. If this payment difficulty is temporary and the guaranteed entity is able to resume all future payment obligations and refund the payment made by the Department of Treasury within thirty (30) days, the Department of Treasury shall undertake an inspection and report to the Minister. If repayment is not made after thirty (30) days, the Department of Treasury shall charge interest on the amount outstanding at a rate approved by the Minister.

11.3. If the guaranteed entity is unable to refund the payment made by the Department of Treasury within thirty (30) days in accordance with clause 11.2, but is able to refund over a longer time

period, the Department of Treasury will prepare a repayment schedule including the interest charge at a rate approved by the Minister in clause 11.2 and submit to the Minister for approval.

- 11.4 If the payment difficulty is permanent and the guaranteed entity is unable to meet any future payment obligations, herein referred to as "in default", the Department of Treasury shall propose to the Minister to appoint the relevant authorities to handle the default in accordance with the laws and regulations of Papua New Guinea. The calling on the guarantee (i.e. calling on the State to meet the debt outstanding) should be the very last resort after all other options including negotiations and others have failed.

Annex 1: Fees

The following fees shall, where applicable, be charged to all guarantees provided by the State in regard to debts:

Nature	Amount	Note
Application Fee	K1,000.00	To be paid with the submission of the application.
Service Fee	Based on the probability of default. The higher the probability of default the higher the fees.	This may be an upfront fee or payable annually on the anniversary of the guarantee approval.
Note: The determination of the probability of default will be defined in the credit risk policy prepared by the Department of Treasury through the Financial Management Division as approved by the Minister for Treasury. The policy will be documented in the guidance note as stipulated in clause 4.2.2.		