SEA Europe Position Paper
International Working Group (IWG) on Export Credits

Updated March 2018

Executive Summary

In order to pursue the target of a global agreement on export credits (between both OECD-countries and non-OECD countries), the International Working Group (hereinafter referred to as "IWG") on Export Credits was created in 2012 as an international – global – negotiating forum, following a high level political initiative by the US and China. Since then, discussions within the IWG have been addressing both horizontal and sector specific issues - including *inter alia* shipbuilding - with the final aim to reach an agreement on export credit terms and conditions ("IWG Understanding"). SEA Europe has been strongly supporting the establishment of an international shipbuilding export credit system between both OECD-countries and non-OECD countries which could foster transparency and global level playing field. As a key stakeholder, SEA Europe has been contributing to the IWG discussions addressing both principal approaches as well as technical recommendations based on its member companies' practical experiences. SEA Europe advocates a balance between keeping ship financing attractive and avoiding over-utilization of the system and risk of creating leeway for less qualified market players. The present paper outlines the SEA Europe's views and comments as submitted in the context of the previous rounds of discussions.

1. ***General Approach:***

SEA Europe is of view that:

- The IWG Understanding should cover newbuilding (e.g. vessels and offshore units), marine equipment, repair, conversion, retrofitting and upgrading.
- Both monetary thresholds and technical thresholds should be exceeded to achieve coverage by the IWG Understanding, partially differentiated according to market segments:
    - Technical threshold of 1,000 CGT (without differentiation)
    - Monetary threshold of SDR 10 million for newbuilding; SDR 5 million for repair, conversion, retrofitting and upgrading. For marine equipment, SEA Europe would be fine with a universal threshold of SDR 5 million or (alternatively) with a threshold of SDR 5 million if the marine equipment is installed e.g. as part of

a repair but to have this figure increased to SDR 10 million if the marine equipment is installed as part of a newbuilding.[1]

- The concept of setting minimum premiums and minimum interest rates should be supported – this will improve transparency and avoid unnecessary competition among all Export Credit Agencies' (ECAs). They would eliminate competition on financial terms and leave shipbuilders to compete on technical and product matters.
- Based on the experiences with the current OECD Ship Sector Understanding (hereinafter referred to as "SSU"), especially for minimum premiums and minimum interest rates, the "net effect" for the ship-owner needs to be calculated. The efforts to agree e.g. on minimum premiums are futile if the ship-owner is supported by the member state / ECA at another point not designated "premium" but having the effect of lowering the premium. Hence, benefits for the ship-owner should become part of the "net effect" calculation – regardless how the benefit is designated and in what connection it is granted.
- Transparency is the key: The IWG Understanding is only "lived out" in case there is an open and retraceable mechanism for transparency, information sharing and monitoring. This also avoids any violations of the IWG Understanding e.g. by illegal government support or the abovementioned artificial increases of the Contract Prices. Under the current SSU, there is suspicion regarding excessive state support from Asia – but nobody is really able to evidence such violations under the current SSU.
- Transparency and information sharing would avoid an inappropriate competition between the ECA's for the lowest premiums and lowest interest rates – and without such competition, the long-term character of the ship-financing will also be supported. Thus, it is important that the set of rules is clear enough and equally applicable for every exporter.
- There should be a balance between keeping ship financing attractive (and making it more attractive / comparable) and avoiding over-utilisation of the system. The member states, ECA's, financing banks and shipyards need to be able to manage all requirements also on the long-term perspective so that the exposure should not be increased extensively – reduced to the core, each coverage increases the exposure.
- There should only be very limited exceptions and differentiations in order to avoid circumventing the rules and intentions of the IWG-Understanding and in order to prevent participants from creating windows e.g. for less qualified projects or excessive support. Not each measurement related to shipbuilding can be covered by the IWG Understanding – and if e.g. the threshold figures are not reached, no coverage can be granted. Should there be any leeway for member states considering measurements as eligible although the threshold figures are not reached, then the threshold figures are finally irrelevant.
- A "selection process" should remain alive to avoid e.g. market participants from entering the market for a short term only. Hence, we should not allow the generation of a speculation bubble.

[1] Typically during a newbuild project higher values are reached (« package deal »).

2. ***Technical and Commercial Details:***

a) Maximum repayment term (MRP):

The repayment term needs to start – like under the current SSU – with the ship-owner taking **delivery**, e.g. of the ship, because at that point in time the yard should get entirely paid. Delivery date of the vessel can be determined very precisely as a starting point and is thus a transparent criterion. Different criteria for determining the starting point would create unclarity in the market, making the financing structure more complicated with the risk of generating misuse affecting level playing field in export credit financing.

Starting from this, a maximum repayment term of 8 years for projects with a Contract Price being lower than SDR 10 million is supported by SEA Europe.

