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Protecting Against Inconvertibility and Transfer Risk: An Outline of Trade Financing Programs of the Export-Import Bank of the United States.

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I. INTRODUCTION

Political, economic, monetary, and military instabilities in many developing countries interfere with and create risks in trade finance. This outline summarizes the efforts made by the Export-Import Bank of the United States (Eximbank) to reduce the risks in trade finance to the exporting community. Eximbank is the export credit agency of the United States Government.[1] Eximbank's efforts are made in order to create extensive markets for United States products internationally and to sustain United States jobs. In Eximbank's fifty years of existence, it has supported over $160 billion in United States export sales.[2]

Developing countries have experienced severe payment difficulties recently.[3] Many lenders in today's market might consider the following statement describing one developing country: "A nation with whom no contract can be made, because none will be kept; unstable in the very foundations of social life, deficient in the elements of good faith, men who prefer any load of infamy, however great, to any pressure of taxation however light."[4] It is only fitting that the export credit agency of the

1. 12 U.S.C. § 635 (1982). Eximbank was first organized in 1934 under Exec. Order No. 6581, 12 C.F.R. § 401, *reprinted in* 12 U.S.C. § 635 (1982).

2. EXPORT-IMPORT BANK OF THE UNITED STATES, 1983 ANNUAL REPORT 3 (1984).

3. *See* E. BRAU & R. WILLIAMS, RECENT MULTILATERAL DEBT RESTRUCTURINGS WITH OFFICIAL AND BANK CREDITORS 22 (IMF Occasional Paper No. 25, 1983). In August 1983 Eximbank received a settlement of $429.5 million from the Government of Iran, of which $394.6 million repaid in full, with interest, all Eximbank direct loans to Iran, and $24.9 million covered claims against the Iranian Government under Eximbank's insurance and guarantee programs. This settlement followed two and one-half years of negotiations.

4. This statement was made by one of the United States' foreign lenders 150 years ago, as

United States provides trade finance that assists today's developing countries to import products which are necesary for economic development in their markets.

II. OVERVIEW OF EXIMBANK'S PROGRAMS

A. Types of Programs

Eximbank finances United States exports by making loans, supplying export credit insurance, and providing guarantees to buyers of United States goods and services. The three types of programs are discussed below.

1. Working Capital Guarantee Program

The Working Capital Guarantee Program supports loans made for export-related marketing or production activities. This program supports loans to United States exporters, while the other two programs support credit extended to foreign buyers. Since this program was introduced in 1983, Eximbank has authorized forty-nine working capital guarantees totaling $55 million.[5]

2. Credit Risk Protection Programs

The two types of Credit Risk Protection Programs are bank guarantees and Foreign Credit Insurance Association (FCIA) policies. These programs protect the United States exporter or lender from default by the foreign buyer for political or commercial reasons.

a. *Bank Guarantees*

(1) Medium-Term Bank Guarantee. Eligible lenders are United States commercial banks, Edge Act[6] corporations, "Agreement" corporations operating under Section 25 of the Federal Reserve Act,[7] and United States branches of foreign banks subject to regular examination by state or federal banking authorities approved by Eximbank. In fiscal year 1985, Eximbank authorized 140 medium-term guarantees, totaling $514 million.[8]

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quoted in Wilson, *Ways to Achieve Risk-Free Trade Finance*, 67 J. COM. BANK LENDING 52, 60 (Mar. 1985).

5. EXPORT-IMPORT BANK OF THE UNITED STATES, 1985 ANNUAL REPORT 3 (1986) [hereinafter 1985 ANNUAL REPORT].

6. Act of Dec. 23, 1913, ch. 6 (codified as amended at 12 U.S.C. §§ 611-633 (1982)).

7. Act of Dec. 23, 1913, ch. 6, § 25 (codified as amended at 12 U.S.C. § 604(a) (1982)).

8. 1985 ANNUAL REPORT, *supra* note 5, at 14.

