Mission improbable?

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The official line ? US Ex-Im backed project financing jumped by a multiple of nine in 2000 to $1.558 billion with the bank developing new risk mechanisms, flexibility and support for smaller transactions.

The unofficial line ? pure speculation in fact ? the pace and scope of change at Ex-Im surely indicates that arranging (like Canada's EDC) is the next logical step forward and not far away.

No-one at Ex-Im is willing to comment on such a radical departure from past mission method. But Ex-Im is already unrecognisable from the conservative institution of the mid-1990's. Developments include a risk sharing program (yet to be ratified by government) with the private sector, a partial risk wrap (for convertibility) as Opic has done, the potential for cofinancing with other ECAs (notably ECGD and EDC), and a higher profile in the telecoms market (the project finance department now has a designated telecoms team that are already in talks with Motorola and Lucent about how they can speed up the support mechanism).

Ex-Im's newfound willingness to take on more risk has a lot to do with its rocketing project volume. As Harmon says, ?If you look at the recent Turkish transaction [Gebze, Izmir and Adepezari deals] ? they are the model of Ex-Im bank's new world. They have pre-completion and comprehensive cover. They are an example of the US being very competitive.? And as Harmon notes, where Opic did $200 million on those deals, US Ex-Im did $900 million ? no rhetoric just dollars.

The bank is also looking at developing its role in terms of small projects ? recognising that smaller deals have higher costs over returns and less chance of pulling in private sector cash.

In effect, US Ex-Im has reinvented itself and Harmon is determined that reinvention will continue in terms of financial product, sectoral and geographical spread.

How and why has Ex-Im's project finance business changed in the last year?

Harmon: When I arrived at Ex-Im in 1996 we focused on the Asian crisis and the projects that we were engaged in. In the prior five years Ex-Im had done around 27 projects. Because of the crisis in Asia and its spread to Latin America and Russia it became a slower period for us and it was time to reflect upon what we were about.

Early on we made the decision to do pre-completion comprehensive cover so that we were getting involved in construction finance. That was an important move. It demonstrated to the sponsors and banks that we were willing to increase our risk exposure. And it came at a time when they were becoming much more cautious.

Often when people become cautious and the markets decline ? that's usually the best time to take new risks. It was a courageous move to go in and support Korea in January 1998 ? and even Russia last year ? because by then a lot of the speculation had washed out.

That's also been true in my judgement of project finance. We therefore decided to take construction risk and listened to our clients closely. We modified or liberalised our local cost policy and moved from the 85:15 disbursement.

We're also modifying our foreign content policy ? a very important issue. And further modifying our local costs. We are even addressing the question of co-financing, which in the past we were cautious about.

Are there any historical reasons why you've been shy of co-financing?

Harmon: Ex-Im was very conservative, some might even say inflexible. We were insistent upon our documentation. If you were using a one-stop agreement with reinsurance and using their documentation how do you really verify that everything n that foreign content area is what you have agreed to with the exporter?

These policy changes are now being vetted with the export community and with organised labour in the United States ? they have not been addressed for some 15 years. It was never the right time for us to get this done. But we are hopeful that these new policies will be in place in January.

These changes are even more radical than the policy changes we made several years ago, although certainly the decision to go into pre-completion comprehensive cover was important. All the things we did two years ago made us more flexible. We have continued to improve on that policy ? learning from the past.

Beyond our influence however, Asia recovered more quickly than we thought. As did Russia. A combination of the market turning and our policy changes, together with the talents of our PF group, meant that we were in a pretty good position this year to be very aggressive in competing to support new projects and exports.

If you look at the recent Turkish transaction [Gebze, Izmir and Adepezari deals], to me they are the model of Ex-Im bank's new world. They have pre-completion and comprehensive cover. They are an example of the US being very competitive: if you look at what Opic did together with Ex-Im ? where Opic did $200 million, we did $900 million.

It's an important transaction for Turkey ? 5 years ago we wouldn't have done it that way.

Another example is the Chad Cameroon pipeline. It has got a number of complications. It had some criticism from NGOs, and we had to look at a lot of issues. But in the end the group and the environmental engineers made some very constructive suggestions and we were able to step up at the key moment.

I believe that we are probably in as good a position as any institution to do a transaction in the project area. Equally importantly we have decided to do small project finance transactions. There's been a very small transaction in Bangladesh recently, working with the exporter Caterpillar.

Will this be the way you want a lot of the future power deals to go, or was it a one-off?

Harmon: You will see more smaller project financings alongside lots of large transactions too. In the past there were a number of small deals that we did not act on because we were so busy with the larger transactions. We had a somewhat conservative position on that. It takes a lot of work to do the small transactions, because you can't afford to have outside advisors and you have to use your own people.

