National Audit Office

Export Credits Guarantee Department

ECGD and sustainability

BRIEFING FOR THE ENVIRONMENTAL AUDIT COMMITTEE
June 2008

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Briefing

Summary

1. This briefing has been prepared by the National Audit Office (NAO) to assist the Environmental Audit Committee's (EAC) inquiry into the Export Credit Guarantee Department (ECGD).[1] The main points are as follows:

- ECGD is a ministerial department which reports to the Secretary of State for Business, Enterprise & Regulatory Reform (BERR) and is responsible for assisting UK exporters by providing financial guarantees and insurance for export contracts in markets where commercial cover would normally not be available.
- Over the last decade, ECGD's portfolio has shrunk considerably and changed in nature. By 2007, it supported less than 1% of UK exports and its portfolio is increasingly dominated by defence and civil aerospace export business.
- Since 2000, ECGD has done much to incorporate policies and processes which seek to ensure that sustainability considerations are taken into account in deciding whether or not to approve applications for support. These meet or exceed all the requirements and expectations set out in international rules on the operation of export credit agencies.
- For all civil non-aerospace applications, including defence exports not requiring an export licence, ECGD carries out an environmental and social impact assessment and, for business involving poorer countries, a debt sustainability appraisal. In 2007-08, just 13 of the 96 exports supported by ECGD required such an assessment. Most applications appraised by ECGD are categorised as having low potential impact, although there have been some high potential impact cases such as the Baku-Tbilisi-Ceyhan (BTC) pipeline project.
- ECGD does not apply its procedures for environmental and social risk assessment to civil aerospace applications or to defence exports which require an export licence - although all such applications must meet ECGD's debt sustainability guidelines. Instead, it relies on other external assurances relating either to conformity with international environmental standards for civil aerospace projects or to BERR's procedures for granting defence export licences which take into account the appropriateness of the expenditure in terms of the economic position of the buyer country. In 2007-08, such business accounted for 87 per cent of all facilities issued, by both number and value.
- Since 2000, ECGD has never rejected an application on the grounds that it did not meet minimum environmental and social standards. Instead, where a proposed project appears to fall short of the required standards, ECGD seeks to influence project sponsors through a process of 'constructive engagement' so that standards are raised to an acceptable level during the application process, prior to ECGD's decision on whether to grant approval.

[1] The NAO study team consisted of Eric Lewis and Leo Watson, under the directorship of Joe Cavanagh.

Introduction

2. The Export Credits Guarantee Department (ECGD) is a small ministerial government department that reports to the Secretary of State for Business, Enterprise and Regulatory Reform (BERR). Its primary function is to help facilitate exports by underwriting export contracts or associated finance and reimbursing exporters or banks in the event of non-payment. It also provides political risk insurance for investments made overseas.

3. As part of its programme of work to support the Environmental Audit Committee (EAC) and at the Committee's request, the National Audit Office (NAO) agreed to provide a briefing on the operations of ECGD in order to inform a potential inquiry on this topic. The Committee subsequently set out for itself the terms of reference for its inquiry in its press release of 15 May 2008. This briefing does not seek to evaluate the performance of ECGD in relation to the many specific questions posed by the Committee but is primarily intended to provide factual and descriptive information of the operations of ECGD and the extent to which it has been able to incorporate sustainable development within its objectives. It should not be taken to represent a formal audit of any aspect of ECGD's operations.

4. While the term 'sustainable development' can involve wide-ranging social issues such as corruption and child-labour, this memorandum focuses mainly on environmental aspects of ECGD's role. This partly reflects the fact that international guidelines for export credit agencies (ECAs) focus more on environmental than on social impacts, and partly mirrors the primary interest of the EAC in environmental aspects of sustainable development. The absence of comment on other areas of sustainable development should not be taken to imply that ECGD has been inactive in these matters: indeed, it has devoted considerable effort to addressing this wider agenda both within the UK and internationally.

5. This briefing is based upon interviews with a range of ECGD staff, a review of procedural documentation, and an analysis of data for guarantees and insurances issued since 2000. We have also included in an Annex a small sample of case studies in order to illustrate how the procedures operate in practice.

6. The briefing is structured as follows:

- Background and statutory remit of ECGD (paragraphs 7 - 12)
- ECGD facilities and processes (13 – 18)
- The Mission and Status Review and the Business Principles (19 – 25)
- Case impact analysis procedures and their coverage (26 – 50)
- Analysis of the portfolio (51 – 57)
- Applying wider government policies (58 – 66)

In each section, key points arising from our review are summarised in bold.

Background and statutory remit of ECGD

7. ECGD was established in 1919 to encourage British exporters to trade after the First World War. It was the first organisation of its kind, and today most developed countries have their own ECA. The aim of ECGD is to benefit the UK economy by helping exporters of UK goods and services win business and invest overseas. It does so by underwriting guarantees and insurance policies that provide protection against the risks of non-payment of the goods and/or services supplied. Most of the support ECGD provides relates to the exports of capital and semi-capital goods and services to markets where commercial cover is not normally available.

8. From 1919, ECGD's role grew in importance until by the 1970s as much as 37 per cent of all UK exports were supported by ECGD-backed guarantees or insurance policies. Since then, this percentage has shrunk substantially. By 2007-08, business supported by ECGD amounted to only £1.8 billion – less than 1% of total UK exports in that year.[2] The declining role of ECGD over the last thirty years reflects a wide range of factors including the privatisation of its short term trade credit insurance operation in 1991 which was responsible for supporting the bulk of exports covered by ECGD, structural changes in the UK economy, the growing maturity of foreign markets, the massive growth in commercially available insurance and finance, the liberalisation of world trade, and the concomitant pressure on national governments to reduce export subsidies.

9. The 1991 Export and Investment Guarantees Act is the current statute from which ECGD derives its powers. It provided the basis for the privatisation of ECGD's Short Term Trade Credit Insurance operations, leaving ECGD to focus on longer-term business.[3] At the same time, a line was drawn under the pre-1991 debt-laden portfolio, to allow subsequent new business to be accounted for separately.[4] ECGD also adopted more commercial disciplines in its operations, whereby insurance premiums were priced according to the scale of risk, to help achieve a ministerial requirement that ECGD should operate at no net cost to the taxpayer. More recently, following a substantial Mission and Status Review in 2000, ECGD's governance has been strengthened through the introduction of a Management Board which, since 2004, has been led by a non-executive chairman, and through refocusing the remit of the Export Guarantees Advisory Council (a statutory body charged with providing advice to the Secretary of State).

10. Over this period, ECGD has also taken account of changes in international agreements and guidelines that impact on the role and operations of ECAs, which have largely emanated from the Organisation for Economic Co-operation and Development (OECD). The OECD 'Arrangement on Officially Supported Export Credits' first came into effect in 1978, but has subsequently been revised a number of times – most recently in December 2007. The Arrangement is a

[2] In 2007-08, the total value of UK exports was £225 billion (HMRC press release, 12 June 2008).

[3] ie financing deals with repayment periods in excess of 2 years where there is generally a requirement to provide guarantees to banks. In practice, repayment periods are typically five years or more for many projects and 12 years for aerospace exports.

[4] During the debt crisis of the 1980s, many developing countries defaulted on their external debts, and ECAs (including ECGD) built up substantial debit balances as a result of the need to pay out large claims to their own exporters and banks.

'gentleman's agreement' between participating ECAs although its terms have now been incorporated into EU law. Its main purpose is to help provide a level playing field and ensure that competition among exporters is based on quality and price rather than on the extent of support provided by each ECA. It does so by setting out certain minimum terms and conditions in a variety of areas (including credit terms and the minimum premium and interest rates which can be charged), and requiring ECAs to report and communicate with each other more transparently. Similarly, the Berne Union – a voluntary association of public and private ECAs and other credit and investment insurers founded in 1934 – has over the years reached Agreements or Understandings regarding terms of payment, reporting systems, and the exchange of information between its members. Its latest General Understanding dates from 2001.

11. Although the OECD and the Berne Union have sought to level the playing field among ECAs, there are significant differences in the ethos of ECAs, including their legal status, the range of business they undertake,[5] and their operational approach (e.g. in respect of risk assessment and pricing). For these reasons, comparisons between different ECAs can sometimes be misleading. The UK government has called for ECGD to continue to promote a more transparent and market-orientated international framework.[6]

12. **The primary objective of ECAs is to support exports, and this is clearly exemplified in the statutory remit of ECGD. They are intended to operate on a broadly commercial basis. Their role should be clearly distinguished from that of development banks, agencies, or departments such as DFID - all of which can offer concessional loans targeted on specific sectors and developmental goals.**

ECGD facilities and processes

13. ECGD offers a number of different types of guarantees and insurance policies ('facilities'). Typically, an exporter will decide what facilities they require and submit the appropriate application. These facilities can broadly be classified into two main groups:

- **Finance**: where a bank (normally in the UK) provides a loan to an overseas borrower in order to finance the purchase of goods or services from a UK exporter. The exporter draws down from the loan as and when goods and services are supplied under the terms of its export contract. Normally, once the contract or project is complete, the borrower repays the bank over the agreed repayment period. ECGD unconditionally guarantees repayment of the loan. Depending on the financial arrangements involved, there are several different types of finance facilities – including Buyer Credit, Supplier Credit Financing, and Lines of Credit. An example of a Buyer Credit is given below.

