Ch. IV Comparison of Major Program Structures
Section A: Large Aircraft

INTRODUCTION

In the context of officially supported export credits, large aircraft refers to airplanes with 70 seats or more[3]. Today there are two primary producers of large aircraft in the world: Boeing in the United States and Airbus SAS (Airbus) in Europe. Airbus is a corporation owned by two European aerospace companies: the European Aeronautic Defence and Space Company (EADS, the result of a merger in 2001 between Aerospatiale-Matra of France, DaimlerChrysler Aerospace of Germany and CASA of Spain) and BAE SYSTEMS of the United Kingdom. The Russians also build large aircraft; however, their products do not compete globally with U.S. and European-produced aircraft.

Because the financing requirements of large aircraft exports differ from other manufactured products (e.g., longer useful life may command longer repayment terms), there is a separate Annex to the OECD Arrangement setting forth the terms of, and procedures for, ECA-supported aircraft financings. The section of the Civil Aircraft Annex that pertains to large aircraft is known as the Large Aircraft Sector Understanding, or LASU. The principal participants to the LASU are the United States and the European Union, which, in this context, represents the interests of France, Germany and the United Kingdom.

The LASU establishes the terms, conditions and special guidelines of export credit support that OECD governments can extend to buyers of large aircraft. It sets a minimum cash payment of 15%, a market-based interest rate for loans extended by an export credit agency (set at 120 basis points and 175 basis points over 10-year Treasuries for 10- and 12-year repayment terms, respectively) and a maximum 12-year repayment term. It also limits the amount of spare parts that can be included in the financing package and bans ECAs from providing support into producer country markets (also known as "home market countries", which historically have included the United States, France, Germany, Spain and the UK). Finally, the LASU prohibits tied aid financing for large aircraft.

Although Ex-Im Bank and the European ECAs that support the export of Airbus aircraft (i.e., ECGD of the UK, France's Coface and Germany's Hermes; collectively the "Airbus ECAs") are subject to the same OECD guidelines, there have been differences in their respective export credit systems for large aircraft. These differences have enabled each side to capitalize on the relative strengths of its respective export credit system. For example, until the end of 2002, only the United States and the UK offered a 100% unconditional guarantee, which enabled the guaranteed lender to generate attractively priced financing. However, as further discussed below, historically all three Airbus ECAs adopted other policies (e.g., the three-year interest rate lock) that were intended to compensate for the shortcomings in their insurance product. Recently, the Airbus ECAs announced that it was their intent that all three would soon offer a

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[3] Comparably sized aircraft configured for cargo carrying purposes are included in the definition of large aircraft.

100% unconditional guarantee for financings of large aircraft and dramatically scale back the interest rate lock flexibility. Although differences in approach still exist, neither side appears to have a competitive advantage since the resulting financing is very comparable.

As illustrated in **Figure 11**, Boeing and Airbus have accounted for roughly equal shares of large aircraft orders over the past five years. This 50/50 split reflects the highly competitive environment in which aircraft manufacturers operate.

Figure 11: Orders of Large Commercial Jet Aircraft

	1998	1999	2000	2001	2002[4]
Boeing	656 (54%)	391 (45%)	611 (54%)	334 (47%)	251 (46%)
Airbus	556 (46%)	476 (55%)	520 (46%)	375 (53%)	300 (54%)
TOTAL	**1,212**	**867**	**1,131**	**709**	**551**

Ex-Im Bank's Policy and Practice

Almost all Ex-Im Bank support for large aircraft transactions is done under Ex-Im Bank's guaranteed loan program. Under this program, Ex-Im Bank provides an unconditional guarantee on repayments of 100% of the principal of the loan plus interest at the contractual rate. As a result, this program results in attractively priced financing on the Ex-Im Bank covered portion of the transaction.

G-7 ECAs' Policies and Practices

In the past (and during the year 2002), the European ECAs allowed buyers of large aircraft to lock-in a fixed interest rate up to three years prior to delivery, provided the buyer entered into a purchase contract with Airbus. Buyers had the choice between this locked-in interest rate or another market-determined interest rate established between the time of contract signing and delivery of the aircraft. The effect of this approach was to provide a free interest rate option to buyers at no additional cost. This approach provided buyers with certainty of a maximum interest rate cost for up to three years prior to drawing down financing. In a volatile interest rate environment, the certainty of locking in an interest rate for up to three years in the future was a highly attractive feature to the buyers of Airbus aircraft.

Beginning in 2003, the Airbus ECAs announced that the "free interest rate lock" described above was being changed. In the future, a fixed interest rate could only be "locked in" under the

[4] Boeing and Airbus received 75 and 67cancellations, respectively, for a net of 176 and 233 orders, respectively, and a total of 409 orders.

following circumstances: (1) up to three or six months in advance of the delivery of the aircraft; (2) only if the fixed interest rate was the 12-year fixed interest rate (i.e., 175 basis points above the relevant benchmark); (3) only if "breakage costs" were paid in the event that the buyer decided not to use the "locked in" Airbus ECA supported fixed interest rate financing; and (4) only if all three Airbus ECAs had agreed to underwrite the transaction. Alternatively, the buyer of the aircraft could elect to use the Airbus ECAs' pure cover program, which enables the buyer to choose either a fixed or floating interest rate, but it does not permit the buyer to set the fixed interest rate far in advance of the delivery date for the aircraft.