Nevertheless, small deals are important, especially in the higher risk markets. In areas like Africa or Bangladesh we're not always going to do the large pipeline transactions ? there will also be smaller ones and we're going to be open to do those.

In summary, there have been a lot of policy changes. We were determined ? from my office and throughout the whole bank ? that we were going to expand our project finance activities. So we structured the bank with the project finance leadership taking over a lot of structured finance transactions. The PF group goes beyond just project finance and includes the more complicated non-sovereign transactions. We broadened and made available the talent in project finance to a larger segment of the work we do here.

We're seeing a far greater number of hybrid structures in project finance. Do you think that Ex-Im will be involved with a greater number of other structures, such as leasing, where your Aircraft people will have been active?

Harmon: We're going to have to be more flexible and more imaginative, because it's more competitive. One recent Canadian deal involved a guarantee of Canadian dollar financing with its many multiples and variations. You certainly have to be more imaginative than you were 10 years ago.

There's been a lot of interest in the new risk-sharing programme that you're working on with Citibank. What's the main rationale behind that? Is this balance sheet management or a whole type of product you would offer?

Harmon: That is a very important transaction at a critical time in decision-making in the United States government. Not every branch of government can do what it wants on its own ? that's one of the great frustrations of public service. We need the support of the office of management and budget and the Treasury department, and we need other departments and agencies to buy into what we're doing.

The reasons we want to do this are multiple. There are some net savings to the government because we're sharing the risk and therefore we can do more on our existing budget ? not much more but some more. Certainly we're bringing the private sector in an important way to sharing risk with us. One of the goals of government today is to find a way to bring more capital to the developing world ? it can't always be provided by the public sector.

Unfortunately in the last 10 years banks have become less anxious to take any risk while holding any assets in the form of loans ? and at a time when the developing world really needs long-term capital. They can't get a rate of return that is competitive with fees on mergers and acquisitions or asset management for example. So they don't want to own loans, they want to sell them, or they want to securitize them. They don't want to take risk.

It is dangerous not to make long-term capital available to the developing world. The United States represents only 4% of the world's population and between 30% and 40% of the world's wealth depending on whether analysed by Gross Domestic Product or assets, like stock and real estate. In simple terms you have got to find a way to bring this capital into play.

This transaction brings in the private sector while sharing risk with us. We want to bring them into what we're doing in the hope that they will stay and do more with us or by themselves.

The second goal at Ex-Im is to learn some of the risk management and some of the credit rating aspects of the private sector, which are probably ahead of the public sector. The private sector can in turn can learn something from us ? our knowledge of the developing world countries.

It's difficult to try to persuade the rest of the government of the merits of risk-sharing ? but we're getting there. This government has the position, ?why should we ever partner with the private sector?? The US government doesn't need resources, why would it need to reinsure itself, especially when it has significant surpluses right now? We have some persuading to do. I hope that in the next month we'll come to an agreement and go forward.

Many of the loans that you've made over the year, such as the Chad-Cameroon pipeline and the Russian oil loans, have made heavy use of account structuring. Has a lot of the effort been in working with governments to create a conducive enough environment to using these?

Harmon: I wouldn't explain it that way. I think we've made a conscious effort to try to modify our programmes and policies so that we can be faster, more efficient and more constructive with the exporter, but not do anything foolish. We've been cautious, but we've also made a conscious effort to take more risk.

Our loss experience has been very modest over a long period of time, including the Asian crisis and the Latin American crisis. We made a profit last year, the fourth year out of the last five that we've made a profit. Our portfolio is actually less risky today because of changes in the risk ratings in some countries, and in project finance and airlines ? and therefore more conservative than we had a year ago. And we're much better balanced in the authorisations of new loans that we made last year between industry sectors and regions. The bank is actually in a stronger financial position and can afford to take greater risk.

Some people thought that the Russian transactions carried greater risk, but we thought that we were very safe. Yes, some have said that we have expanded our mandate to include, quote ?corruption issues?, or foreign issues. It's true that we try where we can to encourage countries to make more reforms, to make their system more attractive to investors and to lenders, even though it's not our principal mission (which is to encourage exports). But I think we try and do it in a responsible way.

Chad-Cameroon was very carefully executed ? we had our environmental engineers working very closely on it for several years. It was a very important transaction and we played a very constructive role with the World Bank. It was not only creditworthy, it was also satisfactory environmentally.

I fully expect that we will continue what we've started the last few years and we will be continuing to take greater risk, continuing to change policies where it's appropriate and try to be more efficient in serving the exporter. I'm pleased that much of that has been recognised by Congress. We just got a budget which certainly is the largest administrative budget that we've ever had before and the amount of funds that we have accessible to us this year is the largest that we've had available.

