



**INSTITUTE OF BRAZILIAN BUSINESS
AND PUBLIC MANAGEMENT ISSUES**

The Minerva Program – Fall 2011

**THE ROLE AND IMPORTANCE OF EXPORT CREDIT
AGENCIES**

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1. PREFACE

The main purpose of this Research Paper is to present some knowledge on the work performed worldwide by the ECA'S - Export Credit Agencies, whose role is often underestimated.

My main motivation for choosing such a topic is derived from the fact that Eletrobras is about to develop a transaction using one ECA, the German EULER HERMES, who will be responsible for providing insurance on the commercial contracts signed by a German supplier, as well as to provide a guarantee for the financing banks involved. On Eletrobras' perspective, the using of ECA's does not often apply, since the Company has low leverage and room for far more indebtedness than it presently has. However, Eletrobras has developed throughout the years some financing using ECA structures, as it has been the case for the financing of a nuclear power project in 1998, and for other financing raised from other ECAs.

Very frequently I have received questions as to what are ECA's and what is their role. From that fact, I took the motivation to start a broader research, in order to enhance my knowledge on them, without the pretense, on my side, to exhaust the subject.

For some years now I've worked for Eletrobras and I'm involved in the Funding area of the Company. Eletrobras has tapped the international markets in order to raise money for the development of its investment program and other corporate purposes. The main choices developed are that of either debt towards financing institutions, multilateral agencies with guarantee from the Federal Government or another source is also found at the international bond market. This much having been said, it is for me a challenge to offer a paper describing the main issues regarding the work and recent developments of the ECA's, mainly because by choosing this subject I'm myself trying to broaden my knowledge on their work.

I wish to forward my thanks and gratitude for my colleagues at Eletrobras, to my team and co-workers. My love and thanks would be directed to my dear family, André, Vitor, Paulo and my mother Suzanna.

2. INTRODUCTION

Export credit agencies (ECAs) provide three basic functions. First, they help exporters meet officially supported foreign credit competition. (When foreign governments subsidize their companies' exports by offering buyers below-market, fixed-rate financings, exporters often find it difficult to offer financing that matches those subsidized rates.) Secondly, ECAs provide financing to foreign buyers when private lenders cannot or will not finance those export sales, even with the risks removed. Third, and perhaps their most important function, ECAs assume risks beyond those that can be assumed by private lenders. ECAs do not compete with private financial institutions. To the contrary, they enhance the ability of their country's lenders to compete internationally. It should also be noted that they do not offer development assistance to other countries; other agencies typically fulfill this role.

The approximately 100 officially supported ECAs share common features in their application process, eligibility criteria, risk classifications, terms, and pricing. They also have essentially the same mission: to increase jobs through exports while not competing with the private sector. The similarities among the ECAs are a result of common business practice, as well as an international treaty signed by most governments and known as the OECD Arrangement (Organization for Economic Cooperation and Development). This is the organization through which regulations on official credit agencies are promulgated.

Generally ECAs are accessed through a country's banking institutions, where the international divisions of larger financial institutions typically have a person or staff that specializes in their use. Essentially banks extend this type of export based on the support being provided to them by their governments. Increasingly, ECAs work directly with the exporters, consultants, attorneys, and advisors. This is particularly the case in the United States where financial intermediation tends to be more fragmented and no longer the exclusive role of banking institutions. For instance, the U.S. Ex-Im Bank permits companies to obtain preliminary financing commitments directly without any involvement of a financial institution.

ECAs address two fundamental risks involved in an export transaction. The first is political risks, which refers to those events that occur due to political actions taken by the government that impact payment by the buyer. These may include transfer risk (inability to exchange the local deposit to that of the ECA country), expropriation, war risks, cancellation of an existing import and export license, and/or political violence. The risks of countries are usually evaluated by OECD and classified into seven categories depending on their risk profile. Countries rated 1 have the lowest risk and those rated 7 have the highest risk. The second risk ECAs address is commercial, which refers to nonpayment as a result of bankruptcy, insolvency, protracted default, fluctuation in demand, unanticipated competition, shifts in tariffs, and/or failure to take up goods that have been shipped according to the supply contract and other factors not covered under political risks.

The solutions ECAs provide targets five basic financing needs of an exporter:

- . Pre-export working capital;
- . Short-term export terms extended to importers;
- . Medium- to long-term financing support to overseas importers;
- . Project financing;
- . Special export structures (e.g., leases, aircraft financing, on-lending credit facilities, etc.).

Working capital support from ECAs significantly reduces a lender's risk on the goods or services for export. This support may also assist in posting standby letters of credit needed to secure down payments, post bid bonds, or other activities required in anticipation of an export sale. An ECA's primary function is to shield the exporter from the commercial and political risks of selling overseas. This can be done as a supplier credit, where the ECA guarantees the obligation of the importer on terms extended by the exporter; or it can take the form of a buyer credit where the ECA supports the obligation of the importer directly. Finally, ECAs have recognized the need to support turn-key solutions with project financing support, as well as tailoring their support to work with the special financing needs of specific industries.

The three forms of support from ECAs come as:

- ▶ Insurance;
- ▶ Guarantees;
- ▶ Loans/credit facilities.

ECAs offer a variety of export credit insurance policies to exporters and financial institutions to reduce repayment risks on foreign receivables due to political and commercial events. Policies may cover single or repetitive sales, to single or multiple buyers. As determined by the product, repayment terms are available for short-term sales (up to 180 days, exceptionally 360 days) and medium-term sales (up to five years). Loans are made directly by some ECAs to overcome financing gaps and compete against foreign subsidized competition with the lowest interest rates allowed under international guidelines. Typically this is on a limited basis, since their goal is not to compete with the private sector. By reducing repayment risks, guarantees from ECAs allow lenders to offer financing to exporters and/or their foreign customers with fixed or floating competitive rates.

Lenders use these programs for several reasons. By limiting the risk inherent in international lending, ECA programs enable lenders to assist their current customers with international sales they otherwise would be unable to finance. These programs also help lenders develop new relationships with exporters and foreign buyers that may grow into long-term, profitable lending relationships.

These programs help exporters meet two critical financial needs. First, ECAs help obtain the working capital financing they need to produce or buy their goods and services for export. Creditworthy exporters sometimes have difficulty securing such financing for a number of reasons: they have reached their borrowing limit with the lending institution; the lender has no relationship with the exporter; or the lender will only provide a low percentage loan against the exporter's collateral, thereby constraining the firm's cash resources. Second, ECAs help exporters secure credit for foreign buyers. Often the exporter cannot complete the sale unless competitive financing can be provided. In some cases, the exporter could expand business with current customers if credit is extended.

3. HISTORY OF ECAs

The first export credit insurance programs in the world were offered by Federal of Switzerland starting in 1906. Federal is a privately owned company still operating as of today. The first government export credit insurance programs were established in the United Kingdom thirteen years later in 1919. The rationale for the British programs then, which were copied by other countries, was “to aid unemployment and to re-establish export trade disrupted by the conditions of war”. In addition to export credit insurance, the British government established a trade finance program, offering up to six-year financing of exports at a preferential rate (1 percent above the Bank of England rate or a minimum of 8 percent). The British programs were administered by the Board of Trade with the consent of the Treasury, with the provision that income should be sufficient to meet possible losses.

As the Swiss and British programs proved themselves of their worthiness, other nations realized the efficacy and need for this type of government stimulation of trade. Accordingly, several other European countries established guarantee and insurance schemes, including Belgium (1921), Denmark (1922), the Netherlands (1923), Finland (1925), Germany (1926), Austria and Italy (1927), France and Spain (1928), and Norway (1929). The major rationale for establishing these programs was to re-establish export trade and revitalize industries devastated by World War I and to facilitate exports to the then existing Soviet Union, a country that posed special risk factors to Western European business and that needed credit.

