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Fading embers

ECAs cool on their support for coal

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Fading embers

As more and more government-backed lenders withdraw from the industry, is ECA support for coal a thing of the past? By Joe Kavanagh.

In January this year, the OECD brought in a fresh set of restrictions on export credit agency (ECA) support for coal-linked transactions. The new rules impact some of the world’s most active ECAs, including some (such as Kexim and NEXI) that have been particularly busy supporting coal-fired power plants.

By turning away from coal financing, ECAs are following a recent trend. Many development banks, intermediaries and even commercial banks have begun publicly withdrawing from the industry in recent years.

Even before the OECD rules came into place, a lot of ECAs had already begun following their own anti-coal policies, notes Andrew Digges, a partner at Ashurst who has advised on power and infrastructure projects throughout Asia. Only a few ECAs were strongly supporting coal before the OECD regulations came into effect, he adds.

ECA-supported deal volumes have been on the decline for several years (see chart). After spiking in 2012 to more than \$10 billion of global support, the total annual volume has fallen each year and in 2015 was less than \$5 billion.

Because they are mostly government bodies, ECAs are bound by the political commitments of their home countries, such as those made in the 2016 Paris Agreement. The terms of this deal

require countries to limit their carbon emissions, which is hard to square with support for coal.

But even commercial banks are leaving the sector behind, with French banks having led the way on this front. Their departure shows that pressure from environmental groups and other political forces is enough to discourage support for the coal sector. Even when the economics of a particular deal are attractive, notes Alec Borisoff, a partner at Milbank, banks are not keen to be associated with the industry.

“Even when there’s a good deal to be had, because of the reputational risk they are just not willing to do it. That’s more calculus of reputation than it is of economics,” he notes.

Some investors are wary about committing to capital-intensive, long-term power plants, in an industry whose long-term viability is uncertain. But political pressure seems to be making an impact.

In the near future, new coal-fired power plants will continue to be built, because the OECD rules say that projects which were already agreed can go ahead, even if they would have been in breach of the agreement.

Despite opposition to the industry, some deals are still getting done and pricing attractively. In March this year, Nippon Export and Investment

Insurance (NEXI) supported a \$1.8 billion loan to support the Tanjung Jati B coal-fired power plant expansion in Indonesia. The syndicate featured seven international banks and priced at 130bp above Libor.

What are the new rules?

The ECA restrictions were introduced by a group within the OECD called the Arrangement on Officially Supported Export Credits (the Arrangement), which is a kind of gentlemen’s agreement that tries to encourage fair competition.

The participants are Australia, Canada, the EU, South Korea, Japan, New Zealand, Norway, the US and Switzerland.

In short, the new rules are not a ban on coal-fired power but an attempt to shift investment away from older plants into higher-efficiency, cleaner technology.

The agreement limits support for large super and sub-critical coal-fired power plants, while allowing support for smaller sub-critical plants in poorer, developing countries. In some cases ECA support is banned in total, and in others there are limits on the maximum repayment terms (see table).

It also allows support for up to medium-size super-critical plants in countries facing energy poverty challenges. There are 78 poor countries eligible for the World Bank’s International Development Association (IDA) support, and these countries benefit from exemptions to some of the restrictions.

Restrictions on support don’t apply to any plants equipped with operational carbon capture and storage, as provided under the existing climate sector understanding.

Another caveat is that ECAs are able to support coal-fired plants when

Maximum repayment terms

Plant unit size	Unit greater than 500MW	Unit between 300MW and 500MW	Unit under 300MW
Ultra-supercritical	12 years	12 years	12 years
Supercritical	Ineligible	10 years, and only in IDA eligible countries	10 years, and only in IDA eligible countries
Subcritical	Ineligible	Ineligible	10 years, and only in IDA eligible countries

Source: *The OECD*

the alternatives (renewable energy, for example) are not financially viable.

The OECD estimates that more than two-thirds of the coal-fired power projects that received ECA support from the member countries between 2003 and 2013 would not have been eligible for support under the new rules.

A knock-on effect?

The terms of the Arrangement mean that the OECD member ECAs will be seen supporting very few deals in the future. But the market is also watching to see whether those ECAs that are not covered by OECD restrictions will follow suit by turning away from coal.

Some crucial ECAs are not members of the deal: China's three ECAs are not included, for example, and nor is India's Ex-Im Bank. Both are large supporters of coal projects.

China's absence from the list is particularly significant due to its disproportionately large influence on the coal sector. The country accounts for 50% of the world's demand for coal, as well as almost of its production, according to the International Energy Agency (IEA).

Coal demand is in the middle of a major shift towards Asia. In 2000, about half of coal demand was in Europe and North America, while Asia accounted for less than half. But by 2015, Asia accounted for almost 75% of coal demand. This trend is going to continue, says the IEA.

Asia is turning away from coal more slowly than other regions due to its higher proportion of developing economies. Coal will remain a cheap source of energy for years to come, so it is attractive to cash-strapped developing countries. Without the financial resources needed to make investments in renewable energy, these countries are pursuing economic growth with the cheapest source of energy available to them. This means that development banks, whose remit is to boost growth in the countries that need it, may continue to support coal where there a few other alternatives available. Given the carve-out in the Arrangement that allows support for



Alec Borisoff

coal projects when there is a development argument to be made, this is what the bulk of ECA deals are likely to be.

"Institutions like the World Bank, IFC, and multilateral development banks and other DFIs will keep doing coal to some extent, because there is that development angle," argues Milbank's Borisoff.

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As for ECAs themselves, most were reluctant to comment when contacted by *Trade Finance*. But market sources believe that they will reduce their exposure to coal over time, even if not required to do so by the OECD.

Speculating whether China and other ECAs not included in the OECD Agreement will reduce their coal support, Ashurst's Digges says he expects some sort of knock-on effect: "They're not strictly required to follow the rules, but they're

in the same marketplace with the same political process."

Some ECA-backed deals are going ahead this year because they were agreed upon before the OECD restrictions came into force. The 300MW expansion of the Morupule coal-fired plant in Botswana, for example, is going ahead this year, financed by a Marubeni-led consortium with the support of JBIC and KEXIM. But the pipeline of deals is running thin.

With a handful of exceptions, ECA support from non-OECD agencies will be "fairly unlikely", agrees a commercial banker based in London.

"There may be a few out there, but I think it's much more likely to be directly state funded," the banker argues, and adds: "If you're a credible ECA [...] there's a certain stigma to getting involved, even if there is no other way to fund it."

The key driver is going to be how much continued pressure there is from NGOs and other pressure groups, adds Milbank's Borisoff. As he says, their influence has been the main reason for coal's unpopularity in recent years.

"I think it's dangerous to underestimate the influence of non-governmental actors and the reputational pressure that a lot of commercial banks and agencies feel in this sector", he notes.

The pressure from environmental groups is mounting each year. A few weeks ago, a decision to go ahead with a coal mining project proposed in Queensland Australia, was deferred by its developer. The Carmichael project, led by Indian billionaire Gautam Adani, is worth approximately \$12.3 billion, but has been stalled by a series of legal challenges.

The last ECA-backed coal project will not come for some years, given the need that certain developing nations have for cheap power. But given the pressure against the industry, both official in the form of OECD restrictions, and unofficial in the form of opposition from environmentalists, the final deal is now closer than ever. ■