SUMMARY DATA

The downward trend in total commercial aircraft orders that began in 2001, and that is expected to continue over the near term, creates additional competitive pressure on both Boeing and Airbus to offer their customers products that meet technical specifications at the lowest possible price and at the most attractive financing terms available. This trend is highlighted by the increased ratio of foreign deliveries shown in **Figure 12**. In the year 2002, Boeing delivered 381 commercial aircraft (down 33% from last year) of which 178 (or 47%) were delivered to foreign buyers. Exports (by number of aircraft deliveries) have accounted for 30% or more of Boeing's deliveries since 1999, and Ex-Im Bank supported exports were about one quarter of Boeing's export deliveries during the 1999-2001 period. In 2002, exported aircraft accounted for a significantly larger share of Boeing's commercial activity, and Ex-Im Bank played a significantly larger role, financing more than 41% of its deliveries in 2002, in supporting those exports.

Figure 12: Deliveries of Boeing Commercial Jet Aircraft (by number of aircraft)

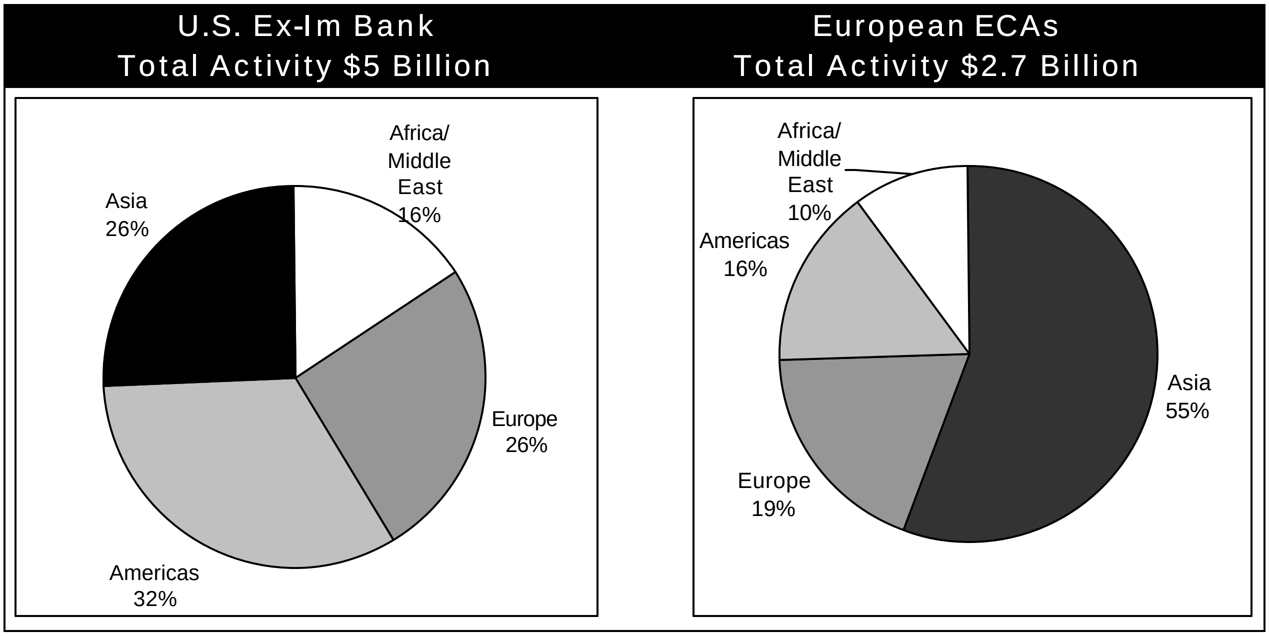
	1999	2000	2001	2002
Domestic	356 (57%)	283 (58%)	363 (69%)	203 (53%)
Foreign	264 (43%)	206 (42%)	163 (31%)	178 (47%)
% Of foreign deliveries supported by Ex-Im Bank	27%	27%	23%	41%
TOTAL	**620**	**489**	**526**	**381**

As shown in **Figure 13**, Ex-Im Bank and the European ECAs that support Airbus financed more than $7.7 billion in large aircraft exports during the year 2002. The average volume of U.S. and European ECA supported large aircraft during the 1997-2001 period was $9.0 billion. Hence, the lower volume of ECA supported aircraft in 2002 reflects the general downturn in worldwide aircraft sales.

In 2002, Ex-Im Bank accounted for $5 billion (or 65%) and the European ECAs accounted for

$2.7 billion (or 35%) of the $7.7 billion total. Large aircraft transactions account for about one-half of Ex-Im Bank's and about one-quarter of Coface, ECGD and Hermes medium- and long-term activity.

