Improving Export Credit Agency Impact Through Full Faith and Credit

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International trade requires sufficient, reliable, and affordable sources of financing. Export credit agencies (ECAs) fill trade finance gaps by offering financing, insurance and guarantees to provide liquidity or mitigate risks. They help to create or secure jobs in the domestic economy. However, comprehensive government support is required to create significant impact. This includes 'full faith and credit' of the state. In the context of public foreign trade promotion, full faith and credit is defined as an explicit, direct or indirect, irrevocable, legal commitment to accept all liabilities of an ECA as unconditional obligations of the respective government. Our policy recommendations for countries with relatively young ECAs, for example in Ukraine, Armenia, and Malawi, are to establish a full guarantee in addition to an efficient legal set-up, sufficient capital, and sound risk management of the respective agency. Without full faith and credit, policy goals of fostering economic growth through foreign trade fall short.

Keywords: trade promotion, trade finance, export credit, export credit agency, export-import bank, full faith and credit, government guarantee

1 INTRODUCTION

Export promotion and the generation of foreign exchange earnings are key priorities not only for highly industrialized countries but also for emerging markets and developing economies (EMDEs), as well as least developed countries (LDCs). Firms' internationalization drives efficient allocation of resources, better capacity utilization and technological improvement. In many EMDEs, for instance, local production and export of finished products must be enhanced, moving away from exporting mainly raw products. Export diversification also helps LDCs to achieve sustainable growth, making countries less vulnerable to external shocks such as severe weather events. Horizontal export diversification into new sectors generates positive externalities on economies as export-oriented sectors gain from contacts

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with importers. Vertical diversification into technology-driven exports is also linked to growth, exhibiting strong spillovers.

As discussed by Chor and Manova (2012), Auboin and Engemann (2014), Klasen (2014) and Oramah (2020), financing and insurance or guarantee gaps lead to export barriers and insufficient commercial offering for trade-related finance. Exporters' demand for financing and risk mitigation includes funded and non-funded products for both pre-shipment and post-shipment. Pre-shipment finance can be defined as equity or loans for innovation and capital expenditure investments, as well as working capital needed for the fulfilment of specific export transactions. Post-shipment supplier credits are common short-term trade finance instruments extended by exporters to foreign buyers. With growing economic diversification focusing on exportability, there are also significant medium- and long-term export credit needs. Access to financing is the most relevant very difficult element in many countries, causing export barriers (Beck and DiCaprio, 2020). This applies, in particular, for exporting small and medium-sized enterprises (SMEs).

In this article, we discuss how to significantly improve the impact of export credit agencies (ECAs) and export-import banks (EXIMs) by ensuring comprehensive government support through 'full faith and credit'. Surprisingly, a systematic analysis of this key aspect of trade policy, and what role the government plays, is lacking, despite the long history of officially supported export credits. Full faith and credit in the context of public foreign trade promotion can be defined as an explicit, direct or indirect, irrevocable, legal commitment to accept all liabilities of an ECA or EXIM as unconditional obligations of the respective government. We assess three institutions without full faith and credit which have been recently established or received additional mandates as an ECA: The Export Development Fund (EDF) Malawi established in 2012 with an ECA mandate since 2023, the Export-Import Agency of Armenia (EIAA) created in 2013 and operational since 2015, as well as the Export Credit Agency (EKA) of Ukraine which was founded in 2018. Furthermore, we look at three well-established peers: Export Development Canada (EDC) was created in 1944 and is Canada's official export credit agency. Finnvera was created in 1998 and is Finland's official ECA, as well as the state-backed financier of the domestic SME sector. Exportno-importná banka Slovenskej republiky (Eximbanka) was established in 1997 as a specialized financial institution, acting as Slovakia's official ECA. Our arguments for a necessity of strong support with full faith and credit are as follows:

The role of governments in the economy has evolved from marginal to central in the last century. States around the globe use broad toolboxes of economic promotion instruments. With foreign trade promotion, governments help firms to develop and secure economic activities in international markets. The main reason for this public intervention is the strong positive relationship between growth and some measure of openness (Edwards, 1993; Sachs and Warner, 1995; Baldwin, 2003). ECAs and EXIMs are governmental or quasi-governmental organizations which primarily grant, guarantee or insure export credits for the promotion of foreign trade. They create and safeguard jobs, responding to market failure. In 2021, ECAs and EXIMs financed, insured, or guaranteed more than USD 2.5 trillion cross border-trade and investment together with private insurers. This is equivalent to 13% of world cross border trade for goods and services (Gianturco, 2001; Klasen, 2011; Felbermayr and Yalcin, 2013; Hale et al., 2021).

