



EXPORT CREDITS GUARANTEE DEPARTMENT

**CONSULTATION ON THE INTRODUCTION OF A PRODUCT
GUARANTEEING REIMBURSEMENT OF UK CONFIRMING BANKS
UNDER LETTER OF CREDIT ARRANGEMENTS**

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CONTENTS

I	Introduction	1
II	Regulatory Impact Assessment and Participation	2
III	Detail on the LCGS	4
	A. Commercial Aspects	4
	B. The Reasons why the LCGS may help UK Exporters.....	6
	C. Wider Policy Aspects of the LCGS	8
	C(i) International Agreements	9
	C(i)(a) The Anti-bribery Recommendation	10
	Relationship between ECGD and a Participating Bank	10
	Relationship between ECGD/Bank and the Exporter	10
	C(i)(b) Other International Agreements.....	11
	C(ii) Other ECGD procedures	11

Annexes

- A. Description of Proposed Letter of Credit Guarantee Scheme.
- B. Preliminary Draft Regulatory Impact Assessment.
- C. List of Consultees.
- D. Code of Practice on Consultation.
- E. OECD Recommendation on Bribery and Officially Supported Export Credits.
- F. OECD Principles and Guidelines to Promote Sustainable Lending Practices in the Provision of Official Export Credits to Low Income Countries.
- G. OECD Recommendation on Common Approaches on the Environment and Officially Supported Export Credits.

I INTRODUCTION

- 1 This consultation paper (Consultation Document) invites representations upon a new product that the Export Credits Guarantee Department (ECGD) is considering launching. The proposal for this new product arises in the following way.
- 2 ECGD is the UK's Export Credit Agency. It is a Department of State whose existence and powers are governed by the Export and Investment Guarantees Act 1991 (EIGA) (as may be amended by the Industry and Exports (Financial Support) Bill 2009). Its principal purposes are to support the export of goods and services from the UK and to insure overseas investments made by UK entities.
- 3 In 1991, ECGD transferred certain tranches of business into private ownership. In broad terms, what was transferred was that business known as the "short-term credit insurance business", where applications made for ECGD support were very high in volume but low in value and the terms of payment extended to buyers were generally not for a period of longer than six months. The division between the book of business sold to the private sector and that retained was not mutually exclusive in all the above respects. For example, ECGD still writes occasional credit insurance policies where the term of repayment is under two years¹; but these are infrequent.
- 4 The global economic downturn has created challenging conditions for the UK economy. According to the 2009 Budget economic forecast, the world economy is expected to contract for the first time in the post-war period, with UK GDP forecast to drop 3½ per cent in 2009. However, the depreciation of sterling is expected to support a rebalancing of domestic and external sources of demand, so that net exports make a positive contribution to economic growth. The Government believes that the UK's trading strengths and its ability to access export markets will be an important contributor to the UK's recovery and future prosperity.
- 5 As the Government announced in its recent industrial policy document "New Industry, New Jobs" and stated in the 2009 Budget, it is essential that ECGD gives UK businesses the support they need. The current economic downturn has decreased the supply and increased the price of export finance at a time when the demand for such financing remains strong. Constraints in the availability of export finance have become a major hurdle in the path of UK companies seeking to take advantage of a favourable exchange rate in order to grow their international sales. For these reasons, it is proposed that the ECGD should launch a new product, which it has provisionally called the Letter of Credit Guarantee Scheme (LCGS). Other governments are either supporting or considering the provision of support for short-term business. A re-entry by ECGD in to the short-term market raises issues regarding certain

¹ Known in ECGD terminology as "cash business" in respect of capital goods and services.

International Agreements and the assessments that ECGD usually makes on its current capital and semi-capital goods business of environmental and social impacts, bribery and corruption, and similar issues.