With the onset of worldwide economic depression after 1929, a new impetus was given to the establishment of official export credit, guarantee, and insurance facilities as a method of keeping up flows of trade and thus maintaining employment and output. During the 1930's, the following countries established such programs: Japan (1930); Czechoslovakia, Latvia, and Poland (1931); Sweden (1933); the United States (1934); and Ireland (1935). It is worth to note that the United States had only official direct credit programs and not guarantee and insurance facilities in the first thirty years of operation of its Export-Import Bank (Eximbank). The other countries concentrated heavily on guarantees and insurance, with back-up discount lending to commercial banks to reduce interest rates. In 1934, a new international organization,

the Berne Union (International Union of Credit and Investment Insurers), was established to encourage cooperation among national export credit insurers; to exchange information on buyers, countries, and technical matters; and to improve the level of competence of member countries.

By the mid-1930's, most export credit agencies were granting the majority of their insured credits to the Soviet Union, and despite the Depression, export credit insurance had proved very profitable. Most of the ECAs at that time were owned and operated entirely by governments. However, four could be classified as "semiprivate" (Czechoslovakia, Germany, Netherlands, and Spain) and were operated by private firms with government financial and administrative assistance.

A major event of 1937 was the establishment of Banco Mexicano de Comercio Exterior (BANCOMEXT) in Mexico – the first ECA to be set up in a developing country. It concentrated on financing trade with North America and Europe in its early years and provided an example of official support, which was subsequently followed by many other Latin American countries.

The outbreak of World War II put a halt to the development of new export credit, guarantee, and insurance agencies from 1939 to 1945. Existing agencies turned their attention to financing activities that would help win the war. In the United States, for instance, Eximbank financed exports that would help develop the rubber industry of Brazil and the mining industries of other Latin American countries whose outputs were vital for the war effort. The Burma Road to China was financed by the U.S. Eximbank, along with other projects that would contribute to military success.

At the end of World War II, the former Axis countries' powers were confronted not only with rebuilding domestic economies but also with restoring their foreign trade. In the late 1940s and early 1950s, Japan established a full range of new insurance and financing programs as an essential aid to restoring exports and assisting in postwar reconstruction. Germany, Italy, and Austria also established new credit, guarantee, and insurance programs in the same time frame and for the same reasons.

In the latter half of the 1950s, significant further developments were realized. In 1956, South Africa established the first African export credit insurance program. In 1957,

the Export Risks Insurance Corporation, a privately owned entity that was later replaced by a state-owned scheme, was established in India. Then in 1959, Morocco approved its own credit insurance program as a department of the Banque Marocaine du Commerce Extérieur.

These actions were followed by the establishment during the 1960s of a number of developing country export credit, guarantee, and insurance programs in Argentina, Bolivia, Brazil, Greece, Hong Kong, Korea, Pakistan, Peru, and Portugal. In all these cases, programs were intended to expand business activity and employment, improve international competitiveness, increase exports, and strengthen the balance of payments.

The third wave of developing countries to establish such programs occurred during the 1970s and included Ecuador, Jamaica, Malaysia, the Philippines, Singapore, Sri Lanka, Taiwan, Uruguay, and Venezuela. Increasingly, the motives for introducing export credit, guarantee, and insurance schemes seemed to include an awareness that the failure to do so would place the country at a severe competitive disadvantage, not only with regard to the OECD countries, but also in relation to other developing nations.

The 1980s saw a new group of countries enter into export credit, guarantee, and insurance activity, including Egypt, Indonesia, Tunisia, and Turkey. Many of the schemes adopted in earlier years were changed in form and substance during this decade, the general trend being the establishment of organizations with more autonomy, a broader range of functions, and greater financial resources. In several cases, different export credit, guarantee, and insurance organizations were merged into one entity.

The 1990s witnessed the greatest growth of all in the establishment of official ECAs. Throughout Central and Eastern Europe and the former Soviet Union, new agencies were formed in the Czech Republic, Hungary, Lithuania, Poland, Russia, Slovakia, and Slovenia. In Kazakhstan, Ukraine, and other countries, foreign trade banks were reconfigured to offer standard ECA programs. In Latin America, several countries reconfigured their structures of export finance agencies, such as Brazil, Colombia, and Venezuela, and Chile opened its doors to a foreign-owned private sector export

credit insurance company. In Africa, a regional export-import bank was formed to help and encourage the development of national ECAs, and in Asia, both China and Thailand formed export-import banks to consolidate and strengthen their dynamic export growth industries.

Throughout the 1980s, most OECD countries experienced heavy operational losses in their export credit, guarantee, and insurance programs. These losses were caused partly by the growing disparity between borrowing rates to fund the programs and the rates at which the funds were lent to finance exports. At the same time, nonpayment of officially supported export loans reached unprecedented magnitudes, as a result of developing country debt problems, defaults, and reschedulings. It was only in the 1990s that most industrial country ECAs returned to profitability as the Third World debt crisis gradually abated, fees and underwriting policies were adjusted, and export credit interest rates were raised to market values.

Most industrial country ECAs have now been in operation for more than fifty years. More than half of the developing country ECAs have been in business for at least a decade and thus can be considered fully experienced in the appraisal and administration of export credit, guarantees, and insurance. The differences between industrial and developing countries in this field, which were tremendous in earlier years, are gradually narrowing and approaching common ground. The industrial countries have pulled back from overexpansion of credit to marginal markets, while the developing countries have sought to take more risk on credit sales with jeopardizing their financial soundness. Both developing and industrial countries have raised their interest rates to market-related levels and their common interest in avoiding a credit trade war has helped lead to greater harmonization of programs, policies, and procedures. With a few exceptions, developing country ECAs have been profitable in recent years, and as a group, they have shown a substantial surplus. Industrial country ECAs have shown steady improvement in financial results during the 1990s, and in 1996, for the first time in seventeen years, they showed a profit as a group, with only a handful continuing to record losses. During the balance of the 1990s, most industrial country ECAs were profitable.

Some common features

Although they might have some local characteristics, ECAs around the world share many features between themselves, including a common set of objectives, which are both economic and financial. The main economic objectives of ECAs usually include:

- . expand nontraditional exports of private sector goods and services;
- . help to finance nontraditional exporters of all sizes, of all products, and of all regions of the country;
- . provide assistance to indirect exporters to encourage development of linkage industries;
- . supplement and complement, and not compete with, the commercial banks and other private institutions;
- . seek to improve the country's balance of payments and to increase domestic employment;
- . help to diversify the products and foreign markets of nontraditional exporters;
- . improve the financial skills of nontraditional exporters and reduce their risks in extending credit to foreign buyers;
- . increase the knowledge and sophistication of the country's banks in the area of export credit;
- . encourage the national insurance industry to participate in coverage of the risks of nonpayment of export credits;
- . provide assistance for exports that are deemed to be in the national interest;
- . help national firms to make investments abroad in order to increase the nation's foreign exchange earnings;
- . seek to match officially supported foreign financial competition;

The main financial objectives of ECAs usually include:

- . realize a profit for shareholders; .
- . support only operations that offer a reasonable assurance of payment;
- . operate in a business like fashion;
- . mobilize funds from domestic and foreign sources to finance national exports;
- . ensure that programs offering a lesser return on capital are offset by programs offering a greater return;
- . charge interest rates and other fees that are sufficient to cover related costs;
- . strive to increase the real value of the organization's capital over time, to serve as a basis for expanded operations;
- . manage investments to maximize returns, consistent with security of payment and cash flow requirements;
- . ensure the availability of funds to make prompt disbursements as required on loans, guarantees, and insurance;
- . conclude coinsurance and reinsurance agreements to limit the possibility of huge losses;
- . follow sound principles of risk-sharing and maintaining a balanced portfolio;
- . maintain a conservative relationship of capital and reserves to actual and contingent liabilities;

Just as they share objectives, ECAs around the world share a number of constraints, imposed by such factors as their total authority and yearly budgetary ceilings, by requirements that they supplement and complement and not compete with private finance, by the need to seek reasonable likelihood of repayment on transactions, by other limits imposed to ensure prudent financial management, by the need to conform to the terms and conditions of international understandings, and by a

number of other restrictions imposed by their authorizing legislation, guardian authorities in government, or private shareholders. The ECAs' own financial condition – particularly the size of their capital and reserves – serves to limit the total amount of exports they can support. A final major constraint is the size of the ECAs' trained staff. Executives, managers, officers, and technicians who are skilled in export credit matters are in very short supply, and their availability represents a severe constraint upon the expansion of ECA operations in most countries.

