SULLIVAN & CROMWELL LLP

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March 25, 2022

Export Finance Updates

EU Council Calls for Deadline to End Export Finance Support for Fossil Fuels; Revised OECD Arrangement; and the ICC Sustainability in Export Finance White Paper

SUMMARY

This memorandum highlights three recent developments in export finance signaling an increased focus on sustainability:

- On March 15, 2022, the Council of the European Union (the "**EU Council**") issued a statement (the "**EU Council Statement**") that EU member states would, by the end of 2023, set their own deadlines for ending export credit support for fossil fuel energy sector projects.
- In January 2022, the Organization for Economic Co-operation and Development (the "**OECD**") published a new version of the Arrangement on Officially Supported Export Credits (the "**OECD Arrangement**") which implements, among other changes, a new restriction on export credit and tied aid support for unabated coal-fired power plants - those without operational carbon capture utilization and storage ("**CCUS**"). This change closes off all avenues for OECD export finance support for coal-fired power plants without CCUS.
- In September 2021, the International Chamber of Commerce (the "**ICC**") published the "ICC Sustainability in Export Finance White Paper" (the "**ICC White Paper**"), which presents product and policy recommendations for the export finance market to meaningfully contribute to the sustainability agenda.

As recognized in the ICC White Paper, export credit agencies ("**ECAs**") have faced criticism for lagging behind the wider sustainable finance market. The EU Council Statement underlines that ECAs need to adapt their policies to support a green energy transition.[1] The revised OECD Arrangement is the first concerted effort by the OECD ECAs to collectively update their sustainability policies since 2016. In contrast, the private sector has seen the adoption of a broad range of voluntary guidelines and/or mandatory regulations regarding ESG-focused investing, ESG-related investment impacts and sustainable finance products such as green, social, sustainable and sustainability-backed bonds and loans during the same period.

This is an area where ECA policies are quickly evolving, presenting challenges to those trying to understand the availability of financing sources for their projects, which is an analysis that generally must be done on a project-by-project and ECA-by-ECA basis.

1. THE COUNCIL OF THE EUROPEAN UNION MARCH 15, 2022 STATEMENT – A PATHWAY TO ENDING SUPPORT TO THE FOSSIL FUEL SECTOR

A. CONCLUSIONS ADOPTED BY THE COUNCIL OF THE EUROPEAN UNION

In a statement published on March 15, 2022[2] following a meeting of EU finance ministers, the EU Council announced that, pending further modernization of the OECD Arrangement, EU member states would have until the end of 2023 to set their own "science-based" deadlines for ending export credit support for fossil fuel energy sector projects, unless in limited and clearly defined circumstances that are consistent with the 1.5ºC warming limit and the Paris Agreement.[3] The OECD Arrangement is the "gentlemen's agreement" that regulates the terms and conditions upon which the ECAs of the OECD participating countries[4] (the "**OECD Participants**") agree to provide officially supported export credits and tied aid.

The Council Statement also calls on the European Commission to launch a discussion with the OECD Participants to include a restriction in the OECD Arrangement on export credit for the fossil fuel energy sector, including oil and gas, subject to limited and clearly defined exceptions that are consistent with the 1.5ºC warming limit and the Paris Agreement.

The Council Statement proposes the introduction into the OECD Arrangement of financial mechanisms to encourage environmentally sustainable projects, such as lower down payments, longer maturities or specific risk-based adjustment to premia. The Council Statement supports the use of the EU Taxonomy on Sustainable Activities[5] (the "**EU Taxonomy**") as the relevant benchmark for EU member state ECAs to identify environmentally sustainable projects.

The Council Statement also notes the importance of the modernization of the OECD Arrangement more widely in the face of growing competition by financing provided by non-OECD countries and supports the European Commission's feasibility study of an EU-wide export credit facility to complement the national export credit facilities of the EU member states.

B. COMMENTARY

The Council Statement does not require EU member states to stop their ECA support for the fossil fuel sector by the end of 2023, but only that a deadline for doing so is set by the end of 2023. This signals the differing views at the EU level on how to phase out export credit support for fossil fuels.

Further, this deadline will only be relevant for those EU member states that have not signed the COP26 commitment to end new direct support for the international unabated fossil fuel energy sector by the end of

2022, except in limited and clearly defined circumstances that are consistent with the 1.5ºC warning limit and the goals of the Paris Agreement (the "**COP26 Commitment**").[6]

Ten European countries (Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Spain, Sweden and the United Kingdom, all signatories to the COP26 Commitment) and their ECAs formed the "Export Finance for the Future" ("**E3F**") coalition with the goal of leading efforts to align export finance with climate objectives, including an assessment of their export finance support to the fossil fuel sector and how best to phase out that support.[7] The E3F coalition has not yet confirmed how it will interpret the COP26 Commitment.

