Policy Considerations for Export Credit Agencies in a COVID-19 Driven Downturn

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INTRODUCTION

The world is navigating through unchartered waters given the current global health crisis stemmed from the Coronavirus (“COVID-19”) pandemic. The pandemic has created unprecedented challenges for global trade and financial sector supporting the infrastructure industry. As seen during the Global Financial Crisis of 2007-08, governmental Export Credit Agencies (“ECAs”) played a critical role in supporting global infrastructure project sponsors and exporters in both the developed and emerging markets. In today’s current climate, we find ourselves at a similar crossroads where access to public financing will be a lifeline to many existing and new infrastructure projects across the globe. Therefore, GE Energy Financial Services has produced a white paper, *Policy Considerations for Export Credit Agencies in a COVID-19 Driven Downturn* to engage key government stakeholders and policy decision-makers to consider collaborative ways the ECA community can support global exporters and its supply chains. This will safeguard critical infrastructure projects and accelerate economic recovery through access to public finance.

OVERVIEW OF CURRENT MARKET CONDITIONS

The impact of the current market conditions has adversely affected the export trade sector. The COVID-19 pandemic has disrupted the world's integrated global supply chains at an unprecedented speed, impacting a wide range of business sectors and industries including the infrastructure sector. The COVID-19 crisis has resulted in a supply and demand shock with far reaching and uncertain ramifications in duration and severity. Global governments have responded quickly, with a range of economic stimulus packages targeting, for example, individual income, commercial liquidity and tax relief. Some public support packages are up to ~10% of Gross Domestic Product (GDP) (e.g. USA, Singapore, Malaysia, Germany and Japan) compared to a global average of ~2% of GDP during the 2007-08 Global Financial Crisis.

Central banks have taken extraordinary steps to address the impaired capital markets by injecting liquidity to support the flow of funds to domestic households and key business sectors in the manufacturing and export space (e.g. aviation, transportation and energy). The current global economic crisis is impacting many industrial sectors and consumers, resulting mainly from the sharp declines in GDP. This has been seen largely in the aviation and consumer-facing sectors, but also in the energy sector with decreased electricity demand resulting in lower power prices globally (~45% in NYC and ~10-40% in Europe).

As a result, infrastructure projects under execution are receiving Force Majeure notices from suppliers, leading to construction delays and covenant breaches, increasing the likelihood of debt restructurings. In general, the financial markets are dislocated and volatile resulting in pricing challenges and reluctance to conduct new business. Banks and investors have switched their focus to managing existing investments and loan books, monitoring covenants and potential losses, rather than originating new business.

In general, the banking sector is seen to be better placed to weather the current financial storm than they were in 2007-08, given the recent emphasis on stress testing and capital adequacy from regulators. The initial response of commercial banks has been "flight to quality" where caution is taking precedence, whilst continuing to provide credit. Despite still being open for new business, many banks are prioritising their "key clients", offering more conservative products, structures and terms, with additional due diligence and analysis on counterparty risk required for infrastructure deals to be approved.

While many private and infrastructure equity investors have an estimated ~$2.5T (source: Preqin) in dry powder, funds remain cautious due to limited lending and valuation concerns. Many investors are taking a "wait-and-see" approach until markets settle and valuations stabilise before deploying new capital.

THE ROLE OF EXPORT CREDIT AGENCIES

ECAs played a critical role in plugging the capital gap in the 2007-08 economic downturn. ECAs stepped into a complex financing environment where private capital had struggled to sustain and meet global financial needs.

During 2007-08, the Global Financial Crisis impacted global trade and led to significant economic fallout. The financial market disruption led to the rethinking of counterparty risks and hindered the ability of banks to support international trade. ECAs took measures to ensure sufficient capital was available to stimulate trade and exports, which played a critical role in reassuring the private sector that state-backed financial institutions are there to partner on key projects that safeguard critical national infrastructure and its global supply chains and workforce, hence stimulating the economy. Some of the measures included, introduction of new products, higher percentage of cover and enhanced support for working capital. Even though it was observed that ECA support fell in the immediate global financial crisis aftermath due to the general drop in trade volumes, cover rapidly expanded with some of the ECAs reporting 30-50% increases in new commitments for 2009.

