Fixed-rate sterling financing of medium and long-term export and home shipbuilding credits

This technical note describes the new arrangements for sterling financing of medium and long-term export and home shipbuilding credits. The main features of the new scheme are a lower public expenditure element and a wider range of participating banks.

On 15th December 1977, the Secretary of State for Trade announced changes in the arrangments for the financing in sterling, at fixed-interest rates, of exports and home shipbuilding with credit terms of two years or more.[1] This note describes the changes.

The present scheme

The present fixed-rate sterling financing arrangements came into effect in March 1972, and were extended, with minor amendments, in October 1974.[2] Under these arrangements, the clearing banks agreed to make sterling finance available at fixed rates of interest for exports which are sold on credit terms of two years or more and are guaranteed by the Export Credits Guarantee Department (ECGD). Identical arrangements apply to home shipbuilding sales guaranteed by the Department of Industry (DI). The interest rates charged by the clearing banks are set for each loan by ECGD (or by DI for home shipbuilding), and are governed by international understandings on credit terms. Each bank is entitled to refinance all such lending above a given proportion of their non-interest-bearing sterling sight deposits, with ECGD or DI as appropriate. On its unrefinanced lending, each bank receives an 'agreed' rate of return, based on the Treasury bill yield and the clearing banks' syndicated base rate. If the return at the 'agreed' rate is lower than the return from the fixed rates charged to borrowers by a clearing bank, the latter pays the difference to ECGD (or DI); and if the return at the 'agreed' rate is higher, the bank receives the difference from ECGD (or DI).

Negotiations and interim measures

The agreement with the clearing banks outlined above was due for review in 1977. Discussions between government departments, the Bank of England and the clearing banks began last May. The Government's prime objective was to achieve substantial savings in the public expenditure costs of refinancing the clearing banks' sterling export credit and home shipbuilding lending [3] both in 1977/78 and in subsequent years, while at the same time ensuring that an adequate supply of fixed-rate finance for such lending would continue to be available. The amount of refinance provided by the Government had been increasing very rapidly: March 1975, £1,482 million; March 1976, £2,037 million; March 1977, £2,582 million.

Before the negotiations began, the clearing banks had agreed, in July 1976, to help reduce the prospective burden of refinancing on public expenditure in 1977/78 by increasing the threshold beyond which they were entitled to receive refinance, from a fixed level of 18% of non-interest-bearing sterling sight deposits to 20%. In December 1976, they agreed to a further increase in 1977/78, to 21%. Public expenditure in this financial year has been further reduced by another increase in the clearing banks' unrefinanced contribution to the existing scheme: although the present scheme was due to expire in October 1977, the clearing banks agreed both to its extension until 1st April 1978, and also to a third increase, before 1st April 1978, in the refinancing threshold from 21% to 24% of their non-interest-bearing sterling sight deposits.[4]

The new scheme

From 1st April 1978, the proportion of fixed-rate sterling export and home shipbuilding credit refinanced by ECGD and DI will be further reduced by the introduction of new arrangements to be applied to all new fixed-rate lending. The expected savings partly depend, however, upon a continuation of the present policy of requiring certain categories of export business to be financed in foreign currency.[5]

As under the present scheme, the interest rates charged by lending banks will continue to be set by ECGD and DI in the light of international understandings on credit terms; and the lending banks will receive an 'agreed' rate of return on the unrefinanced part of their lending.[6] However, the new scheme differs from the present arrangments in several significant respects.

Most importantly from the public expenditure point of view, a bank participating in the new scheme will only be entitled to refinance with ECGD or DI those amounts of its fixed-rate lending which are due for repayment more than five years after commencement of the credit period: there will no longer be a threshold above which all further lending is refinanceable. The lending banks will provide all the finance needed for lending in

[1] The Secretary of State for Trade also announced that the interest rate on bank finance provided under ECGD guarantee for business on credit terms of less than two years, which had previously been fixed at ½% above base rate, could be raised to ⅝% above with immediate effect. (Bank lending under this facility is not eligible for government refinancing or interest-rate support.)

[2] For details of these arrangements, and reference to earlier articles covering the history of the various sterling financing schemes, see articles in the June 1972 and March 1975 issues of the *Bulletin* (pages 205–7, and 48–9, respectively).

[3] Refinancing of clearing bank lending increases both public expenditure and the public sector borrowing requirement.

[4] To 22% in December, and by 1% in each of the following two months.

[5] See December 1977 *Bulletin*, page 451.

[6] Settlement under both the present and new arrangements of the amounts owed to or by the lending banks takes place twice a year.

respect of maturities up to and including five years,[1] and such longer maturities as they are content to hold themselves. The effect of the new arrangements is that the lending banks will carry a substantially higher proportion of their fixed-rate sterling lending on their own books without government refinance.

