Export Credit Agency (ECA) backed funding has long been integral to many project financings. This briefing considers the adaptability of the typical ECA to the changing financial environment in recent years and their ability to continue to adapt in the future.

Initially, ECA political risk cover proved vital in order to mobilise capital and keep the cost of capital at a level that produced manageable tariffs for private developers who ventured to build projects in the emerging economies. In the last twenty years, ECAs have provided a significant amount in debt financing, risk mitigation cover and other enhancements for power generation projects globally, and have been major catalysts for facilitating capital for large projects in more difficult markets.

During the financial crisis, poor economic conditions and the squeeze on credit and insurance markets led to a renewed interest in the financing options ECAs can provide in all markets. The surplus of credit available after the financial crisis raised the question of whether the ECA’s role would eventually be confined solely to supporting higher risk financings in emerging markets; however, with the numerous tools that ECAs can offer in project finance transactions (including political risk insurance (PRI), guarantees for commercial debt, and direct lending), the last few years have shown that ECAs are continuing to provide both political risk and commercial credit risk coverage that substantially opens up commercial bank capacity in many markets.
Even where political and credit risk are not a significant concern, ECAs can bring additional debt capacity in highly rated markets. This is particularly relevant for projects with large capital requirements. Against the backdrop of the capital requirements imposed by Basel III, the lower capital charge that ECA-supported financings attract is important for banks looking to provide debt for big projects.

ECAs have increased in number (notably with a large increase in non-European ECA support) and activity across different sectors. This has encouraged the development of more competitive premiums and products for borrowers. ECAs are also taking a greater role in structured finance transactions, with some institutions offering enhanced products and innovative structures to meet increased demand in this space.

In addition, we are seeing governments providing greater scope for ECAs to offer financial products to borrowers that would normally be offered by private sector market players, seeking to side-step commercial lenders altogether. For example, in a number of sectors, we now see ECAs providing cover for letters of credit and other short tenor products as well as guaranteeing 100% of working capital loans in response to growing demand.

It is clear that ECAs are no longer – as they may have been perceived at one point – just “insurers of last resort” with a role limited to that of a ‘filler’ of liquidity or purely as specialising in products other commercial players are not prepared to offer, such as political risk insurance. They are now an obvious supplement as well as a catalyst for commercial financiers.

The role and impact of ECAs in Project Finance
ECA-supported deals work differently from other forms of finance. Having worked with almost all ECAs involved in the project finance sector across a broad spectrum of projects we have been given an insight into how to manage these transactions to a successful outcome.

ECAs have historically focused their product offering to provide for either direct lending where the ECA provides an export credit loan or tranche direct to the buyer, or ECA-supported funding, where funds are lent by commercial banks with ECA support in the form of a guarantee or insurance policy, thus removing part of the risk of default by the borrower or charterer for commercial banks. Some ECAs provide both types of products.

We have also seen an increased requirement for combined projects and debt capital markets expertise as borrowers look for more innovative finance solutions. In Europe, Asia and New York we have seen demand from a number of banks looking at developing capital markets products with ECA support or in seeking to re-package their export credit finance portfolios.

In the context of current market conditions, obtaining ECA support has become a necessary element of securing finance for larger, more expensive projects, whatever combination is used.

One practical consideration for such projects is the existence of a maximum repayment term (ranging generally from 10 to 18 years for renewable energy/climate change mitigation and adaptation/ water projects; and 14 years for...
other project finance transactions) of an export credit-backed financing as set by the Organisation for Economic Co-operation and Development (whose guidelines we explain in more detail later in this briefing). This term sometimes gives rise to a gap between the desired financing requirements of the borrower benefiting from a long-term loan and the permitted loan duration. Before the credit crunch a number of commercial banks were inclined to offer “stretch” or “mismatch” facilities to address this gap; however, the availability of such facilities decreased with the decline in financial markets.

Where ECA transactions are different
It is worth remembering that ECAs are governmental or quasi-governmental organisations and as such the support they provide is often limited by regulatory framework and local rules, including minimum local content requirements. In addition, traditional concerns relating to control of consents (and which matters require consent of the ECA), veto rights of the ECA to waive defaults or enforce, whether to include the ECA as a majority lender, how break costs and increased costs can be covered, transferability and subrogation are all points which need to be addressed between the borrower, the commercial lenders and the ECA.

Depending on the type of support being provided (and the ECA involved), a borrower may negotiate with the ECA directly but often ECAs that are not lending directly do not wish to take documentary risk and therefore it is incumbent on the borrower and the benefitting lenders to get comfortable that the ECA’s requirements are satisfied. An ECA may also require that it is independently represented by separate legal counsel which has additional cost implications for a borrower.

Beyond addressing the ECA’s specific requirements relating to documentation, (for example the requirement that they maintain a senior ranking position) from the outset, consideration should also be given to the potential processes to be implemented for obtaining waivers required in an enforcement scenario. Furthermore, idiosyncratic internal procedures of the ECA concerned may also need to be complied with (as well as those of the commercial lenders) and this may have additional impact on timing. The approach an ECA takes may also differ depending on whether they are directly funding a project or offering a guarantee or insurance product.

As the commercial lenders will often take documentation risk vis-à-vis the ECA, they will need to be comfortable with the policy documentation provided. This is often in the local language of the ECA and subject to local law, meaning that the counterparties need to be comfortable with translations provided and the local legal framework. An important point to understand is the nature of the support provided – in many cases the policy documentation will provide that the commercial lenders enforce all rights against the security package before seeking recourse from the ECA.

