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Legal Update

Export Credit Agencies and Political Risk Insurers in International Project Financing

Export Credit Agencies – General

An Export Credit Agency (commonly referred to as an ECA) is a national government-owned or affiliated entity that supports the export of domestic goods and services by providing financing to foreign purchasers of such goods and services. The fundamental purpose of an ECA is to increase the volume of exports from domestic producers of goods and services by opening overseas markets for such products through the provision of financing and other risk-reducing products. ECA-supported goods and services can range from large capital goods—such as aircraft, satellites or locomotives—to finished industrial products, such as solar panels, wind turbines, pumps and engines and even further to "soft" exports that can include legal, engineering, technical and other services. In a nutshell, ECAs support the expansion of foreign trade by their national exporters and service providers. In doing so, of course, they also support domestic employment.

ECAs have a long history that is intertwined with the expansion of economies and governmental policies to promote national exports. The first official ECA, the English Credit Guarantee Department (ECGD), was established in the United Kingdom in 1919. In Germany, the predecessor to the present ECA was established in 1917, and the Export–Import Bank of the United States was founded in 1934. In the aftermath of World War II, ECAs were established in Austria in 1946 and Japan in 1951. From the early 1970s to the late 1990s, a number of additonal countries in the Middle East and Asia created ECAs, including Iran in 1973, Korea in 1976, India in 1983, Egypt in 1992 and China in 1994. More recently, new or smaller countries have established their own ECAs, including Serbia and Sudan in 2005, Estonia in 2009 and Armenia in 2013.

Today, there are almost 80 countries that have established ECAs or some variation of national export support or credit insurance agencies. (A list of many of these ECAs, export credit insurers and similar entities is attached as **Annex A**).

ECA Risk Mitigation

The principal benefit of an ECA is to mitigate risks associated with international trade transactions. Cross-border trade in goods and services includes a variety of risks for both buyers and sellers, including credit risks related to payment for goods, as well as political risks associated with the transit and delivery of goods across borders, often at great distances. Such risks are not new, and trade participants in ancient Rome faced the same fundamental question as do modern-day traders in Asia: when does the risk associated with a given transaction outweigh its desirability? Furthermore, if risk for a transaction is deemed too high by the entities to whom exporters and traders often turn to assist them—namely, banks and insurers—trade and exports can suffer as these transactions are deferred or avoided altogether due to risk concerns. [1]

In mitigating inherent political and payment risk, ECAs enhance the ability of market participants to transact—whether they are sellers, buyers or financiers. ECA programs provide direct finance or guarantees of bank finance, and if not providing direct political risk insurance, they can still provide an implicit political risk "umbrella" due to their very presence in the transaction.

As project finance structures are fundamentally designed around the principles of risk identification, allocation and mitigation, ECAs play a key role in the risk-reduction goals of the participants.

Products and Services[2]

Although product offerings have variations among the many ECAs, typically ECAs offer the following:

- Direct Loans;
- Loan Guarantees; and
- Export Credit Insurance.[3]

In addition, ECA products can be offered on either a "Supplier's Credit" or "Buyer's Credit" basis, with the difference being:

- In a Supplier's Credit, the ECA loan or guarantee is made to or benefits the domestic exporter (the supplier of the goods or services) and the supplier is then able to provide financing terms to the foreign buyer, assisting their purchase of the supplier's goods or services.
- In a Buyer's Credit, the ECA loan or guarantee is made to or benefits the foreign buyer, allowing the buyer to finance its purchase of the domestic exporter's goods or services.

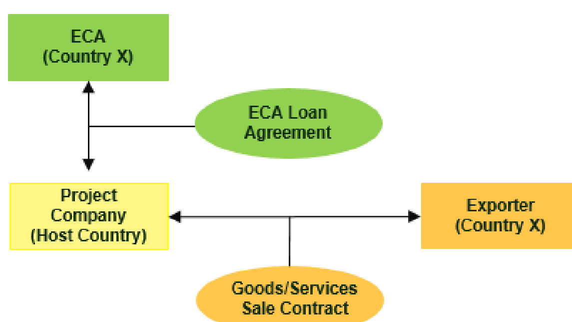
Typical financing period terms for ECA products are short-term (less than two years), medium-term (two to five years) and long-term (over five years and usually 12-15 years).