[5] Many still support exports sold on short terms of credit.

[6] eg Mission and Status Review, 2000

- **Insurance:** ECGD insures exporters directly against specified causes of losses – for example, buyer insolvency or political risks (including war). As with finance facilities, there are several types of insurance policies including Exporter Insurance Policy (EXIP), Bond Insurance Policy (BIP),and the Overseas Investment Insurance scheme which provides insurance cover for UK investments made overseas.

Figure 1: Example of a typical buyer credit transaction

An exporter enters into a contract with a buyer in Country X for a construction project valued at £100m. The buyer may be either a commercial enterprise or a government entity. The project is expected to take 2 years to complete. Due to the high cost, the buyer requires credit and does not pay anything during construction. However, the exporter needs to be paid as supplies are made and the work is undertaken. Therefore, the buyer takes out a loan from a bank from which the exporter draws as the goods and services are supplied. Normally, on completion of the project, the buyer then starts repaying the loan over the agreed credit period - which, typically, can range from 5 to 12 years. Because of the long term nature of the loan and the risks associated with repayment, the bank would be very unlikely to grant such a loan without some form of additional security. ECGD therefore provides a guarantee to the bank that it will repay the loan if the buyer does not do so. This effectively leaves the bank with a zero rated risk. Without the guarantee provided by ECGD, the bank would not have been able to offer the loan and the exporter would not have been able to enter into the contract. In this way, ECGD helps the exporter win the contract and 'facilitates' the export.

Source: National Audit Office

14. In addition to these two main types of facilities provided directly to exporters or banks, ECGD has powers to provide re-insurance to domestic private credit insurers who insure exports sold on short terms of credit. This power was included in the 1991 Act to assist the transfer of the Insurance Services Business of ECGD, which supported exports sold on cash or short terms of credit, into the private sector. ECGD effectively became a 'reinsurer of last resort' for this class of exports. No use has been made of this facility in recent years as the private market has proved sufficiently developed to bear such risks itself.

15. ECGD also operates a Fixed Rate Export Finance (FREF) scheme that enables UK exporters to offer medium and long term finance to their overseas buyers at officially supported fixed rates of interest. Such financing support is made available under the OECD Arrangement at minimum fixed interest rates known as Commercial Interest Reference Rates (CIRRs). Historically, the FREF scheme cost significant amounts in subsidy but, in recent years, these have been substantially reduced as CIRRs are a proxy for commercial rates and ECGD operates its FREF scheme within a restricted budget. The scheme is currently under review and the Government has tasked ECGD to explore how it might be reshaped in a way that continues to meet the needs of exporters and contain its potential cost. The majority of ECGD's business is now conducted on unsupported commercial rates of interest.

16. The financial arrangements and structures involved in some of the facilities provided by ECGD can be complex. Moreover, a single large export deal can typically involve the provision of a number of different ECGD facilities. Therefore, in examining ECGD business statistics there are

significant differences between the number of facilities entered into, and the number of deals to which these relate. ECGD may also include protection for itself in the support it provides.[7]

17. "Persons carrying on business in the UK" are eligible to obtain ECGD support. Given the complexity of many large projects, and the need for project sponsors to obtain supplies from many countries, ECGD can include some foreign content in the support it provides to a UK exporter. Until 2007, ECGD could include up to 30-40 per cent foreign content in its support, but following a review and public consultation in 2006-07, the Government agreed to extend this to 80 per cent where sufficient risk capacity exists to do so, in recognition of changes in UK manufacturing.

18. **Large projects generally involve complex financing structures which may include a number of ECAs, banks and other financial institutions; ECGD may therefore only provide support for a small proportion of the overall financing required.[8] Moreover, financing requirements are sometimes completed after some supplies and provision of services have already taken place, although ECGD seeks to ensure that its involvement in such situations 'facilitates' the export of the goods and services in question as required by its Act.**

The Mission and Status Review and the Business Principles

19. In July 1999, the Secretary of State for Trade and Industry announced a review of ECGD's mission and status – including the rationale for its continued existence and the extent to which its role was consistent with the Government's wider objectives.[9] The final report strongly affirmed that there was a continuing need for ECGD and that its primary purpose should still be to facilitate trade. However, it argued that ECGD should also use its leverage to support projects which underpin the Government's international policies to promote sustainable development, human rights and good governance. It therefore recommended that this wider remit should be explicitly reflected in a new Mission Statement, and that ECGD should demonstrate how it was taking account of it by publishing a set of Business Principles to guide its practice and policies. These Principles would constitute a set of secondary duties, in addition to ECGD's primary duty which was enshrined in the 1991 Act. The Review also suggested that ECGD could widen its customer base and liaise more closely with other Departments and business sectors to target particular export markets.

20. ECGD had already introduced earlier in 1999 an environmental questionnaire as part of its application process. However, in response to the Mission and Status review, ECGD developed a set of Business Principles and created an internal Business Principles Unit (BPU) to support their implementation. The Business Principles were published in December 2000, and the Exports Guarantee Advisory Council (EGAC) was charged with advising on the underlying policies and

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7 Eg recourse rights to the exporter to recover funds where it has paid claims to a bank in respect of a loan default by reason of the exporter's non-performance.

8 In the case of the Baku-Tbilisi-Ceyhan pipeline, for example, ECGD guarantees only related to $106 million out of a total project cost of $4 billion. See Annex A, case study 6.

9 In addition to the Review, there were three other associated reviews launched in the previous two years – namely, the Export Finance Review, the Reinsurance Scheme review, and the Risk Management review.

principles – in particular, how ECGD takes account of the wider impact of projects on overseas countries. In order to embed the Principles within ECGD procedures, the BPU then developed a Case Impact Analysis Process (CIAP), the latest version of which was published in 2004. The CIAP describes the procedures ECGD follows when it assesses all civil non-aerospace applications for any potential environmental and social impacts.[10]

21. Alongside these developments, in 2003 the OECD Export Credit Group published the '*Common Approaches on the Environment and Officially Supported Export Credits*'. This document recommended that, before taking decisions on the provision of officially supported export credits, ECAs should apply common approaches for addressing environmental issues relating to the exports of capital goods and services for which support is requested and the locations to which these are destined; and it sets out both a methodology for screening projects and baseline requirements for assessing environmental impacts. ECGD played a significant role in helping to obtain agreement on the Common Approaches, and its own Case Impact Analysis Process fulfils the requirements for undertaking the screening and reporting set out in that document. The OECD revised the Common Approaches in June 2007 although the changes were not extensive.

22. In 2004 and 2007, the OECD conducted surveys of ECAs to assess how well they were implementing the Common Approaches. Taking account of the 2004 survey, and a variety of other available information, ECGD compiled an internal report comparing all aspects of ECA operations.[11] This showed it to be one of the leading ECAs for incorporating sustainable development issues into its screening processes. For example, unlike some other ECAs, it does not make use of the threshold available under the Common Approaches to exclude from screening requirements projects below a minimum liability of SDR 10 million. Indeed, the Common Approaches represents a minimum set of standards which a number of ECAs, including ECGD, already exceed.

23. The BPU performs a key operational role in assessing projects for potential environmental impacts and ensuring that they are in compliance with ECGD's Business Principles.[12] It is staffed by three full-time ECGD staff each of whom holds environmental qualifications, and it has call-off contracts with two environmental consultancy firms to provide additional resources and specialist expertise when required.[13] Members of the BPU team also participate in international meetings with representatives from other ECAs to discuss issues relating to the implementation of the Common Approaches.

24. The BPU provides an annual report to ECGD's Management Board and the EGAC. This includes details of the number and types of cases reviewed during the year, achievements and developments in the assessment process, any further information on high impact or sensitive

[10] The procedures and their coverage are described in detail in the following section.

[11] '*Report on the Comparison of Export Credit Agencies*', 2004

[12] This is discussed in the following section.

[13] AEA Energy and Environment; and Enviros.

cases, and international developments such as any changes to the Common Approaches. In addition, ECGD's Annual Review and Resource Accounts contains a section on sustainable development that outlines how ECGD has tackled sustainability issues internally and also internationally through the provision of its support for individual projects and for policy initiatives. A review of the CIAP is expected to be carried out later this year and will take account of recent revisions to the Common Approaches.