Official export credit, guarantee, and insurance agencies also share many features with regard to the mechanics of their operations. They have similar eligibility criteria, term differentiation, risk classification, degree of coverage, underwriting techniques, premium and interest rate systems, policy administration, risk-sharing methods, and reinsurance. This is not by chance. The techniques, terms, and conditions of export credit insurance and guarantees have been largely “internationalized” by regular exchanges of information and agreements reached through the International Union of Credit and Investment Insurers (Berne Union) and the Organization for Economic Cooperation and Development (OECD), and there is a growing level of comparability among individual national schemes.

ECAs can help finance short-, medium-, or long-term transactions, and the conditions of financing assistance are usually quite different depending on the tenor. A short-term transaction is usually defined as up to one year, medium-term as one to five years and long-term as over five years. The OECD Agreement on Export Credit currently limits the maximum term to ten years.

Repayment terms supported by ECAs around the world tend to be similar, since they are based upon competitive realities and the needs of importing customers. Most financing is short term, with a maximum period of one year. However, larger sales of manufactured goods, particularly capital equipment and consumer durables, may receive longer terms dependent on contract price, as demonstrated by the following table:

Typical Repayment Terms, by Contract Price

Contract Value	Maximum Term
Up to US 80,000	2 years
US\$ 80,000 to US\$ 175,000	3 years
US\$ 175,000 to US\$ 350,000	4 years
Over US\$ 350,000	5 years

Source: Export-Import Bank of the United States

Major projects and multimillion-dollar equipment sales are often financed on terms of five to ten years. Also, certain products routinely receive terms longer than five years. For example, twin-engine turbo-powered aircraft, including executive jets, are typically financed on a seven-year term. Ships receive an eight-year term, and commercial jet aircraft may be financed by ECAs on a ten to twelve-year term.

Normally, export credit agencies provide assistance that does not exceed 90 percent of postshipment financing, with the exporter or bank taking the balance of the risk for its own account. Pre-shipment assistance is also usually limited to a maximum of 90 percent of required credit.

On medium- and long-term transactions, official schemes require the foreign buyer to make an advance payment of at least 15 percent. On short-term coverage, no advance payment is required from the foreign buyer.

A number of different premium systems are employed by credit insurance schemes. On medium- and long-term transactions, the premiums are normally a function of country, term, and type of buyer (either public or private). On short-term transactions, premiums may be based on such things as experience with the exporter, volume, size of the deductible, country spread, and average term. Some or all of these factors are taken into consideration by every official scheme, with greater or lesser weight being given to individual components.

Interest rates on ECAs' loans are much less subject to variance for individual transactions. They are usually the same for all credits and are normally at fixed rates of interest, related to prevailing market rates of interest.

Governments play many roles in support of ECAs. They can be insurers or reinsurers of risks; they can provide finance to exporters or to their customers; or they can intervene in the cost of financing. It is important to note that government's role in most ECAs is now diminishing, as the private sector in most countries is more willing and able to take risks and assist them in their activities.

Growing private extensions of export credit have reduced the need for official export finance in many countries, and decreases in the volume of mixed credits (a combination of trade and aid financing) have further limited the necessity for government loans to support exports. However, governments are still actively involved in risk-sharing with ECAs in all countries. Even though international private reinsurance of export credit risks continue to grow, governments are still the major insurers or reinsurers of risk, particularly political risks, for their national ECAs.

As of today, there were nine ECAs in low-income countries, twenty-two ECAs in lower-middle-income countries, twenty-three ECAs in upper-middle-income countries, twenty-four ECAs in industrial countries, and twenty-one ECAs in transition countries.

Please refer to the following table:

Countries with Officially Supported Export Credit, Guarantee, and Insurance Programs

Developing Countries		Industrial Countries	Transition Countries
<u>Low-income</u>	<u>Upper Middle Income</u>		
Bangladesh	Argentina	Australia	Albania
Ghana	Barbados	Austria	Bosnia-Herzegovia
India	Brazil	Belgium	Bulgaria
Pakistan	Chile	Canada	China
Senegal	Costa Rica	Denmark	Croatia
Sri Lanka	Cyprus	Finland	Czech Republic
Uganda	Hong Kong	France	Cuba
Vietnam	Iran	Germany	Estonia
Zambia	Jordan	Greece	Hungary
	Malaysia	Iceland	Kazakstan
<u>Lower Middle Income</u>	Malta	Ireland	Latvia
Bolivia	Mexico	Israel	Lithuania
Cameroon	Oman	Italy	Moldova
Colombia	Sierra Leone	Japan	Poland
Cote D'Ivoire	Singapore	Luxembourg	Romania
Ecuador	South Africa	Netherlands	Russia
El Salvador	South Korea	New Zealand	Slovakia
Egypt	Taiwan	Norway	Slovenia
Indonesia	Thailand	Portugal	Ukraine
Jamaica	Trinidad & Tobago	Spain	Uzbekistan
Kenya	Turkey	Sweden	Yugoslavia
Lesotho	Uruguay	Switzerland	
Liberia	Venezuela	United Kingdom	
Maurithius		United States	
Morocco			
Nepal			
Nigeria			
Peru			
Philippines			
Senegal			
Swaziland			
Tunisia			
Zimbabwe			

Source: First Washington Associates, Ltd.

4. ECA POLICY CONSIDERATIONS

Unlike private lending institutions, ECAs have a political agenda. While their primary role is to sustain their country's exports, in carrying out this mandate they are also required to adhere to certain policies and guidelines, some imposed by their governments, others imposed by the OECD Arrangement. These policies are unique to each ECA but generally fall into the following broad categories.

Foreign Content Policy

ECA programs support sales of goods and services produced in their country. However, as globalization has occurred, sourcing of components and services from around the world have made this policy evolve into a more loosely defined view of what is "manufactured/produced/built" in a given country. In many countries ECAs now support goods and services that provide a "substantial benefit" to their economy. Other countries take the view that if the majority of the good or service is made in their country then the entire amount of the sale can be supported. In the case of the United States, however, there are fairly rigid rules of what the U.S. Ex-Im Bank is willing to support.

When providing medium-term or long-term financing support, if the U.S. export contains foreign-made components, EX-Im Bank will provide support only for the U.S. content, as long as the total U.S. content is at least 50 percent of the entire cost of the exported good or service. Of course, under the OECD Arrangement the total supported by the Ex-Im Bank must not exceed 85 percent of the contract price. When supporting short-term transactions (less than 360 days), Ex-Im Bank will support the entire gross invoice value, assuming the product is at least 50 percent U.S. content, exclusive of price markup.

Military Sales

Generally, ECAs do not support sales of military equipment or services. However, the following are some exceptions for financing the sale of defense articles and services to less-developed countries: drug interdiction purposes, dual use items and humanitarian purposes.

Environmental Considerations

ECAs such as Ex-Im Bank are committed to increasing their level of support for exports of environmentally beneficial goods and services and they have designed special program enhancements to support such exports. In general, ECAs are prohibited from supporting transactions that damage the environment. The environmental policies of ECAs vary although a uniform approach is being developed. Generally ECAs adhere to the environmental policies of World Bank Group. Certain ECAs such as the U.S. Ex-Im Bank have voluntarily established several strict guidelines relating to environmental issues. The World Bank defines three categories (A, B and C) of transactions for environmental purposes. Category A defines transactions that have little environmental impact and are therefore excluded from review. Category B identifies locations vulnerable to impact from a project. This includes tropical forests, wetlands, national parks, endangered species habitat, etc. For projects that do not fall into Category A or B, review is handled on a case-by-case basis and placed into Category C.

Bribery

The OECD Convention on Combating Bribery of Foreign Public Official in International Business Transactions was put in force in February 1999. Subsequently, in 2000 an Action Statement on Bribery and Officially Supported Export Credits was issued. OECD countries have taken the issue on bribery seriously while considering the differences in the judicial systems of different countries.

Sales to Certain Countries

ECAs may not support exports to or for use in certain countries. This does not include situations where the ECAs stop supporting business in a country for credit reasons, which occurs from time to time when the economic picture is so bad that a reasonable assurance of repayment can no longer be found. There are countries that are cut off from the ECA credit as a matter of that country's foreign policies. For example, the United States will not permit credit to be extended to Iraq or North Korea.

