

# CRS Report for Congress

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## Defense Export Loan Guarantee Program (DELG)

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### Summary

This report provides an overview of the Defense Export Loan Guarantee Program (DELG) which became operational on November 8, 1996. It discusses the major features of the program, which is aimed at assisting prospective foreign purchasers of U.S. defense equipment finance those purchases through private sector loans. This report will be revised only as notable events relating to the program warrant.

### Introduction

The Defense Export Loan Guarantee (DELG) program originated with Section 3201 of P.L. 104-106, the National Defense Authorization Act for Fiscal Year 1996. This provision of law directed the Secretary of Defense to establish a loan guarantee program for the sale or long-term lease of defense articles and services. Circumstances that gave rise to the DELG program were concerns by U.S. weapons producers that they were at a competitive disadvantage in marketing their products internationally. Representatives of the U.S. defense industry argued that having a U.S. loan guarantee program that could induce private lending institutions to make loans to less-wealthy nations for purchases of armaments would enhance the ability of American companies to compete effectively for prospective weapons contracts abroad. Critics of such a loan program argued that the United States should not expend funds to help underwrite loans for weapons purchases by developing nations that already lacked sufficient resources to pay for major domestic social services. Other critics of this loan program argued that the United States should not provide loan guarantees to nations that were poor credit risks and might default on the loans underwritten by the United States. The DELG program that was enacted is a legislative amalgam that reflects the wishes of those who wished to create a new defense loan program to support U.S. defense exports, but also is structured in such a way to address the policy and fiscal concerns of those in Congress critical of the program and its purposes.

On November 8, 1996, the Defense Department implemented P. L. 104-106 by publishing in the Federal Register the basic framework and elements of this new

program.<sup>1</sup> The stated purpose of the DELG program is to meet national security objectives by encouraging standardization and interoperability of defense systems with U.S. allies, lowering purchase costs of defense items to DoD, preserving critical defense skills, and maintaining the stability of the industrial base by facilitating the export of American-made products. The Secretary of Defense assigned oversight responsibility for the program to the Deputy Under Secretary of Defense (International and Commercial Programs).<sup>2</sup>

## **DELG Program Structure**

The DELG program issues comprehensive guarantees to private sector lenders against losses of principal or interest, or both, for loans to certain sovereign nations. The DELG guarantee commits the full faith and credit of the U.S. government and covers 100 percent of the risk of nonpayment of covered principal and interest. The Defense Department guarantees defense exports loans for up to 85% of the contract value or 100% of U.S. content (whichever is less). The borrower must accept the loan as sovereign debt and make a cash payment of at least 15 percent of the contract price. Guarantees are available for the sale or long-term lease of U.S. defense articles, services, or design and construction services, as defined in the Arms Export Control Act (AECA) (22 U.S.C. 2751, et. seq.). A final commitment for a DELG guarantee will be issued only if the products are licensed for export under the AECA procedures. If the U.S. export contains foreign-made components, only the U.S. content will be supported by a DELG guarantee. The U.S. portion of the production cost of the items exported must be greater than 50% in order to qualify for a DELG guarantee. The DELG Program will cover eligible transactions under DoD's Foreign Military Sales program as well as commercial sales licensed by the U.S. State Department. Current authority limits the U.S. government's contingent liability to \$15 billion under the DELG program. The Secretary of Defense reserves the right to limit the loan amount guaranteed for any one country.

The DELG program functions much as the U.S. Export-Import Bank (Ex-Im Bank) functions to support exports of U.S. non-defense commercial goods and services. The Department of Defense will not guarantee a loan to a country that is ineligible for guarantees from the Ex-Im Bank. By law, the DELG program may not offer loan guarantees with terms and conditions more favorable than those offered by Ex-Im Bank. There are, however, notable differences between the DELG program procedures and those of the Ex-Im Bank.

First, the DELG program, by statute, must charge fees sufficient to cover all expected current and future program costs. The program is not subsidized with funds appropriated to the Defense Department. Second, the legislation which led to establishment of the DELG requires that the exposure fee, paid by the borrower to cover the risk associated

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<sup>1</sup> Federal Register: November 8, 1996 (Vol. 61, No. 218) pp. 57853-57856. Details relating to the Defense Export Loan Guarantee program discussed herein are taken from this source and an official U.S. Defense Department internet website found at <http://www.acq.osd.mil/icp/>

<sup>2</sup> Congress receives a report each quarter of the fiscal year on the implementation of the DELG program. The Secretary of Defense provides this report to the Committees on Appropriations, Armed Services, and Foreign Relations of the Senate and the Committees on Appropriations, National Security, and International Relations of the House.

with a potential default, not be included in the guaranteed loan amount. Third, the definition of export for the DELG program is that given in the International Traffic in Arms Regulation (ITAR)( 22 CFR 120.17). That definition of a defense export includes: (1) sending or taking a defense article out of the United States; (2) the transfer of registration, control, or ownership to a foreign person, to an embassy, or to another entity of a foreign government, even though the defense article has not left the United States; and (3) the disclosure or transfer of technical data, either within the United States or abroad. The provision of defense services, either within the United States or abroad, is also considered an export.