In the absence of an open-ended refinance commitment by the Government, the banks have not been able to give a formal undertaking that fixed-rate finance will always be available under the scheme. But it is expected that such finance will in practice be readily forthcoming. The authorities recognise that if the supplementary special deposits scheme were reimposed, or if some analogous scheme were introduced, a net increase in fixed-rate lending for exports or shipbuilding, arising from previously existing commitments, could mean that a bank was unable to meet demand from its customers for other priority lending. If such a situation should arise, then the authorities will be prepared to consult with the bank and to consider whether, in the light of the prevailing circumstances, some relief should be provided. Over and above this assurance, the Bank of England have agreed to continue to furnish—in somewhat modified form—the last-resort refinance facility originally introduced in 1969. [2] The texts of a notice and a covering letter from the Chief Cashier which were sent to banking associations on 28th February 1978, setting out the basis for this facility, are given in the appendix to this note.

Another important difference between the present and the new arrangements is that the range of banks eligible to receive interest-rate support and refinance under the fixed-rate sterling scheme has been widened. Under the present scheme, only the London and Scottish clearing banks have had access to interest-rate support and to refinance, though other banks have been able to manage syndicates. From 1st April, however, all banks which are both authorised under the Exchange Control Act 1947 and registered as companies in the United Kingdom will, subject to ECGD's and the DI's normal underwriting discretion, be eligible both to manage lending syndicates and to provide finance (and thus receive refinance and interest-rate support). These criteria are similar to those established for leading syndicates under the foreign currency export credit scheme.[3]

Under the new scheme, the lending banks will receive the three months' LIBOR[4] rate on unrefinanced lending, plus a flat margin of $1\frac{1}{4}\%$. This contrasts with the present arrangements, under which the clearing banks receive a rate on their unrefinanced lending which is made up of the arithmetical average of the Treasury bill yield and the clearing banks' syndicated base rate plus $\frac{1}{2}\%$ (the 'observed' rate), to which a tapered margin is then added to give the 'agreed' rate.

From 1st April 1978, all commissions and fees on new loans guaranteed by ECGD and DI will be negotiable between the lending banks and their customers. Under the present scheme, negotiation and management fees for export lending at fixed rates have been charged on a sliding scale with a standard commitment commission of 1%. All fees for home shipbuilding credits have been fixed.

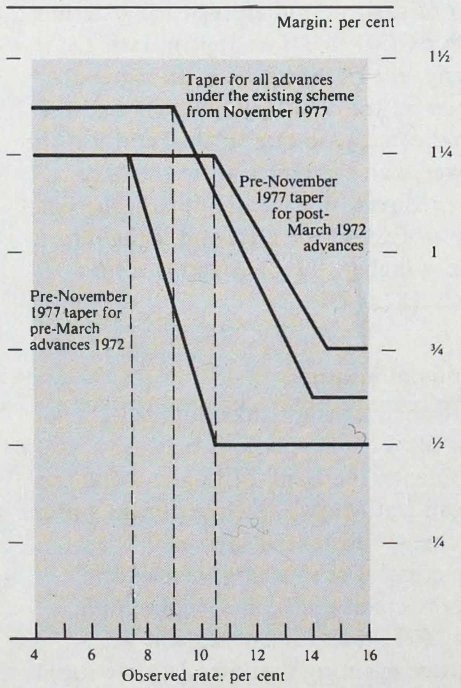
Separate arrangements are being worked out for the financing of exports to other EEC countries, in order to comply with conditions of membership of the EEC.

Transitional arrangements

Transitional arrangements have been made to deal with the clearing banks' lending commitments under the present scheme. The proportion of such lending eligible for refinance will be fixed at the proportion which refinanced lending bears to total fixed-rate sterling lending at the time the 24% threshold is reached. This proportion will apply until loans under the existing scheme are totally run off.

On their unrefinanced lending under the present scheme, the clearing banks will continue to receive an 'agreed' rate after 1st April. The calculation of this rate was changed with effect from November 1977. The 'observed' rate of the average of the Treasury bill yield and clearing banks' syndicated base rate $+\frac{1}{2}\%$ continued unchanged. However, the tapered margin over the 'observed' rate, added to the latter to give the 'agreed' rate, was altered, as illustrated in the chart.

Margin of agreed rate over observed rate for unrefinanced lending under the existing scheme



The new scheme, which may be reviewed at any time, will operate until 20th February 1980 in the first instance.