- 6 The LCGS would take the form of a master guarantee (Master Guarantee) issued to participating UK banks, under which those banks may cede to the guarantee, within limits, potential exposure which they would incur by virtue of confirming letters of credit issued by overseas banks in favour of UK exporters. It would be targeted primarily at emerging markets and developing countries. In respect of individual transactions ceded within the limits of the Master Guarantee, ECGD would guarantee repayment to the confirming bank of sums owed to it by the issuing bank. A fuller description of the LCGS can be found in section III below and in Annex A.
- 7 ECGD invites comments on the proposal to introduce the LCGS. In response to the circumstances referred to in paragraphs 4 and 5 above, ECGD is also considering other potential interventions in the short-term market including an Export Credit Reinsurance Scheme that may be on similar principles to the domestic Trade Credit Insurance top-up scheme of the Department of Business, Enterprise and Regulatory Reform. The details of such scheme or schemes have not been fully worked out at the date of launch of this Consultation Document. It is considered, however, that such scheme or schemes are likely to have similar constraints regarding the application of ECGD policies in relation to social and environmental matters and similar methods of being compliant with international obligations to those applicable to the LCGS. Comments may be directed therefore to any such product on that assumption. If, when such scheme or schemes are more fully worked out, the view is taken that a further Consultation, specific to such scheme or schemes, should be launched, ECGD will announce a new Consultation. A decision will be taken at the same time on the length of that new Consultation, but it may be that such consultation period would be short.

II REGULATORY IMPACT ASSESSMENT AND PARTICIPATION

- 8 Attached to this Consultation Document, at Annex B, is a preliminary draft Regulatory Impact Assessment (RIA). The final RIA, having taken account of the responses received from consultees, will analyse the impact of the proposal contained in the Consultation Document. ECGD thus seeks consultees' comments on its draft RIA. We would also welcome your comments on any unintended consequences or other implications not currently contained in the draft RIA that you may identify.

Participating in the Consultation

- 9 In view of the current national economic circumstances and the urgency of the need to take a decision on whether the proposal which is the subject of this Consultation Document should respond to those circumstances, the Minister responsible for ECGD has agreed, in

accordance with section 2.3 of the Government's Code of Practice on Consultation, published on 8 July 2008 (Code of Practice on Consultation), that the time for responses to this Consultation Document shall be eight weeks rather than twelve weeks or any longer period. This period (Consultation Period) is considered to be sufficient to allow informed comment. The Consultation Period will come to an end on 3 July 2009.

Opportunity to meet ECGD

- 10 ECGD is offering interested parties the opportunity to meet ECGD officials during the Consultation Period, to present their views. If requested, meeting(s) will take place at ECGD's offices at time(s) and date(s) to be arranged. Records of the meetings will be made publicly available. Please contact ECGD's Consultation Co-ordinator, Nina Lefley, if you would like to convey your views in person.

How to respond

- 11 When responding, please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of an organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled.

- 12 According to the requirements of the Freedom of Information Act (2000), all information contained in your response, including personal information, may be subject to publication or disclosure. Moreover ECGD intends to publish all representations it receives unless: (a) confidentiality is requested and (b) it would be consistent with the Freedom of Information obligations to keep such representations confidential.

- 13 A response can be submitted by letter, fax or email to:

Nina Lefley
Export Credits Guarantee Department
PO Box 2200
2 Exchange Tower
Harbour Exchange Square
London E14 9GS
Tel: 020 7512 7035
Fax: 020 7512 7271
Email: consultation@ecgd.gsi.gov.uk

A list of organisations and individuals to whom this Consultation Document is being sent can be found at Annex C.

Additional copies and feedback

- 14 You may make copies of this document without seeking permission. Further printed copies of it can be obtained from Nina Lefley using the contact details above.

An electronic version can be found at www.ecgd.gov.uk. Other versions of the document may be made available in Braille, some other languages or audio cassette on request.

Questions about this Consultation Document may also be addressed to Nina Lefley, whose contact details are given above.

- 15 A copy of the Code of Practice on Consultation, to which ECGD refers on its website, can be found at Annex D.

What happens next?

- 16 When the consultation closes on 3 July 2009, ECGD will consider all of the representations it has received. ECGD's decision in the light of those representations, regarding the introduction of the LCGS, will be published together with a summary of the views expressed as soon as possible. This response will be published on ECGD's website and paper copies will be available upon request.
- 17 If ECGD's decision is to launch such a product, it will proceed to agree the terms of the Master Guarantee(s) with banks participating in the LCGS.