Although many ECAs and EXIMs can rely on full faith and credit, in particular in highly industrialized countries, there is a significant number of institutions without this comprehensive government support, including EIAA in Armenia and EDF Malawi. The same applies, for example, for the new ECA in Mongolia and Etihad Credit Insurance (ECI) in the United Arab Emirates. EKA in the Ukraine also lacks full faith and credit, currently discussing how to implement a full state guarantee. The key challenge to deliver on their foreign trade promotion mandate is that only comprehensive government support of the ECA and EXIM will safeguard a level playing field for businesses in a country relying on these institutions.

Our recommendation is to ensure comprehensive government support for public trade finance and de-risking instruments not only through sufficient capital and sound risk management but also via full faith and credit of the state. The remainder of this article is structured as follows: In section 2, we lay out the background and present the role and relevance of ECAs and EXIMs. In section 3, we explain in detail how strong foundations, i.e., legal set-up, capital, and risk management, create a sound basis for their impact. Section 4 explains in detail the structure, requirements, and merits of our recommendation for securing such comprehensive government support. This includes, in particular, positive rating and regulatory consequences for officially supported export credits. We give examples from successful approaches in Canada, Finland, and Slovakia and assess Ukraine, Armenia, and Malawi. The final section summarizes and recaps the main conclusions of the analysis.

2 THE ROLE AND RELEVANCE OF ECAS AND EXIMS

International trade requires sufficient, reliable, and affordable sources of financing. Imperfect information or information asymmetries between exporters, foreign buyers and financial institutions prevent mutually beneficial investment from occurring (Heiland and Yalcin, 2020; Krummaker, 2020). In line with international rules and regulations, governments step into the breach to fill market gaps, providing officially supported export credits via equity, loans, insurance or guarantees.[1] Export financing is usually a form of lending that provides funds to support exports. ECAs and EXIMs offer a range of export financing products, including direct loans, lines of credit, and buyer financing. Direct loans are provided to exporters to finance the production and shipment of goods or services. Lines of credit provide exporters with a source of financing that they can draw upon as needed, while buyer financing provides financing to foreign buyers to enable them to purchase goods or services from the exporter (Turguttopbas, 2013; Rotblatt, 2018; Franzetti, 2021). Export credit insurance is a form of insurance that protects exporters against the risk of non-payment by foreign buyers. ECAs and EXIMs provide export credit insurance to help exporters manage the risk of non-payment and increase their competitiveness in foreign markets. It covers a range of risks, including commercial and political risks. Guarantees are another product offered by ECAs and EXIMs (Kurkela, 2008; Klasen, 2011; Salcic, 2014; Grath, 2016).

ECAs and EXIMs are usually driven by additionality and catalytic effects. The concept of additionality is based on the theory of market failure. The doctrine of catalytic finance is guided by the principle that government assistance, for instance for a specific export transaction, encourages private actors to participate in the same transaction. This concept of additionality also drives the development of the Arrangement on Officially Supported Export Credits (Arrangement). It provides a related regulatory framework for the orderly use of officially supported export credits without subsidies, seeking to foster a level playing field and preventing a race to the bottom (Coppens, 2009; Dawar, 2020). The standard principle of intervention for ECAs and EXIMs is that the agency or bank is not competing with commercial institutions in the provision of the product, thereby filling a need that would otherwise be not met. In addition, ECAs and EXIMs play a crucial role in mobilizing financing from private-sector sources, creating catalytic effects in export development.

Mandates of ECAs and EXIMs focus on export-led growth policy with the main objectives to finance or insure and guarantee exports, fostering trade, generate foreign exchange earnings and helping to secure jobs in the domestic economy. Governments also look at significant positive effects on trade from the reinforcing interaction of the export credit and insurance market, and export diversity-complexity. The same applies for the support for exports with regard to positive uplift on export levels and volume of exports. ECAs and EXIMs are

1 This particularly includes regulations of the World Trade Organization (WTO) and the Organization for Economic Co-operation and Development (OECD). The Agreement on Subsidies and Countervailing Measures (ASCM) of the WTO addresses multilateral disciplines regulating the provision of export subsidies.

increasingly providing products targeted at 'trade facilitation' or 'trade creation', manifesting a shift away from traditional export financing products that are directly tied or linked to export transactions. Institutions such as Denmark's Export and Investment Fund (EIFO) and the world's first ECA UK Export Finance (UKEF) founded 1919 in the United Kingdom, that were previously more focused on insurance and guarantee provision, have introduced new financing windows to meet the gaps in the availability of liquidity from the private market to fund the transactions. Several ECAs and EXIMs also introduced new financing solutions for climate change mitigation, supporting businesses with innovation and capital expenditure loans or guarantees (Hale et al., 2020; Klasen et al., 2022).

