Chapter 4: Comparison of Major Program Structures
Section D: Foreign Currency Cover

Introduction

Over the past several years, foreign currency financing has become an increasingly important competitiveness component of ECA programs. Foreign currency support works in the following way. 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. In the case of ECA insurance or guarantees, 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. Where the ECA provides a direct loan, the applicable CIRR for the currency will be charged. 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.

For the sake of clarity, it is necessary to define several terms used in this discussion:

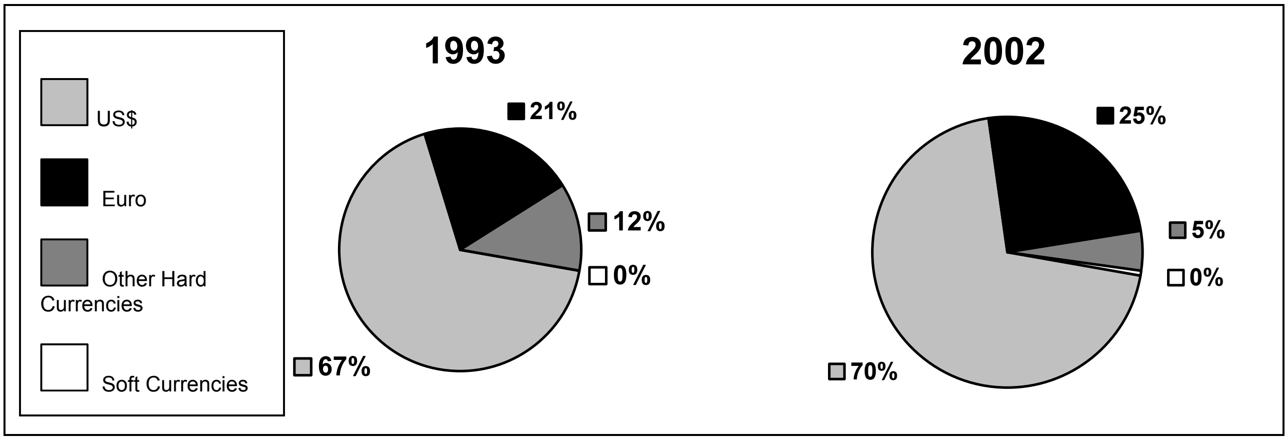
- "Domestic" currency: the currency used in the ECA's country.
- "Local" currency: the currency used in the importer's country.
- "Foreign" currency: any currency other than that used in the ECA's country.
- "Hard" currency: the legal tender of industrialized countries, such as the U.S. dollar, Japanese 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.
- "Soft" currency: the currency that is used only in the buyer's country or region, such as the Mexican peso, South African rand and Indian rupee. Soft currencies are, by definition, also local currencies.

Trends in Foreign Currency Cover

With the adoption of the euro, there has been a consolidation in the hard currencies supported by ECA financings, as illustrated in **Figure 16** below. Nearly 10 years ago, in 1993, 88% of OECD long-term financings were in U.S. dollars or a European currency, while today around 95% of OECD long-term financings are in dollars or euros. Until recently, an ECA's ability to offer support for dollar financing was sufficient, but in today's competitive environment, where ECAs have harmonized and reduced much of the subsidy in official export credits, an ability to provide financing in local currencies is emerging as a differentiating factor among relatively homogeneous ECA offers.

As a result, there has been a modest movement towards increasing local currency financing. In 2002 (2003 data is not yet available), $90 million and 35 transactions (less than one percent) of OECD long-term financings were denominated in a local currency, as opposed to $20,000 and 3 transactions in 1993. The breadth of currencies supported has increased as well, as globalization has intensified and widened demand for local currency financing. In 1993 the two local currencies supported were the U.S. dollar and the Singapore dollar, both "hard" currencies. In 2002 the local currencies supported were the U.S. dollar, the Slovakian koruna, the Czech koruna, the Malaysian ringgit, the United Arab Emirates dirham, and the South African rand – a mix of "hard" and "soft" currencies. This increase in demand appears to stem from importers' decision to introduce the financial management technique of matching the currency of their borrowings with the currency of their revenue stream.

Figure 16: Distribution of Currencies for ECA Long-Term Financings



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 buyer demand for yen-priced offers, but demand has increased the number of currencies that Ex-Im Bank is willing to cover.