Economic Impact

Some ECAs, most notably the U.S. Ex-Im Bank, are required by law to assess whether supporting an export is likely to cause substantial direct injury to the country's industry. For example, Ex-Im Bank will not extend support that would have a net adverse economic impact on U.S. production and employment. (This prohibition does not apply if benefits to industry and employment in the United States resulting from the export transaction outweigh the injury to U.S. producers.

Additionality

The concept of additionality within the context of export finance is defined as the probability that a transaction would not go forward without the ECA's support. Ex-Im is the only significant ECA that applies this policy, and there are a variety of influences and circumstances that can affect the degree of additionality associated with a given transaction.

Ex-Im Bank supports transactions when at least one of the following two conditions exists:

A lack of adequate financing available from other sources, such as commercial banks or the capital markets;

A foreign ECA is offering financing support on behalf of a foreign exporter that is competing with a U.S. exporter for the same transaction.

At the same time of application, Ex-Im Bank must make a positive determination that at least one of these conditions applies. Because the factors, which influence the degree of additionality present in a given transaction, are not always quantifiable or precise, the measurement of additionality is typically a probability of additionality related to an export transaction rather than to an absolute.

Risk Premium (Exposure Fees)

ECAs charge a fee for supporting export transactions. The basic sovereign risk exposure fee (i.e., the minimum fee for a country) is determined by several variables: exposure fee level of the country, percentage of cover, the quality of the product

provided, the length of the draw down and repayment periods, and how the fee is to be paid. Exposure fee levels are established for all markets where it is possible for ECAs to provide cover consistent with OECD country classifications.

Percent of Cover

The OECD norm for coverage is 95 percent. However, the U.S. Ex-Im Bank's normal coverage is 100 percent for medium-term insurance, guarantees and loans. A premium is applied for this additional coverage. Ex-Im Bank is in the process of evaluating the merits of offering a long-term insurance product that may provide less than 100 percent cover.

ECA Products Offered (from least to most expensive)

There are three quality levels of financing product:

Below Standard (conditional insurance product that does not cover post-default interest). The U.S. Ex-Im Bank does not currently offer a below standard product;

Standard (conditional insurance product that covers post-default interest);

Above Standard/Superior (unconditional coverage). Guarantees and direct loans are priced as "above standard".

5. ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD)

The present chapter will be dedicated to delineate ECAs financing terms and conditions, which are governed by agreements, reached among official export credit agencies under the auspices of the Organization for Economic Cooperation and Development (OECD) and guided by conventions established by the Berne Union.

Several basic export credit definitions will be presented for better comprehension of their role and work:

Export contracts are transactions that involve the cross-border sale (or sometimes the lease) of equipment or services. The OECD Arrangement defines export contract value to include the entire value of imported goods and services contracted between the buyer and the supplier.

Export credits are financial obligations that arise from particular export contracts and are directly and explicitly “tied” to such contracts. Financings that simply make funds available to buyers for general foreign purchases are “untied”.

Officially supported export credits are those that benefit from the financial support of ECAs, which are nationally based institutions that provide financial support for national exports. ECAs benefit from varying degrees of explicit or implicit support from national governments. Some ECAs are divisions of government trade ministries. Others act as autonomous or even private institutions that operate an official export credit scheme on behalf of the government. Ex-Im Bank is the official ECA of the United States. Along this paper, we will present other ECAs, including Brazilian BNDES' works.

Pure cover is an ECA offer of protection against nonrepayment by the buyer. Ex-Im Bank's guarantees and insurance are both forms of pure cover. Guarantees typically imply 100 percent cover. Insurance applies a small risk-sharing deductible, which may increase under certain conditions. Most ECAs provide insurance, with some degree of supplier or financial intermediary risk sharing. Ex-Im Bank and its British counterpart, ECGD, offer 100 percent cover under medium-term insurance policies,

but not short-term insurance policies. The interest rates associated with export credits under pure cover are a matter for negotiation between suppliers (or their financial intermediaries) and the buyers.

Official fixed-rate support is an ECA offer of protection against increases in interest rates during the life of an export credit. Official fixed-rate support is delivered by different means by different ECAs. Ex-Im Bank provides official fixed-rate support by means of direct fixed rate loans, where Ex-Im Bank itself serves as the financial intermediary on behalf of the supplier. Other countries (usually not the ECA) guarantee banks for a fixed margin over a floating rate cost of funds when they provide fixed rate financing at arrangement interest rates.

Tied aid credits are a special form of official export financing support involving, at least in part, grants or interest rate subsidies provided by government development assistance (aid) agencies. As with export credits, such support is tied to particular export sales. Tied aid credits are readily identified by their large grant components, very low interest rates (relative to market rates in the currency offered), or exceptionally long terms.

The OECD Arrangement on Guidelines for Officially Supported Export Credits is an evolving agreement among 22 OECD member governments (the “rich” industrial democracies) containing conventions for international cooperation and competition in officially supported export credits with a term exceeding two years (except for defense items and agricultural commodities), including guidelines for many of the export credit financing terms and conditions explained in this chapter. Said Arrangement also contains conventions and guidelines for the provision of tied aid credit supported by OECD countries. The agreement holds the force of law within the European Union, and is elsewhere considered a binding document, morally if not legally. Note that the OECD Arrangement is an agreement among governments, involving oversight ministries, while Berne Union arrangements are agreements among member organizations.

The Berne Union (The International Union of Export Credit and Investment Insurers) is a group of export credit and investment insurers, including official ECAs (the large majority of which provide export credit) as well as private companies. Unlike the

membership of OECD, Berne Union members are made up of institutions not only from “rich” industrial democracies but also developing countries. The Berne Union maintains guidelines for customary repayment terms (stricter than the OECD Arrangement’s maximum terms). More importantly, the Berne Union serves as a forum for the exchange of information among export credit insurers on cover policies for various borrowing countries, data on arrears, claims, and recoveries.

All of the older export credit agencies, and many of the newer ones that meet the membership criteria, belong to the Berne Union. However, there are a number of newer or smaller export credit agencies that do not, as yet, at any rate, qualify for membership in the Berne Union. (This group includes a number of export-import banks, or eximbanks, which lend directly for trade transactions as well as insure lending by others). Some countries with export credit agencies that are not Berne Union members are Bulgaria, Brazil, Chile, Colombia, Croatia, the Islamic Republic of Iran, Kuwait, Latvia, Lithuania, Malta, the Philippines, Romania, Russia, the Slovak Republic, Thailand, Tunisia, and Uzbekistan.

Cash Payments

It is customary in export sales and in export credit financing, as in domestic lines of business and their financing, for suppliers and their financiers to require a significant good-faith cash payment from prospective buyers. The OECD Arrangement codifies this practice by requiring, at a minimum, a cash payment equal to 15 percent of the export contract value for all export credits.

Ex-Im Bank adheres to the minimum 15 percent guideline in its medium- and long-term programs. The Bank requires a prior certification of cash payments before making disbursements. In projects involving progress payments, each disbursement of Ex-Im Bank-supported financing must be preceded by cash payments from the buyer equivalent to 15 percent of the portion of the transaction involved.

That situation also applies to the Eletrobras’ case, where the German ECA EULER HERMES will charge a 15 percent upfront down payment, and will be responsible for coverage of commercial and political risks of 85% of the commercial contract

between AREVA, supplier of equipment to subsidiary company ELETRONUCLEAR, responsible for the execution of nuclear power plant Angra 3 construction.

In practice, buyers often secure alternative financing for the 15 percent down payment. This is permissible as long as the ECA does not officially support such financing. Private financial intermediaries often extend it on relatively shorter terms, and at relatively higher interest rates, than financing provided under pure cover guarantees or insurance. In many cases, private financial intermediaries will extend financing for 100 percent of the value of the export credit contract, on the same repayment terms applying to the 85 percent officially supported.

Export Contract Coverage

In effect, the OECD Arrangement's 15 percent cash payment requirement normally limits the volume of officially supported export credit coverage to 85 percent of the price of an export contract.

However, for transactions involving in-country construction expenditures, it is possible that coverage might effectively exceed 85 percent of the export contract value. This is because a portion of local costs, as well as interest accruing during construction (which is often considered a project expense), may be financed.