25. **Since the Mission and Status Review of 2000 and the publication of the Business Principles, ECGD has done much to incorporate sustainable development considerations into its project screening procedures, and in assessing civil non-aerospace cases it either follows international guidelines or exceeds them. As discussed below, ECGD has been less able to respond to the wider aspirations contained in the Review, such as the widening of its customer base and the identification of particular export markets to support the government's international objectives.**

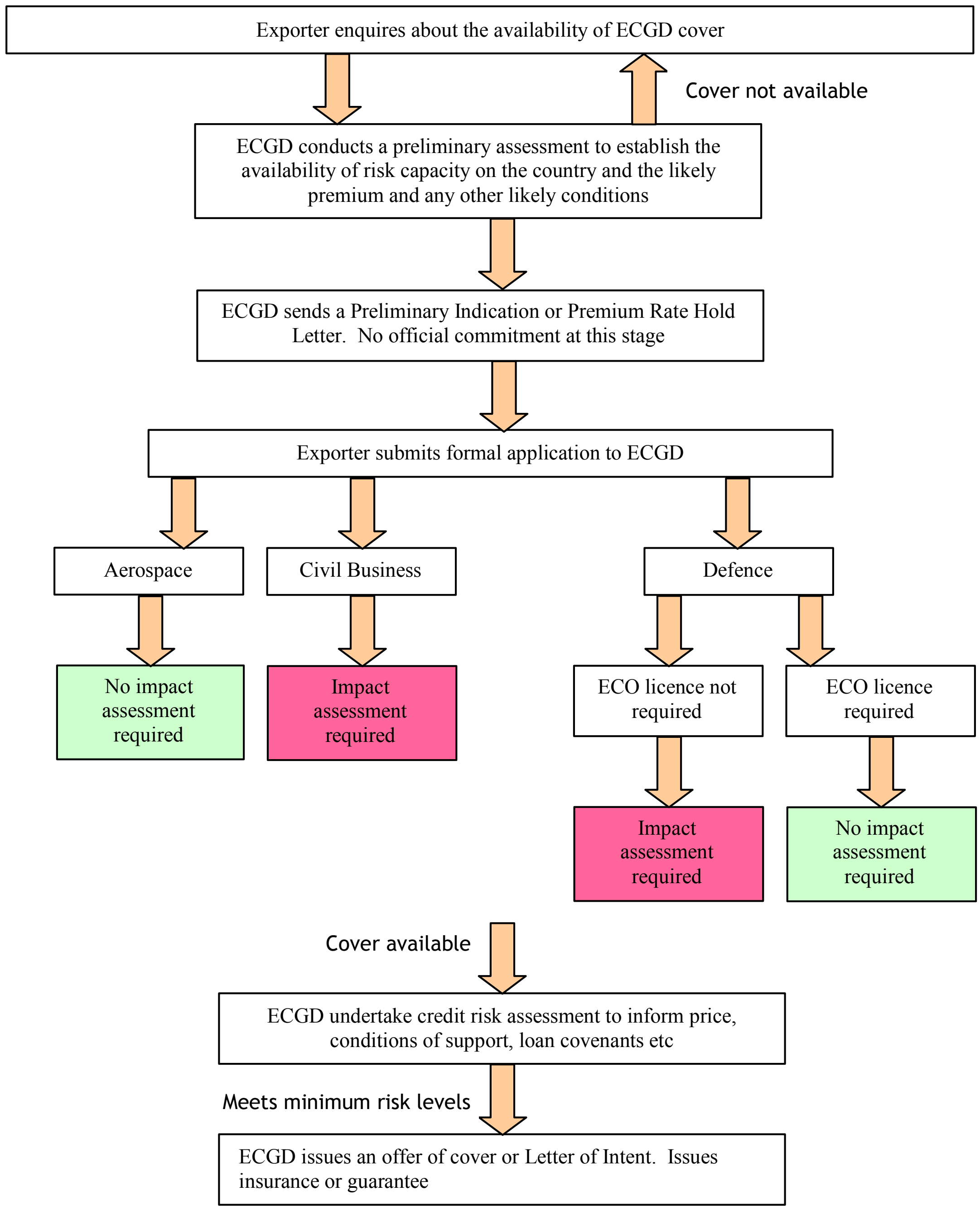
Case impact analysis procedures and their coverage

26. This section sets out the procedures ECGD follows in the case of:

- Civil (non-aerospace) and defence applications where an export licence is not required;
- Defence applications where an export licence is required; and
- Civil Aerospace applications.

27. A typical case will involve an exporter contacting ECGD to enquire if cover can be given for the country they are exporting to. ECGD issues a preliminary indication of the support that may be considered and the likely premium charge on a 'without commitment' basis. If cover is available and the exporter wants to pursue ECGD support, it submits an application form to ECGD. The application will be handled by one of the civil aerospace, defence or civil Business Managers of ECGD. In the case of civil aerospace and of defence export cases which require an export licence, an environmental impact assessment is not carried out. The following diagram sets out schematically the overall processes involved.

Figure 2: Case screening procedures - overview

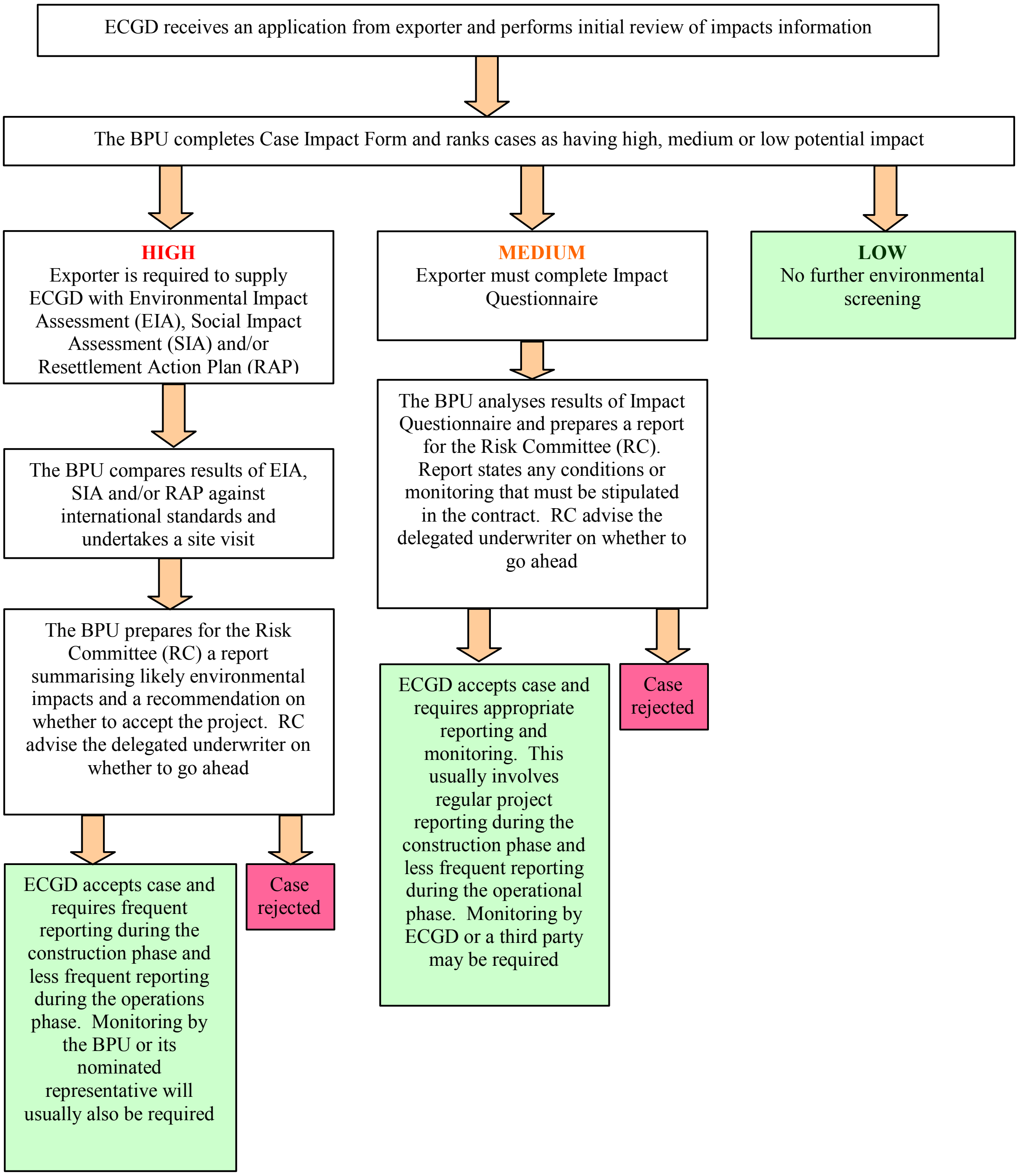


Source: NAO

Civil (non-aerospace) and defence cases not requiring an export licence

28. In the case of civil non-aerospace and defence export cases which do not require an export licence, the Case Impact Analysis Process (CIAP) is applied. The application form should contain sufficient information to enable the BPU to make an initial assessment of the case to determine its potential for having high, medium, or low environmental and social impacts. The results of this screening then determine subsequent procedures, as the following schematic diagram shows.

Figure 3: The Case Impact Analysis Process



Source: NAO

29. The initial screening carried out by the BPU is based on the exporter's response to specific questions[14] in the application form – though these do not need to be answered for defence exports that require an export licence or civil aerospace business that meets International Civil Aviation Organisation (ICAO) standards.