Figure 13: 2002 ECA Support for Large Commercial Aircraft by Region



Exporter and Banker Comments

In response to a survey that addressed the competitiveness of Ex-Im Bank programs and policies for large aircraft exports, Ex-Im Bank received comments that addressed several key issues. Specific comments included:

- The "financial" cost of Ex-Im Bank financing (i.e., interest rate and exposure fees) is competitive with the cost of financing provided by the European ECAs that support Airbus. On the other hand, the nature and cost of legal documentation associated with Ex-Im Bank financing appear to be more complex and more expensive when compared with the European export credit systems. [Note: In light of the European ECAs' announcement to modify their official export credit financing structures for large aircraft transactions, the difference in legal documentary requirements is likely to fade away as the Europeans adopt financing structures similar to those of Ex-Im Bank.]
- With respect to foreign content, the European ECAs provide more flexibility (for example, the European ECAs finance the cost of U.S. engines on Airbus aircraft). Ex-Im Bank's willingness to allow foreign content to be calculated on an aggregated basis provides limited benefit to large aircraft transactions but does not address the

fundamental problem of increasing non-U.S. content in aircraft and installed engines. Increasing the maximum foreign content allowance (without a reduction in cover) would be the single most meaningful policy change that would assist in leveling the playing field with Airbus and the European ECAs.

- Regarding market windows (see Chapter 5, Section B), the response to the survey indicated that the lack of transparency associated with financing provided by Germany's KfW prevents a definitive assessment of how market windows impact U.S. competitiveness. Nevertheless, anecdotal evidence suggests that KfW is a very significant presence in support of Airbus aircraft. Consequently, it is believed that one area where Ex-Im Bank "market window" financing could be useful, particularly in the current environment where commercial financing is very scarce, may be in "home markets."

CONCLUSION

Ex-Im Bank financing for large aircraft exports is generally competitive with financing offered by its European counterparts. While the comments from the export community indicated that certain elements of Ex-Im Bank financing could be improved upon (e.g., lower legal fees and increased support for foreign content) the export community did not cite inferior Ex-Im Bank financing as a reason for lost U.S. export opportunities.

Over the next year, changes to the European system are likely to emerge which could have implications for Ex-Im Bank policies, procedures and overall competitiveness. As such, Ex-Im Bank will consult regularly with the European ECAs and monitor any changes the Europeans make with respect to financing for large aircraft exports, including the impact of the changes to the European ECAs' interest rate system and market window financing. Finally, it appears that a consensus among the LASU participants may be emerging to revisit the issue of renegotiating the LASU. If this development materializes, the United States will be afforded the opportunity to introduce contemporary concepts to the agreement and maximize U.S. exporter competitiveness.

Ch. IV Comparison of Major Program Structures
Section B: Project Finance

INTRODUCTION

Although limited recourse project finance (also referred to as project finance) has been around as a financing technique for a number of years, export credit agencies only started working with this tool in the early to mid-1990s. Unlike standard ECA business, structures involving project finance determine creditworthiness by assessing the cash flows of a project (as defined by the contractual relationships within each project) and do not have recourse to a foreign government, financial institution or established corporation. It has taken many years for ECAs to learn the strengths and weaknesses of this financing technique and then to determine how to competitively differentiate themselves with the various features of this technique. Nearly a decade later, most ECAs offer support for project finance structures and, in fact, frequently work together to put in place a structure that fairly balances the risks between ECAs and other financial partners.

In September 1998, the OECD Participants to the Arrangement established a trial period for using additional structuring flexibilities for project finance transactions. This trial period, which was originally established for two years, has been extended twice, and the flexibilities are now being considered for permanent incorporation into the OECD Arrangement. These flexibilities extend the timing of the first repayment of principal, the repayment profile and the maximum repayment term. They are proscribed by limits on the average life of the structure (seven and a quarter years, with the first repayment occurring within the first two years and the maximum repayment term not to exceed 14 years).

EX-IM BANK'S POLICY AND PRACTICES

Ex-Im Bank created its project finance program in 1994. With its 100% political guarantee during the construction period, and a 100% comprehensive guarantee or direct loan available during the repayment period, Ex-Im Bank quickly had a program that was competitive with the other ECAs. However, after the 1997-1998 Asian financial crisis, Ex-Im Bank found project sponsors were having difficulty obtaining construction financing. To better meet customers' needs and expectations, and because Ex-Im Bank had a better understanding of the construction risks (after over four years of experience), Ex-Im Bank added the option of a 100% comprehensive guarantee during the construction period. This addition increased the competitiveness of Ex-Im Bank's program and at this point is a standard feature, with six of the G-7 ECAs offering a form of comprehensive support during the construction period.