For many projects in developing countries, 100 percent financing of all project costs (goods and services imported from the United States, foreign third-country costs, and local installation or construction costs) is often specified as a bidding requirement. Prospective bidders are responsible for combining various sources of financing to meet such bidding requirements. Ex-Im Bank support would cover only the portion of such project financing eligible for export credit support.

Disbursement Periods and Repayment Starting Points

The OECD Arrangement requires the first payment of principal and interest on an officially supported export credit no later than six months after the proper "starting point", a date which reflects the nature of the underlying export contract. Many exported goods and services are delivered to buyers. For these goods, the proper starting point is delivery.

Many exported capital goods are installed. Some are installed in broader projects that must be constructed. For export credits involving such capital goods, the proper starting point is the conclusion of physical installation or construction. As for projects involving the installation of multiple units of imported capital goods, the arrangement requires either the use of multiple starting points or of an average one.

As export credit's disbursement period is the period between the export credit's first disbursement and the starting point for repayment. For delivered products, the disbursement period is usually very short; in some cases, there may be a single disbursement. For projects under construction, the disbursement period can be as long as four or five years, or perhaps even longer. In such cases, partial disbursements are made as various construction milestones are achieved.

The above situation exactly fits for Eletrobras, where we will be facing a 6-years disbursement period, also known as availability period, during which the company will make disbursements from the external financing in order to meet the supplier's payment schedule.

Interest always accrues on outstanding balances during the disbursement period. In most cases, Ex-Im Bank expects accrued interest to be paid every six months, even during the certain limited-recourse projects. Ex-Im Bank is willing to permit the capitalization of accrued interest during the disbursement period. Such interest during construction, or IDC, represents an additional cost eligible for Ex-Im Bank financing. This same feature also applies for other ECAs, such as in Eletrobras case, where we might have the interest capitalized during the construction period, at the company sole discretion.

Repayment Pattern and Frequency

For export credit loans, the OECD Arrangement requires equal repayments of loan principal, on at least a semiannual frequency, beginning six months after the starting point defined previously. Quarterly frequencies are permitted, but are not as common as semiannual frequencies. Interest payments are also to be made on at least a semiannual frequency. In practice, principal and interest are customarily paid each

semester, in a single payment. These are larger for the first payments due than for the last payments due.

For lease, the OECD Arrangement permits mortgage-style level total payments of principal and interest. This payment pattern has the cash flow advantage of lower payments during the first few years of a term credit. However, there are larger payments during the last few years, and export credit principal is paid down at a much slower pace.

In some cases, particularly aircraft transactions, “special purpose vehicles” (SPVs) serve as buyers and obligors in Ex-Im Bank-supported transactions. The SPVs on-lease the purchased assets to end-users, collect rental payments from end users, and pass through such payments. In such structures, Ex-Im Bank requires the end-user’s payments to the SPV also to meet OECD Arrangement payment requirements. Ex-Im Bank will not permit end users to make reduced streams of payments in violation of OECD Arrangement guidelines, even though such reduced payments, if they can be designated under local laws or accounting as operating rentals, might have tax advantages to the end users.

Interest Rates

Many ECA-guaranteed export credits involve floating rates. Typically, these rates are adjusted semiannually, and are pegged at some spread over an adjustable base rate, often six-month U.S. dollar LIBOR. The extent of the spread is often related to the quality of the guarantee offered by the ECA, and is established at the time of disbursement.

For loans under an Ex-Im Bank comprehensive guarantee covering 100 percent of principal and interest with no risk deductible, the spreads usually are rather small, as there is no residual credit risk taken by the lender. The remaining spreads represent compensation for administrative expenses in making the loan and an element of lender’s profit. For loans guaranteed by those ECAs that cover only 98 percent, 95 percent, 90 percent, or lesser amounts of principal and interest, the lending spreads can be substantially larger, as they seek to compensate for residual credit risk.

Some ECA-guaranteed export credits involve fixed rates. Typically, the private financial intermediary establishes these rates at the time of disbursement. They are pegged at a spread over the yield (at time of disbursement) for a U.S. Treasury bond of comparable average life. The spread over Treasury yields typically has two components: first, the same administrative/profit/credit risk spread described in connection with floating rates; and second, a LIBOR-minus-Treasury “swap spread”, which is more or less the credit spread between the six-month LIBOR and the rate on a six-month Treasury bill. Again, Ex-Im Bank’s 100 percent guarantee of principal and interest helps to minimize the first component of the spread over yields for comparable Treasury bonds.

Also, since notes issued under Ex-Im Bank’s 100 percent guarantee represent the “full faith and credit” of the U.S. government and are freely transferable, such notes can be securitized with relative ease. A financial intermediary’s Ex-Im Bank guaranteed loan can be repackaged as smaller investor-held certificates, each with its own 100 percent Ex-Im Bank repayment guarantee. Securitization may involve higher legal costs than a straightforward Ex-Im Bank guaranteed loan, but the increased access to a wider pool of investors’ funds often lowers the cost of such funds and permits lower spreads to borrowers.

As noted above, private financial intermediaries usually fix their rates at the time of each disbursement, which is when funds for lending are accessed. However, in a rising interest rate environment, some borrowers will want to lock in rates prior to disbursement. Some lenders will offer to lock in such a “forward rate”, which will usually be somewhat higher than the current spot rate for the equivalent term (although probably less than the future spot rate that will prevail at time of disbursement).

Ex-Im Bank, like most ECAs, provides official fixed-rate financing support. For Ex-Im Bank this support takes the form of direct fixed-rate loans offered to borrowers. The Japanese and Canadian export credit systems also operate in this manner, while the British, French, and Italian systems deliver fixed-rate loans.

The OECD Arrangement strictly regulates the minimum interest rates associated with official fixed-rate financing support, whether it is provided via a direct loan or interest

rate make-up mechanism. Each OECD currency has at least one commercial interest reference rate, or CIRR, which is 100 basis points (bps) greater than the yields of government bonds of comparable average life. The CIRRs for each currency are recalculated on the fifteenth of each month.

The U.S. dollar remains the most common currency in long-term export credit finance. There are three U.S. dollar CIRRs, one for each of the three repayment terms.

Term (Number of Payments)	Formulation of U.S. Dollar CIRR
Up to 10 semiannuals	3-year treasury yield plus 100 bp
Over 10 & less than 17 semiannuals	5-year treasury yield plus 100 bp
Over 17 semiannuals	7-year treasury yield plus 100 bp

The OECD Arrangement permits a firm CIRR to be established only after an export contract has been signed. Under Ex-Im Bank's system, firm CIRRs (held for the life of the financing) are permitted only in the context of final commitments, which are authorized only after export contracts have been signed. In the context of export credit financing offers (letters of interest or preliminary commitments), no particular monthly CIRR may be quoted for a period extending beyond the applicable month, except with an additional "hold" spread.

For an export contract involving immediate or near-term delivery in an environment of stable or declining interest rates, a CIRR is often less attractive than the rate set by a private financial intermediary under an Ex-Im Bank guarantee, because the spread established on a guaranteed loan at the date of disbursement is normally lower than 100 basis points. However, for an export contract involving deferred delivery or a relatively long disbursement period in a rising interest rate environment, a CIRR established immediately after contract signing can ultimately prove significantly more attractive than a rate set at disbursement under an Ex-Im Bank guarantee.

Moreover, the OECD Arrangement permits ECAs to temporarily maintain CIRR “hold” rates in export credit financing offers for a four-month period prior to export contract signing. A CIRR hold rate consists of the monthly CIRR rate being held, plus an additional 20 bps. The Arrangement permits the choice of the hold CIRR rate or the current spot CIRR rate, whichever proves more attractive after contract signing. In effect, the use of CIRR hold rates is similar to the market’s use of interest rate caps, except that the 20 bps per annum cost of the interest rate cap is paid only if the hold rate is actually used.

It may be interesting to note that for years, the OECD matrix (SDR-based) rate constituted the greatest potential source of subsidy in standard export credit financing. In the fall of 1994, OECD governments reached an agreement to stop issuing Matrix rate offers, effective September 1, 1995.

