

# Revised arrangements for medium and long-term sterling export and home shipbuilding credits

Certain changes have been made in the arrangements for the fixed-rate sterling financing of medium and long-term export and home shipbuilding credits; these modifications are designed to reduce the public expenditure cost of the schemes by withdrawing refinance facilities on new business while ensuring the continued availability of an adequate supply of fixed-rate sterling finance. In addition, it has become necessary to revise the criteria for participation in such lending in view of the provisions of the Banking Act 1979 and the lifting of exchange controls in October 1979. The main features of the new support arrangements, which will apply to business taken on after 1st April 1980, were announced by the Minister for Trade on 13th February and are summarised below.

## Present arrangements<sup>[1]</sup>

The existing official support arrangements, which have been in force since 1st April 1978, applied to banks registered in the United Kingdom and authorised under the Exchange Control Act 1947,<sup>[2]</sup> acting either individually or as part of a syndicate, to make sterling finance available at fixed rates of interest for:

- exports sold on credit terms of two years or more and guaranteed by the Export Credits Guarantee Department (ECGD); and
- contracts for ships to be built in UK yards for UK owners on credit terms of two years or more and guaranteed by the Department of Industry (D.o.I.) under the Shipbuilding Industry Act of 1967, the Industry Acts of 1972 and 1975, and the Shipbuilding Act of 1979.

The fixed rates charged by the banks have been set by ECGD for each eligible export contract (which excludes those with another EEC member country<sup>[3]</sup>) and by D.o.I. for all eligible shipbuilding contracts; these rates have been governed by international understandings on credit terms.

Since April 1978, each lending bank has been entitled to refinance with ECGD or D.o.I. those amounts of its fixed-rate lending due for repayment more than five years from the start of the credit period. On its unrefinanced lending, the bank has received a floating 'agreed rate of return'—an arrangement designed to reflect the fact that it would normally be financing this medium or long-term business with short-term funds; the rate of return is currently the London inter-bank

offered rate (LIBOR) for three months' sterling deposits plus a margin of 1¼%. If, as has been the case in recent years, this composite rate has exceeded the fixed rate paid by the borrower, then ECGD or D.o.I. has paid the lending bank the difference; if the return at the fixed rate had been higher, the bank would have paid the difference to ECGD or D.o.I. Settlement of the amounts owed to or by the lending banks has taken place every six months. Recently, the high level of sterling interest rates has led to an increase in the amounts which ECGD and D.o.I. have paid to the banks under this 'interest make-up' system; in the fiscal years 1977/78 and 1978/79 the cost of support totalled £71 million and £138 million respectively.

## Arrangements from 1 April 1980

Certain features of the support arrangements will remain unchanged. The interest rates charged by the lending institutions will be set by ECGD or D.o.I. in line with international understandings on credit terms (except in the case of intra-EEC trade); and lenders will continue to receive from ECGD or D.o.I. an agreed market-related rate of return. All fees will still be freely negotiable between the lender and the borrower.

The forthcoming changes affect three aspects of the arrangements; these are the lenders' entitlement to refinance, the procedure for determining the agreed rate of return, and the eligibility rules for lead-management and participation in the schemes.

## Refinance

In future, lending institutions will no longer be entitled to refinance with ECGD or D.o.I. that proportion of any new sterling loan which is due for repayment in more than five years; they will thus have to hold on their books throughout the credit period the full amount of all loans made. They will, of course, receive the agreed rate of return on all this lending. This change will lead to the eventual elimination of official refinance and so help reduce public expenditure.

The absence of a refinance facility is not expected to lead to a shortage of funds for sterling export and home shipbuilding credits. It is expected that a reasonable proportion of fixed-rate medium and long-term export credit will continue to be financed in currencies other than sterling under the ECGD foreign currency schemes,<sup>[4]</sup> and provision has been made for the

[1] Details of these arrangements were given in the March 1978 *Bulletin* (pages 61-3).

[2] Authorised bank status ceased to exist on 24th October 1979 following the lifting of exchange controls. Since that date, the status of each UK-registered bank applying to participate in these arrangements for the first time has been individually assessed by ECGD or D.o.I.

[3] Finance for intra-EEC trade is not available at concessionary rates because the provision of an interest-rate subsidy conflicts with Article 92 of the Treaty of Rome. Fixed-rate finance at market rates is, however, generally available for such trade.