Overall, the features of Ex-Im Bank's project finance package are attractive: 100% U.S. government guaranteed support for all risks (political and commercial) during both the construction and repayment periods, willingness to utilize the project finance flexibilities allowed under the OECD Arrangement, maximum availability for capitalization of interest during construction (IDC) and financing of local country costs. On the margins, however, borrowers still contend with public policy restrictions (such as domestic content and U.S. shipping requirements), advisor and consultant costs and more documentation requirements.

G-7 ECAs' Policies and Practices

Across the board, ECAs offer very similar coverage for project finance transactions. All provide cover for at least 90% of the political and commercial risks during the life of the project, support local costs up to the amount of cash payment and capitalize the interest that accrues during the lengthy construction period. The only difference between ECAs is in the quality of coverage they provide. Ex-Im Bank and ECGD offer unconditional guarantees, EDC and JBIC offer direct loans and the four other G-7 ECAs (Coface, Nexi, Hermes and SACE) all offer conditional insurance. See **Figure 14** for a comparison of ECA program features, **Figure 15** for activity levels from 1998-2002 and **Figure 16** for G-7 shares of project finance transactions.

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Figure 14: Comparison of Project Finance Program Features Offered to Date by the G-7 ECAs

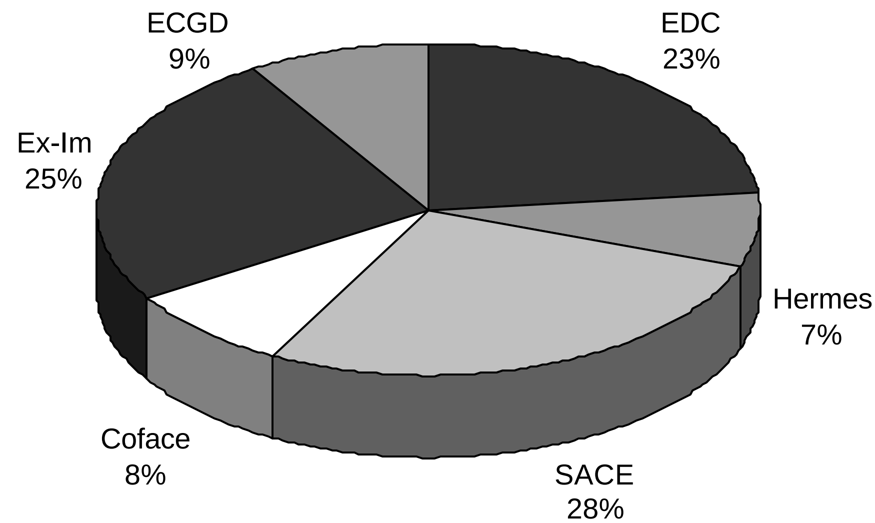
		EDC	Coface	Hermes	Sace	JBIC	NEXI	ECGD	Ex-Im
Pre-completion cover		Compre-hensive	Political only	Compre-hensive	Compre-hensive	Compre-hensive	Political only	Compre-hensive	Compre-hensive
Post-completion cover		Compre-hensive	Compre-hensive	Compre-hensive	Compre-hensive	Compre-hensive	Compre-hensive	Compre-hensive	Compre-hensive
Related conditions		Standard direct loan	95% below standard insurance	95% below standard insurance	95% below standard insurance	Standard direct loan	97.5% below standards insurance	100% above standard guarantee	100% above standard guarantee
Project finance flexibili-ties used	1st repay-ment	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes
	Repay-ment profile	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes
	Repay-ment term	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
IDC up to 100%		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Local costs up to 15%		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Figure 15: Number and Volume of Project Finance Deals Signed*

Number	1998	1999	2000	2001	2002
Signed project financings	458	479	459	276	226
G-7 ECA portion of project financings	19	9	19	7	8
ECAs as % of all project financings	4%	2%	4%	3%	4%
Ex-Im portion of project financings	0	1	7	6	5
Ex-Im as % of ECA project financings	0%	11%	37%	86%	63%
Volume (US$ Bn)	**1998**	**1999**	**2000**	**2001**	**2002**
Signed project financings	$172.0	$198.2	$239.2	$123.5	$70.0
G-7 ECA portion of project financings	$3.6	$2.5	$3.6	$1.4	$2.2
ECAs as % of all project financings	2%	1%	2%	1%	3%
Ex-Im portion of project financings	$0.0	$0.2	$1.6	$1.0	$0.6
Ex-Im as % of ECA project financings	0%	8%	44%	71%	27%

* Source: Dealogic database

Figure 16: Distribution of ECA Project Financings Signed in 2002



Exporter and Banker Views

The banking industry has been highly complimentary of the Ex-Im Bank project finance program and team. One banker commented: “Ex-Im is far more creative and flexible than most, if not all, other ECAs.” Yet despite the strength of this program, Ex-Im Bank does not have a large piece of each of the deals it supports. When asked, bankers suggested that this was due to the strong dollar and the complexity of Ex-Im Bank’s process. Exporters have agreed with this conclusion. From exporters’ perspective, U.S. exports are included in a transaction only to the extent that it will bring Ex-Im Bank in as the political heavyweight in the event problems arise with the host government, but Ex-Im Bank’s public policy requirements are disadvantageous enough that additional support is not typically desired. What is uncertain is whether U.S. exports are lessened as a consequence.