The current economic crisis driven by the COVID-19 pandemic is structurally different than the Global Financial Crisis of 2007-08, when liquidity spreads widened, and markets dried up. In parallel to the current financial market dislocation, COVID-19 is also putting tremendous pressure on many industrial sectors (e.g. aviation, shipping and energy) and the industrial downturn is having an impact on oil prices. These factors have combined to increase the need for ECAs during this unprecedented climate, to not only step up and partner with the private capital sector, but to also to help support stressed supply chains and execution challenges, while continuing to manage the existing loan portfolio.

LIQUIDITY | CREDIT | SUPPLY CHAIN | EXECUTION

Governments have announced sizable liquidity stimulus packages, however, they are primarily focused on domestic policies to assist national companies to ride out the temporary industrial shut-down. GE believes ECAs are well-positioned to deploy capital efficiently and has identified five recommendations that should enable access to capital and sustained export trade for critical infrastructure globally in the COVID-19 recovery phase.

Improving Access to Liquidity

Evaluating Credit Impact

Broadening Financial Product Offerings

Adjusting Sourcing and Content Requirements

Restructuring Existing Loan Portfolio

I. IMPROVING ACCESS TO LIQUIDITY

The COVID-19 pandemic and the attendant economic issues have created challenges for the commercial banking market to support the progression of global infrastructure projects. Banks are re-pricing indications previously issued and face challenges when pricing new business. In addition, GE is observed a decline in bank risk appetite and ticket size capabilities (if able to price opportunities at all), leading to more complicated structuring and execution of transactions. ECAs need to react, as they did in the global financial crisis of 2007-08, by injecting liquidity to infrastructure projects in both emerging and developed markets.

Direct Lending	High Income	Refinancing	Indemnity

Develop and / or expand direct lending programmes:

ECAs can look to expanding direct lending programmes for infrastructure projects. Direct lending tranches provide liquidity to projects and help support the leading bank(s) with syndication efforts. Commercial interest reference rates ("CIRR") are fixed and published monthly, which provides pricing certainty and a predictable repayment schedule. Sponsors are likely to see reluctance by commercial banks to offer fixed rates through swap markets, increasing the need for CIRR products.

Remove "Category zero[1]" (high income) restrictions:

ECAs should evaluate the relevance of market benchmarking. Category zero ("Cat 0") borrowers may require OECD Consensus[2] (e.g. Category 1) terms to carry out projects. Support should be provided based on project / borrower needs without restriction on countries or financing products. The removal of the 50% cap imposed in OECD Consensus on ECA participation in project finance transactions will allow for better financial terms and coverage.

Allow or increase 'reach back' periods for exports delivery:

ECAs can consider extending reach back period eligible exports. Granting or extending reach back periods for exported goods / services will allow projects and companies impacted by COVID-19 to effectively leverage unencumbered assets. Utilizing ECA loan facilities to re-finance their assets will help infuse cash into their operations.

Increase indemnity levels of policy cover from 95% to 100%:

Most of the ECAs have policy covers capped at 95% indemnity level. Increasing this level to 100% will allow for more competitive pricing and more importantly allow a wider pool of banks to participate in evaluating funding for projects.

[1] "Category zero" countries comprised of High-Income OECD countries and other High-Income Euro zone countries

[2] The Organisation for Economic Co-operation and Development ("OECD") Consensus is a "gentlemen's agreement" amongst its Participants: Australia, Canada, the European Union, Japan, Korea, New Zealand, Norway, Switzerland, Turkey and the United States. The Arrangement first came into existence in 1978, building on the export credit "Consensus" agreed among a smaller number of OECD countries in 1976. Since then, it has been regularly developed and updated to reflect Participants' needs and market developments.

II. EVALUATING CREDIT IMPACT

More than 100 countries are in discussion with the International Monetary Fund ("IMF") for emergency funding to help combat the effects of COVID-19. In addition, many organisations are suggesting that debt relief should be considered for many emerging economies. This unprecedented situation will likely result in a number of sovereign and corporate credit rating downgrades at a time when access to capital for re-building economies and business volumes will be at its most critical. ECAs should remain pragmatic regarding credit capacity and focused on project / investment long-term fundamentals as opposed to the current short-term challenges.

