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20 March 2012

Export Credit Arrangements
Productivity Commission
LB2 Collins Street East
MELBOURNE VIC 8003
Commonwealth of Australia
By email: exportcredit@pc.gov.au

Dear Commissioners

Re: Latham & Watkins' submission regarding the vital role that EFIC plays in Australia's export credit arrangements and the financing of large-scale natural resource projects

We appreciate the opportunity to present this submission to the Productivity Commission regarding the vital role that Export Finance and Insurance Corporation (**EFIC**) plays in Australia's export credit arrangements and the financing of large-scale natural resource projects situated in Australia and elsewhere around the world.

Latham & Watkins' experience with ECAs and its existing relationship with EFIC

Latham & Watkins is one of the world's largest full-service international law firms. We deliver integrated client service worldwide, with more than 2,000 lawyers in 31 offices around the world, practising US, English, French, German, Spanish, EU, Russian, Hong Kong and Japanese law. We represent sponsors of, and lenders providing financing for, a wide-range of large-scale natural resource projects. In recent years, we have been involved in certain of the largest natural resource and infrastructure projects being developed worldwide, including projects being developed in Australia and being supported by Australian financial institutions, such as EFIC. The large-scale projects on which we work typically are multi-source financings, integrating into a single capital structure the complex financial requirements of debt sourced from commercial banks, export credit agencies (**ECAs**), capital markets, project sponsors as senior lenders and other credit providers.

In our work, we engage regularly with or represent ECAs (including EFIC) on these large-scale financings. Currently, we are working with EFIC on one of the largest liquefied natural gas projects being developed in Australia. In addition, we have represented EFIC on other large-scale project financings in the past, including the approximately US$18 billion Papua New Guinea Liquefied Natural Gas (**PNG LNG**) project, the financing for which closed in March 2010. At the time of its closing, the PNG LNG project was the largest greenfield project financing ever developed. We hope to continue to work with EFIC on additional transactions of importance to the Australian government beyond our current representations. Based on our extensive experience participating in the development and financing of large-scale natural resource projects and working with ECAs, we would like to share some observations that we consider germane to the Productivity Commission's review of EFIC.

Necessity of ECA support for large-scale project financings

Over the past two decades, the size of large-scale natural resource and infrastructure projects developed globally has increased at a remarkable rate. Historically, sponsors and developers seeking to finance the development of these projects could meet their financing requirements largely through privately available sources of debt. Typically, the sponsors and developers of such projects would have met their financing requirements by turning to a single financial market (such as the commercial bank market or the debt capital markets). Today, the combination of the increased size of many large scale developments and the recent changes in the global financial sector have made it difficult for sponsors and developers of such projects to meet their capital requirements by relying exclusively on private sector financing or from a single source of debt. These changes have resulted in an increase in the number of multi-source project financings and to the prevalence of ECA participation in the financing of these transactions as a vital source of funds to meet the capital requirements of such projects. This trend has been accelerated by the impact of the global financial crisis and with the implementation of new regulatory regimes (such as the Basel III reforms) that came in its wake, further diminishing the capacity of commercial banks and other private sector finance providers to lend the increasingly large sums required by these projects. Many large-scale natural resource and infrastructure projects, including the many projects currently in the initial stages of development in Australia, would not be viable without ECA support of the kind provided by EFIC. EFIC and other ECAs therefore play a vital role in ensuring that these types of projects take place, which provides direct and indirect benefits to businesses in the country where the projects are located as well as the countries of the exporters contributing to such projects.

EFIC's multiplier effect – "Crowding in" other ECAs

EFIC's impact on these financings is not limited to providing direct financing support. In our experience, EFIC's participation in a project often is able to be used to attract other ECAs to participate in providing financial support to that project. We experienced this in the PNG LNG transaction and we are seeing it in the liquefied natural gas project in Australia on which we are working presently. EFIC is seen as a leader within the ECA community and is viewed by other ECAs as technically proficient in assessing the risks associated with such complex projects. This perception is based on the approach that EFIC takes to its participation in these projects, applying a degree of rigour and expertise that other ECAs may not be able to offer, including a pronounced emphasis on assessing the environmental and social impact that a proposed project may have.