The project sponsors have a similar viewpoint. Over the past year they have suggested including Ex-Im Bank in a deal before they approached, or in some cases even considered, other ECAs. Like the bankers and exporters, the sponsors believe that Ex-Im Bank is more creative and flexible than other ECAs and that Ex-Im Bank is a political heavyweight that becomes essential if problems arise with the host government. However, the project sponsors have a different opinion from the exporters as to why the U.S. often has a relatively small piece of a project. They say that the United States is not competitive in price and, thus, U.S. companies are sourcing outside of the United States to obtain lower production costs. In fact, in one transaction the sponsor asked for maximization of U.S. sourcing, yet the U.S. exporters did not do so because it would have made their price uncompetitive.

CONCLUSION

Ex-Im Bank is a significant, but not dominant, player in the project finance arena. In fact, the five-year trend line shows a high level of volatility in the number and dollar volume of project financing, ECA involvement in project finance and Ex-Im Bank involvement in project finance. Certainly the cyclicality of the industry – as it is affected by the health of the world economy and of various industries – has an impact on the volatile nature of the business. Nevertheless, Ex-Im Bank's project finance program, in almost all cases, is equivalent to those offered by the other G-7 ECAs.

Ch. IV Comparison of Major Program Structures
Section C: Co-Financing "One-Stop-Shop"

INTRODUCTION

Responding to exporter concerns regarding comparative efficiency associated with multi-sourced transactions, Ex-Im Bank has established a "one-stop-shop" co-financing program. "One-stop-shop" arrangements allow products and services for one purchase from two (or more) countries to benefit from a single ECA financing package. Without co-financing, the parties would have to secure separate financing contracts with two (or more) ECAs to ensure support for exports from various countries. The location of the largest share of the sourcing and/or the location of the main contractor will generally determine which ECA leads the transaction.

The lead ECA provides export credit support for the entire transaction, and the follower ECA provides reinsurance for its share. This situation results in the lead ECA being able to provide a common documentation structure, one set of terms and conditions and one set of disbursement procedures for the entire transaction. All parties benefit from the administrative ease of a streamlined financing package. As use has proliferated, exporters continue to confirm that availability and ease of co-financing has become a measurable competitive issue.

EX-IM BANK'S CO-FINANCING "ONE-STOP-SHOP" ARRANGEMENTS

In 2001, Ex-Im Bank signed one-stop-shop bilateral (i.e., lead and follow) agreements with ECGD (UK) and EDC (Canada) and initiated discussions with other ECAs to sign bilateral agreements. During 2002, Ex-Im Bank began to gain experience under these and other co-financing arrangements by processing transactions. Additionally, Ex-Im Bank is in negotiations for bilateral agreements with Hermes and Coface.

Unlike most other ECAs, Ex-Im Bank does not require a formal bilateral agreement before considering co-financing transactions when the United States is the lead entity. Thus, Ex-Im Bank will process co-financing requests for transactions with ECAs on a case-by-case basis. In addition, Ex-Im Bank will consider co-financing with smaller, non-Category 1 ECAs. In that regard, Ex-Im Bank has approved co-financed transactions with (Hungarian Export Import Bank).

Figure 17 details the one-stop-shop co-financing transactions that the Bank has authorized in 2002. In summary, the Bank authorized eight co-financing transactions (six long-term and two medium-term) in Brazil, Israel, Luxembourg, Mexico, Saudi Arabia and Turkey, totaling approximately $315 million.

Figure 17: Authorized Ex-Im Bank "One-stop-shop" Co-finance Transactions in 2002

Ex-Im Bank & Co-financing ECA	Market	Project	Amount
Canada: EDC	Mexico	Manufacturing Project	$4 million
Hungary: HEXIMBANK	Turkey	Power Plant	$20 million
Norway: GIEK	Turkey	Power Plant	$10 million
Norway: GIEK	Turkey	Power Plant	$8 million
United Kingdom: ECGD	Brazil	Oil Field Project	$8 million
United Kingdom: ECGD	Israel	Large Aircraft	$114 million
United Kingdom: ECGD	Luxembourg	Large Aircraft	$146 million
United Kingdom: ECGD	Saudi Arabia	Construction Project	$6.5 million

G-7 ECAs' Policies and Practices

As shown below in **Figure 18**, the bulk of co-financing agreements exist between the European ECAs who have signed multiple framework agreements between themselves and have been processing co-financed transactions since 1995. These agreements were originally designed to help European ECAs manage their exposure. In addition, most ECAs have seized upon the administrative efficiency that results from the one-stop-shop for export financing as a means of improving their customer service and competitive image.

