

EXPORT CREDIT AGENCY FINANCE: OVERVIEW

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This note explains the key elements of export credit agency (ECA) covered finance, the nature and operation of ECAs, the types of risk covered, and the claims and recovery process.

For information on key documents and terms, see *Practice note, Export credit agency finance: key documents and terms*.

For information on the types of cover, see *Practice note, Export credit agency finance: types of cover*.

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WHAT IS ECA FINANCE?

Export credit agency (ECA) finance is a general term given to transactions where representatives of individual states lend their financial support to the export of eligible capital goods and related services originating from their home jurisdiction. ECA finance is a particular form of trade finance, which offers benefits to exporters and to foreign buyers. Trade finance enables foreign buyers to access credit from an exporter or from lenders and so spread the cost of payment over time, while enabling an exporter to receive payment upon delivery of the goods or services. For a guide to Practical Law Finance's trade finance resources, see *Practice note, Accessing Practical Law Finance's trade finance resources*.

What distinguishes ECA finance from other forms of trade finance is that the risks associated with financing exports to a foreign buyer are alleviated through the obligations assumed by an ECA.

ECAs have certain features which distinguish them from other credit providers:

- Most ECAs have very strong credit ratings.
- If an ECA's own capital and reserves are insufficient to meet its payment obligations, then it can call upon the financial resources of its home state.
- The majority of ECAs have the authority and expertise to assess and take on certain risks associated with the country of import, and so such ECAs can support commercial lending where lenders could not otherwise satisfy themselves with the credit risk of the foreign buyer.

It is the combination of sovereign-strength balance sheet and the exclusive focus on supporting exports through each stage in the economic cycle which places ECAs into a separate category financing institution.

TERMINOLOGY

Given the variety of ECAs, and the long history of ECA finance, it is an area with a range of terminology, much of which is unofficial. The following sets out the key terminology as used in this note:

- **ECA Cover:** the financial support provided by an ECA. This can take various legal forms such as a guarantee or insurance policy, direct loan or interest rate support (depending on the particular ECA and the transaction)
- **ECA support document:** the contract containing the ECA's obligations in respect of the cover provided and the conditions to such cover.
- **ECA Premium:** the fee payable in respect of the ECA Cover.
- **Export Credit:** an insurance, guarantee or financing arrangement which enables a foreign buyer of exported goods and/or services to defer payment over a period of time.
- **Buyer:** this is the foreign buyer and importer of goods or services under an export contract in respect of which the buyer, the goods, the payment terms and the associated credit terms all meet the eligibility criteria for ECA cover. If it is entering into a loan facility, then it will also be a borrower. The term excludes domestic trade buyers and borrowers who do not meet the terms of ECA cover.
- **Supplier credit:** an export transaction where the exporter offers a Buyer deferred payment terms (that is, following delivery of the goods or services) which are guaranteed by the ECA.
- **Buyer credit:** an export transaction where an exporter is paid upon delivery of goods or services and a Buyer obtains credit terms by utilising a loan facility to make payment.
- **Buyer credit cover:** ECA cover in respect of a buyer credit.
- **Supplier credit cover:** ECA cover in respect of a supplier credit.



PURPOSE AND LEGAL NATURE OF ECAS

ECAs have a long history of supporting the international trade policies of their home state. They are a standard feature of developed market economies and in recent years they have been adopted within many developing markets. An ECA has the financial and legislative backing of its home state, and the obligations it assumes are therefore considered direct (or indirect, depending on the legal status of the ECA) sovereign obligations of its home state.

ECAs are not there to support commercial lenders, Buyers or specific exporters. Their purpose is to support government trade policy, by increasing the international competitiveness of exports from that state, and also promoting exporting within the state by offering financial support to existing and potential exporters. ECAs should generate sufficient revenue to cover their costs and are generally profitable, but they do not prioritise generating profit to the same extent as commercial lenders. However, they are motivated to avoid losses and the cover they provide should be viewed as arms' length commercial transactions rather than aid or grants. The preceding description is not prescriptive, and at any particular time an ECA may be viewed by exporters and commercial lenders as more or less 'commercial' in outlook in comparison with other ECAs.

While ECAs share a common purpose, they are classified into three main legal categories:

- ECAs that form part of the government of their home state. Examples of government agencies include UK Export Finance (UKEF, formerly referred to as the Export Credits Guarantee Department or ECGD), an independent department of the United Kingdom government, and the Export-Import Bank of the United States (USEXIM), which forms part of the executive branch of the US government.
- ECAs that are state-owned corporations; for example, China Export & Credit Insurance Corporation (known as Sinosure) in China and EKF in Denmark.
- ECAs that are privately-owned organisations who administer ECA business on behalf of the home state according to a commercial agreement. Examples include Hermes in German and Atradius in the Netherlands.