Typical Structures

ECA participation in major project financing transactions generally use Buyer's Credit structures and are on a long-term (10-15 year) basis. In this way, the project company/borrower established for the project financing can borrow the ECA loan (or borrow from banks guaranteed by the ECA) and can pair the ECA-supported financing with other project debt borrowed by the project company, thereby assembling a complete financing package for the project with long repayment tenor, enhancing project and sponsor return.

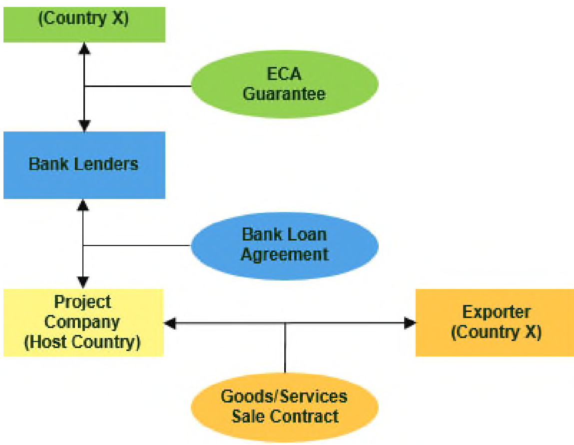
The most commonly used ECA structures in project financings are illustrated below:

EXHIBIT 1 – ECA DIRECT LOAN STRUCTURE



In the Direct Loan structure, the ECA makes a direct loan to the foreign project company to support the purchase by the project company of the exports supplied under the goods and services supply agreement between the project company and the domestic exporter(s) from the ECA country.

EXHIBIT 2 – ECA GUARANTEED LOAN STRUCTURE



The Guaranteed Loan structure is very similar to the prior one, except that in this scenario the ECA provides a *guarantee* of loans made by a bank (or banks) to the project company for its purchase of the exports supplied by the domestic exporter(s) from the ECA country.

Coverage Issues

ECA COUNTRY CONTENT

Given that an ECA serves the purpose of supporting its home country's own national exports, there are domestic content requirements that must be satisfied in order to permit the ECA to provide a loan or guarantee. In project financings, usually the borrower/project company works with the Engineering, Procurement and Construction (EPC) contractors and other suppliers to ensure that domestic content rules are followed. Note that it is often the case that there will be products available from a variety of sources; for example, a Moroccan project company borrower using a German contractor may obtain support from the ECAs of the United States, Germany, Italy and Korea, if the German contractor sources equipment from manufacturers in each such country.

LOCAL COST

Project financings inevitably result in certain costs being incurred in the host country. For example, site preparation, concrete and steel installation and other such activities will require local labor, equipment and supplies. Such project-related costs incurred in the project borrower's country are referred to as "local costs." ECAs will often provide credit support for a fixed percentage of local costs in addition to the national export costs they are financing. This support provides project borrowers with an ability to obtain credit from ECAs for a larger portion of the overall project financing needs, improving project economics by wrapping more of the total project debt into the ECA facilities.

COVERAGE PERCENTAGES AND TYPES

"Cover" is the credit exposure percentage of the eligible goods and services that an ECA agrees to provide through its loan or guarantee to the project company borrower. Such percentages range from 80 to 100 percent, depending on the ECA and the type of ECA program being employed. In addition, ECA programs can offer "comprehensive" cover (meaning both commercial and political risks are covered), "commercial" cover (which excludes political risks) or "political risk" cover (which excludes commercial risks). The optimal goal for most projects is to maximize the comprehensive cover percentage from the involved ECA(s).

Pricing

ECA pricing has multiple components:

- **Interest rates** – These will vary according to whether the ECA credit is a guarantee of commercial bank debt or a direct loan by the ECA itself, and whether the loan is on a fixed or floating-rate basis.