EFIC's multiplier effect – "Crowding in" private finance

In addition to being an important source of liquidity, the involvement of ECAs such as EFIC in a financing structure increases the attractiveness of a proposed financing to commercial debt providers. Far from "crowding out" private sector funding to these projects, ECA support has the effect of increasing the number of, and quantum of debt provided by, private financial lenders. ECA participation in a transaction encourages private sector participation in a number of ways:

- Covering commercial bank loans – ECAs can provide a guarantee or insurance policy for the benefit of commercial lenders providing direct loans (known as "covered loans") to the project. Such a guarantee or insurance policy assures commercial lenders that should the borrower fail to make its debt repayments, the ECA providing the guarantee or insurance will step in and make those debt repayments in place of the borrower. Historically, such guarantee and insurance programs were intended to cover the political risks associated with jurisdictions where it may have been difficult to attract private sector financing. Today, such programs may cover the commercial risks associated with the specific transaction, as well as the political risks of the project. Rather than being viewed as competitors by private sector financial institutions considering extending financing to challenging transactions, some commercial lenders are willing to participate in certain high-risk projects only to the extent that they benefit from ECA cover.

- "Halo effect" – While commercial lenders may benefit from covered loans or other types of political risk insurance provided by an ECA, even where that is not the case, commercial lenders participating in a multi-source project financing together with one or more ECAs often feel that they benefit from the "halo effect" of having ECAs participate in the capital structure. For example, where an ECA is providing credit support, the host government may be less likely to take action that would be objectionable to the government of the ECA's home country, such as expropriating assets or nationalising industries. In addition, ECAs may be able to facilitate more effective government-to-government solutions via channels not available to the private sector. Furthermore, ECAs have stringent internal policies with respect to the environmental and social impact of the projects to which they provide financing. Accordingly, ECAs often require detailed diligence on the potential of a proposed project to have an adverse environmental or social impact on the locale of the project or on the population centres that may be affected by a proposed project. Therefore, ECA participation in a multi-source project financing can provide commercial banks with added comfort that extensive diligence with respect to the project has been conducted by an institution with specialist knowledge of such sensitive areas. This "halo effect" is particularly effective in attracting foreign commercial capital to challenging or sensitive markets and to projects within those markets. This is true of EFIC's participation in high profile projects, even where the level of EFIC's financing actually is quite modest in comparison to the amounts provided by other ECAs.

Far from crowding out investments from private sources, in our experience EFIC's participation in the financing of projects has had a multiplier effect, attracting private sector financing to natural resource and infrastructure projects being developed in Australia or otherwise of importance to the government of Australia.

EFIC's involvement in financings leads to enhanced regulatory compliance, particularly with regard to environmental and social issues

Beyond the purely financial impact that ECA participation has on the development of large-scale natural resource and infrastructure projects, participation by ECAs like EFIC in such

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projects often has the effect of ensuring that the projects meet the most stringent regulatory standards, particularly with respect to environmental and social requirements. This is because ECAs (including EFIC) have stringent internal policies with respect to regulatory compliance by the projects in which they participate. The enhanced diligence that the ECAs require, and the robust reporting and compliance covenants that the ECAs require as part of the financing terms, ensure that projects are structured so that the sponsors and developers meet these stringent standards that are intended to protect against any adverse environmental or social impact that a project otherwise might have. This is true of EFIC's participation in the projects on which we have worked with EFIC.

Conclusion

Based on our experience working with EFIC on a number of large-scale natural resource project financings, including one of the largest Australian-based projects currently being developed, we consider that EFIC plays a vital role in attracting other ECA financing to such projects, fosters increased levels of participation by private sector commercial lenders and ensures that such projects are developed and operated at the highest standards. We have been particularly impressed with the high degree of professionalism, technical expertise and commercial rigour with which EFIC approaches transactions. We consider that EFIC's continued participation in large-scale natural resource and infrastructure projects makes a vital contribution to the continued development of Australian industry and economic growth.

Please do not hesitate to contact Latham & Watkins should any further information or input be required.

Yours sincerely

Latham & Watkins

William H. Voge
Partner