[1] Entitlement to refinance will not commence until total advances made under a fixed-rate sterling contract or loan exceed the amount of credit repayable within a five-year period.
[2] This facility, which was intended for emergency use only, has never been used.
[3] Described in the December 1977 *Bulletin*, page 451.
[4] London interbank offered rate. The lending banks will receive an average of the rates of a panel of clearing banks and accepting houses.

Appendix

Letter of 28 February 1978 from the Chief Cashier to banking associations.

New Fixed Rate Sterling Export and Shipbuilding Schemes

Since writing to you on 15 December enclosing a note summarising the terms of the new fixed rate sterling export and shipbuilding schemes, it has been formally agreed that the last resort refinance facility at the Bank originally introduced in 1969, and continued under the 1972 export and shipbuilding schemes, should continue to be available under the new schemes. Certain amendments have been made to the facility to reflect the modifications introduced into the new schemes, including the fact that a wider range of banks may now participate. I enclose a Notice [reproduced below] in which the terms of the facility are set out.

There are three points on the operation of the facility which need further explanation. Firstly, although the facility is formally available to all banks participating in the fixed rate schemes, in the case of banks with overseas bank shareholders the Bank will continue to expect such banks to look for assistance in the first instance to those overseas shareholders. Secondly, the Bank will, in future, interpret a withdrawal of deposits to include a withdrawal of inter-bank deposits, with the corollary that we would expect the banks to look to the inter-bank market before seeking to use the last resort facility. Thirdly, the purpose of the facility is to provide last resort finance in the case of difficulty to support export and shipbuilding contracts. It is not intended to be used to offset the effects of measures of monetary control and, in particular, to circumvent the application of the Supplementary Special Deposits scheme or to meet a call for Special Deposits. As explained in the Notice accompanying my letter of 15 December, if, through the reimposition of the Supplementary Special Deposits scheme or the introduction of some analogous scheme, a bank was unable, because of previously existing commitments to lend under the fixed rate export and shipbuilding schemes, to meet demand from its customers for other priority lending, the authorities would be prepared to consult with the bank and to consider whether some relief should be provided.

You may wish to bring the enclosed Notice, together with the explanations on the operation of the facility given above, to the attention of your members.

Refinance Facilities for Medium and Long term Sterling Export and Shipbuilding Finance

These arrangements take the place of the refinance arrangements contained in Part I of the May 1969 scheme. The agreement of that date is therefore terminated.

Eligible Banks

Banks which are both authorised under the Exchange Control Act 1947 and registered as companies in the United Kingdom.

The Bank of England will require to be satisfied in each case that the provision of finance on medium or long term for exports or for shipbuilding contracts with British yards is properly to be regarded as a normal part of the business of the bank in question.

The Bank of England may also wish to set a limit to the extent to which it is prepared to accept a commitment to refinance a particular bank and such limits will be subject to periodic review.

Eligible Transactions

Transactions eligible for refinancing are those where the bank concerned, acting either individually or as part of a group of banks, has agreed to provide finance relating to an export contract, or a contract for ships to be built in British yards for British shipowners, the terms of which provide for deferred payments by the buyer or supplier over a credit period of two years or more.

An export contract must be one for which the Export Credits Guarantee Department has agreed in principle to issue a Guarantee direct to the bank or group of banks concerned.

A shipbuilding contract must be one for which the Department of Industry has issued a Guarantee under the Shipbuilding Industry Acts 1967, 1969, 1972 and 1975.

The extent of the Bank's commitment will be limited to 30% of the finance outstanding originally repayable within five years or less in respect of each eligible transaction, or the amount of finance repayable within the next 18 months in respect of each eligible transaction originally repayable within five years or less where such finance amounts to more than 30% of the finance outstanding.

Conditions of Refinance

Subject to prior consultation, the Bank will be willing to refinance eligible transactions on demand when a participating bank represents:

(1) either that it needs to make use of the facility, in the last resort, to raise cash to meet a withdrawal of deposits; or

(2) that its operations are being constrained by an insufficiency of immediately realisable liquid assets.

Refinance shall apply as far as practicable to the nearest maturing instalments of eligible transactions, a schedule of instalment dates to be agreed during the prior consultation referred to above.

Each request for refinancing must be accompanied by the details of the eligible transactions for which refinance is required, the interest receivable and the terms of repayment and include an undertaking:

(a) to issue to the Bank of England, by way of security for the refinance, a promissory note (or notes) providing for interest and repayment in accordance with the terms applying to the eligible transactions for which finance is required;

(b) in the event of payments on the transactions refinanced being received in advance of the due date, to make payment forthwith to the Bank of England;

(c) to exhibit to the Bank of England, if called upon to do so by them, the documents relating to the transactions refinanced.