- **Commitment fees** – A fee expressed as a percentage of the total loan or credit exposure charged to compensate the ECA for reserving ("committing") its funds or credit exposure to the relevant financing transaction for the requested tenor of the loan or support.
- **Exposure fees/premia** – A fee or premium expressed as a percentage assessed on each disbursement of the loan or credit exposure event, that compensates the ECA for the assessed risk associated with the transaction. Exposure fee/premium calculation components will generally include consideration of the host country of the borrower, the nature of the transaction, the tenor of the loan or guarantee and other risk features of the proposed transaction.

In addition, the Organisation for Economic Co-operation and Development (OECD) [discussed below] has established so-called "minimum premium benchmarks" that act to constrain overall fee rates charged by ECAs, by establishing a floor for such fee rates that can only be derogated from in specified circumstances.

Other Important Policies

ECAs typically require adherence to various policies by the project, the contractors and suppliers and the project company and its shareholders. This requirement reflects the fact that ECAs are governmental entities and are also subjected to significant attention by NGOs (Non-Governmental Organizations) that monitor their compliance with various codes and standards related to aspects of foreign direct investment in emerging markets. These policies can have significant impact on project design, construction and operation, as well as on the business practices of the project company. Policies can vary from ECA to ECA, and therefore project companies may often need to comply with a variety of such policies, for example:

- Anti-bribery, anti-corruption and anti-money laundering
- Environmental, social and corporate responsibility
- Gender equality and empowerment
- Anti-terrorism
- UN/international economic and political sanctions
- High carbon-intensity
- Military, security and "dual-use" equipment

Governing and Coordinating International Organizations

THE OECD

In the same way that producers of similar goods compete against each other, ECAs compete against each other to provide favorable credit terms to further promote their respective national exporters, to secure sales and expand foreign trade. Since the ECA-supported exports in most project financings are quite sizeable, the impact of the ECA fee and financing costs also can have a material impact on project economics, and ultimately on sponsor return. The obvious potential downward spiral of increasingly competitive ECA support packages would result in unfair competitive advantage benefitting the national exporters whose ECA was willing to offer the most concessional terms, in turn limiting buyer (i.e., project company/sponsor) choices. In this way, there is potential scope for countries to use their ECA to unfairly subsidize their own exports through ECA credit terms (such as offering longer debt tenors, lower interest rates or other concessional financing terms). The resulting effects would be to skew the market towards all-in price competition (i.e., for goods and financing costs) and away from comparative values of the actual goods produced by differing national producers.

To address these concerns, and more generally to introduce transparency into the ECA market, various countries—including the vast majority of the developed economies whose ECAs have very large combined market share in ECA-supported project financings—are participants in two international organizations that focus on ECA-related issues: the OECD and the Berne Union.

The OECD was established in Paris in 1961 by 18 European countries, the United States and Canada. Today, it has a membership of 36 countries, including a number of leading emerging market countries, such as Mexico and Turkey. The stated mission of the OECD is to provide a forum for government to develop common economic policies on various issues, to establish international standards on various goods, and to be a clearinghouse for reliable data on members' global trade and investment volumes, GNP, GDP, productivity and other economic metrics.

Since 1978, the OECD has administered the Arrangement on Officially Supported Export Credits (the Arrangement),[4] which seeks to level the playing field and eliminate (or severely limit) financial subsidies and potential trade distortions. The Arrangement thus sets forth the most generous export credit terms and conditions that may be offered by its participants.[5] The Arrangement is a "Gentlemen's Agreement" among its participants who represent most OECD member governments,[6] and thus it is a voluntary arrangement and not legally enforceable by its members. Ultimately, the purpose of the Arrangement is a global trade system where exporters compete on the basis of the price and quality of their products rather than the financial terms provided by their ECA, thus eliminating trade distortions and subsidies.

Supplementing the Arrangement are six "Sector Understandings" that cover export credits in the area of (I) ships, (II) nuclear power plants, (III) civil aircraft, (IV) renewable energy, climate change mitigation and adaptation, and water projects, (V) rail infrastructure and (VI) coal-fired electricity generation projects. These sectors have special technical, financial and national policy characteristics that warrant different treatment from other exports of goods and services addressed by the Arrangement.