You've said that you want to have a balanced portfolio by sector and region. But are there any particular areas where you might consider specialising?

Harmon: We're lucky because geographically we haven't had to worry too much. The largest single country exposure we have outstanding is China, which is a little bit more than $6 billion, out of $61.5 billion, so it's less than 10% overall. Mexico is second, but no one country represents more than 10%. By industry sectors, aircraft tends to be the largest, but last year the actual authorisations came down from the prior year and we had a significant rise ? almost 90% ? in manufacturing and in technology and in oil and gas.

We expect that telecommunications will have even more significant growth in the next few years and we're trying to respond to that by having the right people in the right place so that we can service that growth. I think you'll see more diversification and more balance by geography and by industry sector than you might have seen a few years ago. And hopefully we'll have adjusted to that and we'll be more efficient in terms of responding.

Do you have any specialised initiatives outstanding, for instance your increased focus on Africa?

Harmon: Africa, by which I mean Sub-Saharan Africa, was overlooked for many years ? not just by Ex-Im but also by the United States. In Tunisia, Morocco and Algeria we're doing a lot of business, and always have done. We recently took the country ceiling off Algeria ? the only country we had a ceiling on. But Sub-Saharan ? we had not done very much in prior years.

After the 1970s there was almost a de-emphasis on Africa. But President Clinton's focus on the area made us focus there too. I was the first Chairman even to visit Southern Africa, and we've done a lot of business there, much more than we did in prior periods of time.

We will continue to have an African initiative and it will increase. It might not become as large as elsewhere, because it's a market that has a long way to go, but it would not surprise me if we continue to do between $500 million and $1 billion a year there. We should be doing more with 750 million people living there, but it won't be as large as what we do in Russia, with 150 million people, which will be an important market for us in the next year or so.

China has enormous potential because we opened up in the private sector a year ago. What we have done there is sovereign but hopefully we'll have a project finance transaction in the country. Our initiative will continue to be Africa but that's one of many; including Russia and Eastern Europe, China and all over Asia, not to mention Latin America which is very important to us. People don't ask enough questions about Latin America because they assume that, as a neighbouring region, we've done a lot there, but we certainly have a lot pending right now.

Will the power sector take up a lot of your attention there?

O'Boyle: With a lot of the deals pending there's a real shift to Latin America. There's Brazilian power, and a few Mexican ones, but Brazilian telecoms and power will be very active.

Both in Latin America and Asia there must be real pressure from sponsors to provide local currency-denominated financing. You've introduced a couple of initiatives to provide guarantees ? will these be extended or are there certain parameters to what can be covered.

Harmon: There are parameters. The Treasury Department monitors this closely. We have introduced this in only two countries: South African Rand and Indian Rupees. I fully expect in years to come that we will be guaranteeing loans in other currencies.

O'Boyle: We've got commitment offers in Ringit and Singapore dollars and other currencies but they haven't really materialised yet.

Harmon: You'll also see us trying to expand our initiative on sub-sovereign risk. It's getting harder and harder to get countries to give you sovereign cover because the IMF and World Bank have certain restrictions on that. So we've moved to try to adjust that by working at this level. We have picked some 35 or 36 cities or provinces where we feel comfortable with their risk rating and provide them with automatic credit in buying equipment from the United States in advance of even knowing the transactions.

I predict that that number will reach the hundreds, and will include, if a country allows, provinces in China or cities in Russia, not to mention Latin America. You will have a long list of companies who want to sell to them or projects in that area. We'll look at what our rating may be on these and know in advance what they can do with us. That will help speed up the process.

With this increase in flexibility and activity, what should the financial and legal community be expecting from you and what would you be looking for from them?

Harmon: If you look at our aircraft business the banks are coming up with all sorts of ways to make the transactions hedge on interest rates and fuel costs because oil's gone up. There seem to be modifications made almost every month, in some part of aircraft financing, where the banks have been very much responsible for reinvention with the lawyers.

I think you'll see the same type of things invented in other sectors. The bad news is that increasingly banks don't want to take risk so they look to us to take the risk and for them to get arranging fees. The good news is that they are quite willing to be constructive in advice and take a small risk. That means that export credit agencies will play an increasing role in providing credit for the developing world.

There will also come a time when the capital markets will come back in a big way. I don't see that now, but soon. And that will be an alternative source for the countries. But the companies are forced to focus on their relationship with export credit agencies because that's the one reliable, continuous source of funding for projects. During very good periods in the capital markets they can think about dipping in, but they've got to look at the ECAs in order to be assured of sources going forward. For our part we have to use the bankers and the lawyers to help us modify our programmes wherever we can, and to continue to maintain good long-term relationships with sponsors and banks and countries so that we can get things done reasonably efficiently. I see only an increased use of ECAs in the future.