Export credit: foreign currency financing of supplier credits

This note describes the arrangements for foreign currency financing of supplier credits announced on 5 July 1978.

On 5th July, the Secretary of State for Trade announced the introduction of arrangements which will enable certain export contracts concluded on *supplier credit* [1] to be financed in foreign currency with the support of the Export Credits Guarantee Department (ECGD). The new arrangements represent an extension of the scheme announced in February 1977, relating to foreign currency financing of *buyer credit* [1] transactions. This scheme and the rationale for its introduction were described in an article in the December 1977 *Bulletin*, page 451.[2] The extension of this scheme to cover supplier credits is designed to help exporters who are selling capital goods and who find supplier credit more appropriate to their particular business, or who are selling to markets which prefer supplier credit.

To the extent that contracts which would have been financed by sterling supplier credits now come to be financed by foreign currency supplier credits, the new facility could make a modest contribution towards improving the balance of payments capital account. It is not, however, expected that the new arrangements will lead to any significant reduction in public expenditure on refinancing export credit: the bulk of ECGD-supported supplier credit does not involve credit terms of longer than five years, and under the new arrangements for fixed-rate sterling export credit [3] the banks can only refinance with ECGD that part of their lending which has a maturity in excess of five years.

The types of contract which are eligible for cover under the new foreign currency supplier credit scheme are those involving capital goods or projects covered by one of ECGD's specific policies and involving credit terms of two years or more. As under the existing sterling fixed-rate supplier credit arrangements, ECGD issue two guarantees: one to the exporter, and one to the financing bank.[4] It is the existence of these two guarantees that enables an exporter to obtain fixed-rate foreign currency finance from the lending bank. The guarantee issued to the lending bank, as under the sterling supplier credits scheme, is unconditional and for the full amount of the loan. It is denominated in the foreign currency of the export contract. The guarantee issued to the exporter is similar to that issued in the case of sterling supplier credits, but is denominated in the foreign currency of the export contract. During the pre-credit risk period, [5] the exporter is covered against any sterling costs incurred in performing the contract or in closing out or unwinding forward exchange contracts entered into in respect of foreign currency due to be received from the lending bank supporting the contract. In the credit risk period,[6] the exporter is covered for the full foreign currency amount for which he is covered under the guarantee issued to him by ECGD (i.e. up to 90% of the contract value).

The foreign currency supplier credit scheme is also similar to the existing sterling arrangements in that an exporter will have a recourse liability for the finance made available, plus interest at the fixed rate. Both the lending bank and ECGD have recourse against the exporter in certain circumstances: the lending bank may exercise its right of recourse when the buyer refuses to accept a bill against which the bank has made advances; ECGD may exercise their right of recourse for any amount paid to the bank (under their specific bank guarantee) over and above what the exporter can claim under the guarantee issued to him by ECGD. As ECGD's guarantee is denominated in foreign currency, the exporter's exposure to any exchange risk on recourse will be restricted to those amounts not claimable under this guarantee. In order to relieve an exporter of the need to allow for a contingent foreign currency liability in his balance sheet, the exporter's recourse liability in respect of the amount of the facility (but excluding interest) is limited by ECGD to a sterling amount established at the outset of the facility.[7] This limitation of an exporter's recourse liability is similar to the recourse arrangements under the foreign currency buyer credit arrangements.

The other main features of the new supplier credit scheme are set out below; most of them, *mutatis mutandis*, are identical to arrangements under the foreign currency buyer credit scheme:

- Exporters pay fixed rates of interest—normally the relevant minimum rates permitted for the buyer's market under the terms of the OECD Consensus which sets guidelines applicable to officially-supported export credits with a repayment term of two years or more. The basic terms are:

  a maximum repayment period of from five to ten years depending on which of three groups (based on approximate *per capita* GNP) the country of destination belongs to: relatively rich, intermediary or relatively poor; and

  a minimum interest rate of $7\frac{1}{4}$% to 8% depending again upon the group to which the country of destination belongs, and also on the length of the repayment period.

- The return received by the banks is agreed with ECGD, specifically for each contract, at a margin over LIBOR.[8] If LIBOR plus this margin at any time during the life of the facility exceeds the fixed rate of interest received by the bank, ECGD

[1] Supplier credit is when an exporter sells on deferred payment terms and himself borrows from a bank until payment is received. Buyer credit is when the foreign buyer pays the exporter straight away and borrows from a bank in order to do so.

[2] Loans under the foreign currency buyer credit scheme for which ECGD have committed themselves to cover now amount to over $2 billion.

[3] Introduced with effect from 1st April. See the March *Bulletin*, page 61.

[4] Premiums charged by ECGD for these two guarantees are the same as for equivalent sterling guarantees.

[5] The pre-credit risk period runs from date of contract to date of despatch of goods.

[6] The credit risk period runs from date of despatch until payment is received.

[7] This sterling amount is calculated by converting the foreign currency value of the facility into sterling either at the spot rate of exchange ruling when ECGD come on risk under their guarantee to the lending bank, or at the rate of exchange at which the exporter sells forward his foreign currency receipts under the facility from the lending bank.

[8] London inter bank offered rate.

pay the difference to the latter. If LIBOR plus the margin is lower, ECGD receive the difference. In order to comply with EEC requirements, these arrangements do not apply to exports sold to other EEC countries.

- Although there is no automatic ECGD refinancing under the foreign currency supplier credit arrangements, ECGD refinance is in fact available in certain circumstances (with ECGD acting as lender of last resort under Section 3 of the 1975 Export Guarantees Act): for example, if during the life of the facility circumstances arise which prevent a lending bank from continuing to borrow the required funds in the inter-bank market, and no replacement bank can be found.
- The arrangements will in general be limited to contracts in US dollars and deutschemarks, mainly because forward markets extending significantly beyond the traditional short-term maturities exist only in these two currencies. Such a forward market will be required because it is not unusual for the manufacturing period to stretch to two years or more (even though it is generally shorter under supplier than buyer credits). While there should be no need for the Bank of England to become involved in forward deals under the new supplier credit arrangements (because of the generally short manufacturing periods), the Bank will be prepared to assist the market, should need arise.
- To be eligible to arrange a foreign currency supplier credit either in its own name or on behalf of a syndicate, a bank must be an authorised bank for the purposes of the Exchange Control Act, and also registered in the United Kingdom. As under the buyer credit arrangements, where a bank fulfils these criteria but is substantially owned by a non-UK registered company, it may not extend participation in any syndicate which may be established to other banks in its group, unless these other banks are themselves eligible to arrange financing under the new scheme. It is thought, however, that the need for syndication is likely to be relatively rare, given the typical size of most supplier credit contracts.
- All commissions and fees are negotiable between lending banks and their customers.
- Exporters under the foreign currency supplier credit arrangements have access to ECGD's tender-to-contract scheme.