In general, the Arrangement and the Sector Understandings are factored into the equation by the ECA itself in connection with its overall consideration of a requested loan or guarantee for a particular project and the establishment of the various financial terms that will apply to its offered financing to the project company/sponsor.

THE BERNE UNION

Unlike the OECD, which was formed by national governments and whose members are all States, the Berne Union is an international not-for-profit trade association, representing the global export credit and investment insurance industry.[7] The Berne Union has more than 80 members that include ECAs' private credit and political risk insurers and multilateral institutions that provide differing types of financial and insurance support of cross-border trade. As of the date of this writing, ECAs that are Berne Union members are reflected on **Annex A**.

Berne Union members have significant market impact—according to their 2017 statistics, members supported 14 percent of global cross-border trade under the equivalent of US$2.35 trillion of trade financing and insurance support.[8] Of this total, US$179 billion consisted of medium- to long-term credits from ECAs.

Although the Berne Union is a private trade association and not a regulatory or government organization, it provides a forum and clearinghouse for ECAs and trade insurers to discuss policies and issues that affect their various products. As a result, the Berne Union has an important role in the shaping of ECA policies that are implemented in the support of project finance transactions.

Political Risk Insurers – General

Project and infrastructure development and financing transactions face a multitude of risks. Certain of these risks can be addressed by due diligence, contract terms or credit support. Particularly in the emerging markets, risks related to political actors or occurrences can be very difficult to mitigate through such conventional approaches. In these cases, both equity investors and debt providers can use political risk guarantees or political risk insurance to wholly or partially mitigate such risks and cover losses arising from such events. In the words of the World Bank's political risk agency, the Multilateral Investment Guarantee Agency (MIGA): "Political risk insurance (PRI) is a tool for businesses to mitigate and manage risks arising from the adverse actions—or inactions—of governments."[9]

Political risk mitigation products are offered by many entities. In general, the market consists of public agencies and private providers. The public providers include multilateral agencies (such as MIGA), many ECAs and so-called bilateral agencies or development finance institutions (DFIs). These DFIs are governmental agencies whose purpose is to promote developmental objectives in the emerging markets.

On the private side of the market, major political risk providers include a variety of insurance companies and associations, many of which are "household names," including AIG, AXA XL, Chubb, Lloyd's of London, Sovereign Risk Insurance Ltd. and Zurich Insurance Group.

Although there are many public and private entities providing PRI, in emerging market project finance transactions the most significant providers are MIGA, the ECAs and the DFIs.

PRI Form

Typically, ECA political risk products are referred to as political risk guarantees, whereas the products offered by MIGA, DFIs and the private market are referred to as political risk insurance. While there are legal distinctions between these two forms of coverage and the associated mechanics for claim and payment, these distinctions are not relevant for this article. As a result, the term "PRI" will be used here to refer to all forms of this coverage, whether guarantee or insurance.

PRI Risk Coverage[10]

PRI risk coverage can be obtained to address the following types of risks that are of common concern in project finance transactions:

- **Expropriation**: Losses arising from actions or inactions of the host government that eliminate, deprive or reduce ownership and/or control over project assets or the project investment, including physical assets and shares in the project company.
- **Currency Inconvertibility and Transfer Restrictions**: Losses arising from the inability or restriction of conversion of local (host country) currency into foreign currency, or on the transfer of foreign exchange outside the host country.
- **War and Civil Disturbance**: Losses arising from destruction or damage to project assets caused by politically motivated acts

of war or civil disturbance in the host country.

- **Breach of Contract**: Losses arising from a host country's breach or repudiation of a contract with the project.
- **Award Frustration**: Losses arising from a host government's non-payment of a binding arbitral or judicial decision.

