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Export Credit Agency Supported Financing

An Introduction

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What is Export Credit Financing?

What are export credit agencies?

Export Credit Agencies (ECAs) are institutions whose principal objective is to promote exports from their own country. ECAs may be private companies or quasi-governmental institutions, and their precise status varies from country to country.

Who are they?

There are innumerable ECAs, some of whom we have listed below (G7 countries):

United Kingdom	ECGD	UK Export Finance (formerly Export Credits Guarantee Department)
France	COFACE	Compagnie Française d’Assurance pour le Commerce Extérieur
Germany	Hermes	Euler Hermes Kreditversicherungs-AG
United States of America	EXIM	Export-Import Bank of the United States
Italy	SACE	Istituto per i Servizi Assicurativi del Credito all'Esportazione
Japan	JBIC	Japan Bank for International Cooperation
Canada	EDC	Export Development Corporation

What do they do?

ECAs can offer both 'tied' financing (i.e. financing linked to a supply of goods or services from the ECA's country) and 'untied' financing which is not linked in this way. This paper will focus on tied financing. ECAs provide a range of support for importers/exporters which typically covers the following:

- Buyer credit – providing financing support to importers to allow them to purchase the exported goods/services (an ECA may itself provide finance direct to the buyer, or may provide a guarantee in favour of commercial lenders that are financing the buyer – see "Typical financing structure" below)
- Supplier credit – providing financing support to exporters (in this case the export contract would provide for deferred payment through the issue and discounting of bills of exchange or promissory notes purchased by the exporter's bank, which an ECA may purchase or guarantee)
- Political risk cover (insurance)
- Interest rate subsidy

Export credit support addresses three key issues:

Deferred payment – allowing a buyer to defer its payment to the supplier for the relevant goods/services

Credit risk – protecting the supplier (and lenders) against the risk of non-payment owing to the insolvency or default of the buyer

Political risk – protecting the supplier (and lenders) against the risk of non-payment as a result of the occurrence of certain political risks

OECD Consensus Agreement

Arrangement on Officially Supported Export Credits

The terms on which ECAs provide support are enshrined in an agreement between the member countries of the Organisation for Economic Cooperation and Development (OECD) called the Arrangement on Officially Supported Export Credits (also known as the "Consensus").

The Consensus regulates permissible levels of subsidy to particular categories of country with the aim of maintaining a level playing field for exporters, whereby competition is based on the price and quality of the exported goods and not the financial terms provided, and eliminating subsidies and trade distortions related to officially supported export credits.

It divides eligible countries into Category I (high income OECD countries) and Category II (all other countries) and sets levels of permissible subsidy according to the Category of the importing country.

The latest version of the Consensus came into force on 1 September 2011.

Outline of financial terms and conditions

The key conditions set out in the Consensus for officially supported export credits can be summarised as follows:

- At least 15% of the contract is to be covered by an up-front cash payment
- Maximum repayment term is:
  - Category I – 5 years (or 8.5 years on special dispensation)
  - Category II – 10 years
  - Non-nuclear power – 12 years
  - Project finance transaction – 14 years
- Minimum interest rates (based on CIRR or "commercial interest reference rates", which are supposed to represent commercial lending interest rates for first class domestic borrowers in the domestic market of the currency concerned)

Sector Understandings

The Consensus also establishes modified arrangements for the following sectors:

- Ships
- Nuclear power plants
- Aircraft
- Renewable energies and water projects

These arrangements are set out in separate Sector Understandings.