[4] Details of these schemes were given in the December 1977 *Bulletin* (pages 451-4) and the September 1978 *Bulletin* (pages 377-8).

participation of a wider range of lending institutions to help to ensure a sufficiency of sterling finance (see below). If, however, the banking system should have difficulties in meeting the demand for such finance, the authorities will be willing to consider means of resolving or reducing those difficulties within the constraints imposed by the Government's monetary policy at that time.

The Bank of England will continue to make available its last resort refinance facility; details of this arrangement, which has never been drawn upon, are set out in a notice sent to the banking associations which is reproduced in an appendix to this note.

#### **Agreed rate of return**

The agreed rate of return comprises the three months' sterling LIBOR plus a margin. Since April 1978, this margin has been fixed at 1½% and could be altered only within the context of a general review of the fixed-rate sterling finance support arrangements. It has now been agreed that, in order to provide more flexibility, the margin may be reviewed every six months in the light of market conditions, either on the initiative of the authorities or following representations from the lending institutions. It has also been agreed that, unless there is a significant change in market conditions in the meantime, the margin over three months' sterling LIBOR for the six months beginning 1st April 1980 will remain at 1½%.

#### **Eligible lending institutions**

Three factors made it necessary to revise the current eligibility rules for institutions seeking to lend under these support arrangements: the removal of exchange controls and the consequent ending of authorised bank status; the new categories of lending institutions established by the Banking Act 1979; and the desirability of maximising the availability of finance for exports and home shipbuilding. Accordingly, from 1st April 1980 the following eligibility rules will apply for both ECGD and D.o.I.-guaranteed fixed-rate sterling lending, and for ECGD-guaranteed fixed-rate foreign currency lending—subject, as before, to the underwriting discretion of ECGD or D.o.I.:

- eligibility to act as a sole lender, or to arrange lending syndicates, and to qualify for the agreed rate of return, will be open to all banks in the United Kingdom recognised under the terms of the Banking Act 1979;
- in cases where an institution's application for recognition under the Banking Act 1979 is still under consideration, that institution will be eligible to act as a sole lender or a lead-manager only if it would have been eligible to do so under the criteria previously in force;
- eligibility to participate in syndicates and to qualify for the agreed rate of return will be open to any deposit-taking institution and any non-deposit-taking institution, provided that in either case the institution is acceptable both to the syndicate as a whole and to ECGD or D.o.I., as appropriate.

## Appendix

*Letter of 28 February 1980 from Mr E. A. J. George (Deputy Chief Cashier) to the banking associations.*

### **Sterling fixed-rate export credit and home shipbuilding schemes**

As promised in my letter of 13th February, I now enclose details of the last resort refinance facility which the Bank makes available in connection with the above schemes. Apart from those amendments necessary to take account of the new criteria for eligibility to participate in the schemes, the terms of this facility are identical to those that have applied hitherto. The only change, therefore, is that, as from 1st April 1980, the facility will be available to institutions which have been either recognised or licensed under the Banking Act 1979.

I would take this opportunity of reiterating the three points concerning the operation of the facility made by the Chief Cashier in his letter of 28th February 1978 to the banking associations. First, although the facility will be formally available to all recognised banks and licensed deposit-taking institutions participating in the sterling

fixed-rate schemes, the Bank will continue to expect institutions with overseas bank shareholders to look for assistance in the first instance to those overseas shareholders. Secondly, the Bank will continue to interpret 'a withdrawal of deposits' as including a withdrawal of inter-bank deposits, with the corollary that institutions would be expected 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 monetary control measures and in particular to circumvent the application of the supplementary special deposits scheme or to meet a call for special deposits.

I should be grateful if you would circulate a copy of this letter and the accompanying Notice to the members of your association.

### *Notice*

#### **Refinance facilities for medium and long-term sterling export and shipbuilding finance**

These arrangements amend the refinance arrangements set out in the Notice attached to the Chief Cashier's letter to the banking associations of 28th February 1978.[1]

##### **Eligible institutions**

Recognised banks and licensed deposit-taking institutions within the terms of the Banking Act 1979.

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 institution 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 institution and such limits will be subject to periodic review.

##### **Eligible transactions**

Transactions eligible for refinancing are those where the institution concerned, acting either individually or as part of a group of institutions, has agreed to provide sterling 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 institution or group of institutions concerned.

A shipbuilding contract must be one for which the Department of Industry has issued a guarantee under the Shipbuilding Industry Act of 1967, the Industry Acts of 1972 and 1975, and the Shipbuilding Act of 1979.

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 eighteen 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 institution represents:

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

- 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;
- 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;
- to exhibit to the Bank of England, if called upon to do so by them, the documents relating to the transactions refinanced.

[1] See the March 1978 *Bulletin*, page 63.