Beyond this, **a maximum repayment term of 12 years for newbuilding projects (like under the current SSU) is clearly preferred, in particular – but not only- for cruise ships.** In the past it has been proven that a 12-year maximum repayment period works well and is also attractive to shipowners. As only sustainable projects shall enter the market, longer MRP are counterproductive. Longer MRP, indeed, means more doubtful and weaker financial strength on the customers' side which is likely to create a disadvantage for the European shipbuilding industry. Longer financing could be costly and risky for both ECAs and banks which could in turn face problems on extending the repayment period.

In case compromises need to be made, a maximum repayment term of 15 years would also be acceptable – if e.g. a threshold value of SDR 100 million is exceeded.

Hence, the 12 years should remain valid or (alternatively) there is some kind of graduation possible:

- Contract Price below SDR 10 million = 8 years repayment term
- Contract Price above SDR 10 million and below SDR 100 million = 12 years as repayment term
- Contract Price above SDR 100 million = 15 years as repayment term

Finally, it is important to add that the "contract value" should **not** be a factor in determining the MRP, as suggested by some delegation in the past, since this would invite to misuses, e.g. artificially increasing the contract values to possibly increase the MRP term which would ultimately distort the market. Equally, "export value" or "total delivered costs", besides being very difficult to define, will be in contrast with project-transparency, making project -comparability more difficult.

b) Balloon Payment Scheme

In accordance with the above-mentioned general statements and the statements on the maximum repayment term, SEA Europe considers any form of **balloon payment scheme should be avoided.** This goes e.g. back to the principle that a balloon payment scheme attracts less qualified market players – and this is even more valid if the maximum repayment term is also increased.

Hence, the exposures of the ECA's, the financing banks etc. would increase – also under consistent market conditions without additional market players – since the repayments would be a) generally lower and b) received later. Accordingly, also only with balloon financing – but without increased repayment terms – there will be some kind of "bundle risk" created.

Additionally, SEA Europe considers "any form" of balloon payment scheme as very critical since a structure like limited balloon payment scheme is finally changing the repayment profile and might "invite" some participants for circumventions – even if certain precautionary measures like weighted average life of credit term etc. are incorporated.

Moreover, balloon terms would be very difficult to determine

c) Minimum advance payments and minimum equity requirements

SEA Europe prefers both 20% as minimum advance payments and 20% as minimum equity requirement. Both requirements ensure that only ship-owners or project partners will become part of the business (and therewith benefit from coverage by the IWG Understanding) which incorporate the necessary degree of financial strength and provide the financing banks & ECA's with a "practically working" business case instead of an only "theoretically working" business case. The latter would e.g. become working with low reserves for equity and lower advance payments – hence all risks would be postponed. Further, both items could invite ship-owners to place tactical / speculative orders e.g. to sell the delivery slot or the ship itself.

Reducing the amount of pre-payments would generate additional risk for the shipyards and additional moral hazards for the ship owners. Our proposal to re-balance the risks is to keep the 20% equity requirement but have a higher amount of advance payments during construction. To facilitate this, the system should explicitly allow – at least for financially stronger customers – for pre-delivery financing (i.e. financing of the advance payments). This would generate lots of benefit for the yards and would contribute to mitigate the "bubble risks" for the system. Equity for the ship owner would be the same and interests and principal would be repaid starting from the delivery of the vessel.

In case a compromise has to be made, advance payments amounting to 15% would finally be acceptable but the equity requirement should remain at 20% – as under the current SSU.

3. Conclusion

The European shipbuilding industry strongly supported the establishment of an international shipbuilding export credit system between both OECD-countries and non-OECD countries. Only such a global system is able to cover the needs of the European shipbuilding industry – the competition takes place globally, so such systems need to be negotiated & concluded globally as well. It is of vital importance that the new export credit system should be able to provide an improved – and more comparable – level playing field with increased transparency and information sharing. Any loopholes that could lead to abusive use of the ship-financing system or excessive / illegal support should be closed. An appropriate balance needs to be found between the attractiveness of the ship-financing system and the long-term character of the same system. In very broad terms, each facilitation for one party leads to additional needs for another party (e.g. lower advance payments for ship-owner = higher construction financing needs for shipyard). SEA Europe looks forward to a continued engagement in the upcoming discussions, a well-functioning system of export credits being indispensable for the European maritime technology industry.

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Background Note

SEA Europe, the European Ships and Maritime Equipment Association, is the voice of the European maritime technology industry. SEA Europe promotes and supports European business enterprises which are involved in the building, construction, maintenance and repair of all types of ships and other relevant maritime structures, including the complete supply chain of systems, equipment and services. The EU 28 maritime technology industry is currently the leading global region in terms of aggregated production value of shipbuilding and ship systems production (EUR 112.5 Billion), and an important generator of employment (900.000 direct and indirect jobs).

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