[14] The questions relate to the description of the exports and the overall project; whether or not the exports could be sold in the UK without modification; the current and future activities on the project site; and beneficial and adverse impacts of the project.

30. The BPU then carries out its initial screening utilising an internal checklist.[15] This is comprehensive and includes coverage of international environmental designations, adherence to human rights treaties and international labour conventions, and any potential conflicts with UK international obligations. The implications of responses in terms of impact ranking are spelt out in the CIAP. In many instances, the BPU completes the initial review within a few weeks of receiving the application.

31. Subsequent procedures depend upon the initial assessment of potential impact. For low potential impact applications, no further examination is usually required. If an application is ranked as medium potential impact, the exporter must complete a more extensive questionnaire giving further details – including, for example, the intended location of the project, the consumption of energy, minerals and ores, and the production of harmful substances. Where an application is ranked as having high potential impact, ECGD publishes basic details on its website so as to provide an opportunity for any interested parties to submit comments. It also requires a full Environmental Impact Assessment (EIA), and a Social Impact Assessment (SIA) or Resettlement Action Plan (RAP) if applicable, to be supplied. The BPU would normally expect a reputable independent environmental consultancy firm to be employed for this purpose. Such assessments can involve significant time and resources. Indeed, in the case of major high potential impact projects such as Sakhalin and the BTC pipeline, it can take months or even years before the requisite information is provided and the assessments are completed, upon which ECGD can judge the acceptability of the application for its support.[16]

32. On the basis of the information available, the BPU then assesses whether the project is compatible with the standards and guidelines set out in ECGD's CIAP and, as necessary, reports its advice to ECGD's Risk Committee. Taking into account both the BPU's advice and the associated credit risk analysis and any other factors, the Risk Committee then decides whether or not an application is acceptable for ECGD support.

33. Where a buyer is based in a country listed as a Heavily Indebted Poor Country (HIPC) by the World Bank Group, or else can only borrow from the International Development Association (IDA), ECGD requires the application for cover to pass a Productive Expenditure (PE) test. The exporter has to complete a questionnaire or provide a productive expenditure report giving more detailed economic information in order to ensure that the project provides social and economic benefits without harming the country's debt position. ECGD liaises with DFID and the Treasury for this purpose, though it is the Treasury who makes the final decision as to whether ECGD support should be offered. This process enables ECGD to satisfy itself that it supports only sustainable lending to those countries that could be vulnerable to debt servicing difficulties. The OECD has recently issued new guidelines on sustainable lending.

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[15] This is publicly available at Annex A of the Case Impact Analysis Process document. See: http://www.ecgd.gov.uk/ecgd_case_impact_analysis_process_-_may_2004-4.pdf

[16] In the case of Sakhalin, for example, updated impact assessments were not completed until late 2005, nearly two years after the formal application.

34. ECGD's responsibilities do not necessarily end once a guarantee or insurance policy has been issued. Depending on the conditions on which ECGD provided its support, the BPU may be involved in ongoing monitoring of individual projects. For medium potential impact cases, this may involve regular reporting to ECGD by the project sponsor. For high potential impact cases, the BPU (or a representative of the group of lenders if more than one ECA is involved) is likely to make periodic site visits; and ECGD would usually also require regular monitoring and reporting from an independent environmental consultant.

35. **The case impact analysis process which ECGD has been operating since 2001 provides a good framework for assessing environmental and social impacts of civil non-aerospace projects. However, it does depend for its effectiveness upon on the experience of staff within the BPU. In addition, the timescales involved in obtaining all the necessary information on the impacts of major projects are lengthy. This may result in ECGD only being in a position to consider whether financial support would be consistent with its Business Principles at a relatively late stage of the underwriting process.**

Defence exports that require an export licence

36. Defence export applications that require an export licence from the Export Control Organisation (ECO) within BERR are not assessed by ECGD in respect of their environmental and social impacts. ECGD relies on the ECO processes to address sustainability issues in deciding whether or not to grant an export licence.

37. When assessing whether to issue a licence, the ECO seeks advice from other departments against eight criteria.[17] Although the last of these is entitled 'Sustainable Development', it does not involve an assessment of environmental and social impacts[18] but is similar to ECGD's Productive Expenditure test in that it aims to ensure that developing countries, and heavily indebted countries in particular, do not spend excessively on defence equipment. In such cases, a decision is made by the ECO taking account of advice from DFID, MOD and FCO.

38. Exporters have to declare in their application to ECGD whether they need a licence for their exports. It is the responsibility of the exporter to contact the ECO in order to establish whether a licence is required or not, and the process of deciding whether a particular export requires a licence can be lengthy.[19] Where an insurance facility is involved, ECGD does not check whether the licence is in fact obtained but it would not pay a claim if an export licence was required but had not been obtained. In the case of finance facilities, it is normally a condition precedent to loan drawings that the licence has been issued and evidenced to the financing bank.

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[17] These creiteria were announced to Parliament by the then Foreign Secretary in October 2000, and are referred to in the export control legislation enacted in 2002. They mirror the EU Code of Conduct on arms exports, agreed at EU level and implemented in all EU Member States.

[18] In its response to EAC's July 2003 report on ECGD, the government stated that they '*were confident that DTI's process of screening is rigorous and takes proper account of human rights and sustainable development issues*'.

[19] This can be particularly the case for 'dual use' equipment – ie equipment that could be used for either military or civil purposes.

39. **Applications for defence exports which require an export licence from the Export Control Organisation are subject to an economic assessment of expenditure within developing countries, and this will to some extent take into account social impacts. They are not subject to any form of environmental impact appraisal, though in practice it is difficult to envisage how such an assessment might be made.**

Aerospace cases

40. ECGD's civil aerospace portfolio is dominated by the support it provides for Airbus exports.[20] The guarantees which ECGD provides are in respect of the portion of the aircraft that is manufactured in the UK. Airbus exports are therefore co-financed by ECGD and the ECAs of the other participating countries - France and Germany. ECGD also provides guarantees for Rolls-Royce in respect of the engines it exports, which are not only fitted to Airbus aircraft but to those of other aircraft manufacturers (eg Boeing).

41. Exports of civil aircraft and engines are not assessed by the BPU for environmental impacts, on the grounds that environmental impacts have already been taken into account within the regulatory requirements governing the certification of new aircraft.

42. Civil aircraft and engine types from EU-based manufactures are required to meet European Aviation Safety Agency (EASA) standards, and these incorporate ICAO standards for aircraft emissions and noise. EASA provide manufacturers with a Type Certificate for aircraft to indicate the design's compliance with all relevant safety, technical and environmental standards. Any aircraft of a given type which are subsequently manufactured are required to comply with the specifications set out in the Type Certificate. Individual aircraft also require a Certificate of Airworthiness from the aviation authority in which they are registered, which for new Airbus aircraft would initially be EASA, and this would not be issued without a Type Certificate. It is an explicit requirement of ECGD's support that a Certificate of Airworthiness must be held for any aircraft exported, and this provides assurance that each aircraft meets international standards.

43. ECGD does not attempt to assess the environmental impacts relating to the use of aircraft after they have been exported nor does it possess the necessary information upon which to base such an assessment. In many cases, the provision of ECGD support involves the purchase of new aircraft to replace older, inefficient, models. Where the latter are scrapped, there can be a positive environmental impact in terms of both emissions and noise; where they are sold on to other airlines and continue to be used, the overall impact – at least in the short term – would be negative, as it would simply reflect an overall increase in the number of aircraft in operation.

44. **Civil aerospace exports are not subject to ECGD case screening procedures on the grounds that new aircraft and engines are required to meet international environmental standards for emissions and noise. Conformity with such standards is ensured by the regulatory processes by which Certificates of Airworthiness are issued, and ECGD require these certificates when issuing guarantees and insurances for aerospace exports.**

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[20] ECGD guarantees and insurances relating to Airbus amounted to 95% of the total guarantees issued in this sector in 2007-08.

Benchmarking against standards

45. In accordance with international guidelines for ECAs, ECGD compares the potential environmental impact of projects against international standards published by the World Bank Group (WBG) including the International Finance Corporation (IFC), the World Health Organisation (WHO), and other relevant bodies. ECGD always requires compliance with the host country's standards where these are more stringent than international standards. While ECGD does not, therefore, specify a single set of international standards which it will use, its policy is to employ the highest standards that are available.

46. These international standards include, for example, the environmental, health and safety guidance produced by the IFC in 2007-08, which sets out, within a comprehensive analysis of all industrial and business sectors, the minimum standards to be obtained in each different type of construction project or industrial process. The following example from this guidance illustrates how these standards can be used as a benchmark against which the BPU can assess a specific application.

Figure 4: Example of IFC guidance: Environmental, Health and Safety Guidelines for Liquefied Natural Gas (LNG) Facilities

The EH&S Guidelines outline how environmental and social impacts can be minimised by through consideration of specific issues associated with LNG facilities, including:

- Threats to aquatic and shoreline environments
- Hazardous material management
- Wastewater
- Air emissions
- Waste management
- Noise
- LNG transport

The EH&S Guidelines describe the potential risks and how the facilities should be designed to minimise these risks. For gaseous emissions and liquid effluents numeric limits are given: for example, hydrotest water that is to be discharged onto land must, amongst other limits, have a pH in the range 6 – 9 and a total hydrocarbon content of less than 10 mg/L.