ECAs can be distinguished from multilateral agencies (which are supported by multiple states) and development finance institutions (which are focused on development rather than exports). They can operate alongside both.

How perceptions of ECAs can depend on perspective

- Is an ECA a legitimate national supporter of exporting industries or does it provide economic subsidies which interfere with free market economics?
- Should an ECA's first priority be to increase export business or protect taxpayers from financial loss?
- Should an ECA prioritise high value transactions for multi-national exporters at the expense of small value transactions for the SME sector?
- How do ECAs balance protecting their taxpayers with other policies such as debt relief to heavily indebted poor countries which have been prior beneficiaries of ECA support?
- To what extent should an ECA impose environmental or social conditions to its support of infrastructure development in developing markets, and should an ECA support transactions which potentially contribute to climate change, for example, fossil fuels?

To follow the views of certain non-governmental organisations on this subject, see [ECA Watch](#).

REGULATIONS GOVERNING THE ACTIVITIES OF ECAS

ECA activity is constrained by various national and international rules. An ECA will need to match its financial support to whatever limits may be set under national budgets and applicable legislation (for example, UK Export Finance is subject to UK legislation, and ECAs of European Union member states are subject to applicable EU regulations). ECA activity is also subject to the World Trade Organization (WTO) rules on export credit and export subsidy.

ECAs will comply with applicable sanctions regulations in the same manner as other financial institutions, and due to their official status have traditionally taken a very cautious view of potential reputational risks, for example, bribery and corruption risks, possible environmental and social consequences of export transactions, and ensuring lending to buyers within indebted states is at sustainable levels.

OECD ARRANGEMENT ON OFFICIALLY SUPPORTED EXPORT CREDITS

The Arrangement on Officially Supported Export Credits (the Arrangement, also known as the Consensus) published by the Organisation for Economic Co-operation and Development (OECD) is an arrangement between consenting participants which aims to promote

fair competition between participant ECAs and their governments as regards financial support of export business, so that exporters primarily compete on price and quality rather than by reference to the most favourable credit terms available. The Arrangement establishes agreed minimum requirements for ECA support of transactions involving extension of credit for two or more years. The exclusion of export credits of less than two years means the Arrangement relates to export credit support for capital goods (which are produced for use in making other goods or services) rather than goods produced for sale to consumers. The Arrangement establishes "...the most generous export credit terms and conditions that may be supported", beyond which ECAs cannot go without a suitable exception. Specific rules apply to certain sectors where increased levels of support are deemed acceptable given the nature of the exports, including ships, civil aviation, renewables and rail infrastructure. Exports of agricultural commodities and military equipment are not covered by the Arrangement as they are subject to their own separate regulations.

The Arrangement is technically non-binding, although the participants monitor each other (and separate regulation obliges EU member states to ensure their ECAs comply with the terms of the Arrangement). The participants are Australia, Canada, the European Union, Japan, Korea, New Zealand, Norway, Switzerland and the United States. Therefore, the Arrangement applies to ECA activity of developed market economies and excludes important exporters such as the BRICS states.

The general perception of the Arrangement is that it has been successful in its aims over the course of multiple credit cycles. Developments continue which are aimed at expanding the OECD approach beyond the OECD participants in order to include ECAs of significant exporting states among developing markets.

The Arrangement has been amended a number of times since its publication, with the most recent version being dated October 2017 (see [Legal update, OECD Arrangement on Officially Supported Export Credits \(October 2017 version\)](#)).

BENEFITS AND DRAWBACKS

ECAs are a permanent and influential part of the short and medium to long-term export finance space, and their existence has benefits and drawbacks.

Benefits

- ECA cover can counter a lack of supply in the commercial markets. Certain ECA cover, for example, political risks in respect of the jurisdiction of a Buyer, which may not be available at all from commercial insurers or only with patchy availability or on exorbitant terms.

- Similarly, credit relating to a Buyer may not be available for the duration required for an export transaction, whether in the form of loans or trade (non-payment) credit insurance. ECA support can unlock financing resource by expanding the pool of commercial lenders prepared to provide credit in respect of a Buyer.
- Most ECAs have very strong credit ratings.
- If an ECA's own capital and reserves are insufficient to meet its payment obligations, then it can call upon the financial resources of its home state.
- ECAs may also be willing to provide credit directly by lending to Buyers at highly competitive rates.

Drawbacks

ECA activity has to be monitored and regulated to ensure that ECAs complement rather than compete with commercial loan and insurance markets, a dynamic assessment that changes with the business cycle.