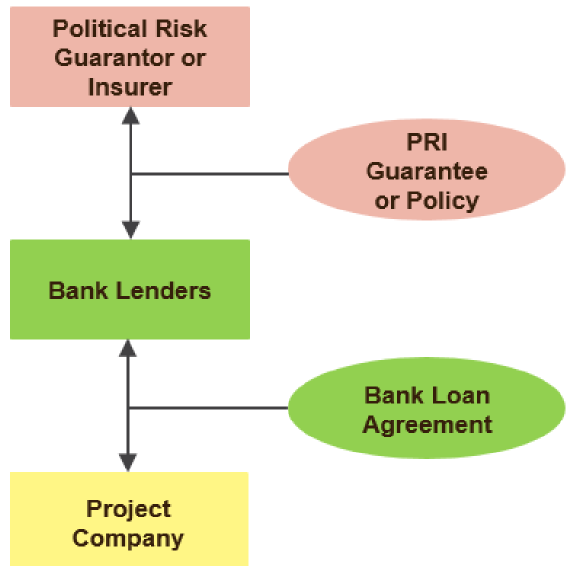
Typical Structures

PRI can be obtained by either the equity investors (sponsors) of a project or by the lenders. In general, equity coverage will focus on risks that deprive the investors of their ownership interests, value of the project assets or ability to repatriate dividends and/or profits. Lenders, who are not project owners and are fundamentally interested in recovery of their debt (principal and interest), will focus on coverage that provides timely repayment of their loans and financial exposure.

In addition, a significant volume of PRI has been taken out to support capital markets issuances (bonds), especially in circumstances where the rating of the bonds would be limited by country risk concerns. In these circumstances, PRI can be used to help bond issuers to "pierce the sovereign ceiling" and achieve an investment grade rating not otherwise achievable due to political risk.

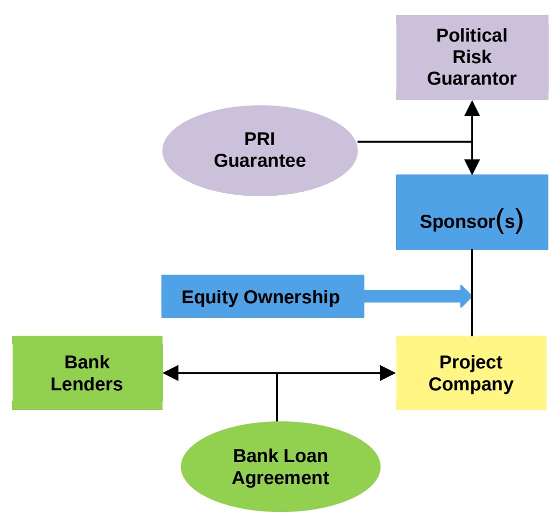
Typical PRI structures in project financings are illustrated below:

EXHIBIT 3 – POLITICAL RISK GUARANTEE OR INSURANCE IS PROVIDED TO PROJECT LENDERS



In this structure, the project lenders have secured PRI to provide credit support for the repayment of their principal and interest in the event of covered political risk events adversely affecting the project company's ability to make debt service payments.

EXHIBIT 4 – POLITICAL RISK GUARANTEE OR INSURANCE IS PROVIDED TO THE SPONSOR(S)



In this structure, the project sponsor(s) have secured PRI to protect their equity investment and the enterprise value of the project and project company in the event of covered political risk events affecting the value of their equity investment in the project.

Coverage Issues

ECAs that provide PRI generally have coverage requirements and limitations that track those found in their financing programs discussed above.

PRI providers that provide insurance products typically have limitations of the following types:

- Criteria regarding the eligibility of the investment (specific asset or equity interest) to be insured
- Tenor of policy—most often from one to 20 years
- Percentage of eligible investment that the policy will cover—generally, the policyholder is required to risk-share with the PRI provider by retaining some percentage of the risk of loss (for example, up to 90 percent of an eligible investment, with the investor retaining a 10 percent risk share)
- Specific claims procedures requiring submission of documentation in specified time frames, exclusions to cover and, as a condition of payment, transfer and/or subrogation of the insurer of the insured's covered investment.

Pricing

PRI is priced on a premium basis, with premia calculations dependent on factors specific to the relevant investment, including country, sector, transaction type, nature of covered risks and coverage tenor.

Governing and Coordinating International Organizations

ECAs that provide PRI are subject to the OECD Arrangement's terms discussed above.