III DETAIL ON THE LCGS

A COMMERCIAL ASPECTS

- 18 The current outline of the proposed LCGS appears at Annex A. This represents the result of discussions to date with other commercial parties, principally banks who may be guaranteed by ECGD and with whom ECGD will have the primary contractual relationship. The LCGS has been worked out in sufficient detail in order to allow comment to be made in this Consultation Document. But ECGD reserves the right to make alterations which may transpire to be appropriate, in addition to making such alterations to the LCGS as may appear to ECGD to be the right course as a result of consideration of the representations received.
- 19 Reference should be made to Annex A for full details: what follows is a description sufficient to explain the basic workings of the LCGS that are necessary to form an understanding of the way in which it will differ from ECGD's standard medium and long-term contracts of support.
- 20 It may be helpful to begin with a brief description of the workings of international letters of credit where there are both confirming and issuing banks. A letter of credit is a well-established payment mechanism in international trade. It gives the exporter the security of knowing that it will be paid if it obtains the stipulated shipping or equivalent documents. In an unconfirmed letter of credit, the foreign buyer's bank (known as the Issuing Bank) promises to pay to the exporter the agreed price of the goods or services upon the exporter presenting the specified documents to the bank. In a confirmed letter of

credit, a second bank, usually in the exporter's country (the Confirming Bank), adds its own promise (known as a confirmation) to pay to the exporter the agreed price upon the presentation by the exporter of the specified documents. The letter of credit may be payable at sight or after a specified term for example at 30, 60, 90 or 180 days. The Issuing Bank is obliged to reimburse the Confirming Bank for payment to the exporter against the correct documents. A confirmed letter of credit gives the exporter added security in that it can deal direct with a bank in its own country.

- 21 The LCGS envisages one agreement only, the Master Guarantee, with any Confirming Bank participating in the scheme (a Participating Bank). It is not envisaged that ECGD will issue a separate guarantee in respect of each letter of credit which will receive support under the LCGS. To do so would be impracticable. Although the lead times between the date of the export contract and the date of despatch vary from case to case, exports are often concluded with short lead times. In such cases, where payments are to be made by a confirmed letter of credit, the exporter will require receipt of the confirmed letter of credit before preparing and despatching the goods, and the letter of credit will therefore have to be confirmed very quickly. Once the Issuing Bank notifies the proposed Confirming Bank of the letter of credit, the Confirming Bank is required by UCP600² to make a prompt decision on whether to accept the business. If it accepts the business, it should then notify the letter of credit to the exporter, adding its own confirmation. For ECGD to negotiate a separate guarantee for each letter of credit would take too long and could jeopardise the transaction as the exporter might not receive the confirmed letter of credit in time to prepare and despatch the goods.
- 22 Individual exposures of Participating Banks (ie, where a Confirming Bank has undertaken to confirm the letters of credit with the corresponding right to be recompensed by the Issuing Bank) would be ceded to the Master Guarantee. This cession would take place without the individual approval of ECGD; to do otherwise would, for the reasons given above, be impracticable. Cessions would, however, be subject to limits and conditions.
- 23 Further, in accordance with its usual practice in issuing guarantees, ECGD would require payment by the Participating Bank of a premium calculated with reference to risk and costs.
- 24 It is not proposed that ECGD would cover every cause of non-payment by an Issuing Bank to a Participating Bank. ECGD would not cover a situation where the Participating Bank's inability to recover from the Issuing Bank was caused by discrepancy between the documents presented and the terms of the letter of credit, or where the Issuing Bank had failed to comply with UCP600, or where fraud had been committed or is alleged to have been committed (unless and until such

² Uniform Customs and Practice for Documentary Credits, 2007 Revision, ICC Publication No. 600, published by the International Chamber of Commerce.

allegation had been resolved) in relation to any party in connection with the letter of credit and/or the underlying sale contract.

B THE REASONS WHY THE LCGS MAY HELP UK EXPORTERS

Current Situation

- 25 The current economic crisis has decreased the supply, and increased the price, of export finance at a time when the demand for such financing remains strong. The contraction in the availability of export finance has become a major hurdle in the path of UK companies seeking to take advantage of a favourable exchange rate in order to grow their international sales.

The Supply of Export Finance

- 26 Current economic circumstances, in particular the rapid contraction of credit markets, have made financial institutions both more aware, and less accepting, of risk. This has affected all financial markets, with the imposition of lower loan-to-value ratios, higher loan spreads and greater collateral demands, leading to a widespread credit tightening across all sectors of the economy. The erosion of banks' capital bases, coupled with internal and external (ie, regulatory) "capital adequacy" requirements, mean that their ability to provide credit has been significantly reduced. The supply of export finance has been affected by the severe reduction in exposure limits termed – "deleveraging" – that banks have been applying across all their operations.
- 27 Deleveraging reduces the availability of trade credit in two ways. First and most directly, banks have reduced their overall "credit appetites", being their exposure limits for any individual counterparty (foreign bank) or country. In a trade finance survey conducted by the International Chamber of Commerce (ICC), 51 per cent of responding banks indicated that their trade credit lines for financial institutions had decreased between Q4 2007 and Q4 2008.³ Respondents cited more stringent credit criteria and capital allocation restrictions, exiting markets and reduced inter-bank lending as reasons for these reductions in credit lines. Second, many banks now reserve their exposure limits for their own customers and will no longer participate in trade finance deals originated by other banks. Participation in this 'secondary market' allowed other banks to share and diversify their exposure to countries and counterparties, enabling them to provide more trade finance for exporters. The sharp fall in secondary market activity, exacerbated by the complete withdrawal of some former participants, has further reduced the availability of trade finance.

