Joint Business Position: Export Credits and Covid-19

July 2020

1. Background

By impinging on demand and supply, COVID-19 has affected the world economy to an extent that had not been witnessed since World War II. Although it is difficult to provide exact estimates of the economic impact at this stage, it is already clear that businesses of all sizes and sectors are suffering worldwide.

In its June 2020 Economic Outlook, the OECD projects the deepest recession seen in peacetime over the past century. Notably, it stresses that the recovery is likely to be hesitant, and could be interrupted by another coronavirus outbreak. In its "double-hit scenario" assuming a second outbreak later in 2020, global GDP growth is expected to decline by -7.6% in 2020, while in an alternative scenario where a second outbreak is avoided ("single-hit scenario"), global GDP growth is projected to decline by -6.0%. The effects of the crisis are expected to leave long-lasting scars in many economies – by the end of 2021 the median OECD country will have lost more than 5 years of income per capita growth.

The immediate impact of the pandemic on global trade is already profound due to production interruptions, supply chain disturbance, and widespread uncertainty. World trade was already weak prior to the pandemic outbreak and is projected by the OECD to decline by 11.5% in the double-hit scenario in 2020, and 9.5% in the single-hit scenario.

For companies, the crisis leads to concerns about the availability of short-term trade finance and working capital, as well as weaker demand for exports. It also reduced the anticipated demand for future exports and raised concerns about the availability of finance in the medium-term. Moreover, reduced cashflows put increasing pressure on corporate liquidity, thereby heightening credit risks and ultimately default and insolvency risks. In addition, the availability of non-cash instruments such as short-term credit insurance or technical guarantees will be constrained. **For banks**, the crisis will thus likely result in repayment difficulties for some of their clients due to defaults, restructuring, or deferred payments. A rise of non-performing loans (and risk weighted assets) impacting the system is expected as a result. Risk aversion is likely to increase, resulting in more selective financing and higher margins.

This is why the recovery and post-Covid-19 period needs to be framed against appropriate set of rules. We believe that the OECD has an important role to play in supporting and stimulating the response to and recovery from the Covid-19 crisis. We present in this paper a summary of the policy recommendations, which we believe are now urgently required to help to realize projects and trade which has been postponed or even cancelled due to the recession, fill finance gaps and support economic recovery. This includes our suggestions for a) much needed immediate updates of the OECD Arrangement on Officially Supported Export Credits, which we outlined in a joint Statement in November together with b) guiding principles for fundamental modernization.

2. Policy Considerations: Short-term liquidity support & urgent reform needs of the OECD Arrangement

Summary of key policy recommendations

a) General considerations and short-term liquidity support

- Improving access to liquidity
- Evaluating credit impact
- Broadening financial products offering
- Enhancing re-insurance agreements with other ECA's
- Restructuring existing loan portfolio

b) Actions specifically related to the OECD Arrangement

- Increasing the current local costs limitation to 50% of the total scope
- Greater flexibility for ECAs in covering the minimum 15% down payment
- Allow market-reflective repayments to better align with the nature of different projects
- Increase the maximum repayment term to 18 years and cease to distinguish between different sectors
- Revise the premiums applied to private borrowers in high-income OECD countries
- Introduce an easy to define, transparent & predictable CIRR to provide a level playing field
- Temporary suspension of country risk category reviews until at least 31 December 2021
- Temporary relaxation of TCMB - Cat 0 pricing benchmarking requirements

a) General consideration and short-term liquidity support

Export credit insurance has a key role to play during this crisis as it helps to promote cross-border trade and foreign investment, acting as a lubricant for both export and finance, filling finance gaps and then later supporting economic recovery. We thus welcome the swift actions taken by governments and export credit agencies (ECAs) across different countries. These include:

- Maintaining of both public cover and financing volumes
- Widening of the risks covered (waiver of 5% risk retention)
- Short-term support (e.g. supply chain and bridge financing, as well as working capital)
- Support for the issuance of technical guarantees
- Development of new products adapted for the new conditions
- Improvements in the regulatory environment (e.g. European Commission decision to temporarily relax ban of state intervention in intra-EU short-term credit insurance)