Currently, the EU Taxonomy, which permits certain gas power generation or heating and cooling to be classified as "sustainable,"[8] is not binding on EU member state ECAs. The suggestion, in the EU Council Statement, that ECAs adopt the EU Taxonomy as the relevant benchmark for EU ECAs to identify environmentally sustainable projects may indicate how EU member state ECAs may develop their policies on oil and gas.

The Council Statement's call for the modernization of the OECD Arrangement and the inclusion of financial incentive mechanisms to support environmentally sustainable projects echoes the recommendations of the ICC White Paper (see below).

In the absence of more concrete concerted action, individual ECA sustainability policies are developing in real time, presenting challenges to those trying to understand the availability of financing sources for their projects. Understanding financing sources for a project may involve more detailed analysis of both the revised OECD Arrangement as well as individual ECA policies (which are under ongoing updates in various countries). Early consideration of financing sources by project sponsors, in particular to explore the growing incentives available for sustainable finance, may help to widen the sources of available finance for a project.

2. REVISED OECD ARRANGEMENT – THE END OF OECD ECA SUPPORT FOR UNABATED COAL-FIRED POWER PLANTS

A. THE REVISED OECD ARRANGEMENT

In January 2022, the OECD Arrangement was updated (the "**revised OECD Arrangement**"). Effective as of November 1, 2021, the key change is a prohibition on export credit and tied aid support (the "**Prohibition**") for:

- new coal-fired power plants or parts thereof,[9] including all components, equipment, materials and services (including the training of personnel) directly required for the construction and commissioning of such plants; and

- existing coal-fired power plants unless (a) the purpose of the equipment supplied is air, water or CO_2 pollution abatement, and (b) such equipment does not extend the useful lifetime or capacity of the plant.[10]

Importantly, the Prohibition does not apply to coal-fired power plants that operate with effective CCUS facilities or the retro-fitting of existing coal-fired power plants to install CCUS facilities.[11]

This represents a major change from the previous rules regulating export credit support for coal-fired power plants. Those rules, set out in the 2016 Sector Understanding on Export Credits for Coal Fired Electricity Generation Projects ("**CFPSU**"), allowed support for certain plants, including those in developing countries facing energy deficit challenges. The CFPSU has now been removed in its entirety by the revised OECD Arrangement.

B. COMMENTARY

The Prohibition closes off OECD export credit support for unabated coal-fired power plants. While many western ECAs had largely already excluded coal-fired power plants from their portfolios, this is an important move for the Japanese and Korean ECAs that had continued to support the industry. Days after the OECD decision on the Prohibition, China followed suit with a pledge to stop funding overseas coal projects.

It remains to be seen how the OECD ECAs will implement the Prohibition in the context of larger energy intensive projects – such as mining projects – with on-site unabated coal-fired power plants. While such projects will become increasingly rare as project sponsors ramp up their climate change commitments (voluntarily and as a result of increasing regulation) and adapt their operations accordingly, there has been no official OECD guidance addressing this. Individual policies will develop over time, but it is likely that OECD ECAs participating in the financing of such projects would at a minimum continue to require ring-fencing of their export credit support from the construction and commissioning of any on-site unabated coal-fired power plants.

The revised OECD Arrangement does not address export finance support for coal mining. It also does not deal with oil and gas projects, although a majority of the OECD Participants signed the COP26 Commitment. It is perhaps a sign of the compromise achieved by the OECD Participants on the scope of the revised OECD Arrangement that the Prohibition will be reviewed by December 31, 2022 "in order to contribute to the common goal of addressing climate change,"[12] a mere 13 months from the date it became effective and coinciding with the COP26 Commitment deadline.

3. THE ICC WHITE PAPER ON "SUSTAINABILITY IN EXPORT FINANCE"

A. THE ICC WHITE PAPER

The ICC and partners published the "ICC Sustainability in Export Finance White Paper"[13] in September 2021, which presents product and policy recommendations for the export finance market to meaningfully contribute to the sustainability agenda.

The ICC White Paper was prepared independently and supported by the Rockefeller Foundation and a steering committee of 16 leading commercial banks. It draws on the contributions of commercial banks, exporters, borrowers and ECAs, and their supervisory government authorities across the world.

The ICC White Paper concludes with several recommendations, including:

- Harmonizing sustainability-linked definitions and frameworks utilized by banks and ECAs;
- Aligning the mandates of ECAs, development finance institutions and domestic financing initiatives to enable a "whole of government" approach towards global sustainability commitments;
- Increasing support by banks and ECAs for emerging companies that are developing innovative technologies addressing sustainability goals, including leveraging blended finance structures to meet the capital expenditure needed to develop such technologies. The paper also found that exporters and sponsors that consider sustainability goals earlier in their projects and bid design widen the range of available financing options; and
- Modernizing the OECD Arrangement to promote transactions that support global sustainability goals (namely, the UN Sustainable Development Goals[14] and the Paris Agreement), including by adopting incentives (*e.g.*, increased flexibility,[15] premium discounts, longer tenors), disincentives (*e.g.*, exclusions, premium surcharges) for certain industries and technologies and further sector restrictions (already a proven approach under the OECD Arrangement's "sector understandings").