Some ECAs and EXIMs such as EDC in Canada and Türk Eximbank in Turkey have been able to reach high impact by supporting business volumes equivalent to more than 15% of their country's foreign trade in recent years. The same applies for the Export-Import Bank of Korea (KEXIM) and Korea Trade Insurance Corporation (K-Sure) with disbursements, guarantees and insurance equivalent to more than 25% of exports in recent years (Gisiger and Klasen, 2021). Most European ECAs, for instance, support up to 3% of exports but show high impact on important technology-driven sectors such as aerospace and renewable energy. Empirical studies from Greenaway, Guariglia and Kneller (2007), Badinger and Url (2013), Felbermayr and Yalcin (2013) and Choi and Kim (2021) demonstrate a range of positive impacts resulting from ECAs and EXIMs. Export multipliers of 0.7 to 2.8 due to officially supported export credits have been discussed. Results show that a 1% increase of export credit is correlated with 0.5% to 12% additional exports. Furthermore, there is evidence that more credit-constrained firms are less export-oriented. Egger and Url (2006) also provided an econometric assessment of commitments by the Austrian ECA based on a gravity model. Results show that there are significant but relatively small short-term effects on exports, as well as robust and sizeable long-term effects of export credit guarantees, ranging from 0.44 to 0.5 in elasticity levels. A 1% expansion of guarantees generates an up to 0.5% long-term export increase. From these figures, a multiplier of 2.8 can be derived, i.e., USD 100 of export guarantees generate USD 280 additional exports. Felbermayr and Yalcin (2013) gave evidence that German sector-specific exports to a specific destination market, i.e., a country-industry pair, for which export credit guarantees were available/had been used, were 17.3% higher as compared to a market sector for which those guarantees were not available/had not been used.

3 FOUNDATIONAL REQUIREMENTS

Reaching high impact requires not only comprehensive government support but also appropriate foundations of an ECA or EXIM. These requirements include the legal set-up, the capital or authorization of the institutions, as well as the risk management approach and risk frameworks. The rationale of this section is to create a sound basis for the analysis of full faith and credit as a key success factor for ECAs and EXIMs.

3.1 Legal set-up

There are three main forms of officially supported export credit operations (Kim, 2020; Heard and Laryea, 2021): First, an ECA or EXIM might be part of the government. One example is the export finance instrument of the United Kingdom. UKEF is one of 23 ministerial departments together with, for example, the Department for Business, Energy & Industrial Strategy, or His Majesty's (HM) Treasury. Second, the agency can be embedded in a commercial organization, acting on behalf and for the account of the government. For instance, credit insurer Allianz Trade[2] manages the official export credit insurance programme on behalf and for the account of the German Federal Government. Third, countries design ECAs or EXIMs as an agency of the government, or as a state-owned independent legal entity.

This article focuses on the third form because many successful ECAs and EXIMs globally are agencies or government-owned independent legal entities. Legal forms vary, i.e., some institutions are an agency of a central government, some are independent public companies, and others are state-owned joint stock companies. Looking at international set-ups, there are numerous examples for this model such as EIFO in Denmark, EXIM Malaysia, Export Finance Australia, India Exim Bank, Indonesia Eximbank, Swiss Export Risk Insurance SERV in Switzerland and Türk Eximbank.

We focus on institutions in Canada, Finland, and Slovakia in order to assess best practices on different continents: EDC is established as a statutory Crown Corporation since 1969, acting as an agent on behalf of the government.[3] The Canadian ECA offers lending, guarantees and insurance, bonding products, small business solutions, and support to foreign direct investments (FDI) and investments into Canada.[4] Finnvera is a specialized joint stock financing company fully owned by the government of Finland. It offers loans, guarantees, export credit insurance,

[2] Trademark of the Allianz Group's credit insurance subsidiary Euler Hermes Group S.A.S.
[3] Export Development Act (R.S.C., 1985, c. E-20), para. 18.
[4] Furthermore, EDC provides direct venture and growth capital investments, as well as knowledge products. Canada's development finance institutions FinDev is a wholly owned subsidiary.

bonding products, interest equalization and FDI support. Eximbanka is an independent legal entity established by law and fully owned by the government of Slovakia. The bank provides support to exporters through export-related banking activities including direct credit, refinancing, investment loans and guarantees, as well as insurance and reinsurance offerings.[5]

Looking at younger ECAs, EDF in Malawi is an incorporated private limited company according to Malawi's Companies Act, founded in 2012. EDF is wholly owned by the Reserve Bank of Malawi (RBM), the country's central bank. The fund provides a venture capital facility, loans for exporters and manufacturing guarantees, adding a standard ECA product portfolio in 2023. EIAA is a closed joint-stock insurance company in line with Armenia's Law on Joint-Stock Companies. It was established in 2013 and is wholly owned by the Republic of Armenia (Abgaryan and Rosenthal, 2017). EIAA provides pre-export financing insurance and post-shipment export credit insurance. EKA is a joint stock company wholly owned by the Ukrainian state, offering short term trade credit insurance, export related guarantees and working capital loan guarantees.