We believe that the above measures, mainly aimed at providing sufficient liquidity during the immediate phase of the virus outbreak, should be deepened where necessary and be widely implemented across countries. Much-needed measures broadly fall under the following five categories:

- Improving access to liquidity (e.g. develop/expand refinancing programs and increase indemnity levels of cover, while the development of direct lending will remain critical for SMEs and in high-risk markets)
- Evaluating credit impact (e.g. relaxation of credit evaluation criteria for political risks and clarification of economic risks' evaluation criteria)
- Broadening financial products offering (e.g. provision of solutions for extended payment terms, more flexibility around 'bridge' or shorter-term solutions)
- Enhancing re-insurance agreements with other ECA's (work across multiple ECAs on reinsurance basis, streamline and fast-track intra-ECA approval processes for multi-sourced transactions)

Restructuring existing loan portfolio (e.g. streamline process for amending existing loans terms) and consider the global rise of debt burden resulting from the sudden and deep global recession.

b) Actions specifically related to the OECD Arrangement

For the period of recovery following the pandemic outbreak, it is important to keep in mind that the impact on exporters will be of a protracted nature. This is due to the fact that potential customers worldwide have postponed and even stopped projects to address the crisis (e.g. on employees' salaries during the containment period), and the risk of a deeper and more severe recession that has been prognosed as of today beyond the pandemic's first wave. **If we wait to prove that support was required to help stimulate recovery it will in many cases be too late to implement the measures required to provide support at the time it is most needed.**

In November 2019, we published our joint business vision for the future of the OECD Arrangement on Officially Supported Export Credits ("the Arrangement"), calling on policy-makers and the OECD to ensure a global level playing field for business by reforming the Arrangement and transforming it into an easy to understand, transparent, predictable, market reflective and consistent framework.

We believe that the crisis reinforced the urgency of many of our recommendations related to "much needed immediate updates" and "guiding principles for fundamental modernization" of the Arrangement. What was a necessary modernisation in 2018, has now become a matter of necessity when looking not only at the recovery, but also at the needs of a post-Covid-19 world. It is likely that in the medium-term global financial competition will increase even further, both inside and outside the scope of the Arrangement and with both OECD members and non-members. Official trade-related finance may be increasingly tied to the promotion of national interest, including in the area of so-called "strategic goods" and related to national security issues[1], further decreasing the relevance of the Agreement. There is a risk that state driven projects and unfair competition will sharply increase to support domestic companies' bidding for the fewer, remaining projects resulting from the economic downturn.

Yet, in order to allow companies to drive recovery and foster job creation, a level playing field is of critical importance. Many of the immediate measures proposed by us in November 2019 have, besides creating a level-playing-field, the potential to stabilize and support post-crisis the business of exporters, buyers, lenders, and borrowers.[2] We outline a number of selected key actions from our November position, which we deem essential and urgent.

i. Local costs / Local content

As we outlined in November, the current treatment of local costs does not reflect market realities and is especially problematic for large scale turnkey projects in developing markets where localisation requirements exceed the OECD limit. In addition, it hampers the ability of ECAs to play a more active role supporting the global sustainability agenda.

In response to the pandemic, we must consider how to bridge requirements in the short-, medium- and long-term. Revision of local cost treatment is all the more warranted to support buyers and sellers.

[1] While it is not always obvious to assess what constitutes a risk for the national security of a given country, this should not be a disguised restriction on trade, or a basis to address trade deficits or limit investment. [Business at OECD, Considerations for Trade and Investment, Priorities for future OECD work, March 2020]

[2] In the current context, buyers and borrowers count on a workable and functioning OECD-ECA system given their desire to purchase goods and projects based on high technical and sustainable standards from OECD industries and exporters, but need particularly during this crisis to rely on simultaneously provided long-term and tailor-made financing solutions. Providing the latter provides thus a win-win situation for both exporting and importing countries.