Advantages of Export Credit Financing

Benefits for the Importer

The key benefits for the buyer are:

- Credit/deferred payment – the buyer does not have to meet the full cost of the contract with the supplier up-front
- Fixed/subsidised rates of interest

Benefits for the Exporter

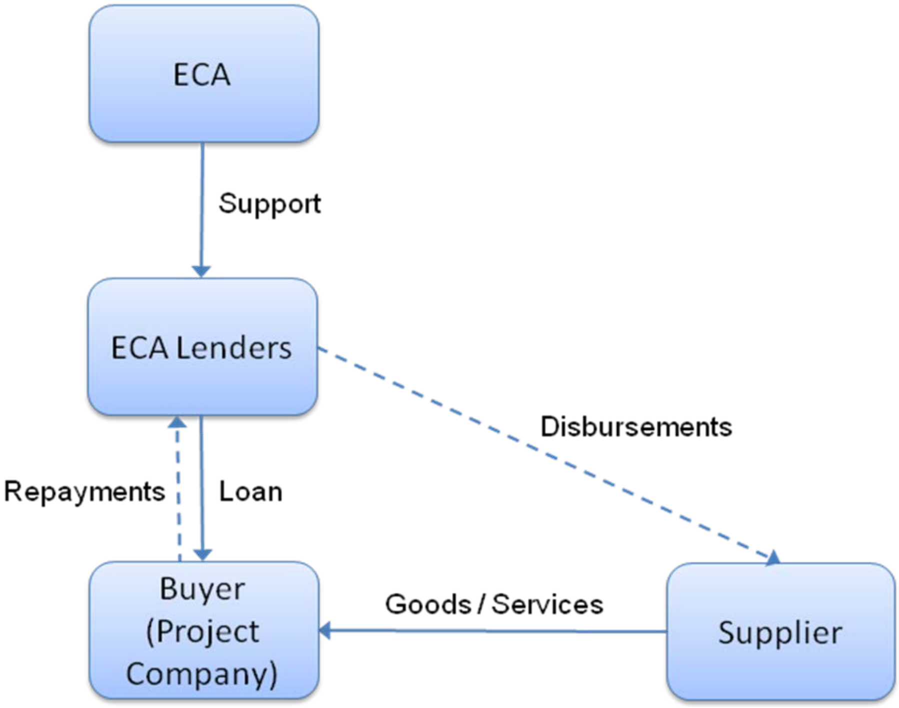
From the perspective of the supplier, the main advantages are:

- Protection against non-payment by the buyer
- Allowing the supplier to offer competitive terms

Benefits for the Exporter's host government

The principal aim of any ECA is to encourage trade with the host country by supporting its exporters. ECAs and their host governments may also seek to be involved on specific projects for wider political or reputational reasons.

Typical Financing Structure



The diagram shows a typical "buyer credit" financing structure.

Documentation

Commercial bank loan agreement
A commercial bank or banks provide a loan to the buyer which is used to fund payments under the contract between the buyer and the supplier. The loan will be structured on either a Disbursement or Reimbursement basis – i.e. each drawdown of the loan will either be paid by the lenders directly to the supplier or will be paid to the buyer once it has paid the supplier under the contract.

Each drawdown notice under the loan must be accompanied by a qualifying certificate which will confirm that the loan is being drawn to pay for the agreed proportion of goods/services provided under the contract between the buyer and supplier.

Where an ECA participates in a project financing alongside commercial banks or other funders, the financing documents will typically be structured on the basis of an umbrella Common Terms Agreement (containing common representations, undertakings and events of default), and then separate facility agreements with the individual facility amounts, interest rates and disbursement mechanics.

ECA guarantee/support agreement
The commercial loan is backed by a guarantee or support agreement from the ECA. Where the ECA is providing a guarantee, it will repay the commercial banks if the buyer fails to make repayment of the loan.

The ECA may also (or alternatively) provide interest rate support, compensating the commercial banks for any difference that there may be between the interest rate under the loan agreement and the commercial rate.

Premium agreement (supplier recourse)
The ECA will charge a premium for the support that it provides. The level of premium will vary according to the level of risk assumed by the ECA – i.e. the credit risk of the buyer and the sovereign risk (in the case of political risk cover).

The ECA will also require that it has recourse to the supplier in the event that the supplier does not comply with its contract with the buyer. The level of recourse against the supplier varies (and may range from 10-100%).