(2) Financial Guarantees. Eligible lenders are domestic or foreign commercial banks. In fiscal year 1985, Eximbank authorized twenty-four financial guarantees totaling $779 million.[9]

b. *FCIA Policies*

FCIA was created in 1961 by Eximbank and a group of fifty-one private insurance companies.[10] Eximbank insures the political risks under the FCIA policies. As of September 23, 1983, Eximbank assumed all liability for commercial risk which it either insures directly or reinsures through FCIA. FCIA insurance can be issued to an exporter or to a United States bank. FCIA accounted for $6.5 billion, or seventy-seven percent of Eximbank's authorizations in fiscal year 1985.[11]

3. Fixed-Rate Financing Programs

These programs include the Medium-Term and Small Business Credit Programs, the Direct Credit Program, and the Engineering Multiplier Program. The Medium-Term and Small Business Credit Programs enable commercial banks profitably to extend medium-term fixed-rate loans at the minimum rates allowed by the Organization for Economic Cooperation and Development (OECD).[12] In the Direct Credit and Engineering Multiplier Programs, Eximbank offers financing directly to foreign buyers at the OECD consensus rates. In fiscal year 1985, Eximbank authorized 175 transactions totaling $316 million in the Medium-Term Lending Program and thirteen Direct Credits totaling $320 million.[13]

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9. *Id.* at 13.

10. EXIMBANK, FINANCING AND INSURING EXPORTS: A USER'S GUIDE TO EXIMBANK AND FCIA PROGRAMS X(A) (1986) [hereinafter USER'S GUIDE].

11. 1985 ANNUAL REPORT, *supra* note 5, at 13.

12. The OECD Arrangement on Guidelines for Officially Supported Export Credits establishes minimum interest rates for fixed-rate loans offered by the export credit agencies in 22 OECD member countries. These rates vary by the classification of the importing country and the repayment term of the loan. They are linked to market interest rate movements and are subject to revision on January 15 and July 15 of each year. The table below shows the OECD rates for medium and long-term loans by country classification as of July 15, 1986.

		Repayment Term	
	Country Classification	2 - 5 years	5 years or more
I.	Relatively rich	9.55%	9.80%
II.	Intermediate	8.25%	8.75%
III.	Relatively poor	7.40%	7.40%

OECD, ANNUAL OECD ARRANGEMENT INTEREST RATES, BY COUNTRY CLASSIFICATION AND REPAYMENT TERM AS OF JANUARY 15, 1986.

13. 1985 ANNUAL REPORT, *supra* note 5, at 13.

B. Simultaneous Programs

Sometimes an exporter or lender will use several Eximbank programs at once. For example, financial guarantees can be used with Direct Credits. FCIA insurance or commercial bank guarantees can be used along with the Medium-Term Credit Programs.[14]

C. Eligibility

All products sold must be produced or manufactured in the United States.[15] Goods must be shipped from the United States. Services must be performed by personnel based in the United States or personnel temporarily assigned in the host country.

III. RISKS COVERED BY MEDIUM-TERM BANK GUARANTEES AND FICA INSURANCE

A. Type of Buyer and Risk

1. Sovereign Public Buyers

Sovereign Public Buyers include ministries of finance; central banks; or other government departments, agencies, or offices whose obligations are guaranteed by the ministry of finance, central bank, or otherwise determined to carry the full faith and credit of its government. Eximbank determines whether a buyer in a particular transaction is deemed to be a sovereign public buyer. Eximbank will cover 100 percent of the risks of nonpayment by a sovereign public buyer, whether for political or commercial risks.

2. Risks

a. *Political Risk*

The risk of default is due to (1) cancellation of an import or export license; (2) war or other hostilities that occur in the buyer's country after shipment and on or before the due date; (3) expropriation; (4) confiscation of or intervention in the buyer's business; or (5) failure of the appropriate government authority to transfer the buyer's local currency deposit into United States dollars (transfer risk). Eximbank covers 100 percent of the political risk for guarantees and insurance.[16]

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14. For further information about these programs, see USER'S GUIDE, *supra* note 10, or call the Eximbank Hotline 1-800-424-5201.

15. USER'S GUIDE, *supra* note 10, I-3.

16. *Id.* III-5, X(A)-3.

b. *Commercial Risk*

Any risk of default which is not defined as a political risk is a commercial risk. Commercial losses are those that affect business anywhere, such as a buyer's insolvency or failure to pay an obligation within six months after the due date, including a failure to pay because of a currency devaluation. Disputes with the buyer are not covered. Eximbank covers between 76.5% and 85.5% of the commercial risk in the Medium-Term Bank Guarantee Program and up to ninety percent of commercial loss coverage under FCIA insurance.[17]

c. *Preshipment Risk*

Eximbank issues to exporters a contract guarantee covering selected preshipment risks in transactions that are also covered in Eximbank's bank guarantee program. For private buyers, the contract guarantee covers the risk of insolvency of the buyer and such political risks as cancellation of export and import licenses, war, and revolution. It does not cover the buyer's cancellation of the contract or the buyer's refusal or unwillingness to accept the goods. For public buyers, the contract guarantee covers war risk and cancellation of an export license. The contract guarantee is designed primarily for specially fabricated products.[18]

d. *Transfer Risk*

Transfer risk is a form of political risk, defined as the inability to obtain dollars in a lawful market of the buyer's country and to transfer

17. *Id.* III-6. For short-term sales (up to 360 days), at least one-half of the value (excluding price mark-up) must have been added by labor or material exclusively of United States origin. The table below shows the coverage available on medium-term exports with foreign content.