3.2 Capital

The standard approach of ECAs and EXIMs acting as agencies or owned by the government is either to have a government authorization from the state budget, or to issue ownership shares held by the government (Gianturco, 2001). Many institutions in developed economies are well-capitalized with shareholders' paid-in equity. Capital injections and increased authorizations in the past few years were often driven not only by single events but also by poly-crises, i.e., the Global Financial Crisis 2009, the Euro crisis, the Covid pandemic, as well as climate change.

Furthermore, some ECAs and EXIMs have access to additional funding through a callable capital facility from the government. This applies not only for multilateral institutions but also for some national agencies. National jurisdictions can differentiate between: authorized capital, i.e., the amount of capital an institution is authorized to issue; issued capital, i.e., the part of the nominal capital which is actually issued; subscribed capital, i.e., the amount of the nominal value of shares which have actually been taken up; paid-up capital, i.e., the called-up capital which is actually paid up; as well as callable capital, i.e., the portion of capital

[5] In addition to export-related operations, Eximbanka provides guarantees and credit to importers with the aim of supporting the government's strategy of promoting trade and employment.

subscribed to but not yet required to pay to an entity.[6] The purpose is to serve as a capital source that can be called upon if certain circumstances arise, for example experiencing substantial losses, or anticipating severe losses that exceed the current paid-in capital reserves. In addition, some ECAs and EXIMs fund their balance sheet through capital markets financing instruments, such as short-term commercial paper and long-term instruments. Qian (2022) and Jennekens and Klasen (2023) discuss that bonds intended to encourage sustainability and support green investment have become much more relevant, particularly from a climate finance perspective.

EDC's authorized share capital was substantially increased in 2020 to CAD 15.0 billion (USD 11.1 billion). Furthermore, the Canadian ECA funds its balance sheet through capital markets financing instruments such as short-term commercial paper and medium-term notes. EDC was the first Canadian financial institution to issue a green bond in 2014. Finnvera's equity amounted to EUR 0.9 billion (USD 1.0 billion) in 2021. In addition, the Finnish ECA funds its balance sheet through international bond markets, seeking to diversify source and maturity. Main funding programmes are a EUR 15 billion (USD 16.0 billion) European medium-term note (EMTN) programme established in 2019 and a EUR 3 billion (USD 3.2 billion) commercial paper programme established in 2021. Eximbanka's equity is EUR 0.3 billion (USD 0.3 billion). The bank is not active on capital markets but cooperates with multilateral institutions for additional funding. In 2020, Eximbanka signed a loan agreement with the European Investment Bank (EIB) in order to support SMEs and mid-caps.

In Malawi, EDF's total equity amounted to MWK 9.2 billion (USD 8.9 million) by the end of 2019. According to EDF's Mid-Term Review Report on its Strategic Plan 2018–2022, it is the fund's goal to increase the capital to an amount equivalent to USD 50 million. EIAA's share capital amounts to AMD 1.5 billion (USD 3.6 million). Together with a statutory general reserve and retained earnings, the total equity of the Armenian agency added up to AMD 2.4 billion (USD 5.7 million) by the end of 2020, a very small equity base given its mandate to support Armenian exporters with de-risking solutions and provide accessible financial resources to SMEs. Ukraine's EKA has been created with a relatively low capital of UAH 200 million (USD 5.4 million). In 2022, after the beginning of the Russian war against Ukraine, the capital was increased tenfold to an amount of UAH 2 billion (USD 53.9 million) (Janus, 2022).[7]

[6] Export Finance Australia is an example for a national ECA with formal regulations for callable capital.

[7] *See also* Law of Ukraine 'On financial mechanisms to stimulate export activities' No. 2154-IX of 24 Mar. 2022.

3.3 Risk management

ECAs and EXIMs require a robust risk management framework and systems linked to business strategy and objective-setting to identify, assess, monitor, and manage their risks. Many institutions have developed sophisticated Enterprise Risk Management (ERM) frameworks. Credit risk is central to risk-taking of agencies and is a well-understood and defined risk for most ECAs and EXIMs. There is also a growing importance of other risk management aspects, concerning their own market risk and liquidity risk (Salcic, 2014). The wider ERM is recognized as increasingly relevant to long-term viability. As financial institutions, ECAs and EXIMs are now often following private commercial bank and insurance risk management principles and practices.