Despite the significant interest in soft currency deals, Ex-Im Bank authorized one medium-term soft currency transaction and two short-term soft currency transactions in 2003. The medium-term transaction was for a line of credit in Mexican pesos for a Mexican airline, while the short-term deals were for sales denominated in Mexican pesos and Czech koruna. Ex-Im Bank did, however, authorize over $2 billion in hard currency financings: $2 billion for aircraft sales (5 euro deals, 1 Canadian dollar deal, 1 Australian dollar deal) and $1 million of euro financing for an export of medical equipment. Thus, over 15% of Ex-Im Bank's authorizations in 2003 were for transactions denominated in a foreign currency.

G-7 ECAs' Policies and Practices

Availability of support for local currency transactions, pricing and limits on exchange risk are the three main factors that differentiate the G-7 ECAs' foreign currency support. As noted above, all of the OECD ECAs provide support for hard currency deals, as the standard currency of trade is the U.S. dollar, followed by the euro. More than half of the OECD ECAs have supported transactions in the importer's local currency. However, only a handful of ECAs have supported transactions in a soft currency. **Figure 17** shows soft currency transactions supported by OECD ECAs from 2000-2002. None of Ex-Im Bank's G-7 competitors has supported a soft currency transaction, although six of the smaller OECD ECAs have done so.

Figure 17: Soft Currency Transactions Supported by OECD ECAs, 2000 - 2002

ECA	Number of Soft Currency Transactions	Country of Soft Currency Transaction
OeKB (Austria)	1	Slovak Republic
EGAP (Czech Republic)	1	Slovak Republic
EKF (Denmark)	1	Czech Republic
GIEK (Norway)	1	Latvia
EKN (Sweden)	1	Malaysia
ERG (Switzerland)	1	United Arab Emirates
Ex-Im Bank	1	South Africa
Total	7	

Generally the ECAs do not change their pricing for transactions denominated in hard currencies, although several ECAs evaluate the risks inherent in such transactions on a case-by-case basis and reserve the right to add a surcharge to their fee. The practice is mixed on the soft currency transactions.

The Arrangement's premia rules allow for a discount of the minimum premium for those transactions that: (1) are denominated in a local currency; (2) are not subject to transfer risk; and (3) maintain the obligation in the local currency throughout the life of the transaction (e.g., payments made after a default are still made in the local currency). ECGD's foreign currency program meets the criteria for the local currency discount, and ECGD is willing to discount the premium on a local currency transaction. Most other ECAs are unwilling to discount the premium, as they believe that some local currency transactions have other risks that offset or negate the benefit of financing in a local currency. In fact, most would add a surcharge for a soft currency transaction. From 2001-2003, there have been just three soft currency premia discount notifications, two from Ex-Im Bank and one from Sweden.

Of those G-7 ECAs willing to support local currency transactions, all but EDC limit their exposure to exchange risk at the time of default. The mechanisms used vary by ECA, but transactions are structured to maximize the ECA's ability to collect enough payments after an event of default to ensure that the recoveries, when exchanged into the domestic currency, equal the ECA's cost of paying the claim (i.e., the amount of domestic currency the ECA had to spend to pay the claim in the local currency).

Figure 18 summarizes the foreign currency experience of the G-7 ECAs.

Figure 18: G-7 ECA Medium- and Long-Term Foreign Currency Transactions

	Exchange Risk Accepted by ECA?	Hard Currency Transactions Approved	Soft Currency Transactions Approved
EDC	Yes	USD, EUR, GBP, JPY	None
Coface	No; fix exchange rate at time of default	USD, JPY	None
Hermes	No; fix exchange rate at time of claim payment	USD, JPY, GBP	None
SACE	Yes	USD, JPY	None
NEXI	Yes	USD, EUR	None
ECGD	No; cap liability in British pounds	USD, EUR, AUD, JPY, CHF	Omani rials, Thai bahts*
Ex-Im Bank	No; convert obligation to dollars at time of claim payment	EUR, JPY, CAD, AUD	Mexican pesos, Egyptian pounds, Czech koruna, South African rand, 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 Lender Survey Results

Ex-Im Bank received a limited number of comments on the competitiveness of its foreign currency cover. The exporter who most regularly uses the program wrote: "Ex-Im Bank continues to be flexible regarding foreign currency guarantees." Thus, in comparison to the other G-7 ECAs, Ex-Im Bank is generally competitive.

Conclusion

In sum, Ex-Im Bank's foreign currency program is generally competitive with that of other ECAs. Ex-Im Bank is a leader among the G-7 ECAs in the offering of local currency cover, and it is competitive with other ECAs in pricing local currency cover and in its limitations on taking exchange risk after default.