The Guidelines set out industry benchmarks for energy and water consumption by LNG facilities against which individual facilities can be compared; and they state that individual projects should use these benchmarks as points of reference and so as to target continual improvement in these areas.

They also provide guidance on how to monitor the operation of LNG facilities - including the frequency of monitoring, the training of monitoring staff, record-keeping, and the review of monitoring data so that any necessary corrective actions can be taken.

Source: National Audit Office analysis of World Bank guidance

47. In some cases, ECGD has devoted considerable effort to working with project sponsors, exporters and other financial institutions to ensure that a project does meet international standards. This approach is described by ECGD as 'constructive engagement'. In the case of the Baku-Tbilisi-Ceyhan pipeline, for example, ECAs, including ECGD, were able to influence the project sponsor to ensure that formal monitoring arrangements of the resettlement process

in Turkey were similar to those proposed for the other two countries, Azerbaijan and Georgia. In addition, a condition of ECGD's guarantee was that waste should be handled in accordance with EU regulations, and the ECAs are continuing to monitor the position in Georgia to check that this condition is fulfilled. Another example of the way in which ECA influence led to improvements is in the case of the now withdrawn application by the Sakhalin Energy Investment Company (SEIC). Here it is arguable that the ECAs and financial institutions involved were instrumental in obtaining more comprehensive and detailed appraisals from SEIC, and in requiring SEIC to set out in the Health, Safety, Environment, and Social Action Plan the specific criteria and standards that the project should comply with. It is likely that this has resulted in project improvements which would not otherwise have been achieved. These include, for example, the creation of the Western Grey Whale Advisory Council, and the associated measures ensuing from it.[21]

48. The BPU does not attempt to measure or quantify the impact of its work in terms of such improvements to projects and, in any case, it could be very difficult to do so with any degree of objectivity. Moreover, project sponsors and exporters may sometimes decide to withdraw applications where they are unwilling to improve aspects of the project design so as to meet international standards. No statistics on the extent to which this has happened are readily available.

49. **International standards provide information and specific criteria against which the BPU can assess applications. As yet, ECGD has not rejected a project on the grounds that it would conflict with its Business Principles. However ECGD's policy of constructive engagement with project sponsors can lead to improvements in project design so as to be able to meet international standards. If project sponsors are unwilling to engage with ECGD in this way, the application for support would fail or might be withdrawn. ECGD does not collect data which would track or demonstrate the impact of its policy of constructive engagement because of the inherent difficulties of measuring such impacts.**

Sustainable Supply Chains

50. Many large companies have supply chain policies. For example, Rolls-Royce has a Supplier Code of Conduct which seeks to ensure that its suppliers conduct their business operations and provide products in a way that protects and sustains the environment in accordance with all applicable laws and regulations. There are currently no international standards that ECAs apply in their policies for supporting exports in relation to sustainable supply chain management. However, following a commitment made by the Government in 2007 in its response to the Public Consultation on revisions to ECGD's Foreign Content rules, ECGD has started an initiative to explore whether such standards could be developed.

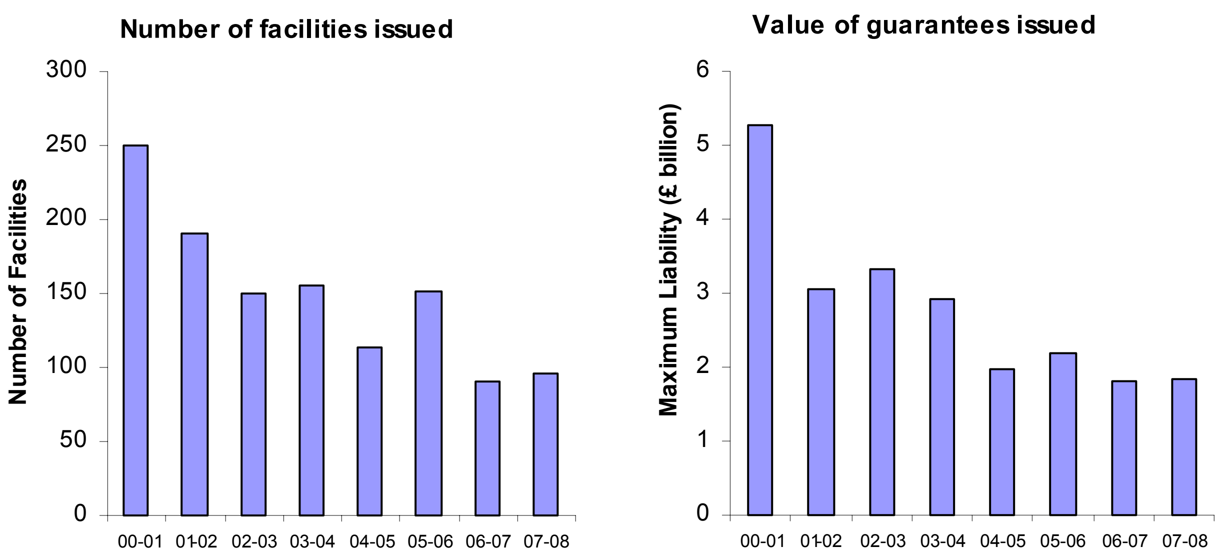
[21] See case studies 6 and 7 in the attached Annex

Analysis of the portfolio

51. This section sets out key features of ECGD's portfolio which are likely to be of interest to the Committee in the context of its current inquiry. It is based on the NAO's own analysis of data provided by ECGD covering facilities issued since 2000-01. It is worth noting that ECGD itself devotes considerable resources to portfolio analysis and the production of comprehensive reports on a regular basis for its Management Board, the Shareholder Executive and HM Treasury.

52. The most notable feature of ECGD's portfolio is the substantial decline in ECGD business since 2000. The number of facilities issued has fallen by some 60 per cent from 250 in 2000-01 to 96 in 2007-08. Similarly, the total value of new ECGD business over the same period fell from £5.3 billion to £1.8 billion. This decline represents a decrease in applications made by exporters, and is due to a range in factors including changing patterns in manufacturing, the increasing maturity of foreign markets, and the availability of insurance from the private sector. The graphs below demonstrate the decline in both the number of facilities and their value.

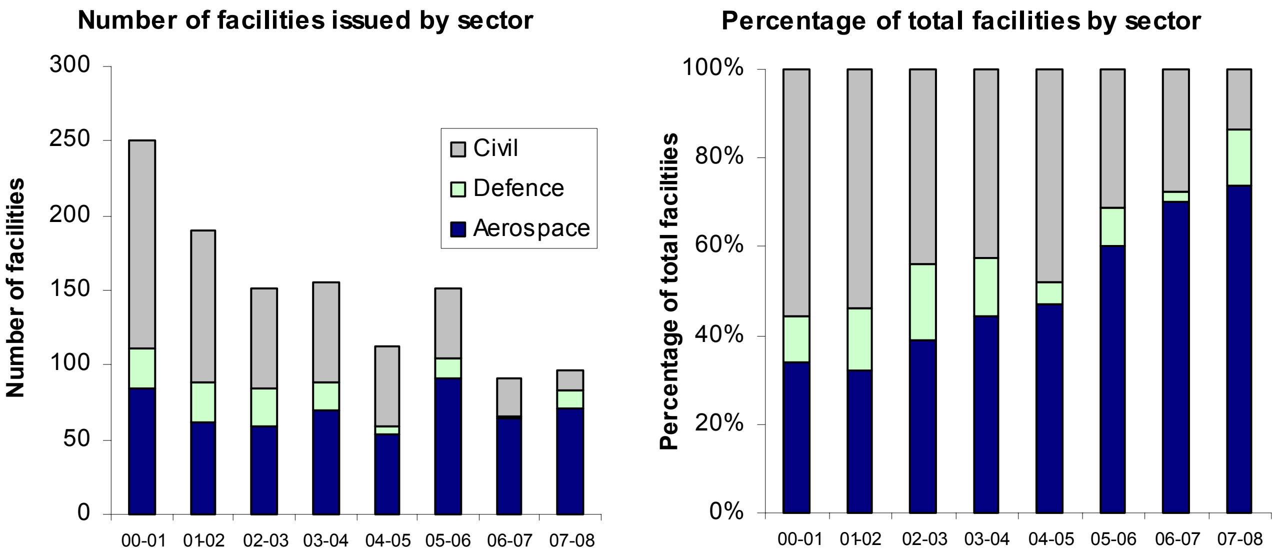
Figure 5: The decline in ECGD's portfolio since 2000-01



Source: National Audit Office analysis of ECGD data

53. The extent of this decline has given rise to a second key feature of the portfolio – a radical change in its sectoral make-up. The civil aerospace sector has remained relatively unaffected by the downturn in business and the number of guarantees issued has fluctuated between 50 and 90 a year (though most of these relate to only two exporters - Airbus and Rolls-Royce). Similarly, defence exports have fluctuated between 20 and 12. By contrast, the number of civil cases has fallen markedly from 139 to 13. As a result, in terms of the percentage of guarantees and insurance policies issued as a proportion of the total risk portfolio, the civil aerospace sector has risen steadily from around 35 per cent in 2000-01 to 74 per cent in 2007-08. The impact of these trends on the number of cases subject to environmental assessment is discussed later in this section.