Also, as discussed above, the Berne Union plays a prominent role in the dialogue among public and private PRI providers, and has more than 80 members actively supporting international trade and investment transactions, many of which are PRI providers. According to its recent statistics, in the first half of 2018, Berne Union members paid US$2.65 billion of total claims, with 53 percent of such claims relating to medium- or long-term export transactions for capital goods and infrastructure.

ANNEX A

SELECTED GLOBAL ECAS AND EXPORT CREDIT INSURANCE/SUPPORT ENTITIES

COUNTRY	EXPORT CREDIT AGENCY	BERNE UNION MEMBER (Y/N)
Argentina	Banco de Inversión y Comercio Exterior	N
Armenia	Export Insurance Agency of Armenia (EIAA)	Y
Australia	Export Finance and Insurance Corporation (EFIC)	Y
Austria	Oesterreichische Kontrollbank AG (OeKB)	Y
Bangladesh	Sadharan Bima Corporation	N
Belgium	Credendo – Export Credit Agency	Y
Bosnia and Herzegovina	Izozno Kreditna Agencija BiH	N
Brazil	Brazilian Guarantees Agency	N
	Banco Nacional de Desenvolvimento Econômico e Social	N
Bulgaria	Bulgarian Export Insurance Agency	Y
Canada	Export Development Canada (EDC)	Y
China	The Export-Import Bank of China	N
	China Export and Credit Insurance Corporation (SINOSURE)	Y
Colombia	Bancóldex	N
Croatia	Croatian Bank for Reconstruction and Development (HBOR)	Y
Czech Republic	Česká Exportní Banka, a.s.	N
	Export Guarantee and Insurance Corporation	N
Denmark	Eksport Kredit Fonden (EKF)	Y
Egypt	Export Credit Guarantee Company of Egypt	Y
Estonia	KredEx Credit Insurance Ltd.	Y

SELECTED GLOBAL ECAS AND EXPORT CREDIT INSURANCE/SUPPORT ENTITIES

COUNTRY	EXPORT CREDIT AGENCY	BERNE UNION MEMBER (Y/N)
Finland	Finnish Fund for Industrial Cooperation Ltd.	Y
	Finnvera plc	Y
France	Bpifrance Assurance Export SFIL	Y
Germany	Euler Hermes	Y
	KfW (refinancing entity for Hermes-covered loans)	N
	KfW IPEX-Bank (support entity through ERP Export Financing Program and Shipping CIRR Programme)	N
Greece	Export Credit Insurance Organization	Y
Hong Kong	Hong Kong Export Credit Insurance Corporation (HKEC)	Y
Hungary	Hungarian Export-Import Bank plc (EXIM HU)	Y
India	ECGC Limited	Y
	Export-Import Bank of India	N
Indonesia	Indonesia Eximbank (LPEI)	Y
Iran	Export Guarantee Fund of Iran	Y
Israel	Ashra – The Israel Foreign Trade Risks Insurance Corp. Ltd.	Y
Italy	SACE spa	Y
Jamaica	The National Export-Import Bank of Jamaica (EXIM J)	Y
Japan	Japan Bank for International Cooperation (JBIC)	N
	Nippon Export and Investment Insurance (NEXI)	Y
Jordan	Jordan Loan Guarantee Corporation (JLGC)	Y
Kazakhstan	KazakhExport EIC JSC	Y

ANNEX A

SELECTED GLOBAL ECAS AND EXPORT CREDIT INSURANCE/SUPPORT ENTITIES

COUNTRY	EXPORT CREDIT AGENCY	BERNE UNION MEMBER (Y/N)
Korea, South	Korea Eximbank (KEXIM)	N
	Korea Trade Insurance Corporation (KSURE)	Y
Latvia	JSC Development Finance Insurance Altum	N
Lebanon	Lebanese Credit Insurer s.a.l. (LCI)	Y
Luxembourg	Office du Ducroire (ODL)	Y
Macedonia	Macedonian Bank for Development Promotion (MBDP)	Y
Malaysia	Export-Import Bank of Malaysia Berhad (MEXIM)	Y
Mexico	Banco Nacional de Comercio Exterior	Y
Netherlands	Atradius Dutch State Business NV	Y
New Zealand	New Zealand Export Credit Office (NZECO)	Y
Nigeria	Nigerian Export-Import Bank	N
Norway	Garanti-instituttet for eksportkreditt (GIEK)	Y
	EksportKreditt Norway	N
Oman	The Export Credit Guarantee Agency S.A.O.C.	Y
Poland	Export Credit Insurance Corporation (KUKE)	Y
Portugal	Companhia de Seguro de Crédito	Y
Qatar	Tasdeer (QDB)	Y
Romania	EximBank Romania (EXIM R)	Y
Russia	Export Insurance Agency of Russia (EXIAR)	Y
	Eximbank of Russia	N
Saudi Arabia	Saudi Arabia Export Program (SEP)	Y