Foreign Tied Aid

“Tied aid” is concessional government-to-government foreign assistance that is explicitly tied to the purchase of exports of goods and services from suppliers in the donor’s country. Tied aid financing is always more attractive to government borrowers than standard export credits, which are likewise tied but that offer, at best, maximum standard OECD Arrangement terms. However, tied aid financing are subject to their own set of OECD Arrangement rules and procedures.

One key element is that nearly all forms of tied aid financing (grants and near-grants are the exception) require prior notification of at least 30 working days before a firm offer or commitment is made by the offering government. The major purpose of prior notification is to ensure that other governments have the opportunity to provide matching tied aid financing – an opportunity that the United States has seized with Ex-Im Bank’s Tied Aid Capital Projects Fund. Another key element is the use of “no aid” common lines. The OECD Secretariat will issue, on behalf of any member government and on a confidential basis, a request to OECD governments that they accept a “no aid” common line for a particular project. Any government can reject this common line request; however, if all OECD governments either accept or remain silent, the “no aid” common line is approved. Ex-Im’s Bank’s Tied Aid Capital Projects Fund uses the common line procedure to ensure that an attempt is made to preserve

standard OECD terms. Tied aid sometimes takes the form of stand-alone grants for 100 percent of an export contract. Grants do not need to be repaid. Other times, a grant element of 35 percent or more of a contract is combined with an export credit, on standard OECD Arrangement terms, covering the remaining 65 percent or less. This structure is called a mixed credit. Tied aid can also be offered in the form of soft loans, which are exceptionally long-term (20-40 year) credits at highly concessional interest rates. Sometimes, a soft loan can be combined with a standard export credit, or a grant, to form additional mixed credit permutations. According to the OECD Arrangement, export credits cannot be combined with grants aid credits without the entire package being defined as a tied aid financing.

“Concessional” is a measure of the financial stability of the recipient government. The concessional of tied aid credits is typically underwritten by development assistance (aid) agency budgets rather than export credit agency budgets. A stand-alone grant offers 100 percent concessional, a stand-alone export credit offers zero percent concessional, and a mixed credit with a 35 percent grant portion offers 35 percent concessional. For a soft loan, concessional depends on the present value of such financing, discounted at a market-related rate in the currency of the financing offered. The lower the present value, the higher the concessional. The lower the interest rate, relative to market rates in the currency of the financing offered, or the longer the repayment term, the more concessional is the soft loan. Most tied aid credits involve concessional at, or just slightly higher than, 35 percent. The minimum concessional level specified in the OECD arrangement is 35 percent.

Government-to-government tied aid is concentrated in several markets. China and Indonesia solicit bilateral aid financing for priority capital projects, and historically have been the largest recipients of tied aid by a wide margin. Several other developing countries, mostly in Asia, welcome bilateral tied aid financing for capital projects, even if they may not actively solicit such financing for a large spectrum of projects. While tied aid is not as significant a commercial factor in key markets in Europe and the Americas, the OECD Arrangement prohibits tied aid use in a number of developing country export markets including Mexico, Brazil, Argentina, Venezuela,

Russia, Poland, Hungary, the Czech Republic, the Ukraine, South Korea, Hong Kong, Singapore, and Taiwan.

Several Eastern European governments are willing to accommodate China, Indonesia, and other countries with bilateral tied aid offers. These donor governments mix two competing motives in providing tied aid: transferring financial resources to recipient countries and supporting national export and domestic employment. Once a tied aid offer is in hand, recipient governments are unwilling to take serious negotiations with other exporters who cannot likewise demonstrate that they bring along matching tied aid financing.

The OECD Arrangement has a provision that helps shift tied aid use away from those areas most likely to cause trade distortion-the OECD Arrangement's "commercial non-viability" rule, by which the only projects eligible to be supported by tied aid financing are those that are found "commercially non-viable", in the sense that their operating revenues would not be able to service the debt contracted on standard OECD arrangement terms. This rule, as well as the OECD challenge and consultations process established to clarify and enforce the rule, has led to a major shift in foreign tied aid offers away from commercial projects in manufacturing, power, and telecommunications-preserving the primacy of standard export credits in these important sectors. There are still some gray areas where some projects are found commercially viable and some are not, but generally projects that generate positive operating income are found commercially viable. However, there are many kinds of projects that offer minimal or no commercial viability and yet are sufficiently commercially attractive to attract foreign aid credits. These are the kinds of projects where Ex-Im Bank's Tied Aid Capital Fund can be used to counter foreign tied aid credit offers.

Ex-Im Bank's Tied Aid Capital Projects Fund

Ex-Im Bank uses the Tied Aid Capital Projects Fund to counter those trade-distorting foreign tied aid credits not prohibited under the OECD Arrangement. Ex-Im Bank's countering activities take advantage of the matching provisions contained in the OECD Arrangement. The Fund is not used to initiate U.S. tied aid credits into foreign competitive situations, where foreign tied aid is not already a factor. Its mission is to

provide tied aid counteroffers to known foreign tied aid offers. Tied aid preliminary commitments, which are directly convertible to Final Commitments, are only available once a foreign tied aid offer has been prior-notified to the OECD, and have cleared the OECD challenge-consultations process.

A tied aid credit is trade distorting when the target export contract would likely have been financed on standard export credit terms, but where introduction of concessionality (nearly 35 percent) is clearly intended to sway procurement decisions, not only for the immediate contract, but also potentially for many follow-on contracts. Ex-Im Bank is unlikely to approve a tied aid credit if it is apparent that the sale is a unique opportunity, with no significant follow-on sales opportunities.

Sometimes, other OECD governments offer tied aid financing of very high concessionality (50 percent or higher). Such offers are expensive for Ex-Im Bank to match, in terms of budget, and Ex-Im Bank is unlikely to provide a matching tied aid offer. Sometimes, foreign tied aid will be provided to less creditworthy governments, which otherwise have limited access to standard export credits. Typically, even standard Ex-Im Bank export credits to these governments involve high budget cost; these costs are far higher when tied aid is involved. It is unlikely that Ex-Im Bank will match a foreign tied aid credit in riskier markets.

In countering a foreign tied aid offer, the Ex-Im Bank's intention is to frustrate a foreign government's intention to use tied aid to advantage its exporters on sales to a capital project. Ex-Im Bank's intention is either to supplant the foreign export sale in its entirety, dollar-for-dollar, or to deny foreign exporters the full volume of exports originally intended as a result of their aid financing by helping the U.S. exporter win part of the sale. Ex-Im Bank will not permit a matching tied aid offer to be diverted to a second project or to a second phase of the initial project. In determining project scope for matching purposes, Ex-Im Bank relies on information included in foreign tied aid notifications to the OECD, and also in commercial viability studies whenever these are prepared for an OECD tied aid consultation.

SPECIAL PROGRAMS

Lending Facility

Here the ECAs work with financial institutions so that they can provide financing to buyers of exports. Both the ECAs and users benefit from such facilities. The ECAs can leave the work of analysis to the local banks that have better understanding of the local companies. ECAs reduce the repayment risks of the local company, and users of such facilities do not have to go through the ECA application process.

Exchange Risk Insurance

Exchange risk insurance protects exporters against currency depreciation, prior to the receipt of payment for goods sold, when the majority of their contract is in a foreign currency. Coverage is usually limited to one year, but may be as long as five years.

In the event that the exporter's currency depreciates against the foreign currency of the contract, it is often the policy that the exporter pays the insurer a portion of the profit.

Premiums of the insurance are calculated based on a per-case risk of the specific foreign currency and the length of the coverage. In the case of the Ex-Im Bank, only a select list of hard currencies are subject to guarantees. In addition to premiums, credits are also subject to a risk-based exposure fee and a commitment fee of 1/8 of 1 percent on the undisbursed amount of credit. Exchange risk guarantees are most beneficial to those industrial nations whose own currencies are appreciating against the dominant currencies of the developed world.

Project Finance

This form of financing has been growing in popularity due to the flexibility it provides the sponsors, as they have limited or no recourse. In this type of structure, the future cash flows backs the debt instead of the sponsor's balance sheet. This type of financing is particularly useful in natural resources and infrastructure-related projects.

In these types of projects, long-term purchase agreements can be executed, thus insuring the project cash flow.