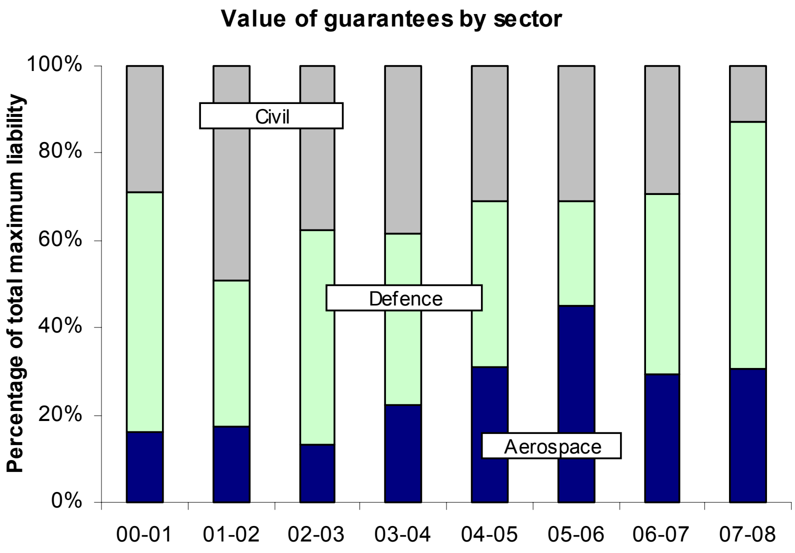
Figure 6: The growing predominance of civil aerospace in ECGD's shrinking portfolio



Source: National Audit Office analysis of ECGD data

54. In terms of the value of business, the defence export sector still dominates ECGD's portfolio. Although defence export facilities issued are few in number, they often involve large contracts and therefore feature more prominently in terms of their value.[22] In 2007-08, for example, only 12 defence cases were supported out of 96 but these represented 56 per cent of ECGD's maximum liability. As the following graph shows, the defence and civil aerospace sectors together account for 87 per cent of the total value of ECGD business in that year.

Figure 7: Defence and civil aerospace account for most of the portfolio by value



Source: National Audit Office analysis of ECGD data

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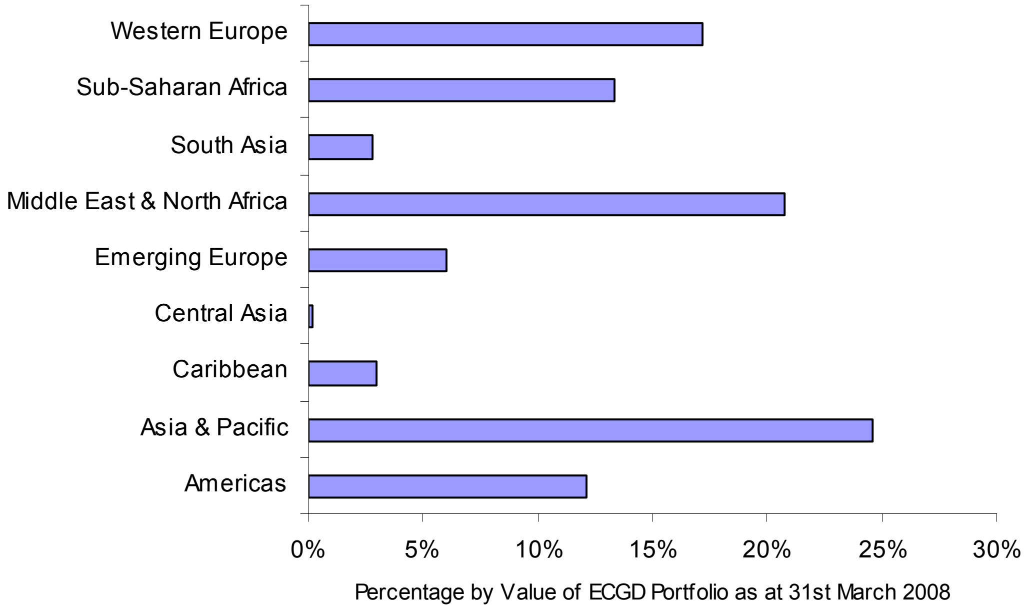
[22] These include support for the long-standing Saudi British Defence Cooperation Programme ('Al Yamamah') which dominates the defence portfolio.

55. In terms of geographical markets, most ECGD business relates to non-OECD countries. In terms of the percentage of cumulative financing since 2000, Asia, Africa and the Middle East dominate ECGD's portfolio, as the following graph demonstrates.[23] This primarily reflects the scale of defence exports to countries in those regions.

Figure 8: The geographic spread of ECGD's portfolio



Note: The relatively large value shown for 'Western Europe' is due primarily to a South African defence deal for which ECGD has sought reinsurance from the Swedish export credit agency. The exposure is therefore categorised as Swedish even though the exports are for South Africa.

Source: National Audit Office analysis of ECGD data

56. The overall decline in the portfolio has impacted considerably on the BPU. Information available in BPU's annual reports shows that the number of cases which it considered dropped from 83 in 2001-02 to 14 in 2007-08, mirroring the overall decline in civil non-aerospace applications.[24] From an analysis of the results of the screening process carried out by the BPU, the following table shows the number of cases rated as having high, medium or low potential impact. Cases are shown as 'not ranked' if insufficient information was received from the exporter which meant that the applications could not proceed, or the case fell through before the screening process was complete. The extent to which this influenced 2006-07 and 2007-08 data partly reflects the lengthy negotiations which can often be involved before ECGD can issue its support. Such cases would therefore amount to 'work in progress'.

[23] See the note on the figure relating to Western Europe.

[24] It is important to note that the figures quoted here and in the following table relate to applications considered by the BPU, rather than guarantees and insurances issued; and that they cannot therefore be compared with the figures quoted earlier in this section. In relation to the cases actually supported by ECGD in 2007-08, only 13 of the 96 facilities approved were subject to the Case Impact Analysis Process as the remaining 83 related to civil aerospace or defence exports.

Figure 9:Trends in the volume and type of cases assessed by BPU

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	TOTAL
Potential Impact:								
- High	10	6	13	7	13	1	1	51
- Medium	28	30	16	15	14	9	5	117
- Low	45	36	57	29	25	14	2	208
Not Ranked	0	0	0	0	1	8	6	15
Total Cases	83	72	86	51	53	32	14	391

Source: National Audit Office analysis of BPU annual reports

57. **The volume and value of ECGD business has been declining for several decades, but there has been a particularly sharp downturn since 2000. This raises significant issues for ECGD as its customer base has continued to shrink and it is now largely dependent on a small number of exporters operating in the civil aerospace and defence sectors. There has also been a marked decline in the number of cases subject to the environmental screening procedures, as civil non-aerospace business now only constitutes a relatively small percentage of the applications ECGD receives.**

Applying wider government policies

The Export Guarantees Advisory Council

58. The Export Guarantees Advisory Council (EGAC) has existed for many decades. It has a statutory function to give advice to Ministers and, in particular, to give advice where Ministers are requested to consider the provision of reinsurance by the private market in support of exports sold on short terms of payment. However, while its advisory role has not changed, its remit has been refocused. The Mission and Status Review of 2000 recommended that EGAC should become responsible for monitoring the compliance of ECGD with the Mission Statement and Business Principles and since 2004 it has concentrated largely on this remit. EGAC's role is therefore relevant to any consideration of the extent to which ECGD takes account of sustainable development issues in its work. The members of EGAC are unpaid, and they meet four times a year and once with the Minister. Minutes of its meetings are made public.

59. EGAC has no executive responsibility and, therefore, does not review issues arising on applications being considered for support: this would fall to ECGD's Management Board as necessary. It can, however, review cases after they have been approved (eg to assess the basis on which environmental screening judgements have been made), and for this purpose it can request information and papers from ECGD. The Council also reviews policies and procedures. It produces a short Annual Report which is published within ECGD's Annual Review and Resource Accounts. In it, EGAC comments briefly on how it has performed its role over the past year including, for example, the number of times it has met, the organisations (including NGOs) it has liaised with, and the main topics on which it has focused. It also provides an assurance that ECGD is indeed operating in accordance with its Business Principles, though no substantive evidence or argumentation is included to support this.

