Be prepared

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Atradius Dutch State Business (formerly NCM) set up a special project finance unit in the mid-1990s. Atradius has participated as an ECA in a number of projects in various sectors around the world, such as Nigeria LNG, CSPCL Nanhai Petrochemical plant (China), Caucedo harbour (Dominican Republic), South Pars 9 & 10 (Iran) and various other projects.

Atradius, like other ECAs, has adapted to market conditions and has also become more involved in the arranging process and in structuring transactions in emerging markets such as Africa, Middle East, Latin America and Asia. Since ECAs provide comprehensive cover they have become one of the principal risk takers in project finance in emerging markets. But ECAs still face challenges – despite improvements, the ECA route is still perceived as adding complexity, increasing costs and time consuming.

One of the major challenges for Atradius is reconciling being more market-oriented with its institutional constraints (national and international standards and public accountability). More experienced teams are important in light of the increased complexity of deals and the increased competition amongst ECAs and multilateral institutions for the same deals, and ECAs want to be able to operate as quickly and flexibly as possible, especially with regard to approval procedures and deal negotiations.

ECAs need to have very short lines of communications with their supervisory authorities to minimise red tape – particularly important in deal negotiations. For example, on a number of recent transactions the ECAs' turn-around time for documents was less than other parties. In addition, the Netherlands has been able to provide offers within a few months or less, and has closed a transaction in as little as 5 months, but this is only possible with the help of its supervising authorities, the Ministry of Finance and the Central Bank.

While ECAs provide a guarantee of some sorts (either in the form of insurance or a guarantee backed directly or indirectly by the government) to lending institutions such as banks, ECAs are not banks and do not operate in the same way. The ECA process is not the same as bank syndication, and a government commitment takes some time.

Many participants still have the impression that a government commitment is obtained by simply walking into an ECA. This misperception about the nature of ECAs and a certain lack of understanding of the ECAs is unfortunate, because ECAs provide opportunities for projects that would never be possible or very difficult to realise without their support.

Speed

The timing of ECA involvement has become more important in recent years since ECAs across the board have started playing a more active role in structuring deals. ECAs are the primary risk takers in project finance in emerging markets, so it is crucial that sponsors approach them earlier. Take, for example, markets like Iran (the roughly $1.7 billion South Pars 9 & 10 project) or Nigeria, where ECAs in general covered around three quarters of the debt of a project.

Given their position as lender of last resort and their constitutional constraints, it is only natural that some issues are left for the ECAs to deal with and other parties will not raise issues that they know the ECAs will tackle. It has happened that a project structure (terms and conditions) has been sold to the sponsors by the arranging banks but the ECAs have had a different opinion on the matter. For example on NLNG Plus (a $2 billion project) a process of re-negotiation did ensue, causing a delay in the financing. It is a role which, for ECAs, comes with the territory and therefore ECAs are sometimes the bringers of bad news and lengthier schedules.

Another frequent problem dogging transactions is that sponsors tend to underestimate how long due diligence will take. Environmental issues, for example, get and need much more attention from different parties. ECAs and sponsors have to deal with that. Fortunately, more and more parties in project finance seem to have begun to realise this.

Solicit ECA involvement the sooner the better, whether it concerns the structure of the deal or the due diligence. Recently (for example Qatargas II) ECAs structured the deal in first instance before banks were approached. It will be interesting to see what model (Qatar or simultaneous involvement of arranging banks and ECAs) will be adopted in future deals. This early involvement and more active participation requires a more pro-active approach from ECAs as well as experienced and dedicated teams. Moreover, it also requires some fine tuning of the relationship between the ECA and the insured, i.e. the lending bank.

Sourcing and resourcing

Exports from their respective countries are a requirement for ECA involvement. Recently, however, sourcing from the various ECA countries is only identified at a very late stage in the deal, and thus an ECA's final involvement will only be finalised close to financial close. Early stage involvement of the ECA compounds this issue. The challenge with which ECAs are then confronted is resource and time allocation versus uncertainty as to the size of their involvement.

Clearly this is a dilemma that ECAs have to solve. They are, within limits, comfortable with the sourcing uncertainty – for instance Atradius allows for up to 50% of foreign content and thus this creates the necessary flexibility. Some additional comfort can be created by letting ECAs use good advisers, legal and financial, to assist with the workload involved. Nevertheless, sometimes an ECA's participation gets reduced or the project does not happen at all.

For example, in a recent project in the Middle East Atradius had allocated a lot of time and resources but in the end the deal did not materialise for Atradius because of last minute changes driven by the host government. This is to be occasionally expected, but ECAs like to avoid this, or at least soften the blow by coming to some understanding with the sponsors about this.