Additionally, the private sector has benefited from ECA co-financing and is refining it to the benefit of exporters around the world. For example, European banks together with European insurer ECAs (e.g., Coface, SACE and Hermes) have developed a co-financing framework agreement with Algeria's national hydrocarbon company Sonatrach. The European banks and Sonatrach have agreed to a common documentation structure that governs their relationship, and a pre-approved line of credit has been established for various European commercial banks. ECA approval is given on a case-by-case basis, and at that time the transaction is reviewed and tailored to the commercial contract as well as any additional ECA policy or procedural requirements. This process has created administrative efficiencies by establishing a "fast track" review process, and it has facilitated the support of European content.

Figure 18: G-7 Co-financing "One-Stop-Shop" Agreements (as of December 2002)

	Ex-Im	ECGD	EDC	Hermes	Coface	SACE
Ex-Im		X	X			
ECGD	X		X	X	X	X
EDC	X	X			X	
Hermes		X	X		X	X
Coface		X	X	X		X
SACE		X		X	X	

JBIC is the only G-7 ECA that has not signed any co-financing framework agreements.

When determining which transactions are eligible for co-financing, most ECAs agree that this program can be used across sectors and transaction size. While certain ECAs prefer to use co-financing for larger transactions, no fixed dollar limits currently exist on Ex-Im Bank co-finance transactions. In addition, due to the complex nature of project finance transactions, the one-stop-shop is not often used to support exports to non-recourse projects.

EXPORTER AND BANKER VIEWS

About half of the survey respondents indicated that Ex-Im Bank's co-financing program was less competitive than its foreign counterparts. In particular, several exporters and bankers indicated particular dissatisfaction with the fact that "Ex-Im has only set up two one-stop-shops and that one-off deals are exceptions not pro forma." Another exporter remarked that the Bank does not seem willing to enter into one-stop-shop deals "when Ex-Im is not the lead lender." In addition, several bankers encouraged Ex-Im Bank to establish a long-term insurance product to facilitate additional co-financing agreements. Specifically, one banker remarked: "Ex-Im Bank is clearly at a disadvantage (at least for deals over $10M) given its use of guarantees vs. insurance because guarantees are clearly less flexible, and make co-financing arrangements more difficult to implement."

On a positive note, some exporters remarked that the co-financing program is "excellent" and "has made it possible to compete with co-financing programs being offered by other foreign ECAs."

CONCLUSION

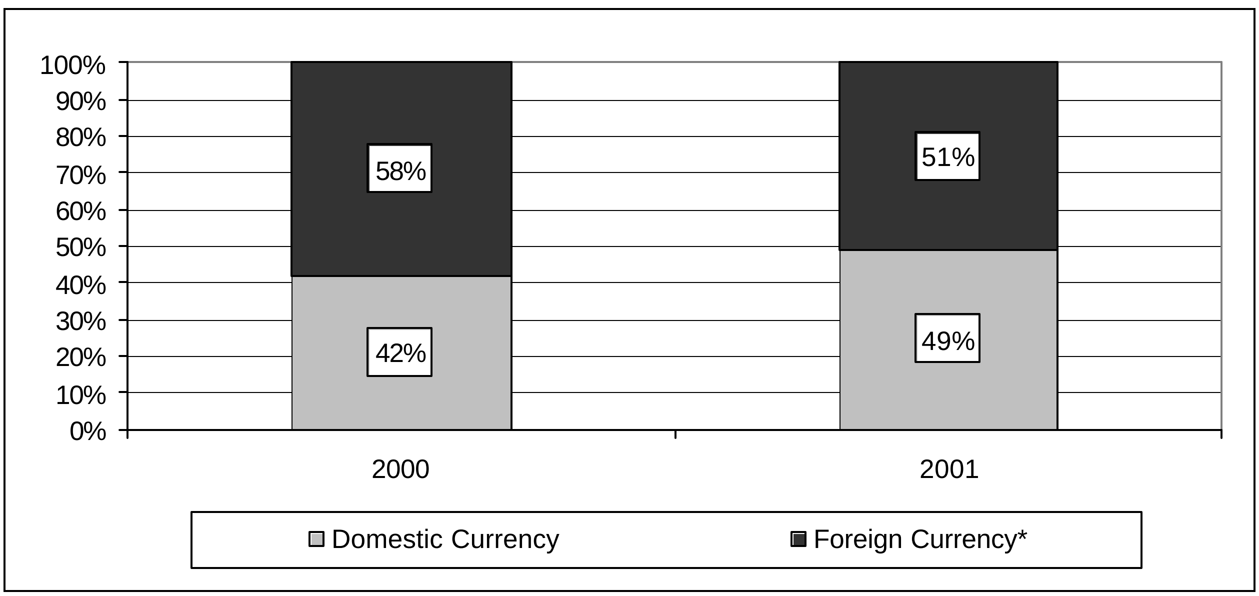
Ex-Im Bank's co-financing program is less available (and, to that extent, is less competitive) than the programs of most of the other G-7 ECAs. The lack of signed bilateral agreements with insurer ECAs is the main contributor to the Bank's disadvantage vis-à-vis foreign export credit agencies. Nonetheless, Ex-Im Bank has addressed transaction-specific requests for co-financing. In this regard, Ex-Im Bank is unique in that it will consider co-financing on transactions with foreign export credit agencies that represent a greater risk than the top tier ECAs, and the Bank is willing to consider transactions absent a bilateral framework agreement.