Credit Evaluation	Premium	Country Limits

Evaluate credit through the economic downturn:

Borrowers should be evaluated based on the project's long-term fundamentals, assuming any COVID-19 related issues are at a macro level are likely to be short-term. It is impossible to ignore the impact that COVID-19 will have on underwriting infrastructure transactions, but it is imperative to be able to underwrite "through the cycle" and evaluate the project fundamentals beyond the COVID-19 factors.

Reduce premium rates and provide better repayment schemes:

ECAs should have the flexibility to consider possible reductions in premium rates for agreed increased collateral (credit enhancements). In addition, ECAs should consider an automatic approval to allow capitalisation of premium, to help cash conservation. ECAs should also consider allowing premiums to be "paid as drawn" or as incremental margin on the facility, rather than the current requirement of an upfront payment at first draw.

Evaluate and increase capacity for countries / lift exposure limits:

Many sovereigns and large corporations are likely to face a downgrade in the coming months, either due to the COVID-19 pandemic, continued depressed oil prices, or a confluence of both. Many ECAs will review and adjust country limits and capacity in line with updated ratings. However, countries will need to sustain capacity in order to continue to build much needed infrastructure. Before removing capacity, ECAs should engage with the exporter community to understand the countries where support (e.g. capacity, new products) is required the most. Further, ECAs should evaluate the impact of credit downgrades and manage their exposure with an eye on exporter demand.

III. BROADENING FINANCIAL PRODUCTS OFFERING

Industrial companies are experiencing significant declines in revenues, new opportunities and order backlogs. Cash and receivables have decreased, with companies rightly focused on paying employees and suppliers. Lenders are facing challenges in taking any unsecured risk, even with short-term purchase receivables. The creation of additional payment solutions will allow customers to manage immediate cash flow needs, whilst supporting exporters to remain as competitive as possible. ECA support can enable these infrastructure projects to move forward, facilitating exports and securing jobs.

Down Payment	Alternative Buyer Credit Structures	Supply Chain Financing

Relax requirement for down payments and / or provide financing for it:

In order to support and stimulate the progression of infrastructure projects, consideration should be given to extending ECA cover to include the down payment element of a given project under the long-term covered facility or, as an alternative, provide an option to consider shorter-term parallel facilities.

Provide solutions for extended payment terms:

ECAs could help infrastructure project sponsors meet their working capital requirements through a shorter-term "bridge" facility during the construction phase. This should provide breathing space for capital markets to return to normality, giving wider options for customers to re-finance. The solution could be coupled with options to "flip" structures to longer-term financing once project completion or Commercial Operation Date ("COD") is achieved.

For small ticket transactions there are a lack of banks willing to support transactions below ~$30-40MM. In order to alleviate this, ECAs should consider drafting a simple, short-form, non-negotiable buyer credit loan agreement, to be funded from Direct Lending Schemes.

Supplier credit financing for short/medium term solutions:

In the current COVID-19 environment importers will seek extension to payment terms from suppliers. Development of a simple Supplier Credit facility that allows the exporter to factor the receivables will provide access to additional liquidity. This will allow greater flexibility for "bridge" or shorter-term financing solutions, particularly during the construction phase for the exporter.

IV. ADJUSTING SOURCING & CONTENT REQUIREMENTS

Supply chains and the labour workforce are constrained in the current COVID-19 environment. Exporters will face disruption and potentially be forced to adjust or re-focus supply chains in order to adapt to an evolving situation during the global recovery phase. It is likely that more localisation requirements will be introduced to help re-build economic activity. ECAs can support domestic manufacturers by softening their content policies to adapt to supply chain disruption and build stronger/more robust re-insurance agreements with global ECAs.

Local Costs	National Content	Re-insurance

Increase allowable local costs from 30% to 50%:

This policy item is already under consideration at the Organisation for Economic Co-operation and Development (OECD), with a wide consensus from ECA member participants. It is possible, due to supply-chain or logistical challenges in the current COVID-19 environment, to require more localised procurement to aid infrastructure project execution. This could lead to an adjustment of the local cost allowance. In addition, it is possible that future government public procurement policy will shift towards higher localisation requirements as a way of stimulating local economies.

Relax minimum national content policies, both in terms of % as well as calculation:

A decrease in the minimum national content requirements will allow exporters to win critical new infrastructure projects and factor shifts (temporary and / or permanently) in supply chain. ECAs should consider content assessment at “Finished Goods” or by place of manufacture / assembly, rather than at individual component level.