In most circumstances there will be little or no scope to negotiate the form of ECA support to be provided. Often the borrower will not have sight of the policy and should therefore be cautious of undertaking matters by reference to a policy which they will not have reviewed.

A further scenario is that of the transfer of portfolios between financial institutions of which WFW has been involved in a large number in the last few years. A number of these transfers have involved ECA-backed financings. Key issues here relate to

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“IN THE LIGHT OF INCREASING DEMAND BEING PLACED ON ECAS FINANCING AND THE MOVE TOWARDS USING THE DEBT CAPITAL MARKETS FOR RE-FINANCING MAJOR PROJECTS, FURTHER INNOVATION AND DEVELOPMENT OF THE PRODUCTS OFFERED BY THE ECAS IS LIKELY TO FOLLOW.”

transferability of the policy as well as any notifications which may need to be given for changes of agent/security trustee or consents sought arising from the subsequent amendments which may be necessary to document the transfer of the portfolio. Linked to this is the ability of the ECA to step into the shoes of the lenders in the event it pays out under an insurance policy or guarantee. In addition to the subrogation rights which exist at law, the ECA will often require express provisions dealing with subrogation or assignment of loan participations.

In the light of increasing demand being placed on ECAs financing and the move towards using the debt capital markets for re-financing major projects, further innovation and development of the products offered by the ECAs is likely to follow. However, we envisage that some of the documentary and policy issues highlighted above will need to be overcome to ensure ECA-supported products can be sufficiently attractive to bondholders.

**Governance**

(1) OECD Guidelines

While there is no binding international treaty governing the work of ECAs it has long been recognised that without cooperation on the terms of credit, competition among governments could result in an export subsidies war as previously experienced in the 1950s.

As mentioned above, the non-binding ‘Guidelines for Officially Supported Export Credits’ (the Guidelines) agreed under the auspices of the Organisation for Economic Co-operation and Development (OECD) go some way to tackle this issue.

The Guidelines are a ‘Gentlemen’s Agreement’ setting out principles with respect to matters such as the minimum interest rates payable and the duration of the credit. The current revised version came into force on 15 January 2015 with its participants including Australia, Canada, the members of the European Union, Japan, Korea, New Zealand, Norway, Switzerland and the United States.

Although the Guidelines served well to level the playing field and promote the orderly use of export credits, their impact is limited because they are voluntary and limited in membership. Significant markets such as Brazil, China, India and South Africa remain outside OECD membership and thus its governance.

There has, however, been evidence of increased engagement with OECD instruments by non-OECD countries. In 2011, for instance, Brazil became the first non-OECD country to sign up to the revised Aircraft Sector Understanding, the agreement governing export credit financing with respect to the aviation industry which came into force at the beginning of 2013.

It should be noted that there are four main groups of ECAs, divided geographically between Europe, North America, Asia and Australia. Each group (and therefore each ECA) has its own interpretation of the Guidelines. This is particularly the case in respect of the definition of the export credit value. As a result, as concerns a given export contract value, one ECA may be able to provide a greater level of support than another.
(2) Specific Regulations

Arising from the Guidelines are understandings relating to specific sectors including:

- the Sector Understanding on Export Credits for Renewable Energy, Climate Change Mitigation and Adaptation, and Water Projects;
- the Sector Understanding on Export Credits for Rail Infrastructure; and
- Terms and Conditions Applicable for Project Finance Transaction.

Broad terms of the various Sectors and Terms and Conditions cover, for instance:

- scope of application for eligible projects;
- size of down-payment;
- maximum repayment term; and
- repayment conditions of the principal and interest, including frequency of intervals and instalments.

The future of ECAs

Despite the desire of ECAs to increase their product offering and competitiveness with other sources of financing, ECA financing for projects, to a large extent, still requires the involvement of commercial banks. Demand for funding for renewable energy and infrastructure amongst others is likely to remain significant in the coming years. Furthermore, the evolution of the Basel III regulations towards a higher percentage risk weighting may result in limiting the banks’ participation in project finance and therefore further increase the importance of the ECAs.

Policy considerations requiring justification for use of public funds cannot be ignored and can impact on the ambit and variety of product offerings of ECAs under greater scrutiny given that funds come directly from the public purse. In the last few years, many European ECAs have reported significant increases in claims under guarantees and insurance policies and requests for extensions. Given the fact that, generally, ECAs are ultimately covered by their national governments, a substantial increase in claims could make their business model difficult to sustain if pricing is forced to rise.

Nonetheless, recent years have demonstrated that ECAs are growing more flexible and innovative in the financing schemes they can offer, working within the regulatory framework to meet the shifting needs of their clients. In addition, governments continue to demonstrate their willingness to be flexible during particularly difficult economic periods for example, by expanding the scope of direct lending. The products and services offered by ECAs are therefore seen as key to meet the needs of businesses involved in projects looking for competitive finance and it seems unlikely that this will change in the foreseeable future.

“WE HAVE ALSO SEEN AN INCREASED REQUIREMENT FOR COMBINED PROJECTS AND DEBT CAPITAL MARKETS EXPERTISE AS BORROWERS LOOK FOR MORE INNOVATIVE FINANCE SOLUTIONS.”
FOR MORE INFORMATION

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