Risk taking

ECAs' role as risk takers has increased over the years as they have expanded their cover to include commercial risks. In practice, Atradius is always asked to provide comprehensive cover, i.e. take political and commercial risk in the project.

Many of the main project finance ECAs have specialised teams of underwriters, thus minimising the risk of providing cover for uneconomical and/or white elephant projects as well as the risk of moral hazard that increases with comprehensive cover. Another means of mitigation is sharing risk with banks.

Besides the ability to carry substantial risk and provide financial compensation to the insured, ECAs bring government involvement to a project. For projects in trouble and in difficult environments, government involvement is important. This is because they provide indemnification and have the ability to resist pressure and exercise clout in difficult times. It is interesting that precisely these qualities are so often disliked and held against ECAs in the arranging/underwriting process by other project parties. This seems to be part of the negotiation process.

Although ECAs are primary risk takers in emerging markets projects, there is a trend towards more ECA involvement in projects in developed markets. Atradius is currently working on some projects in developed markets. These projects are not necessarily easier or less risky projects. In principle the approach is the same but the focus is slightly different. In fact, certain risks are more profound as, for example, the security package may be weaker because of more competition on the lending side or a stronger negotiating position of the sponsors, and weaker contractual mitigants for aspects such as market risk than would be the case in developing markets projects. The focus is less on political/country risk and more on the business project risks.

Know your ECA

Given the diverse backgrounds of ECAs, a common standard for insurance policies and guarantees is difficult to achieve. Together with the fact that the nature of ECAs is often misunderstood, this often leads to frustration.

On the other hand, ECAs face people with little ECA experience, which also complicates matters. So ECAs need to become better known, particularly amongst project financiers, since knowledge in the banking community about specific ECAs and their respective policies tends to lie within the export finance department and not in the project finance department. Export finance is not the same as project finance, but Atradius sometimes encounters a lot of intermediaries or miscommunication, since participants do not always speak the same language. It is important to get to know the strengths of your ECA and also their capability to work with other ECAs and financial parties.

Competition and co-operation

Another challenge is the competition between ECAs, since they compete for the same projects some sponsors may wish to minimise the number of ECAs involved.[1] This competition can also extend to ECAs and multilateral institutions. But co-operation between ECAs has improved. For example, on Nigeria LNG, ECGD, US Ex-Im, Sace and Atradius worked well together. The same was true for the $4 billion Nanhai petrochemical project .

This co-operation increases the speed of the process, but has the disadvantage that sponsors often perceive it to be the case that the toughest stance is presented in the negotiations. This is not the case, but it is fair to say that the ECAs have not been very effective at correcting that impression. Ultimately co-operation may lead to the (by some sponsors much desired) 'one-stop-shop' approach in project financings, although the increasing complexity of deals may not help to facilitate that approach. Moreover, this will substantially reduce the competition between ECAs and thus the ability of the sponsors to benefit from this competition between ECAs on pricing.

Cost and consultants

ECAs' premiums are always too high – as far as the parties which have to pay them are concerned. As the minimum premiums that ECAs are allowed to charge are set internationally by the OECD, this is a phenomenon that persists across the board. Atradius has found that such complaints are particularly frequent on oil and gas projects.

Another cost factor is the use of consultants, in particular the use of law firms. The sharing of legal counsel among the ECAs is now more common, and the sharing of legal counsel between the commercial lenders and the ECAs is being tested at the moment. Atradius might, in certain cases, be willing to share legal counsel with lenders provided that separate partners for the ECAs and the commercial lenders are available, especially in key areas of conflict of interest such as the intercreditor agreement. In other areas, for example in due diligence, the sharing of legal counsel does not pose a problem.

Atradius has been involved in a number of transactions where sharing a law firm between lenders and ECAs has been possible. However, the results have been mixed. As banks need to become insured it is sometimes difficult for counsel to advise one party against the other. Moreover, where the insurance policy contravenes, for example, the term sheet, counsel may be in very difficult position. It needs to be seen if the desired cost reductions are realised by sharing a law firm with lenders and whether those reductions are worthwhile

Finally ECA advice to participants – to reduce costs please keep the documentation simple and clear. All too often clauses or documents become too long in order to accommodate parties back at home. Our impression is that many of these elaborate scenes are required to appease the ultimate decision makers and are unnecessary in getting the project successfully closed.

Footnote

[1] Depending on the reasons for involving ECAs in a project this may or may not be a wise choice.