- There is a level of competition between ECAs which, if unchecked, can over time convert support into outright subsidy (hence the need for regulation).
- Buyers must pay ECA premium (fees) in order to obtain cover, which needs to be considered against the potential savings in interest and other finance costs.
- The time it takes to negotiate and execute a transaction tends to increase with ECA involvement, sometimes significantly.
- The requirements of ECAs, in terms of due diligence for a transaction (that is, the underlying purchase) and ongoing documentation delivery, will be greater than under a commercially funded loan facility.
- While transactions negotiated with ECAs are treated as confidential, ECAs may be subject to transparency rules requiring them to disclose certain information in relation to transactions (for example, the jurisdictions in which an ECA has provided cover). Where the potential buyers or number transactions are small, it may be possible to identify a transaction from the anonymised information disclosed, which may be a material consideration for exporters with sensitivity about the confidentiality of their customer relationships.

ECAs do not act in a vacuum and while their policy objectives may appear reasonably clear, their practical application is more nuanced. All ECAs are subject to continuous tensions, internal and external, as to their aims and priorities and how these interact with other government policies, views of non-governmental organisations and behaviours of commercial financiers. The issues for a particular ECA will be influenced by factors such as attitudes to free trade, whether an ECA is located in a developed or developing market, or an ECA's sensitivity to financial

loss versus growth in export business. If an ECA is successful in implementing its policy objectives, this may influence the economic, market and political conditions in which the ECA acts. This impact can lead to change in those conditions, which can cause an ECA to reprioritise its objectives and activities, or be required to do so by government and exporters. Similarly, if an ECA is perceived to be unsuccessful in meeting the policy objectives set for it, it will have to reconsider its approach. Irrespective of performance, there will always be external debate as to whether an ECA is prioritising the correct policy objectives.

TYPES OF RISK COVERED

The cover available from ECAs can be considered in terms of the nature of the risks covered and the duration for which cover is given. The duration of cover is relevant in understanding the rules relating to the cover (see [Duration of cover](#)). The nature of the risks covered relate to delivering export goods prior to payment and fall into four categories:

- **Political risk.** This includes actions in the buyer's country to impose a general moratorium on payments, or other actions which delay or prevent payments out of the country or otherwise delay or prevent performance of the supply contract (that is, certain force majeure events). Equivalent circumstances arising in the ECA's own country will be excluded from cover. ECAs do offer cover for political risks only, under products which are similar to the insurance cover offered by commercial insurers. Such products are not discussed further in this note.
- **Commercial risk.** This refers to the failure of a Buyer to pay amounts due in connection with the export transaction or any related credit provided. Non-payment can be due to insolvency (inability to pay) or unwillingness (that is, a protracted default in payment). It is a risk inherent with trade finance where credit terms are offered to the buyer. The expertise and resources of ECAs mean they can typically go beyond commercial financiers in the cover provided, particularly for medium and long-term cover.
- **Interest-rate risk.** This refers to the adverse effect that increases in reference rates (for example, LIBOR) can have on the financing costs of export credit made on a floating interest rate basis. ECAs are permitted to provide interest rate support, allowing covered loans to be made on the basis of fixed interest rates. It is discussed further below in the context of buyer credit cover.
- **Other export contract performance risks.** ECAs can also offer cover for risks indirectly related to exporting on credit terms. These can have similarities to common commercial insurance products. Risks include consequential loss arising

from buyer payment default part-way through a delivery schedule and the risk of an improper call made on a bond provided under an export contract in support of the exporter's performance obligations.

ECAs can also support the raising of working capital needed to fund manufacturing and staffing costs in advance of buyer payment. ECAs provide specific products in respect of some or all of these risks, which an exporter needs to source in addition to obtaining cover in relation to the credit terms. For an introduction to performance guarantees, demand guarantees, bonds and standby letters of credit, see [Practice note, Bonds, guarantees and standby credits: overview](#).

One risk not typically covered by ECAs is termed **documentation risk**. This means that an ECA will not accept liability for any claim made if the Buyer's obligations are not legal, valid, binding and enforceable (other than for illegality covered by political risk cover), or where non-payment is due to an error in the terms of the document. However, there are some important exceptions to this general rule, and so one should query the point if necessary on a transaction.

DURATION OF COVER

A generally accepted classification of products is to distinguish between short-term and medium/long-term cover (and the Arrangement draws this distinction).

Short term export credit cover

Short term export credit cover provides cover for less than two years. A typical product is trade credit insurance in respect of export markets where the private credit insurance market fails to match the demand from exporters in the ECAs home jurisdiction. ECAs can also offer products such as bills of exchange discounting facilities, receivables discounting facilities, guarantees in support of letters of credit and bid bonds as well as revolving short-term lines of credit.

Medium/long-term cover

Medium/long-term cover refers to cover provided for a period of two or more years. It is typically provided in the form of guarantees or insurance of Buyer payment obligations under term credit facilities, for the benefit of commercial lenders. Some ECAs also provide export credit cover directly, by making so-called 'direct loans' to a Buyer (see 'Direct Lending' below). ECA support of medium or long-term lending is most commonly used in connection with Buyers in the aerospace, energy, infrastructure, oil and gas, transport and defence sectors.