Leases

Certain ECAs such as the U.S. Ex-Im Bank provide financial support in the form of loans, guarantees, and insurance programs to facilitate leases, especially in the area of large products, such as aircrafts. The terms and conditions of ECA aircraft programs are governed by the OECD sector understanding on Export Credits for Civil Aviation (Annex III to the OECD Arrangement). Here the dependent factors are the type, size, and age of the aircraft.

Similar to aircraft, ECA financing support for locomotives (known as “rolling stock equipment”), ships, and trucks are governed by the OECD Arrangement. The terms and conditions are influenced by the country category of the borrower.

PITFALLS

After a long track record since their first years after creation, it is worth noticing that many firms seeking ECA support make the same mistakes or have the same misunderstandings. These are mentioned in the following next paragraphs.

The most common misunderstanding is that ECA financing is subsidized. In most cases, however, this is not true. The staffs of ECAs use sound policies and procedures in reviewing applicants. The result of this can be seen by the profitability and relatively low default rates of most ECAs in the last decade. Applicants must be creditworthy and face the same analysis as they would with a private bank. Since the rates charged by ECAs are regulated, the financing benefits are neutralized and, therefore, firms have to ultimately compete in the quality of their products and services. In certain limited circumstances, certain ECAs such as Canada’s EDC offer rates that are lower than the OECD-required rates. This is achieved when it is determined that the private sector has rates below the OECD rates.

The second most common mistake by exporters is their lack of proper understanding of ownership and content. The requirements vary among ECAs. Exporters assume that just because the product is exported from the home country it will be eligible for

ECA support irrespective of the percentage of foreign content. Others assume that the products exported must contain no foreign products. Proper management and understanding of ownership and content allows more financing to leave the table. In general the content requirements are more stringent for medium-and long-term programs than for short-term programs. For example, for medium-and long-term programs, Ex-Im Bank will support either 100 percent of the U.S. content or 85 percent of the net contract price. However, for short-term programs, Ex-Im requires products at least U.S. origin exclusive of mark-up.

Applicants should also be aware that the application process tends to take longer than clients anticipate. ECAs have policy requirements such as environmental and workers rights issues that need to be met. ECAs outside of the United States tend not to work directly with exporters and importers. They are more likely to wholesale products to banks and often rely heavily on local banks. The timing of application differs among ECAs. In general, ECAs require that the applications be submitted prior to the product being shipped.

Applicants of ECA support need to be aware that certain ECAs require that the vessels used in export trade must be those of the country of product origin. However, waivers can be obtained for a certain percentage of products.

Clients need to be aware of the down payment requirement of buyers. As mentioned earlier, the OECD Arrangement codifies this practice by requiring, at a minimum, a cash payment equal to 15 percent of the export contract value for all export credits. The down payment can be paid by an alternative source of financing such as private financial intermediaries.

In theory, ECAs are supposed to work cooperatively with each other and with other multilateral lending institutions. In reality, all of these institutions see themselves as senior lenders and thus sharing of collateral is often a problem. This lack of cooperation and consensus results in projects being delayed, and thus clients lose valuable time and money.

6. KEY FACTORS FOR SUCCESS OF EXPORT CREDIT AGENCIES

Based on experience with ECAs around the world, twelve elements have been identified as common features in their successful performance:

Capital Adequacy

The most successful ECAs have substantial paid-in capital, which is invested in interest-bearing securities. Investment earnings are sufficient to keep the ECA profitable even during the first few years of operation, when operating revenues are relatively low. Capital is equal to at least 25 percent of anticipated outstanding loans, guarantees, and insurance for the early years of operation and gradually declines as a percentage of outstandings in subsequent years.

Organizational Autonomy

Organizational autonomy is very important. Successful ECAs have the authority to make their own decisions, guided solely by their managers and board of directors. They do not make business decisions for political reasons only and are not required by government to undertake unprofitable operations unless the ECA is acting as agent for the government using government funds or committing the government to the related risk.

Support from Government

Support, or at least benign neglect, from government is a hallmark of successful ECAs. This support is primarily in the form of assuming political risk coverage but may also consist of the provision of funds on favorable terms, the availability of government guarantees to cover lending operations, publicity given the ECA by government agencies, as well as other forms of encouragement given by the government to use the ECA programs.

Proper Risk-Sharing

Vital to success is an ECA's requirement that commercial banks and exporters share risks in every transaction. Also, the best ECAs limit losses by coinsurance and

reinsurance agreements with their own governments, with foreign reinsurance companies, and with other ECAs. Political risk assumption by government can be an essential condition for success.

Appropriate Fee Structure

Successful ECAs operate on the principle that availability of funds is more important to the exporter than cost and that an ECA must be profitable over the long run in order to survive. Accordingly, interest rates and premiums reflect the real costs of doing business and maintaining the value of capital. Interest rates are market-based, and guarantee and insurance premiums are designed to cover related claims and administrative expenses.

Diversity of Operations

In order to be fully successful, the best ECAs offer a full range of products, including loans, guarantees, insurance, and technical assistance. The need for, and use of, these programs will vary over time, as will their profitability. By offering all types of programs, the ECA maximizes its impact on exports and cushions low returns in some areas with higher returns in others. Also, the programs are mutually supporting. For example, technical assistance can reduce risks and improve repayment of transactions that are supported by loans, guarantees, or insurance.

Quality of Management

The most successful ECAs are run by finance professionals who have extensive prior experience with the management of private financial institutions. They are thoroughly familiar with the techniques of trade finance and are flexible, efficient, profit-conscious managers. In order to obtain and keep such individuals, the ECA provides compensation comparable to that in private sector banks.

Efficiency of Procedures

Paperwork and administrative procedures are simple and straightforward in the best ECAs. Average processing time for loans, guarantees, and insurance is five days or less, and internal analysis is often confined to a checklist procedure rather than

memo writing. Discretionary commitment authority is given to officers within the organization, and delegated authority is given to exporters and banks, depending upon the risks they are willing to take and the procedures they follow.

Aggressive marketing

Marketing is a constant feature of ECAs, and is designed to familiarize banks and exporters with ECA programs and encourage their use. Marketing is directed to all types and sizes of exporters and to all geographic regions of the country and is frequently done through third parties, such as banks and trade associations.

Skill in Credit Analysis

Successful ECAs have loan officers and underwriters with sound judgement, extensive experience, and mastery of the techniques of risk analysis. Losses due to inadequate analysis in the early years are gradually reduced as the ECA learns from its mistakes and upgrades its skills.

Appropriate Collateral and Guarantees

Collateral and guarantee requirements of successful ECAs follow generally accepted business practices in the markets they enter. Security requirements take into account competitive realities and the practicality of enforcing collateral rights. Underwriting policy emphasizes taking security consistent with the acceptable risk parameters for the whole portfolio.

Technical Sophistication

The best ECAs utilize the latest financing techniques and instruments, changing them as needed be, to match foreign competition. These ECAs make every effort to transfer their knowledge of financial innovations and successful risk management to their nation's banks and exporters.

7. CONCLUSION

As mentioned in the Introduction of this paper, I intended to provide some information on the role and importance of the ECAs, providing information on their main characteristics and how they operate. Since they usually stand behind the scenery, so to speak, their work is often underestimated, being for that reason called the “unsung giants” of international trade and finance. As described previously, they nevertheless represent highly specialized financial institutions that currently cover about US\$ 800 billion of exports each year, but seldom receive proper attention of the press or from the average citizen.

According to statistics, one out of every eight dollars of world trade is now financed by ECAs. Much of the remaining seven dollars is influenced by what the ECAs do: whether they advocate a restrictive or expansive policy of selling goods to other nations affects exporters’ willingness to trade with particular countries and buyers and influences the terms and conditions on which trade is conducted. There are only about 200 ECAs in the world – domiciled in 100 countries- but their contribution to trade and development has been massive and intensive in the success of globalization and a healthy economy.

ECA activity far exceeds that of all multilateral development banks (MDBs), such as the World Bank, International Development Bank – IDB and KfW. By the way, these institutions represent a constant source of funding for Eletrobras’ funding activities. Eletrobras has recently developed a loan agreement with World Bank, whose resources will be channeled to a project from the Eletrobras’ System distribution companies. ECA loans, guarantees, and insurance are also far greater than the activity of all overseas development agencies (ODAs), such as the U.S. Agency for International Development. Despite this, few people really know about the ECAs and what they do. The ECAs’ relative anonymity cannot be blamed on recent arrival on the world scene: as explained before, they have been around since 1906, roughly twice as long as the MDBs, which have been operating only since the late 1940s.