The two introductory chapters, with comprehensive reviews of the export finance market and the sustainable finance market, are worthwhile reading for those looking for an overview tracking all recent developments internationally.

B. COMMENTARY

The ICC White Paper represents an unprecedented undertaking with its broad-base participation. It calls on ECAs, who have a track record for supporting important, often challenging, projects, to play a greater role in the sustainability agenda.

The revision of the OECD Arrangement outlined in Section 2 above did not cover all of the areas of possible modernization of the arrangement identified by the ICC White Paper. There is a growing awareness of the urgency of the modernization of the OECD Arrangement, as shown by the EU Council Statement. The E3F coalition also intends to promote the modernization of the OECD Arrangement to include sustainability policies. On the basis of the pace of developments to date, it may take some time to build a consensus among the OECD Participants on how to integrate global sustainability goals within the rulebook of the

OECD ECAs. However, it remains to be seen whether the Ukraine crisis will accelerate these efforts as OECD Participants grapple with the challenges of replacing Russian oil and gas, decarbonization and strengthening their energy security.

We continue to monitor this area closely and are available to discuss this with you at any time. For additional ESG and sustainable finance-related updates, please see [Environmental, Social and Governance (ESG) (sullcrom.com).](#)

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ENDNOTES

1 The recent case brought by the not-for-profit environmental protection organization, Friends of the Earth, against the UK Secretary of State for International Trade and the UK ECA, UKEF, to challenge the legality of UKEF's decision to approve USD 1.5 billion of export finance support for the Mozambique LNG Project, highlights the growing awareness that ECAs have a part to play in the climate change agenda. Friends of the Earth was not successful in its challenge, but has been given leave to appeal the decision of the English High Court handed down on March 15, 2022. *R (on application of Friends of the Earth Limited v The Secretary of State for International Trade / Export Credits Guarantee Department (UK Export Finance) [2022] EWJC 568 (Admin).*

2 Council of the European Union press release of March 15, 2022, https://www.consilium.europa.eu/en/press/press-releases/2022/03/15/the-council-adopted-conclusions-on-export-credits/.

3 The Paris Agreement, https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement.

4 Australia, Canada, the European Union (and its member state ECAs), Japan, Korea, New Zealand, Norway, Switzerland, Turkey, the United Kingdom and the United States, https://www.oecd.org/trade/topics/export-credits/arrangement-and-sector-understandings/.

5 Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, https://ec.europa.eu/info/law/sustainable-finance-taxonomy-regulation-eu-2020-852_en.

6 "Statement on international public support for the clean energy transition," November 4, 2021, UN Climate Change Conference UK 2021, https://ukcop26.org/statement-on-international-public-support-for-the-clean-energy-transition/.

7 Communiqué issued by the Ministry of the Economy, Finance and Recovery in April 14, 2021, https://www.tresor.economie.gouv.fr/Articles/2021/04/14/seven-countries-launch-international-coalition-export-finance-for-future-e3f-to-align-export-finance-with-climate-objectives.

8 Similarly, the Korean sustainable finance taxonomy also contemplates certain LNG projects qualifying as "green" for a transition period.

9 The revisions also provide that the addition of a coal-fired electricity generation unit to an existing plant is deemed to be a new coal-fired power plant (ref: Article 6(a), Chapter 1 of the Arrangement on Officially Supported Export Credits, January 2022 [TAD/PG(2022)1]).

10 Within the parameters of the "Project Class A" category for the purposes of Appendix II to Annex IV of the revised OECD Arrangement. Ref: Article 6(b), Chapter 1 of the Arrangement on Officially Supported Export Credits, January 2022 [TAD/PG(2022)1].

11 Ref: Article 6(c), Chapter 1 of the Arrangement on Officially Supported Export Credits, January 2022 [TAD/PG(2022)1].

12 The factors that will be taken into account as part of that review include (i) the most recent reports on climate science and the implications for global infrastructure investment decisions of holding the increase in the global average temperature to well below 2 degrees Celsius above pre-industrial levels; (ii) officially supported export credits or tied aid support to other coal-related projects; and (iii) the availability of CCUS and non-CCUS CO_2 abatement technologies. (ref: Article 6(e), Chapter 1 of the Arrangement on Officially Supported Export Credits, January 2022 [TAD/PG(2022)1]).

13 "ICC Sustainability in Export Finance White Paper," September 2021, https://icc.academy/sustainable-export-finance/.

14 The UN Sustainable Development Goals, https://sdgs.un.org/goals.

15 Amendments that increase flexibility could take the form of, *e.g*. the recent temporary change to the OECD Arrangement minimum down payment terms from 15% to 5% for public buyers (with sovereign guarantee) in category II countries for one year, valid from 5 November 2021, https://www.oecd.org/trade/topics/export-credits/documents/Participants_CL_still_valid-(2022).pdf.

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