Financing investment in renewable energy

60. In 2002, the Prime Minister announced at the time of the World Summit on Sustainable Development in Johannesburg that the UK would make available through ECGD some £50m export credits to support exports in the renewable energy sector to help developing countries limit greenhouse gas emissions. While UK Trade and Investment[25] has promoted the availability of this credit facility where possible, to date ECGD has received no applications for such support. Indeed, the purpose of the £50 million facility is unclear as any exporter of renewable technology is already free to approach ECGD for support and ECGD can, in any event, consider contracts in excess of £50m where sufficient risk capacity exists.

61. The history of this initiative highlights a number of underlying difficulties facing ECGD in fulfilling its objective of supporting the government's wider policies. The first relates to its statutory function of facilitating exports and overseas investments. While ECGD can take account of wider Government policies (including environmental policies), it cannot allow these to prevent it from fulfilling its statutory purpose. The 1991 Act precludes discriminatory treatment and limits the extent to which ECGD can promote or target particular sectors and exporters: for ECGD to act otherwise might open up the possibility of legal challenge. Moreover, ECGD's role, as established by Ministers, is to complement, rather than compete with the private market. Therefore, ECGD does not actively pursue business opportunities, but limits its marketing role to that of making the exporting community generally aware of its facilities and services.

62. The second difficulty relates to the fact that ECGD does not provide subsidised facilities. To do so on a tied basis to UK exporters would not only conflict with international guidance for ECAs but might be viewed as anti-competitive and incur the risk of legal action – for example, by the EU or WTO.[26] In any event, HM Treasury requires ECGD to operate on a break-even basis over time. ECGD is neither a development bank nor an aid agency, and to transform it into one would not only require a fundamental statutory change but also risk duplicating the functions of other organisations such as DFID.

63. The third difficulty facing ECGD relates to the nature of UK manufacturing industry. Its portfolio is dominated by business from the civil aerospace and defence sectors because the UK still has significant manufacturing capability in these sectors, as well as strength in the petrochemical engineering sector. But in the case of renewable energy, the UK has relatively little manufacturing capability and those firms which do exist tend to be small and pursue export opportunities in OECD markets. As a result, they do not yet need the facilities which ECGD provide. ECGD cannot generate demand; it can only respond to those who seek and demand its services

[25] UK Trade and Investment was formerly known as Trade Partners UK. It is a government organisation responsible for supporting companies in the UK doing business internationally and overseas enterprises seeking to set up or expand in the UK.

[26] Such action could be based on the OECD Arrangement and the WTO Agreement on Subsidies and Counterveiling Measures (ASCM).

64. These difficulties have made it hard for ECGD to fulfil its objective of taking account of the government's wider objectives, and in particular to make progress on the 2002 commitment to support exports of renewable energy technologies.

The ECGD's Sustainable Development Action Plan

65. ECGD, like other departments, is subject to various government initiatives to improve environmental performance in the operation of its own estate, and to wider government initiatives to encourage sustainability in policy-making. ECGD produced a Sustainable Development Action Plan (SDAP) in 2005 which was later updated in 2007. The SDAP outlined how ECGD would make a difference on sustainable development issues, both through its international business ventures and internal operations. The Sustainable Development Commission has categorised ECGD as 'gaining momentum', a mid-ranking position. ECGD is due to consider whether to update its SDAP in 2008.

66. Much of ECGD's SDAP relates to its operational management. As a very small organisation, its environmental footprint is small, but its SDAP contains comprehensive objectives and targets in this respect. The SDAP also contains action points relating to the nature of ECGD's business. These cover the application of the Case Impact Analysis Process (for which various process based measures are included in Appendix B of the Plan) and making progress on sustainable development standards in international fora. But they do not seek to measure the overall environmental impact associated with the guarantees and insurances that ECGD issues. In relation to some of the wider objectives contained in the Business Principles of supporting the government's international policies, no specific targets are provided. However, the nature of multilateral international negotiations, where ECGD is but one player, would make it difficult to establish such targets. It therefore remains unclear what steps ECGD can take to pursue these wider objectives – particularly given the overriding requirement on ECGD to fulfil its statutory purpose.

Annex: Case Studies

The case studies described below were selected by the NAO to illustrate ECGD's screening procedures across all the main exporting sectors in respect of which applications for its support are received. The studies therefore include two defence and two civil aerospace cases, as well as three civil cases.

The two defence export cases illustrate that applications for defence exports which are subject to export licensing are excluded from ECGD's Case Impact Analysis Process; instead, ECGD relies on the licensing process carried out by the Export Control Organisation (ECO) within BERR. The ECO licensing process includes an overall assessment of the application against eight criteria – including debt sustainability in relation to the economic circumstances of the buyer country. In any event, it can be difficult to assess environmental impacts relating to defence exports against any objective criteria, particularly in the context of security concerns the buyer country may have; and it is therefore unclear how ECGD could apply its environmental screening process in a meaningful way.

The two aerospace cases illustrate how ECGD relies on internationally agreed standards and certification processes for aeroplanes and aero engines. These include environmental standards for emissions and noise. ECGD considers that compliance with such standards satisfies environmental screening requirements, and that there is therefore no value in applying its internal Case Impact Analysis Process. The cases also illustrate that it would be difficult to assess the wider environmental impacts of such exports, in the absence of information on the use of the aircraft and whether older aircraft had been retired.

The three civil cases include both the Baku-Tbilisi-Ceyhan pipeline and the now withdrawn application relating to the Sakhalin project, as these were two of the highest potential impact cases with which ECGD has recently been involved. They illustrate how ECGD works alongside other ECAs and financing institutions in large projects of this kind, and how the process of constructive engagement can be very lengthy but may result in improvements to the project implementation. They also demonstrate how ECAs can have a continuing role in monitoring projects after completion.

Case Study 1: Defence - Supply and installation of two Tacan radars

In November 2005, Fernau Arionics Ltd (Fernau), a small/medium sized enterprise, contacted ECGD in relation to a contract it was negotiating for the supply and installation of two tactical air navigation Tacan radars to the Department of Defence of the Republic of Indonesia. It subsequently applied for a supplier credit facility. No other ECGD financing products or other ECAs were involved in this case. Indonesia's Department of Finance was to raise the loan on behalf of the Department of Defence. In the application, Fernau declared that an export licence would be required from ECO, and Fernau later confirmed that it had been obtained. The environmental impact questions on the application form were therefore not completed. The only involvement of the BPU was to confirm that there was no adverse history relating to those involved in the contract and its negotiation, and to review Fernau's Code of Conduct particularly in relation to ECGD's policy of not supporting contracts that may be tainted by bribery and corruption. The case was submitted to the Risk Committee in October 2006. ECGD offered its guarantee in December 2006. The guarantee was issued on 12th April 2007 with a maximum liability of £1.7 million.

Case Study 2: Defence - Three Offshore Patrol Vessels (OPVs)

In January 2005, VT Shipbuilding International Limited (VTSI) approached ECGD about the possibility of receiving support for the export of three offshore patrol vessels to the Trinidad and Tobago Coast Guard. In November 2006, VTSI formally applied for a buyer credit guarantee and declared that an export licence would be required from the then Export Licencing Unit at the DTI. VTSI were therefore exempt from the environmental assessment process. The vessels were to be used to improve security and the policing of the Trinidad and Tobago coastline, and to provide disaster relief to neighbouring countries. The buyer was Trinidad's Ministry of National Security and the borrower was the Ministry of Finance. A condition of the Letter of Intent dated 23rd November 2006 was that the relevant export licence should be obtained by the exporter and this was later acquired. The environmental impact questions were not completed on the formal application for this guarantee as this was a defence case requiring an export licence.

For completeness, in addition to the buyer credit facility, VTSI also requested an Export Insurance Policy (EXIP) and a Bond Insurance Policy (BIP). A separate application had to be submitted for this insurance. The application for this EXIP and BIP was submitted to the Risk Committee on 15th October 2007 and was shortly followed by a Premium Rate Hold Letter on the 25th October. The EXIP and BIP was formally offered and accepted on the 6th and 10th November respectively. The total liability for buyer credit was £264 million at the time the guarantee was issued.

Case Study 3: Aerospace - Four Airbus A321 aircraft

Each quarter, Airbus send to ECGD an updated list of aircraft deliveries they expect to make over the following 2-3 years. This provides ECGD with an indication of the potential number of formal applications they are likely to receive and their timing.

In June 2006, Airbus formally applied for buyer credit guarantees to cover the UK share of the export of ten Airbus A321 aircraft to Vietnam Airlines (VNA), the first four of which were scheduled for delivery between January and February 2007. Airbus also applied to Coface and Euler Hermes (the French and German ECAs) for guarantees to cover the remaining portions of the contract. No other guarantees or insurance products were applied for. Title to the aircraft was assigned to a special purpose company (SPV) in the Cayman Islands which then leased the aircraft under a finance lease to VNA. In the event that the airline defaulted on its lease payments, the SPV could seek to repossess the aircraft as its legal owner acting under the instruction of the ECAs. The ECAs requested a Jurisdiction Memorandum in order to assess Vietnam's legal environment before agreeing to the structure.