Several agencies such as EIFO and UKEF have introduced highly sophisticated risk management systems based on risk classification systems and rating tools. Furthermore, country risk classifications are a fundamental building block of the Arrangement on minimum premium rates (MPR) for credit risk.[8] Some agencies calculate economic capital, which is the capital required to cover the potential risks being incurred. These economic capital calculations include credit risk and contingent currency risk. In addition, many governments have created maximum authorizations or exposure limits for their ECA or EXIM which then have implemented their own internal portfolio or exposure limits, for example regarding countries, sectors, or foreign buyers. In Germany, for instance, the Federal Government grants cover within the 'statutory maximum exposure limit' which is fixed by parliament every year under the annual Federal Budget Law.

Furthermore, reinsurance as well as coinsurance have been a common approach for several decades. This can be an important solution for ECAs and EXIMs regarding their unfunded products, particularly for entities with limited financial capacities or substantial eligibility restrictions for foreign content. The concept of reinsurance is critical for capital management, as reinsurance can be seen as a kind of shadow capital. Highly sophisticated ECAs and EXIMs have numerous coinsurance and reinsurance agreements with other ECAs and EXIMs. Furthermore, several agencies increasingly use private markets. On a single transaction basis, reinsurance can be found via a facultative reinsurance arrangement. On a portfolio basis, treaty reinsurance is often regarded as a superior approach.

For example, EDC's ERM includes a three-lines-of-defence model (3LoD), an industry best-practice approach to risk governance and clear risk appetite articulation. In line with the Basel II Advanced Internal Rating-Based (AIRB)

[8] A claims example is described in M. Bärtl & S. Krummaker, *Prediction of Claims in Export Credit Finance: A Comparison of Four Machine Learning Techniques*, 8(22) Risks (2020), doi: 10.3390/risks8010022.

approach, credit risk is tied to probability of default (PD) and loss given default (LGD). EDC is measuring its internal capital adequacy via a documented internal capital adequacy assessment process. Numerous reinsurance and cooperation agreements exist. Finnvera has defined risk appetites for all major risk types and monitors market risks, liquidity risks, operational risks, and credit risks, issuing an internal credit rating. The rating includes PD and LGD. Finnvera uses an economic capital framework and has numerous reinsurance agreements.[9] Eximbanka also applies a 3LoD risk approach, monitoring operational risks, market risks and liquidity risks, complying with the prudential rules of the Slovakian Ministry of Finance. Credit risks are assessed in line with an internal assessment model based on scoring and internal rating of the clients.

EDF in Malawi applies an ERM policy and an ERM framework for an effective risk management. The fund implemented a 3LoD model with business and risk departments, as well as a credit committee. EDF also aims to close existing gaps in the risk management system such as reinsurance arrangements for risk mitigation. This is currently missing. EIAA has created a risk framework in line with national insurance regulations and international reporting standards. Furthermore, the ECA developed a benchmark-based financial model that scores buyers against industry data. The scoring system reflects a weighted approach to risk appetite and provides an early warning system to prospective risks. EIAA reinsures its risks with a private international reinsurer. The Ukraine established a very detailed risk management system for EKA, replacing partial and insufficient previous rules. The ERM does not only cover, for instance, capital adequacy and solvability coefficients but also mandatory reporting procedures, provisioning of insurance, prudential and other reserves. A 3LoD model is established, but a bold panel of reinsurers is missing.

4 FULL FAITH AND CREDIT AS A KEY SUCCESS FACTOR

Based on the foundational requirements discussed above, section 4 explains in detail the structure, as well as requirements and merits of our recommendation for securing full faith and credit as a core government support activity. Only this full faith and credit will safeguard a level playing field for businesses in a country relying on ECA and EXIM due to critical aspect of rating and regulatory issues.

9 Finnvera calculates economic capital with a commonly used credit risk model (VaR and Expected Shortfall). Although not required to do so, Finnvera calculates its capital adequacy in line with Basel III. The government has set a minimum capital adequacy target of 15% for Finnvera's domestic operations, while no target is set for the export operations. However, maximum authorizations exist, e.g., EUR 38 billion (USD 40.6 billion) for export credit guarantees.

4.1 The full faith and credit approach

The term 'full faith and credit' originated in the constitution of the United States (US) and refers to the obligation that state courts are required to accept laws and court decisions of other states (Vines, 2008; Schmitt, 2013; Woolhandler and Collins, 2014). Today, it is used in a much broader understanding and extends to financial obligations. In short, full faith and credit means that the state bears the obligation to be fully responsible for the actions and resulting financial obligations of its institutions.