We stand behind our recommendation of increasing the current local costs limitation to 50% of total scope. The Covid-19 impact will increase the need to source locally, together with emerging countries' efforts to stimulate local employment while lacking long-term local currency funding and experiencing increased crisis-related capital outflows. Our proposal allows for a consistent interpretation by all OECD members, contributes to a level playing field across actors, is easy to measure (50%), and not restricted to a few industrial sectors. The access to additional funds will allow buyers/borrowers, particularly in developing countries, to return much earlier to investment in projects that will result growth and prosperity.

Moreover, the nature of construction services, whether they are part of an industrial plant construction or a pure infrastructure project, is such that building or infrastructure "products", such as roads, railways, ports, dams, hospitals, etc. are provided locally. For (industrial plant/infrastructure) construction service companies it is therefore necessary to source construction materials, labour force and sometimes equipment locally. For these projects – that significantly contribute to the SDGs – ECA's have the opportunity to play a more active role. Hence, we call upon the OECD to consider in future amendments to the current Arrangement to no longer differentiate between foreign content and local cost.

In this regard it is worth highlighting that local costs and national foreign content restrictions do not apply under untied investment schemes, which is one of the main reasons of the growth of untied investment schemes at the expense of regulated export credits we have been witnessing.

ii. Down Payment

In November we addressed the provisions of the OECD consensus permitting more flexibility to support for up to 85% of the export contract value before the starting point in selected cases, including third country supply, leaving a cash "down payment" requirement of at least 15% of the contract value.

Down payment is a crucial issue for the exporter and the ECAs as both generally consider a down payment as a risk mitigant. Especially for SME exporters advance payments are an important test for the seriousness of the order, also for some companies it is a working capital component.

Due to the Covid-19 crisis, funding especially for the 15% down payment, particularly for large government contracts is expected to be challenging. The consequence is delay or, ultimately, no export, as public sector contracts tend to be subject to the political cycle. The result is that much-needed infrastructure remains un-built, or is sourced from non-OECD countries, with a negative Sustainable Growth agenda impact.

Covid-19 has compounded the problem due to increased market volatility and uncertainty. Some commercial banks are having greater difficulty pricing or sourcing credit appetite for the uncovered commercial loans financing the 15% portion of export orders supported by OECD ECAs. In addition, for many sovereign borrowers private market credit insurance is not available or extremely limited and banks will generally not lend the 15% without it in some form. Unless action is taken, export volumes will likely suffer.

Hence, we believe that ECAs should have more flexibility in supporting the financing of the down payment temporary and with a particular focus on Sub-Saharan Africa, for example through government-backed reinsurance. An alternative approach could be a two-tranche solution with a shorter term for the down payment, and a longer term for the balance. In order not to impose additional burden on exporters such financing would be disbursed to a borrower as a refinancing six months after the down payment was paid in cash. The Buyer/Borrower can use these additional funds for local construction work and hence address the total financing need.

Notably, in order to foster quick implementation and effectiveness, we propose support for 100% finance cover of the total contract value under two conditions only:

- **Temporary** whilst markets are in flux as a result of the Covid-19 pandemic
- **Limited to emerging and developing markets** (in particular sub-Saharan Africa) where there is no or limited private market credit insurance available (a demonstrable market failure)

This would help all OECD exporters and developing countries alike, and would be limited to the duration of the crisis.

iii. Repayment profiles and terms

In line with our November paper, we believe that the OECD consensus should be made more market-reflective with respect to financing terms such as repayment profiles. More market-reflective repayments would reinforce exporter competitiveness on the one hand and strengthen borrower ability to repay in a timely manner on the other hand, and would be critical for many sectors during times of economic difficulty. Hence, we propose a closer tying of loan life to asset life and, where appropriate, of repayments to expected revenues or budget allocations.

In addition, we propose an increase to an 18-year maximum repayment term across all sectors of the Arrangement. Differentiation of tenor among corporate, sovereign, or bank risk loans and guarantees on the one hand, and project finance transactions on the other, should be terminated in favour of a longest possible term.