Repayment and interest

Where an ECA is providing tied financing, the OECD Consensus arrangement (see page 2) will apply. This stipulates certain terms for repayment and interest which, for project financings, can be summarised as follows:

- Maximum repayment term of 14 years (unless ECA support comprises over 35% of the syndication for a project in a high income OECD country, in which case the maximum repayment term is 10 years[1])
- Repayment of principal may be in unequal instalments, to match project cashflow, as long as:
  - no single repayment in any six month period exceeds 25% of the principal sum
  - the first repayment is made no later than 24 months after the "starting point of credit" (i.e. completion of construction or commissioning of the facilities) and is at least 2% of the principal sum
  - interest is paid at least once every 12 months and the first interest payment is no later than 6 months after the starting point of credit
  - the weighted average life of the repayment period does not exceed 7.25 years (or 5.25 years in high income countries[1])
- Each ECA will have a Commercial Interest Reference Rate (CIRR) for lending which is set at 100 bps above that ECA's base rate (or 120 bps if the repayment term is in excess of 12 years)
- The ECA will charge a risk premium, calculated in accordance with the terms set out in the Consensus.

The OECD Consensus does not apply to untied funding, so where a company from the ECA's country has an ownership interest in or manages the relevant project, the terms of funding from the ECA may be more flexible.

Points to note for project financings involving ECAs

Do ECAs impose stricter terms on borrowers?

ECA requirements can differ in some respects from typical requirements of other financing parties. In particular:

Eligibility
An ECA will want to fix terms that make the financing eligible. In the case of tied lending, there will be requirements as to the minimum value of goods/services from the ECA's country in the contract.

Due diligence
In terms of the ownership of the project company and sponsor involvement with the project, an ECA will typically require comprehensive due diligence on the parties involved, which may be more extensive than a commercial lender would require.

ECAs may also require more input from environmental advisers than a commercial bank would otherwise seek, as ECAs often have specific internal requirements in this area. However, commercial banks that have signed up to the Equator Principles are likely to have similar requirements.

Completion risk
Some ECAs will not take completion risk.

Environmental and social responsibilities
ECAs may impose stricter terms on borrowers than commercial banks would in relation to environmental and social undertakings and consequences of breach. This is not necessarily the case, as Equator Principles banks, in particular, are likely to have similar requirements. However, for reputational reasons (among others) this is an area of particular sensitivity for ECAs.

Lender ratings
An ECA may have internal requirements as to the credit rating of the commercial lenders for any loan that it supports during the drawdown period.

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[1] The revised provisions for projects in high income countries will apply to transactions for which a final commitment is issued on or after 1 January 2013.

Process consequences

Where an ECA will be participating on a project financing, there will generally be a need to engage with the ECA earlier than would necessarily be the case with commercial banks (as internal processes can take longer with an ECA).

It is also important to keep in mind that ECA terms can dictate the overall financing. It is easier to structure a project with the ECA(s) first and then go out to commercial banks than the other way round. ECA terms will generally be acceptable to commercial banks, but the terms of documentation negotiated with commercial banks may not be sufficient for ECAs.

Intercreditor arrangements

In general, an ECA will rank at the same level as other senior lenders in any project financing. It will be paid at the same level in the cashflow waterfall, share in the security package and there should not be any intercreditor issues in terms of priority as between ECAs and other senior lenders.

However, there may be debate about voting and control rights as between the different funding groups.

Where an ECA has provided support (e.g. a guarantee) for a loan facility, it will generally control the voting of any lenders within that facility.

In terms of voting and control rights as between different facilities, that will be a matter for negotiation on the individual transaction. It is common to structure such deals in 'tranches' – e.g. a commercial bank tranche, ECA tranche, bond tranche. Where there is a bond tranche, in particular, bondholders may want to have a right of enforcement without the other tranches. One arrangement that is often used is a structure whereby, on the occurrence of an event of default, there will be a standstill period and then enforcement may be commenced by any one tranche, if during the standstill period there has not been a valid vote against enforcement or a waiver.

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