³ *Rethinking Trade Finance 2009: An ICC Global Survey*. 31 March 2009. The survey received responses from 122 banks in 59 countries. See website:
http://www.iccwbo.org/uploadedFiles/ICC_Trade_Finance_Report.pdf

The Demand for Export Finance

- 28 The economic downturn has increased both risk and the perceptions of risk among exporters, increasing the demand of exporters for secure forms of payments. Respondents to the ICC survey reported that customers are asking for confirmed letters of credit where they previously accepted unconfirmed letters of credit, cash against documents or “open account” (unsecured payment terms). The demand for secure forms of payment has grown with the increasing difficulty encountered by exporters in accessing trade credit insurance to cover the credit risk from exporting on open account. Without trade credit insurance, an exporter trading on open account bears the full risk if a buyer is unable or unwilling to pay.
- 29 Although some UK exporters are already reporting difficulties in accessing export finance, the full effects of the contraction in credit markets have been masked by the decline in world trade. The 2009 Budget report cited data suggesting that world trade volumes have fallen almost 17 per cent since September 2008. Lower levels of exports usually entail less demand for export finance products, such as letters of credit; and the total volume of documentary credits has indeed decreased. The proportion of export transactions making use of these export finance products had, however, increased. In the ICC survey, 52 per cent of responding banks had experienced an increase in demand for confirmation requests between Q4 2007 and Q4 2008, indicating the desire for increased security by exporters.

Export Finance Pricing

- 30 Increased demand and reduced supply has led to a rise in the pricing of export finance. In the ICC survey, 40 per cent of respondent banks cited a significant increase in fees for issuing bank undertakings, such as commercial letters of credit, standby letters of credit and payment guarantees in the past two years, while 58 per cent of respondents reported an increase in fees for confirming commercial letters of credit over the same period.
- 31 In an IMF/BAFT survey, respondent banks identified their own increased cost of funds (71 per cent of respondents), increased capital requirements (58 per cent of respondents) and increased risk (39 per cent of respondents) as the three main reasons for the recent increase in pricing of export finance products.⁴

Need for Intervention in Short Term Export Finance

- 32 During recessions, it is normal for international trade activity to decline. In this downturn, however, world trade has fallen much more quickly than can be justified by the decline in demand alone. Empirical evidence indicates that the decrease in the availability of export finance has made the situation worse. In the ICC survey, one third of the banks reporting an increase in demand for bank undertakings admitted that

⁴ IMF-BAFT Trade Finance Survey. March 2009. See website:
http://baft.org/content_folders/Issues/IMFBAFTSurveyResults20090331.ppt

they had been unable to satisfy all of their customers' needs. The World Bank has estimated that restrictions in export finance are responsible for 10-15 per cent of the fall in global trade.

- 33 The current severe problems in the global financial system have caused previously unseen financial market failures that have reduced export financing capacity. UK exporters, who would have obtained export finance in a well functioning market, are now unable to obtain this due to the limited risk appetite of banks. The contraction in the availability of short-term export finance is likely to become more severe once world trade begins to recover. Although world trade in goods and services is forecast to decrease by 10¾ per cent⁵ in 2009, the greater part of this decline is expected to take place in the first half of the year, with trade picking up as seasonal demand picks up and the pace of destocking slows.
- 34 The absence of a well-functioning export finance market, with all its attendant adverse economic effects, means that there is a strong case for government intervention until an appropriate degree of normality returns to the export finance sector. The LCGS would address directly the current failings in the financial markets for exporting companies. The purpose of LCGS is to enable UK exporters to obtain letter of credit confirmations to facilitate the export of goods and/or services. This policy intervention would be temporary, while financial market failures persist.