Extension of repayment term will allow Buyers/Borrowers to reduce required cash flow for debt service and hence, in a liquidity-constrained environment, allow them to pursue a higher debt load whilst still realizing economic growth goals. This would be especially useful for borrowers in low-income countries. In addition, longer repayment terms would allow the ECA community to better work together with International Development Multilaterals and Development Finance Institutions (DFIs), which have comparable longer repayments terms, on mobilizing much needed capital for developing countries.

iv. Revise the premiums applied to private borrowers in high-income countries

In our November paper, we argue that the new framework for the calculation of ECA premia in Category 0 (Cat.0) countries established a level playing field amongst ECAs based on the “Through the Cycle Market Benchmark” (TCMB) model, but led to significantly higher pricing for shorter tenors. Premia for Cat.0 borrowers are exceeding premia for Cat.1 and lower categories’ borrowers with the same rating.

We recommended inviting commercial banks and the export industry to a constructive dialogue to assess this issue and agree to mutually acceptable solution. In the meantime, we recommend limiting the premium at Cat 1 levels for Cat.0 borrowers.

Review of the relevant methodologies for country risk classification is also warranted in order to strive for a more appropriate balance between the model-based approach and qualitative adjustments.

v. TCMB – Cat.0

The TCMB – The Cat.0 pricing benchmarking requirement should be relaxed at least temporarily (e.g., through 31 December 2021, as for country risk below). Otherwise, ECA premiums for OECD borrowers benchmarked to the secondary bond/CDS market would require ECAs to charge 'inflated' premiums, out of-line with the countercyclical behaviour. As seen in previous major crises, the private sector is likely to leave the market. We expect private sector financial actors to take time to return to full strength in serving these markets. Whilst kick-starting exports will provide a benefit to exporting and importing countries, the reliability of government based ECAs will be essential in OECD Cat.0 markets.

vi. Country risk category reviews

We would recommend a temporary suspension of country risk category reviews until at least 31 December 2021, as likely downgrades will otherwise increase ECA minimum risk premia and increase the burden on borrowers longer-term and CAPEX spending. Once the permanent impact of the crisis becomes clearer and uncertainty eases, reviews would be conducted. The methodology of the country risk category reviews should be further elaborated in order to increase the focus on objective economic factors in the risk categorization.

vii. 2030 Agenda for Sustainable Development

Finally, the Covid-19 crisis strongly underlines the critical importance of different finance channels to the fulfilment of the Sustainable Development Goals (SDGs). For example, the fact that countries outside and inside the scope of the Arrangement are providing ECA debt in tandem with providers of Official Development Assistance (ODA) such as Multilateral and Bilateral Development Banks (DBs) or Development Financial Institutions (DFIs) to win operations and maintenance contracts for the supply of infrastructure projects, will become even more relevant. The new Arrangement must find answers to combining Development Finance and Export Finance and broaden the scope of the Arrangement. Any such broadening will need to be sensitive to both commercial bank's activities with regard to sustainable finance to date as well as industry's technology development already being pursued today and all the step ups needed to improve on sustainability. It must focus on how to provide solutions for closing the financing gaps especially for the SDGs by focusing on favoring the SDGs rather than by excluding traditional approaches. We fully expect the financing needs for the 2030 Agenda for Sustainable Development to grow. Hence, supporting the 17 SDGs and identifying SDG impactful industries / sectors / technologies for stronger support beyond what is available on official export credit terms will be decisive.

Notably, the role of ECAs is currently not properly recognized in this field. For example, ECAs could in fact play an important role in the recovery alongside DBs, DFIs and commercial banks. Better cooperation between DBs, DFIs, commercial banks and ECAs is important to meet the levels of funding that are required to bridge the current infrastructure funding gap or to meet the commitments made by donors and commercial financing institutions in the field of international climate finance. This also requires realistic mobilisation measurement systems and for ECAs to report more consistently on their contribution in leveraging private finance. Similarly, improved coordination and combination of Development Finance, commercial finance, ODA and ECA-supported long-term credits is needed and will help those developing and emerging markets where the positive results of the past decade risks being erased by the current crisis.

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