SELECTED GLOBAL ECAS AND EXPORT CREDIT INSURANCE/SUPPORT ENTITIES

COUNTRY	EXPORT CREDIT AGENCY	BERNE UNION MEMBER (Y/N)
Serbia	Serbian Export Credit and Insurance Agency	Y
Singapore	ECICS Limited	Y
Slovak Republic	Export-Import Bank of the Slovak Republic (Eximbanka SR)	Y
Slovenia	Slovene Export and Development Bank	N
South Africa	Export Credit Insurance Corporation	Y
Spain	Compañía Española de Seguros de Crédito a la Exportación (ESCE)	Y
Sri Lanka	Sri Lanka Export Credit Insurance Corporation (SLECIC)	Y
Sudan	National Agency for Insurance and Finance of Exports (NAIFE)	Y
Sweden	Exportkreditnämnden (EKN)	Y
	Svensk Exportkredit (SEK)	N
Switzerland	Swiss Export Risk Insurance (SERV)	Y
Taiwan	Export-Import Bank of the ROC	N
Thailand	Export-Import Bank of Thailand (THAI EXIMBANK)	Y
Trinidad and Tobago	Export-Import Bank of Trinidad and Tobago	N
Turkey	Export Credit Bank of Turkey (TURK EXIMBANK)	Y
United Arab Emirates	Export Credit Insurance Company of the Emirates	N
United Kingdom	UK Export Finance (UKEF)	Y
Ukraine	State Export-Import Bank of Ukraine (UKR EXIMBANK)	Y
United States	Export-Import Bank of the United States (US EX-IM)	Y
Uzbekistan	Uzbekinvest National Export-Import Insurance Company (UZBEKINVEST)	Y

For more information about this topic, please contact the author, Barry N. Machlin.

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Endnotes

[1] From *The Changing Role of Export Credit Agencies*, Malcom Stephens, International Monetary Fund, 1999.

[2] This discussion and those that follow regarding coverage and terms are drawn from the programs of a number of leading ECAs, including Bpifrance Assurance Export, Euler Hermes of Germany, JBIC of Japan, Korea Eximbank, SACE of Italy, UK Export Finance and U.S. Exim Bank.

[3] In this discussion we will focus on the loan and guarantee programs of the ECAs, as export credit insurance is not a major component of ECA participation in project finance transactions.

[4] The Arrangement can be found at: http://www.oecd.org/tad/xcred/theexportcreditsarrangementtext.htm.

[5] The Arrangement includes procedures for prior notification, consultation, information exchange and review for export credit offers that are exceptions to or derogations of the rules as well as tied aid offers.

[6] The Arrangement participants are: Australia, Canada, the European Union, Japan, South Korea (Republic of), New Zealand, Norway, Switzerland and the United States.

[7] The formal name of the Berne Union is the International Union of Credit and Investment Insurers. Its web site can be found at: http://www.berneunion.org/.

[8] These and other Berne Union Statistics come from *The Bulletin*, Berne Union Spring Meeting Newsletter, 19 March 2018 (available at http://cdn.berneunion.org/assets/Images/6345be17-145a-4695-aaa1-44fa4980b71c.pdf).

[9] https://www.miga.org/political-risk-insurance.

[10] This discussion and those that follow regarding coverage and terms are drawn from the programs of a number of leading "official" PRI providers, including MIGA, OPIC, NEXI of Japan and KSURE of Korea.