C WIDER POLICY ASPECTS OF THE LCGS

- 35 In December 2000, pursuant to the 1999 Mission and Status Review,⁶ ECGD adopted certain business principles (the Business Principles)⁷. The policy set out in the Business Principles is that ECGD takes into account in its decision-making wider government policy relating, among other things, to the deterrence of bribery and corruption and the assessment of the environmental and social impacts of projects which relate to exports for which ECGD support is solicited. The Business Principles were written, and subsequently elaborated in a series of policy statements, in relation to ECGD's business as it existed in 1999 and 2000. The type of exports (capital and semi-capital goods) and the usual horizons of risk associated with them that derive from the length of the permitted repayment terms, have not altered in the last ten years.
- 36 Since the promulgation of the Business Principles in December 2000, there have been two streams of developments relating to ECGD's consideration of wider government policy. The first is the development of a number of International Agreements created in the forum of the OECD (see paragraph 39 below); and the second is the elaboration of the Business Principles in ECGD policy statements.

⁵ 2009 Budget.

⁶ See website: www.ecgd.gov.uk.

⁷ See website: www.ecgd.gov.uk

37 The two elaborations of policy that are principally relevant are constituted by ECGD's published Case Impact Analysis Process (CIAP),⁸ relating to the environment, and ECGD's Final and Concluding Responses to its Consultation on changes to its anti-corruption practices.⁹ Further reference will again be made below to these in relation to the LCGS.

38 It would be impracticable for all ECGD's current assessment procedures, whether relating to sustainable development, the environment or bribery and corruption, to be extended beyond the type of product for which they were designed to the LCGS. The LCGS would, however, have a number of terms relating to bribery and corruption issues that would make it compliant with the International Agreements referred to below.

C(i) International Agreements

39 Three International Agreements are of particular relevance:

- (1) OECD Recommendation on Bribery and Officially Supported Export Credits (the Anti-Bribery Recommendation);
- (2) OECD Principles and Guidelines to Promote Sustainable Lending Practices in the Provision of Official Export Credits to Low Income Countries; and
- (3) OECD Recommendation on Common Approaches on the Environment and Officially Supported Export Credits.

The text of these Agreements is to be found at Annexes E to G. With regard to EU State Aids rules¹⁰ and the provision of short-term export credits, the current intention is that the LCGS would apply to Letters of Credit extended in relation to supplies to non-marketable risk countries only. If the scheme were to be extended in future beyond such an ambit, EU agreement to such an extension would be sought.

40 With regard to the Anti-Bribery Recommendation, the position under the LCGS is proposed to be as follows.

C(i)(a) The Anti-Bribery Recommendation

⁸ Published May 2004. See website:

http://www.ecgd.gov.uk/ecgd_case_impact_analysis_process_-_may_2004-4-1-1-0.pdf

⁹ See website:

http://www.ecgd.gov.uk/index/public-information/public-consultation/final_response_to_ecgd_public_consultation.htm

¹⁰ Communication of the Commission to the Member States pursuant to Article 93(1) of the EC Treaty applying Articles 92 and 93 of the Treaty to short-term export-credit insurance (1997/C 281/03) as amended, a copy of which is available at:

[http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31997Y0917\(01\):EN:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31997Y0917(01):EN:HTML)

See also:

<http://eur-lex.europa.eu/Notice.do?val=221470:cs&lang=en&list=225304:cs,218229:cs,220521:cs,220520:cs,220519:cs,220518:cs,220517:cs,224315:cs,224314:cs,221470:cs,&pos=10&page=1&nbl=12&pgs=10&hwords>

- 41 Export credits having a short repayment term (“short-term products”, generally regarded as those having a repayment term of under two years), are not excluded from the Anti-Bribery Recommendation. But the Anti-Bribery Recommendation recognises that its suggested provisions will have to be modified in their implementation to such short-term credits.¹¹ The way in which the Anti-Bribery Recommendation provisions will be modified in relation to this LCGS are as set out below. In this context, two different relationships must be distinguished: the relationship between ECGD and the Participating Bank; and the relationship between ECGD/Participating Bank on the one hand and the UK exporter on the other.