Foreign Content	Coverage
Up to 10%	All of financed portion
Between 10 and 30%	Only U.S. content (70% to 90% of financed portion)
More than 30%	Only U.S. content if: -no U.S. company manufactures the product -equivalent of foreign components not available in United States

For long-term exports financed by Direct Loans and Financial Guarantees, Eximbank will only finance the U.S. content of the export.

18. USER'S GUIDE, *supra* note 10, III-16.

such dollars to the insured or commercial bank in the United States.[19] In order to qualify for transfer risk coverage, the buyer or guarantor must have deposited, within ninety days of the due date and with a bank or other depository prescribed by law or administrative regulation, the local currency equivalent to the amount of dollars due on such date.[20] The deposit must be made in accordance with existing exchange control regulations and at the exchange rate applicable to the transaction at the time the deposit is made or the due date, whichever is later.[21] If a buyer defaults because of an inability to generate sufficient local currency to purchase dollars to service his or her dollar debt, the resulting loss is not considered to be transfer risk. The local currency deposit required to establish transfer risk coverage is used to distinguish between the creditworthiness of the buyer (commercial risk) and the ability of the buyer to obtain dollars in a lawful market of the buyer's own country (transfer risk).[22] If the loss does not qualify under transfer risk coverage, the loss is treated as a commercial loss and is compensable on that basis. The transfer risk provision assumes that:

(1) a formalized mechanism to convert local currency into dollars through a specified deposit institution such as a central bank or its authorized agent, e.g., a commercial bank, exists in each country;

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19. *Id.* XIV-5.

20. *Id.*

21. The relevant transfer-risk provisions in typical Foreign Credit Insurance Association policies read as follows:

Coverage B—Political Risks

1. Transfer Risk

Eximbank will indemnify the Insured in United States dollars for the percentage stated in the Declarations of the United States dollar equivalent of the currency of the *customer's* country deposited on or before 90 days after the *due date* (as hereinafter defined) of any *contract payment* of the *customer* to the Insured as payment or part payment of the amount due in connection with *covered services,* which deposit has not been transferred because of inability to obtain United States dollars in a lawful market of the *customer's* country and to effect the transfer thereof to the Insured in the United States if:

a. the deposit has been made in a bank in the *customer's* country, or with a depository in such country designated by law or administrative regulation for the acquisition and transfer of United States dollars; and
b. the failure of the appropriate exchange authority to transfer local currency into dollars is not due to the fault of the *customer* or any of its agents including but not limited to:
   (1) failure to comply with the applicable laws and regulations for the acquisition and transfer of dollars, including submission of necessary documentation to the exchange authority; and
   (2) application for dollars at a rate of exchange which is not applicable to the transaction involved.

22. *Id.*

(2) the government will exercise its control over its foreign exchange reserves by temporarily delaying both the conversion of local currency into dollars and the transfer of such dollars to creditors in the United States, rather than through massive devaluations of its currency; and

(3) the monetary authorities of the buyer's country will assume the responsibility to provide dollars at some point in the future when the foreign exchange shortage eases.

3. Illustration

Mexico responded to its foreign exchange crisis on August 5, 1982, by announcing exchange control regulations. By August 13, 1982, the government banned sales of foreign exchange and converted all dollar accounts with Mexican banks into peso accounts. On September 1, 1982, the Mexican government acquired complete control of the country's foreign exchange reserves by nationalizing the private commercial banks and introducing a fixed rate exchange control system. By December 1982, after arrangements were made with the International Monetary Fund, the Mexican government permitted a secondary market to emerge where dollars could be purchased at a rate set by supply and demand. The peso-dollar exchange rate in 1983 was 96.48 to one,[23] which, when compared to the rate in 1982 of 26.23 to one,[24] represented a peso devaluation of approximately 400%. Eximbank agreed to consider political-risk claims on obligations which were not in default prior to August 5, 1982, if there was no evidence, or reason to believe, that the default was due to the buyer's own financial problems.[25]

B. National Bank Lending Limits

The Comptroller of the Currency has held that certain loans guaranteed or insured by Eximbank could be made without regard to the national bank lending limit.[26] Under an exception to the National Bank