This apparent lack of knowledge cannot be traced to a lack of importance. They have helped their countries to pave the track to alliances with other nations, to develop

overseas sources of raw materials, open up new markets for manufactured products, support friendly nations and punish unfriendly countries, develop the manufacture of new products and strategic industries, promote economic growth in poor countries, facilitate foreign direct investment, and increase their own countries' ability to purchase goods from foreign suppliers. Most important, however, is the fact that they have succeeded in increasing domestic employment, raising business sales and profits, and expanding national tax bases by stimulating exports.

A frequent question offered is: what are the ECAs and what do they do? A generally accepted definition is: (1) a highly specialized bank, insurance company, finance corporation, or dependency of the government; (2) offering loans and/or guarantees, insurance, technical assistance etc., to support exporters, (3) covering both commercial and political risks related to export sales, (4) with the backing or the approval of the national government, and (5) dedicated to supporting the nation's exports. Ownership is usually government or mixed, but privately owned ECAs are rapidly becoming more prevalent and dominant. As for what they do, ECAs provide the financing that is essential for export success, financing characterized by the National Association of Manufacturers of the United States as "the lubricant that keeps the export engine operating smoothly; without it, exports and a growing number of jobs are at risk."

ECA financing takes the form of loans, guarantees, insurance, and related technical assistance which are used to support export sales. In order to fund these operations, the world's ECAs obtain monies from both domestic and international capital markets that are then lent to their nations' exporters. Most importantly of all, perhaps, the ECAs are a repository of information and technical skill, which are used to show exporters and banks how to extend credit to foreign buyers in a sound fashion. The ECAs excel in the techniques of intelligent risk management, which they apply in their own extensions of short-, medium-, or long-term credit. These techniques are picked up, and carried on, by a nation's exporters and banks, regardless of whether the ECA provides financing or other assistance for a particular sale.

In their extensions of credit for international transactions, ECAs stand in a middle position between the exporters and commercial banks (which prefer to keep export credit relatively short term with high interest rates) and MDBs and ODAs (which lend

at very long terms with relatively low interest rates and, in some cases, grants and financial contributions). Most ECA credit activity falls into an intermediate range: longer than thirty days but less than five years, with interest rates close to their country's prime rates. ECAs can lend, guarantee, or insure for longer or shorter periods, but such activity represents a minority of their overall credit extensions.

There are two ways in which most exporters use ECAs: (1) either directly, by making application to the ECA for a loan, guarantee, or insurance, or (2) indirectly through the exporter's commercial bank, which applies to the ECA for a loan, guarantee, or insurance. The indirect route is often mandated by an ECA if a loan to an exporter is involved: the ECA generally prefers to have the commercial bank handle the paperwork, administration, and risks involved in making a loan to an exporter. In these cases, the ECA "rediscounts" the commercial bank's loan, lending money to the commercial bank, which passes it on to the exporter. The exporter has the liability to repay the commercial bank, and the commercial bank has the liability to repay the ECA. To the contrary, insurance is usually issued directly to the exporter by the ECA. In return for a premium paid by the exporter, the ECA insurance covers the risk of nonpayment by the exporter's foreign buyers. If nonpayment from the buyer occurs, the ECA makes payment to exporter under the insurance policy. Finally, the ECA's guarantees are almost always issued directly to a commercial bank, covering the bank's loan to the exporter for pre-shipment or post-shipment purposes. Alternatively, the guarantee may cover a commercial bank loan to a foreign buyer to help the buyer purchase goods from the ECAs country. In exchange for a guarantee fee paid by the bank, the ECA covers the risks of nonpayment by the exporter or, under the alternative form of guarantee, the risk of nonpayment by the foreign buyer if the foreign buyer was the borrower under the bank's loan.

Despite active use of these programs, the ECAs remain a well-kept secret to nonusers, as the ECA managers have been far better at producing income for exporters and economic benefits for their nations than at marketing their role and explaining their operations to the general public. In my own turn, the research was motivated, as mentioned before, to the fact that Eletrobras is about to develop a structure using a ECA.

In fact, the world's ECAs play a major role in the national and international economies. On a national level, for instance, the world's ECAs finance an average of about 12 percent of their country's exports. In most countries, this is the difference between a national trade surplus and a deficit. Export industries generally are the most dynamic component of a country's economy. They tend to pay higher wages than other industries and support employment growth at a much higher rate than firms producing solely for the domestic market. Export producers are usually the most efficient in a country because of their need to compete with the world's best companies and are potent transmitters of new technology and improved management techniques. Exporting companies' tax contributions are significant in every country, and their backward linkages with domestic suppliers of goods and services (which are incorporated in export products) are important contributors to domestic growth.

They also represent essential drivers for the growth and welfare of the international trade and economy. ECAs together financed over US\$ 600 billion of world trade in 1996 (although the statistics are aged, they represent a proxy of the actual number)-most of it on relatively short terms of payment. However, at the end of the same year, ECAs also held about US\$ 500 billion of medium- and long-term indebtedness from developing and transition countries. This represented more than 24 percent of all foreign indebtedness of these countries.

The ECAs have performed the invaluable function of making credit available to many countries where commercial banks and other private lenders are not willing to make transborder loans, and of making credit available to most developing countries at interest rates and repayment periods that are more favorable than alternative private sources of funds. This has enabled the developing world to purchase much more of the equipment, goods, and services that the industrial countries have to offer, with a resulting dramatic improvement in social welfare, the standard of living, and investment in new infrastructure and the productive sector. ECAs' transfers of medium- and long-term capital to developing countries rose from about US\$ 12 billion in 1976 to US\$ 43 billion in 1995. This accounts for 20 to 30 percent of all medium- and long-term debt flows.

The level of export credit agency activity grew rapidly in the early 1990s as international trade increased at a rate approximately three times that of domestic growth. Export trade is now widely acknowledged as the primary engine of economic growth and development and, as such, notorious of special financial institutions to help with the proper structuring of credit sales, the necessary extension of appropriate loans, the sharing of related risks, and the encouragement of other institutions to participate in this business. In recent years, industrial capacity has expanded, consumer tastes have changed, trade barriers have fallen, and competition among supplier nations has intensified. As a consequence, all countries face growing pressures to adapt their financing systems to new trading requirements.

The current activity levels of individual ECAs vary widely and can be correlated with a number of factors, including the strength and risk appetite of other types of financial institutions, the age and experience of the ECA, the support it receives from public and private sectors, and its geographic region. Export support is highest among Asian ECAs (which financed an average of US\$ 15 billion of exports apiece in 1996). In the same year, Western European ECAs supported an average of almost US\$ 10 billion of exports per annum, and North American ECAs covered an average of almost US\$ 6 billion. African ECAs covered an average of US\$ 881 million, Central and Eastern Europe (CEE)/Newly Independent States (NIS) ECAs an average of US\$ 276 million, and South American ECAs an average of only US\$ 50 million in 1996.

The importance of ECAs in different regions of the world can further be quantified by comparing their support to the total value of gross domestic product (GDP). Asian and Western European ECAs were involved in roughly 2 percent of their countries' GDP in 1996, and Australia/New Zealand ECAs in a little more than 1 percent. North American and CEE/NIS ECAs helped to produce somewhat less than 1 percent of their nations' GDP. By contrast, the ECAs of South America were responsible for less than one-tenth of 1 percent of GDP in 1996, and their relative weakness is believed to be both a cause and an effect of their countries' relatively poor trade performance.

In order to maintain the flow of trade, ECAs are increasingly called upon to finance exports to countries with commercial, economic, and political problems. As a consequence, ECAs activities continue to grow, while their risks of doing business

also rise. Under present and foreseen future circumstances, there is little doubt that the ECAs of the world will be required to play an even greater role than they have in the past. This is because they have formerly proven to be flexible instruments of national policy and effective contributors to international economic development in the face of political uncertainties and rapid changes in trade.

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