Enhance re-insurance agreements with other ECAs:

Working across multiple ECAs on a re-insurance basis will help mirror today’s global supply chain with financing. Re-insurance agreements will streamline and fast-track intra-ECA approval processes for multi-sourced transactions, relying primarily on the due diligence of the leading ECA. Whilst many ECAs hold re-insurance agreements with each other, even today, executing a multi-sourced transaction typically involves parallel underwriting of transactions, which is not the intention for sovereign and corporate transactions.

ECAs should evaluate re-insurance schemes for project finance transactions and align their respective guarantees / policies to reflect the global nature of today’s supply chains.

In transactions where the localisation is mandated by the sponsor, the host country project destination ECA should be considered for support as a means of sharing risk and capacity.

V. RESTRUCTURING EXISTING LOAN PORTFOLIO

Borrowers of infrastructure capital will be increasingly challenged to service, as well as comply with covenants, on their existing loans as a result of cash and liquidity constraints. Execution schedules on many projects are facing delays due to supply chain issues, with an uncertain impact on the overall final commissioning of projects. ECAs need to be proactive and pragmatic when evaluating potential re-structure requests.

In-Construction Adjustments	Restructuring	Content

Extend availability and repayment periods:

ECAs should provide extensions to facility availability periods via a simplified loan amendment process for a limited period, without additional costs to the borrower, due to COVID-19 related execution schedules delays. Granting a post-completion grace period or sculpting of repayments for sovereign and corporate deals will help borrowers impacted by COVID-19 by conserving cash in early operations. For example, adoption of a pragmatic approach to the Starting Point of Credit (“SPOC”) calculation for projects with multiple completions under a single financing facility will allow for better cash position alongside various execution schedules.

Streamline process for amending existing loans terms:

ECA portfolio teams should be reactive and sympathetic to restructure requests, with the ability to defer principal and interest payments. With cross-default clause relaxation, borrowers might need to prioritize key infrastructure projects, calling a default due to COVID-19 related missed payments to be used only as a last resort. Implementation of a streamlined process for any loan restructuring requests with no, or limited, additional costs to the borrower will allow for better debt management.

Relax minimum content requirement on projects in execution:

National content relaxation should be considered in the event of a COVID-19 driven supply chain disruption during project execution, causing failure of the exporter to comply with minimum content requirements (which otherwise would have been met in a “normal” business environment).

CONCLUSION

The current COVID-19 crisis will require ECAs, more than ever, to partner with exporters and the private financial institutions during the recovery phase of today's global economic downturn.

Public sources of finance will need to provide solutions for the infrastructure sector and its global supply chain. Injecting public capital into critical projects around the world will safeguard many communities and their local economies. It is imperative for ECAs to consider their role in the post-COVID-19 recovery phase.

GE has made recommendations to the ECA community in five areas such as access to liquidity, credit, broadening financial products, national content and portfolio matters, which all play an instrumental role in supporting the infrastructure sector as it comes out of the current downturn. To position exporters to come out strong a review and the adoption of revised ECA export trade and finance policies will arm exporters with financial tools to support existing and new global infrastructure projects.

ECAs should evaluate the benefits of policies changes and work with the respective exporter communities as they look to collectively navigate through a COVID-19 recovery phase. Some policy areas may need broader consensus across OECD member states, which will require active debate and agreement to implement some of these policy changes.

GE's Top 5 COVID-19 Exporter Recovery Phase Takeaways:

- ECAs are best positioned to **provide counter-cyclical liquidity** through deploying programs such as direct lending and providing 100% financial cover to address project/borrowers' needs.

- ECAs should look beyond the current destabilized financial market conditions by taking a **"through the cycle" credit view** on borrowers and lifting exposure limits for countries where support is required.

- ECAs are in position to step up with **broader financial product offerings** to address short term working capital needs more effectively and to "bridge" projects financing requirements during construction phases.

- ECAs can encourage **job preservation through adjusting sourcing and content requirements,** enabling exporters to sustain their **supply chain**. Maintaining the fundamental structure and capacity of an interconnected supply chain and trade ecosystem will enable a robust global economic recovery.

- ECAs can partner with exporters and borrowers to **preserve existing projects** by taking proactive and pragmatic approach in any restructuring requirements, allowing for successful project completion.

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