23. INTERNATIONAL MONETARY FUND, 39 INTERNATIONAL FINANCIAL STATISTICS, No. 9, 344 (Sept. 1986).

24. *Id.*

25. Memorandum from W. Glick, General Counsel to Eximbank's Board of Directors (Mar. 9, 1983).

26. Letter from Comptroller of the Currency to Peter D. Rowntree, Esq., of Milbank, Tweed, Hadley & Clay (June 29, 1984) (regarding a credit agreement with the Republic of Brazil insured by Eximbank); letter from Comptroller of the Currency to Warren W. Glick, Esq., General Counsel of Eximbank (July 18, 1984) (regarding a credit agreement with *Petroleos Mexicano* (PEMEX), the Mexican state oil agency).

Lending Limit Act,[27] loans and extensions of credit secured by unconditional take out commitments of a federal government entity are not subject to any limits based on capital surplus.[28]

C. FCIA Claims

In fiscal year 1981, FCIA processed 1000 claims and paid out $19.7 million.[29] This includes $15.1 million for commercial losses and $4.6 million for political losses.[30] In fiscal year 1982, FCIA processed 1500 claims and paid out $34 million.[31] In fiscal year 1983, FCIA processed 40,000 claims equalling $190 million, including $76 million in commercial claims and $114 million in political claims.[32] Additional claims of $229 million were filed in 1983 but processed throughout 1984.[33] In total, nearly $750 million was paid out for 1983 claims.[34]

D. *N.F. Industries v. Eximbank*[35]

Eximbank is litigating a claim involving the insurance policy's transfer risk provisions in *N.F. Industries v. Eximbank.* The claim arose when the Government of Argentina issued decrees on April 22, 1982, prohibiting the exchange of Argentine pesos into United States dollars or other nonlocal currencies. N.F. Industries (N.F.) accepted payment in the United States dollar equivalent of pesos on the date of payment. Eximbank has taken the position that N.F.'s acceptance of payment in pesos precluded it from receiving transfer risk coverage.[36]

IV. NEW DEVELOPMENTS

A. New FCIA Multibuyer Policy

Eximbank and FCIA are developing a new Multibuyer Policy which would give exporters the option to obtain equal coverage for political and commercial risks. Equal coverage would eliminate uncertainty and con-

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27. 12 U.S.C. § 84(c)(5) (1982).
28. *Id. See also* Letter from Comptroller of the Currency to Peter D. Rowntree, *supra* note 26; letter from the Comptroller of the Currency to Warren W. Glick, *supra* note 26.
29. Wilson, *supra* note 4, at 56.
30. *Id.*
31. *Id.*
32. *Id.*
33. *Id.*
34. *Id.*
35. Nos. H-83-5450 and H-83-5526 (S.D. Tex., filed Oct. 19, 1983).
36. Letter from Peter J. Vatter to L. T. Nicol (Sept. 17, 1982).

flict in post-default determinations by Eximbank on whether the cause of loss was commercial or political.

B. The Central American Trade Credit Insurance Program

Eximbank and the Agency for International Development created a $300 million Trade Credit Insurance Program (TCIP) to help Central American countries obtain financing.[37] Under the TCIP, United States' banks extend lines of credit to banks in Central America which have their governments' guarantees. Participating Central American banks draw from the lines of credit to extend financing to local importers of United States goods and services. Eximbank's export credit insurance provides repayment protection for the United States lending bank. These programs were set up in response to recommendations of the National Bipartisan Commission on Central America.[38]

C. Expropriation Coverage

This coverage supplements the private insurance market, providing expropriation coverage for assets (especially aircraft) on long-term lease, or for goods abroad on consignment or being used to provide services (e.g., drilling rigs or construction equipment). An expropriatory act is defined as any act of expropriation taken or authorized by the government of the host country which would prevent the insured from exercising its rights with respect to the property.[39]

V. CONCLUSION

Eximbank offers a variety of programs which can protect against inconvertibility and transfer risks in trade finance. This outline summarizes several features available under current policies to provide credit enhancement in difficult export markets. For detailed information, Eximbank's helpful staff should be consulted directly.[40]

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37. The Trade Credit Insurance Program, authorized for fiscal year 1985, was designed to facilitate short-term financing for United States exports to the Central American private sector. Although all Central American countries are eligible under the TCIP, Costa Rica, Guatemala, El Salvador, and Honduras have been the most active.

38. H. KISSINGER, REPORT OF NATIONAL BIPARTISAN COMMISSION ON CENTRAL AMERICA 49 (1984).

39. USER'S GUIDE, *supra* note 10, XII-3.

40. *Supra* note 14.