The critical question is, why a full faith and credit approach is of such a high importance for ECAs and EXIMs. The answer is in most cases directly linked to the legal nature of the respective institution: As discussed above, many public agencies and state-owned banks around the globe are incorporated in the form of a private law entity. In such a venture, the state holds directly or indirectly a majority of shares, in most cases between 51 and 100%. From a legal point of view, however, this means that there is a risk that the ECA or EXIM can legally go bankrupt, since the total liability is limited to the institution's share capital. Even an only theoretical risk of bankruptcy of a state-owned financial agency drastically reduces the trustworthiness of such an entity.

It is international best practice that ECAs and EXIMs rely on full faith and credit of their government. This provides confidence that market gaps are filled and capital relief for commercial banks is secured, creating stakeholders' trust in the institution. Government guarantees apply to non-reinsured transactions as well as reinsured exposure (and usually also operational expenditures). However, there are different approaches: First and inherent to ECA and EXIM mandates and missions, commitments create a direct obligation of the government. EDC reports to the Canadian parliament through the Minister of Small Business and Export Promotion and International Trade. The agency's obligations constitute direct obligations of the government. EDC can bind the government by its actions, with the state being ultimately fully liable for those actions undertaken by the agency within the mandate.[10] Second, ECAs and EXIMs have an explicit or de-facto legal commitment of the government through a government letter of confirmation (e.g., Eksfin in Norway) or the respective legal act. Under KEXIM's legal act, the government is obliged to make up for any losses incurred by the bank that are not covered by its own reserves. This is considered a de-facto solvency guarantee by rating agencies and other core partners, i.e., EXIMs, ECAs, commercial banks and reinsurers. Third, agencies can have full faith and credit for specific activities but not for all commitments. In Finland, there are partial

[10] *See* Moody's, *Export Development Canada. Credit Opinion*, Report Number 1339057.

government compensations for losses from domestic business. While the state compensates 50% of these losses, the remainder must be covered by reserves. Concerning export credits and special guarantees, the Finnish State Guarantee Fund steps in if Finnvera's reserves are insufficient to cover losses.[11] When necessary, the fund is supplemented by appropriations from the state budget, i.e., applying a 'waterfall mechanism'. Eximbanka has been established by a special law. This includes an explicit state guarantee except for short-term marketable risk.[12] The extensive partnerships with other ECAs and EXIMs, international commercial banks and reinsurers are predicated on this fact. However, short-term marketable risk activities are provided under 'market window' terms and do not benefit from full faith and credit.

Younger institutions such as the new Mongolian ECA or ECI in the United Arab Emirates lack a direct and unconditional guarantee although they are fully government-owned and have a public policy mandate. In Malawi, RBM's ownership of EDF goes beyond pure shareholding and includes regulation of the fund. This is a significant but not sufficient proof of state support. Since EDF's share capital is relatively low and reinsurance agreements are not in place, EDF is very much limited in its operations. EIAA faces similar challenges since its start of operations in 2015. Although several conditions for an almost certain likelihood of government such as full state ownership and board membership of government officials are met, the important factor of an explicit state guarantee for EIAA is missing. In Ukraine, significant changes to the positive have been made in the last two years. The capital increase by means of the Ukrainian Treasury, the subjection of EKA under the regulation of the National Bank of Ukraine (NBU) and the detailed risk management regulations bring EKA even closer to the Ukrainian state. There is an intention of the government now to implement a state guarantee. However, details of the new regulation have not been disclosed yet and the introduction is pending. For the time being, there is no unconditional sovereign liability of Ukraine for EKA's obligations and thus no full faith and credit.[13]

4.2 Rating

A lack of full faith and credit is reflected by rating consequences. A credit rating equal to sovereign is practically not achievable for a private legal entity acting as

11 Act on the State Guarantee Fund, 18 Jun. 1998/444 for details.

12 According to Art. 26 of the Act No. 80/1997 Coll., 'the state shall be unconditionally and irrevocably liable for the commitments of Eximbanka arising pursuant to this Act, except for commitments arising from marketable risks insurance and reinsurance'.

13 Paragraph 20 of EKA's Statute explicitly states that neither the shareholder is liable for EKA's losses nor the company for any obligations of the shareholder.

provider of state guarantees, insurance, or export loans. Relevant stakeholders such as international commercial banks, reinsurers, multilateral institutions, other ECAs and EXIMs, as well as rating agencies do not assess ECAs and EXIMs on a stand-alone basis. They tie their evaluations to those of the country due to the agency role and the guarantee provided by the government. Rating agencies gear to the integral link of the EXIM or ECA with the state, the almost certain likelihood of receiving timely and sufficient government support, and the status as the country's official ECA. ECA and EXIM ratings then mirror those of the government.[14]

Obligations of an agency reflect the application of the rating methodology for government-related issuers. Since the status of the official ECA makes obligations direct obligations of the respective government, rating agencies such as Moody's or Standard & Poor's (S&P) do not assess an ECA or EXIM on a standalone basis but instead use a credit substitution approach where ratings are tied to those of the country. Alternatively, the on-par rating of an EXIM or ECA with the country is underpinned by and reflects a guarantee provided by the government. The rating difference has an immediate effect on cost of finance. The concepts for solving this problem require additional efforts to bring the company's products on a risk level comparable to sovereign liabilities. Since the shareholding as such is insufficient, the link to the government must be boldly materialized by other means.