Relationship between ECGD and a Participating Bank

- 42 It would be a term of the Master Guarantee¹² that:
- (1) the Participating Bank has not engaged, and will not engage, in corrupt activity in relation to any of the letters of credit which are ceded to the guarantee;
 - (2) the Participating Bank is subject to regulation by the Financial Services Authority (FSA) and to current UK/EU legislation and regulations prohibiting money laundering and bribery and corruption;
 - (3) if the Participating Bank has any reason to suspect that any of the letter of credit arrangements ceded to it have been, or will be, used for the purposes of money laundering (as defined in the Proceeds of Crime Act 2002), the Participating Bank has complied with its obligations in that regard under the Proceeds of Crime Act 2002; and
 - (4) the Participating Bank’s Compliance Officer must certify that neither the Participating Bank nor any person who is or was during the past five years a Board Director of the bank, and whose principal place of employment is or was the United Kingdom, has at any time admitted to engaging in corrupt activity to the Compliance Officer or, to the Compliance Officer’s knowledge, been found by a court of competent jurisdiction to have engaged in corrupt activity; in either case, while the Board Director was employed by the Participating Bank.

Relationship between ECGD/Bank and the Exporter

- 43 It would be a term of ECGD’s arrangements with the Participating Bank that the Participating Bank shall enter into an enforceable contract,

¹¹ See footnote 2 on page 2 of the Anti-Bribery Recommendation.

¹² The terms above are the proposed terms if a Participating Bank is a UK bank. The terms of the Master Guarantee will need to reflect any differences which derive from the status and domicile of any Participating Bank. It is to be noted, for example, that EU banks doing business in London may be regulated in part by the FSA and in part by the financial authorities in their country of incorporation.

governed by English law, with a UK exporter for whom it confirms a letter of credit, which shall have, amongst others, the following terms:

- (1) a notice informing exporters requesting a letter of credit confirmation about the legal consequences of bribery in international business transactions under the UK law and encouraging them to develop, apply and document appropriate management control systems to combat bribery;
- (2) that the exporters contractually warrant that neither they or anyone acting on their behalf, such as agents, have engaged or will engage in corrupt activity in relation to the letter of credit or the export which underlies it; and
- (3) that if, after the Participating Bank has added its confirmation to the letter of credit and ceded its potential exposure to the Guarantee, bribery is proven against the exporter, the exporter will repay to the Participating Bank any sums which the Participating Bank has paid to that exporter and which the Participating Bank has claimed from ECGD. ECGD will have contractual rights against the Participating Bank to control the enforcement of this term.

44 The imposition in the above relationships of the above terms represents, in ECGD's view, the most appropriate and practicable implementation of the Anti-Bribery Recommendation to a multi-buyer export credit guarantee.

C(i)(b) Other International Agreements

45 Exposure under letters of credit would only be ceded to the Master Guarantee where they have a repayment term of less than one year. In consequence, neither the Recommendation on Common Approaches to the Environment and Export Credits, nor the Principles on Sustainable Lending Practices would apply to the LCGS.

C(ii) Other ECGD procedures

46 On the basis explained in paragraph 35 above, ECGD has developed (for example, in the CIAP and ECGD's Final and Concluding Responses to its consultation on changes to anti-corruption practices) procedures which go beyond the provisions of the International Agreements discussed above. For instance, ECGD always requests the names of an exporter's agent in relation to bribery and corruption enquiries; and ECGD does not avail itself of the right not to apply the Common Approaches by reason of a short repayment term or low contract value. For the reasons of practicality in relation to volume and timing set out in paragraph 21 above, it would not be feasible to apply to the LCGS the frequently lengthy processes of enquiry relating both to corruption and the environment in which ECGD currently engages in relation to its capital goods support. In consequence, it is not proposed that ECGD's policies in or deriving from its Business Principles which concern assessment of matters other than payment risk, including the

CIAP and the full enquiries described in the Final Response to the Consultation on anti-corruption practices,¹³ will be implemented in relation to the LCGS. In relation to anti-corruption issues, ECGD would, instead, rely upon compliance with the Anti-Bribery Recommendation in the manner set out above. ECGD would of course continue to assess financial risk.

Export Credits Guarantee Department

8 May 2009

¹³ See footnote 9 above.

Annex A

Description of Proposed Letter of Credit Guarantee Scheme

Annex B

Preliminary Draft Regulatory Impact Assessment

List of Consultees

Code of Practice on Consultation

**OECD Recommendation on Bribery and Officially Supported
Export Credits**

**OECD Principles and Guidelines to Promote Sustainable Lending
Practices in the Provision of Official Export Credits to Low Income
Countries**

**OECD Recommendation on Common Approaches on the
Environment and Officially Supported Export Credits**