Vietnam is listed as an International Development Association (IDA) market. Therefore, ECGD required the completion of a Productive Expenditure questionnaire which VNA and Airbus submitted in September 2006. From this, ECGD prepared a Productive Expenditure Screening Case outline for DFID. It was agreed by DFID and HM Treasury that the Productive Expenditure criteria were met by this case. As VNA is publicly owned, the Ministry of Finance of the Socialist Republic of Vietnam also guaranteed the payment for the aircraft.

The environmental impact questions were not completed on the application as this is an aerospace case that met ICAO standards. These aircraft would partially replace old planes and add to the existing fleet, but no consideration was given to any potential further use of the older aircraft which were being replaced. In November 2006, ECGD issued its Letter of Intent which provided a commitment to support the four Airbus planes on the satisfactory completion of a number of conditions as stated in the letter. ECGD's maximum liability in respect of the aircraft at the time of issuing the final guarantee on 8th February 2007 was £44 million.

Case Study 4: Aerospace - Rolls Royce Trent Engines

This case refers to the support by ECGD of the supply of Rolls Royce engines to be fitted to US-built Boeing aircraft. In such cases, ECGD collaborates with the American ECA (Eximbank) and the level of support it provides is determined by the value of the UK content in the overall export. In the case of aero-engines attached to Boeing aircraft, this can range from 15% to 25% of the value of the overall export. This particular case involved the supply of 8 engines to Cargolux to be fitted to Boeing 747 airframes, and the level of support provided by ECGD amounted to 15.5% of the overall support (in respect of the airframe and engines). The guarantee was issued in August 2007. The environmental impact questions were not completed on the application form by Rolls Royce as this is an aerospace case that meets international /ICAO standards.

Case Study 5: Civil - Blast Furnace (Dragon Steel Corporation, Taiwan)

In September 2005, Siemens VAI Metals Technology Ltd, a heavy engineering company, submitted an application to ECGD in relation to a contract it was negotiating for the supply, installation and commissioning of a new blast furnace at Taichung Steel Works in Taiwan. The purchaser was the Dragon Steel Corporation of Taiwan.

In view of the nature of the project, Siemens VAI also submitted with the application an impact questionnaire. This provided estimates for the consumption of metals, minerals, coal and gas, as well as technical details of the project (including the use of a turbine recovery system to generate electricity from surplus heat). The impact questionnaire also contained estimates for emissions of CO_2, SOx, and NOx.

The case was forwarded to the BPU, and the BPU completed its review by December 2005 after obtaining some further information from the exporter. It assessed the case as of ‘medium potential impact’ but was satisfied that there were no significant negative environmental or social implications. It based this judgement on the fact that the blast furnace was to replace an existing furnace and did not involve any expansion of the industrial site. The BPU also ensured that emissions met World Bank standards for this kind of project. No further appraisal was therefore deemed necessary.

ECGD first indicated a willingness to offer an Export Insurance Policy (EXIP) to underwrite the Taiwanese risk in October 2005. However, there was some delay on the part of Siemens VAI, and the insurance was eventually only issued and accepted in January 2007, some six months after Siemens VAI had actually signed the contract. ECGD’s maximum liability under the terms of the EXIP was for £70 million.

Case Study 6: Civil - Baku-Tbilisi-Ceyhan Pipeline

ECGD has been involved with the BTC pipeline project since the late-1990s. The project objective was to construct a 1,760 kilometre pipeline to transport oil from Azerbaijan through Georgia and to the Mediterranean coast of Turkey. Construction work began in 2003, and the pipeline became operational in 2005 - though it only reached its full capacity of 1 million barrels per day in 2007.

A consortium, in which BP was the lead company, was set up to develop the project. The total cost was US$4 billion, of which over 60% was debt provided by international financial institutions and commercial lenders. ECA-backed financing amounted to US$766 million, of which the ECGD guarantee constituted US$106 million. The other major ECAs involved were those of Japan, the US, Germany and France. ECGD's guarantee was issued in February 2004.

In accordance with standard practice, the project consortium appointed an independent environmental consultant, Mott McDonald prior to financial close and D'Appolonia after financial close, that owed its duty of care to the financial institutions. The project company produced extensive documentation including an Environmental and Social Impact Assessment (ESAP), a Resettlement Action Plan and an Environmental and Social Action Plan for each of the three countries. In view of the scale of the project and its environmental and social impacts (such as the extent to which it involved the resettlement of local peoples), it was assessed by ECGD as a high potential impact case at an early stage. Over a period of two years, the BPU reviewed the information available on the project from a variety of sources - including documentation from the project company itself, the work of the independent consultants and of the Lenders' Environmental Working Group, consultations with other financial institutions and ECAs, and a site visit by the Head of the BPU. On this basis of this information, it compiled a comprehensive assessment of the project which was submitted to the Risk Committee in 2003. In it, the BPU advised that the project complied in all material respects with the relevant guidelines and standards, and recommended that the offer of ECGD support should be subject to compliance with certain conditions, including the full implementation of the ESAP.

The process of constructive engagement with the project company helped to ensure adherence to international standards. Specific examples of this include the requirements that waste should be handled in accordance with EU regulations, and that arrangements for monitoring the resettlement process in Turkey should be as effective as those proposed for the other two countries. The BPU, in partnership with other ECAs and financial institutions, continues to monitor progress against such commitments through reports from the project company and regular site visits by the independent environmental consultant.

Case Study 7: Civil - Sakhalin Phase II

The Sakhalin project in the Russian Far East is one of the largest developments of oil and gas reserves in the world, and ECGD was heavily involved with Phase II of this project mainly since 2003. The project consortium, the Sakhalin Energy Investment Company (SEIC), originally dates from 1991, and was formed to extract and export reserves of oil and gas. The main participants in the consortium were Shell, Mitsui and Mitsubishi – until in 2007 Gazprom bought a majority stake.

The Sakhalin II project involved substantial further development, including offshore platforms (in addition to the one installed for Phase 1), undersea pipelines, 800 km of onshore pipelines, a liquefied natural gas plant, and oil and gas exporting facilities. Project funding was envisaged as being provided by loans from the Japanese and US ECAs (for US$3.7 billion and US$250 million respectively), some US$1.5 billion of commercial loans, a facility of US$600 million from the European Bank for Reconstruction and Development (EBRD), and equity contributions from consortium members (ie Shall, Mitsui, and Mitsubishi). In 2003, SEIC applied for support from ECGD in respect of a prospective US$650 million loan intended to finance UK supplies of goods and services to the project – notably from AMEC, Parsons, and Rolls Royce.

Following its appraisal of project documentation and the Environmental, Social and Health Impact Assessment (ESHIA) which SEIC published in early 2003, the BPU assessed the case as potentially sensitive and high potential impact, put details on its website, and consulted with other departments. It also liaised closely with other ECAs and other financial institutions to assess the extent to which the project Environmental, Health and Safety Impact Assessment (ESHIA) met international standards. In partnership with these institutions, it concluded that the project did not fully meet some of the relevant World Bank Group guidelines, but that there was scope for SEIC to take action to bring it into line with these standards. It wrote to SEIC in March 2004 to make a conditional support offer and specifying various underwriting conditions to be met.

Together with other lending institutions, ECGD continued to put pressure on the project developers to improve standards. This process of constructive engagement resulted in SEIC developing and publishing in late 2005 a far more comprehensive set of plans and commitments. These included a substantial *addenda* to the ESHIA and a Health, Safety, Environment and Social Action Plan (HSESAP) in which SEIC agreed to comply with both Russian and international standards and employ the higher of the two standards where these differed. The HSESAP also contained over 2,000 specific commitments and constituted the basis for project monitoring by the financial institutions and by AEA Technology, the independent environmental consultants appointed by SEIC but with a specific duty of care to the financial institutions. EBRD publicly endorsed the overall documentation package as being fit for purpose, while AEA considered that the HSESAP was both comprehensive and detailed and provides a good framework for the implementation of the required mitigation measures and monitoring programmes.

Where no international standards existed, the financial institutions also negotiated with SEIC to develop measures on the basis of expert advice and best industry practice. A specific example of this was the creation of an advisory panel of scientific experts to review and report on the likely impacts of the project on the endangered Western Gray Whale. As a result of the recommendations of this panel, the offshore pipeline was re-routed to avoid crossing the feeding grounds.

ECGD's assessment of the project was rendered more difficult due to the fact that on-site construction work on it had started in 2003. As a result, ECGD and the other financial institutions were obliged not only to assess project plans against international standards, but to monitor whether SEIC commitments published in 2003 and 2005 were actually being observed. By 2006-07, it was becoming clear that this was not the case, and following further engagement with the financial institutions SEIC published a Remedial Action Plan in August 2007. This detailed specific actions to be taken in relation to the onshore pipelines, which were still being installed although other parts of the project were substantially complete.

By early 2008, ECGD had still not made a substantive decision on whether to issue a guarantee. The BPU had not finalised its own evaluation of the project in the light of the latest evidence, and ECGD was awaiting further information from SEIC in respect of the financial aspects of the project. In late February 2008, following a funding review, SEIC wrote to ECGD withdrawing its application for support and ECGD subsequently confirmed that its conditional offer of support had been withdrawn.