Because EDC's obligations constitute direct obligations of the state, debt is implicitly rated equivalent and the agency's ratings mirror those of the Canadian government (e.g., Moody's Aaa rating). Due to the fact Finnvera's debt obligations are explicitly guaranteed by the state, the agency's ratings also mirror those of the Finnish government (e.g., Moody's Aa1 rating). The same applies for Slovakia: Because several commitments are guaranteed by the state, Eximbanka has been rated on the level of the Slovak Republic (e.g., S&P A+ rating).

EDF currently has a very narrow capital base and hardly any access to longer term financing. Any bold and reliable guarantee of the Malawian state for financial obligations of EDF is currently not existing. Under these circumstances, it is not possible for EDF to receive a rating that is identical with that of the Republic of Malawi. In Armenia, rating agencies such as Moody's also take the lack of any implicit or explicit government guarantee into account. Credit opinions mention an only moderate probability of government support, taking not only into account positive aspects such as full ownership of EIAA by the Armenian government but also negative aspects including the lack of any implicit or explicit government guarantees. The current credit ratings for Ukraine (e.g., S&P CCC rating with

14 The role of an agent or the explicit, irrevocable, full faith and credit, legal commitment of the government can replace the need to obtain a separate, stand-alone credit rating for an EXIM or ECA providing insurance and guarantees. According to recent experience, however, a separate rating can be important to create trust and allow effective collaboration with other partners.

negative outlook) reflect Russia's ongoing war on Ukraine's territory and the fact that a restructuring of Ukraine's foreign currency external debt has been announced.[15] With an absence of full faith and credit, there is no realistic opportunity for EKA to receive a rating at least equivalent to the (very low) sovereign credit rating of Ukraine.

4.3 Regulatory consequences, in particular CRR

Furthermore, having regulatory clarity is of critical importance to ECAs and EXIMs. Otherwise, the government can send conflicting directions. It is crucial to find the right balance between government control and oversight versus allowing an ECA or EXIM to act efficiently and effectively. Although some entities in developing economies can have different approaches,[16] it is the international best practice that ECAs and EXIMs are only accountable to their respective government through their minister or secretary of state. Highly successful ECAs and EXIMs in developed economies are thus usually not regulated by any external banking or insurance body. For example, UKEF is a ministerial department, EDC is not subject to Canadian banking or insurance laws and EIFO is not required to follow national banking or insurance regulations.[17]

Regulatory approaches and, in particular, capital requirement regulations regarding commercial banks' export financing activities are closely related to a government guarantee for an ECA or EXIM. Non-funded products offered by an ECA or EXIM with commercial banks providing the loan are either guarantees or insurance products, qualifying as unfunded credit protection. In order for banks to use this unfunded credit protection for the purpose of capital enhancement, certain legal requirements need to be satisfied. The Basel Framework and its calculation of risk-weighted assets for credit risk defines the risk-weighting of claims on sovereigns, i.e., for ECAs and EXIMs with full faith and credit of the government. It also provides the opportunity and is critical to apply a lower risk weight to domestic banks' exposures to the sovereign denominated in domestic currency and funded in that currency. However, there are minimum requirements for commercial banks to obtain capital relief by using ECA and EXIM unfunded instruments in line with the standardized approaches for the recognition of credit

15 As agreed upon within the USD 15.6 billion 48-month Extended Fund Facility arrangement with the International Monetary Fund (IMF).

16 Indonesia Eximbank, e.g., is supervised by the Indonesia Financial Services Commission. The Central Bank only regulates the bank with regard to the payment system. The Ministry of Finance is responsible for guidance and supervision.

17 For instance, the Danish Minister of Industry, Business and Financial Affairs undertakes supervision of Denmark's Export Credit Agency and lays down the statutes for the Danish ECA.

risk mitigation: Documentation must be binding on all parties and legally enforceable in relevant jurisdictions. Furthermore, commercial financial institutions must have conducted a sufficient legal review to verify this and have a well-founded legal basis to reach this conclusion.[18]

In the European Union (EU), for example, the Capital Requirements Regulation (CRR) is addressed to supervise financial institutions. It reflects Basel III rules and contains the quantitative requirements for banks, such as the rules on capital adequacy, large exposure limits and liquidity levels. If an ECA or EXIM is an independent legal entity backed by the government, a government guarantee in compliance with Articles 213 to 215 CRR is necessary to create the full effects for lending institutions. In particular, the agency itself must have a direct, clearly defined, incontrovertible and enforceable claim against its own government.[19] Non-compliance with the CRR regulations leads to the result that lending institutions cannot apply the country rating of the government for ECA or EXIM cover but only, if available, the individual rating for this entity.