Ch. IV Comparison of Major Program Structures
Section D: Foreign Currency Guarantees

INTRODUCTION

As procedures and guidelines are standardized for numerous aspects of international financing, ECAs are looking for other means to differentiate themselves. One such effort is providing support for transactions denominated in foreign currencies. As seen in **Figure 19**, ECA support for foreign currency transactions (as opposed to domestic currency business, i.e., U.S. dollar for Ex-Im Bank, Japanese Yen for JBIC, etc.) in 2000 and 2001 has comprised approximately 50% of total financing support for long-term transactions, indicating that foreign currency financing is an important ECA offering. For the purposes of this discussion, the term "foreign currency" is broken down into two subsets: hard currency and local/soft currency. Hard currency refers to the legal tender of industrialized countries such as the U.S. dollar, Japanese yen, Swiss franc and the euro (and its precursor currencies), all of which tend to have global acceptance as a medium of exchange and savings. Local/soft currency refers to the currency that is used only in the buyer's country or local region. Examples include the Mexican peso, South African rand and Indian rupee.

Figure 19: Percentage of OECD Long-Term Transactions Denominated in Foreign Currencies



*Foreign currency includes both hard currency (approximately 99%) and local/soft currency business (approximately 1% of the foreign currency business).

Foreign currency support is based on an ECA's standard product(s), i.e., loans, insurance and/or guarantees. In essence, a commercial bank (or in the case of EDC or JBIC, the ECA) extends an export credit denominated in a foreign currency to a foreign importer. The interest rate applicable to the foreign currency transaction is negotiated between the borrower and the lender, and the ECA provides political and commercial risk coverage for both the interest and principal. Because hedging markets are very thin and prohibitively expensive in the medium- and long-term, the existence and utility of ECA coverage has a competitive effect on a buyer's sourcing decision.

Ex-Im Bank's Policy and Practice

For more than two decades, Ex-Im Bank has provided comprehensive guarantee and medium-term insurance coverage for foreign currency denominated transactions. Ex-Im Bank originally established this program to enable U.S. exporters to meet the buyer demand for yen-priced offers. Globalization has only intensified and widened such demand.

A key feature of Ex-Im Bank's foreign currency program is how Ex-Im Bank handles the exchange risk arising from a mismatch between the dollars paid to the U.S. exporter and the foreign currency debt obligation provided to the foreign importer. Under standard guarantee policies and procedures, Ex-Im Bank would be exposed to the mismatch risk during the claim payment and recovery period, because Ex-Im Bank would use dollars to pay the lender's claim while the expected recoveries would be denominated in the foreign currency. However, as a special feature of the foreign currency guarantee program, Ex-Im Bank requires the buyer's obligation to be converted to dollars at the exchange rate in effect at the time the claim is paid.

Several years ago, Ex-Im Bank began offering coverage for *acceptable* (as determined by guidance from the Department of Treasury as to the breadth and depth of that currency's market) local/soft currencies on a case-by-case basis. Every year Ex-Im Bank receives roughly five to ten inquiries about support for foreign currency transactions and approves about four applications each year. Customers have evinced interest in continued expansion of the program and note the receptiveness of other ECAs as a further justification for Ex-Im Bank's involvement in local currency deals.

The only significant growth area has been in the size of the transactions for which foreign currency guarantees have been requested, due entirely to the active use of the program by airline industry buyers. Another interesting trend, which is reflective of the current environment, is the shift in the types of currencies requested. In the mid-1990s, the currencies requested were predominantly hard currencies. Today, many of the requests are for local currencies. Nonetheless, the vast majority of Ex-Im Bank's transactions have been denominated in U.S. dollars.

G-7 ECAs' Policies and Practices

As noted in the introduction above (and compared in **Figure 20** below), all major ECAs (including all of the G-7 ECAs) actively support transactions denominated in hard currencies, most significantly U.S. dollar transactions. In 1999, however, ECGD began aggressively marketing its willingness to support local currency transactions. Since that time, four other ECAs (Ex-Im Bank, EDC, Coface and Hermes) have entered the fray. In reality, very few medium- or long-term local currency transactions have materialized. Ex-Im Bank is aware of at least six medium- or long-term local currency export finance transactions supported by an ECA in the past three years, three of which were done by Ex-Im Bank.