TYPES OF COVER

There are two particular terms which are used to describe the common forms of export credits to which ECA cover applies: supplier credit and buyer credit. For more information on these and on ECA direct lending, see *Practice note, Export credit agency finance: types of cover*.

KEY DOCUMENTS AND TERMS

For information on key documents (such as the application for cover, the ECA support document, and the facility agreement), as well as key ECA support terms and facility agreement terms in relation to an ECA buyer credit facility, see *Practice note, Export credit agency finance: key documents and terms*.

CLAIMS AND RECOVERY PROCESS

The purpose of ECA cover is to enable a claim to be made on behalf of lenders should they suffer an eligible loss in respect of a covered facility. The claims process is separate from the obligations owed to an ECA and would run in parallel to any steps taken against a Buyer following an event of default. Where a potential claims trigger event has occurred, there may be an initial waiting period following notification to the ECA, at the end of which a claim can be submitted if the circumstances still persist. The documentation required will vary between ECAs. If a claim is accepted by an ECA then it will typically pay out a claim on the basis of the original repayment schedule even if the ECA consents to or requires the buyer credit facility to be accelerated or rescheduled. The ECA can decide to pay out as if the facility had been accelerated. The ECA support document will set out the basis for sharing recoveries amongst the covered and uncovered portions, and deal with allocation of enforcement costs. The claims process under the ECA support document will include the right for the ECA to reduce the value of a claim made where it considers a lender to have been at fault in complying with its obligations to the ECA.

A detailed consideration of the ECA recovery process is beyond the scope of this note. However, the payment of a claim by an ECA does not automatically release lenders from their obligations to the ECA. ECA consent will continue to be required for any proposed transfer of a lender's uncovered portion of the loan to a buyer. The ECA may continue to give directions to finance parties and will control the timing of any enforcement action against a defaulting Buyer, including in respect of a lender's uncovered portion. Where the Buyer is owned by or is a developing market state, the recovery process can be greatly extended if the recoveries are dealt with as part of a broader negotiation of debt restructuring or forgiveness between a range of

sovereign creditors and the government of the defaulting Buyer. The Paris Club is an informal group of developed markets creditors (including ECAs of OECD participants) who negotiate with developing markets debtors with the intention of finding consensus agreement on debt relief via debt rescheduling and reduction.

ADDITIONAL CONSIDERATIONS FOR LAWYERS

When advising a lender, it is helpful to remember that an ECA is not merely another finance party. An ECA aims to assist financing of exports from their jurisdiction, rather than facilitating opportunities for banks to lend. Where a lender is new to the ECA finance space, it is important to ensure that the lender is aware that it is not 'business as usual': ECA cover is not simply loan additional collateral because the ECA is the controlling party in the transaction. Similarly, the arranging bank will be aware of the preferences an ECA has in terms of the manner negotiations are conducted and that persuasion rather than confrontation is the most appropriate way in which to engage with an ECA.

Lenders increasingly require formal legal opinion comfort in relation to the ECA's obligations under the ECA support document, to support the lender's treatment of the covered portion of the facility as sovereign risk. It should be possible to obtain an opinion as to enforceability of the ECA support documents from legal counsel in the jurisdiction of the ECA. For more information, see *Standard clauses, Legal opinion from non-English lawyer: foreign company and foreign law documents*. Typically, ECAs will not themselves provide opinion comfort as to matters of capacity and due authorisation, nor possibly evidence of compliance with any internal approval processes, but the approach can vary between ECAs.

When advising a Buyer, it is important to understand what prior experience the Buyer has of ECA finance. The structural, operational and documentary conditions imposed upon an ECA covered financing by the Arrangement and otherwise can be hard to understand if encountered for the first time. ECA consent will be required for amendments, waivers and consents. The practical consequence of this for a Buyer is that the involvement of the ECA may increase the time taken to consider requests.

When advising an exporter, it is advantageous to understand the exporter's level of current awareness of ECA finance products, as ECAs have tended to expand their product range in recent years. Where an exporter has manufacturing facilities located in or provides eligible services from more than one jurisdiction, it may be possible to consider

potential ECA cover options outside those available in the exporter's jurisdiction of incorporation. It is also worth bearing in mind that an ECA may require a recourse agreement between it and the exporter. Such agreements allow the ECA to recover loan losses guaranteed by the ECA which are directly attributable to performance by the exporter under its supply and/or services agreement with the Buyer. Recourse agreements can also document audit requirements of the ECA with respect to the exporter.

When advising ECAs one should be clear on the approach they are taking to a specific transaction, both in terms of risks covered and their requirements in terms of information provision by the Buyer (particularly regarding compliance with environmental undertakings and other similar reputational issues).

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