This set-up is missing in Malawi, Armenia, and Ukraine. Banks are not able to refinance or acquire export guarantees or loans issued or guaranteed by EDF, EIAA or EKA applying a zero risk-weighting for local currency exposures. Particularly for medium and long-term financing activities the full faith and credit would be indispensable. The set-up of international best practice ECAs and EXIMs complies with Article 214 CRR. EDC's Customer Financing Guarantee, for example, is compliant with Articles 203, 213 (1) and 215(1) CRR. The same applies for Finnvera and, for instance, its Buyer Credit Guarantee. The set-up of Eximbanka and its Buyer's Credit Insurance policy are also compliant with relevant CRR articles.

5 CONCLUDING REMARKS

ECAs and EXIMs enable export transactions that would otherwise not take place without officially supported financing, guarantees and insurance. Offerings not only in highly industrialized countries such as Canada, Finland, and Slovakia but also in EMDEs and LDCs including Ukraine, Armenia and Malawi safeguard existing and create additional employment, provided that new export transactions are generated by the support. The importance of ECA and EXIM offerings is

18 For further details, *see* BIS (2019) CRE20, Standardized approach: individual exposures, para. 20.4., BIS (2019) CRE20, Standardized approach: individual exposures, para. 20.5, as well as BIS (2019) CRE22, Standardized approach: individual exposures, para. 22.9.

19 For further details, see Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 Jun. 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012, Arts 213 and 214.

particularly relevant related to high-growth and simultaneously high-risk export destinations of exporters in EMDEs and LDCs such as Malawi and Armenia, looking at the current stage of economic development and diversification. Officially supported export credits provided by the national export credit agency (EKA) might play an even more important role in Ukraine, supporting the reconstruction of the economy during and after the war.

Legal set-up, capital, or authorization of the ECAs and EXIMs, as well as the risk management approach and risk frameworks of the institutions are important factors for impact. Designing an institution as a public legal entity with an agency function is in line with global best practices. It is often regarded as the most efficient and effective approach. Leading ECAs and EXIMs follow this legal set-up: EDC in Canada is a statutory Crown Corporation, Finnvera is a specialized financing company owned by the Finnish government, and Eximbanka in Slovakia is an independent legal entity fully owned by the government. Relatively young ECAs including EDF in Malawi, EIAA in Armenia and EKA in Ukraine follow this model as well. In addition, they have implemented sound ERM frameworks and internal governance structures in line with relevant regulatory requirements and international best practices. However, low endowment with capital in relation to their public policy mandates to foster economic growth through trade creates significant challenges.

ECAs and EXIMs such as EDF, EIAA and EKA step into the breach when commercial banks or private insurers do not offer sufficient facilities, i.e., they are additional. Furthermore, they enable market involvement through insurance and guarantees, crowding-in financing from private-sector sources. For commercial banks to use products for the purpose of capital enhancement, however, certain legal requirements must be satisfied. Non-funded products of ECAs and EXIMs qualify as unfunded credit protection. In line with the Basel Framework and the calculation of risk-weighted assets for credit risk, international commercial banks using unfunded ECA or EXIM products without full faith and credit do not benefit from a better risk weighting. In order to be attractive in the future, direct, incontrovertible, legally effective, and enforceable guarantees from the government in order to be compliant with CRR regulations are required. At discretion of the central banks, a 0% risk weighting can immediately be applied to domestic banks' exposures to the respective agency, denominated in and funded in the local currency. Domestic financial institutions would thus be able to effectively transfer risk from the obligor to the government.

To summarize, 'full faith and credit' of the government can be defined as an explicit, direct or indirect, irrevocable, legal commitment to accept all liabilities of an EXIM or ECA as unconditional obligations of the government. Full faith and credit is linked to an appropriate legal set-up, a sufficient funding approach and sound risk management. For young ECAs such as EDF, EIAA and EKA, the most relevant approach to create impact is a mechanism that direct obligations are backed by a guarantee of the government giving evidence, for example, with an explicit statutory commitment or a letter of confirmation provided by the respective Ministry of Finance. Only full faith and credit gives the necessary evidence for strong government relationships, leading to better rating treatment and full compliance with commercial banks' capital requirements.

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