All ECA foreign currency programs have one basic feature in common: they are designed to help buyers control certain risks associated with export credits by effectively spreading exchange rate fluctuation risk among a number of parties. Thus, ECAs take some fluctuation risk with their cover, but they also expect the lender or exporter and the foreign borrower to take some of the risk as well. The sharing of the risk with the borrower is generally accomplished at the time of default. For example, Coface fixes the exchange rate between the foreign currency and the euro at the time of default. So regardless of how the exchange rate fluctuates after the default, the buyer is required to pay enough of the foreign currency to make Coface and the insured party whole. Hermes has a similar feature, although they do not fix the exchange rate until they pay a claim. ECGD caps the total amount of its British pound liability, thus limiting the amount of claim payment and ECGD's exposure to exchange rate risk. Ex-Im Bank's approach is similar to that taken by Coface and Hermes: Ex-Im Bank converts the obligation to dollars at the time of claim payment, basically fixing the exchange rate at the time of claim payment.

One area of significant difference between ECAs offering support for foreign currency transactions is pricing. Under the rules of the OECD agreement on premia, ECAs providing cover for a *local currency* transaction may apply a discount of 35% to 50% (depending on the legal structure of the cover). ECGD has indicated that they would be willing to provide a 50% discount to the minimum required premium for a local currency transaction. Ex-Im Bank has also indicated a willingness to provide a discount, though the structure of our guarantee and insurance programs is such that the Bank could only provide a 35% discount. All the other G-7 ECAs (except SACE, which has not commented) have indicated that, due to the risks inherent in (and/or administrative costs of) a foreign currency transaction, they would charge a surcharge for such cover. For a comparison of ECA foreign currency programs, see **Figure 20** in the summary data section below.

SUMMARY DATA

Figure 20: Comparison of G-7 ECAs' Support for Medium- and Long-Term Foreign Currency Transactions

	Foreign Currency	Local Currency	ECA Limit to Exchange Risk?	Discount Surcharge	Hard Currencies	Local Currencies Transactions Approved
EDC	Yes	Yes	No	Surcharge	USD, EUR, GBP, JPY	N/A
Coface	Yes	Yes	Yes, fix exchange rate at time of default	Surcharge	USD, JPY	None
Hermes	Yes	No	Yes, fix exchange rate at time of claim payment	Surcharge	USD, JPY	Malaysian ringgit (is considering)
SACE	Yes	No	No	N/A	USD, JPY	N/A
NEXI	Yes	No	No	Surcharge	USD, EUR	N/A
ECGD	Yes	Yes	Yes, cap liability in British pounds	Discount up to 50%	USD, EUR, AUD, JPY, CHF	Omani rials and Thai bahts*
Ex-Im Bank	Yes	Yes	Yes, convert obligation to dollars at time of claim payment	Discount up to 35%	EUR, JPY, CAD, AUD	Mexican pesos, Egyptian pounds, South African rand and Indian rupees**

*For non-export credit transactions, ECGD has also supported Indian rupees, Hong Kong dollars, Malaysian ringgits, Egyptian pounds and Pakistani rupees.

**In response to inquiries, Ex-Im Bank has indicated a willingness and ability to support Malaysian ringgits, Thai baht, Israeli shekels, New Zealand dollars, Singapore dollars, Chinese renminbi, Brazilian real, Turkish lira, Korean won, Russian rubles, Philippine peso and CFA franc. Ex-Im Bank will also consider other currencies as inquiries arise.

Exporter and Banker Views

In the 2002 survey of Ex-Im Bank's competitiveness, both exporters and bankers encouraged Ex-Im Bank to support and expand its foreign currency (including the local currency subset) program. Bankers commented that this program is beneficial to borrowers and that demand for it is expected to increase as local bank and capital markets grow.

Exporters also asked for further development of the program, with one large equipment manufacturer stating that they would be willing to increase their risk participation in a transaction in order to increase usage of this program.

Conclusion

Overall, Ex-Im Bank is fully competitive with other ECAs on the qualitative practice of supporting foreign currency transactions, including the local currency subset of that group, and on the quantitative features of its program. One ECA commented that there is a lot of smoke and no fire with the local currency issue.

Ch. IV Comparison of Major Program Structures
Section E: Ex-Im Bank's Major Program Competitiveness

With the exception of co-financing, Ex-Im Bank is generally competitive with its G-7 ECA counterparts, and in some selected areas Ex-Im Bank is more competitive in the way that technical features are incorporated into programs. With regard to co-financing, Ex-Im Bank's limited number of bilateral co-financing agreements has placed Ex-Im Bank at a competitive disadvantage vis-à-vis our counterparts. Moreover, the absence of a product that fits well with the insurance product used by our counterparts inherently yields differences in co-financing that can be difficult to resolve on a bilateral and on a case-by-case basis. In the general category of major program structures, Ex-Im Bank receives an A-, indicating it is selectively competitive.

Figure 21: Grading of Ex-Im Bank's Major Program Competitiveness

Key Elements	Grade
Large Aircraft	**A**
Interest rate level	A+
Interest rate determination	A-
Project Finance	**A**
Core program features	A+
Repayment flexibilities	A+
Policy requirements	A-
Co-financing	**B**
Bilateral agreements	C
One-off deals	B+
Flexibility re: lead vs. follow	B
Foreign Currency Guarantee	**A+**
Foreign currency cover	A+
Local currency cover	A+
Total Average Grade	**A-**