## Eligible Countries

By law, only the countries in the following categories are eligible for participation in the Defense Export Loan Guarantee program:

- A member of the North Atlantic Treaty Organization (NATO);
- A country designated, as of March 31, 1995, as a major non-NATO ally pursuant to Title 10 Section 2350a (I) (3);
- A country in Central Europe, as designated by the Secretary of State, that: (a) has changed its form of national government from a nondemocratic form to a democratic form since October 1, 1989 or (b) is in the process of changing its form of national government from a nondemocratic form to a democratic form;
- A noncommunist country that was a member nation of the Asia Pacific Economic Cooperation (APEC) group, as of October 31, 1993.

In accordance with the above criteria, the following countries listed are eligible to participate in the DELG program as of December 3, 1996. The State Department will review this list of eligible countries periodically and may add or delete nations from it. *NATO*: Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, Turkey, United Kingdom; *Major Non-NATO Allies as of March 31, 1995*: Australia, Egypt, Israel, Japan, South Korea; *Central European Countries*: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia; *Non-Communist Asian Pacific Economic Cooperation Members, as of October 31, 1993, that are not listed above*: Brunei, Indonesia, Malaysia, New Zealand, Philippines, Singapore, Taiwan, Thailand.

Changes to this list of eligible countries, if made, are posted on the Defense Department's official internet web site for the DELG. This site is found at <http://www.acq.osd.mil/icp/>.

## Lending Institutions and the DELG Program

Any U.S. or foreign bank, other financing institution, or other responsible party including the supplier/exporter may be a lender under the Defense Export Loan Guarantee program. Lender participation is based on two requirements: qualification and eligibility. Lenders currently qualified for loan guarantees under the procedures of the Ex-Im Bank are automatically qualified for the DELG program. Lenders not currently qualified by Ex-Im Bank must apply to Ex-Im Bank and become qualified. Ex-Im Bank reviews the institution's international lending experience, the most recent annual report and three years

of audited financial statements before it will qualify a lender. A qualified lender will be eligible to participate in the DELG program upon execution of the Department of Defense Master Guarantee Agreement (MGA). The MGA is the standard agreement between a lender and DoD that contains the terms and conditions applicable to every guarantee issued under the DELG program. The attachments to the MGA provide a set of standard forms that will be used for the disbursement, repayment, and claims procedures.

To execute an MGA, a qualified lender must apply by submitting an application fee of \$2,500, made payable to the Defense Export Loan Guarantee Program, and a statement that includes the name and address of the lender, the signature of an authorized representative of the lender, and the date the lender was deemed eligible for participation in Export-Import Bank programs. The lender must also certify the following verbatim:

"(i)The lender is not currently, nor has it been within the preceding three years:

1. debarred, suspended or declared ineligible from participating in any Federal program;
2. formally proposed for debarment, with a final determination still pending;
3. voluntarily excluded from participation in a Federal transaction;
4. or indicted, convicted or had a civil judgment rendered against it for any of the offenses listed in the Regulations Governing Debarment and Suspension (Government-wide Nonprocurement Debarment and Suspension Regulations: Common Rule), 53 Fed. Reg. 19024 (1988), or

"(ii) that if the lender is unable to make the certification set forth in (i), it has attached a detailed explanation of the grounds for this failure (including dates, identification of any debarring or suspending official, as such terms are defined in the Debarment Regulations, and his or her agency, and details of any proposed or actual debarment, suspension, declaration of any ineligibility, voluntary exclusion, indictment, conviction, or civil judgment.)"

The Master Guarantee Agreement and its attachments are the only agreements and forms that DoD will use to issue and administer guarantees under the DELG program. The DELG credit agreement must be executed by the lender and the borrower and approved by DoD for each transaction. A promissory note must also be executed by the borrower for the benefit of the lender to further evidence the credit. All loans guaranteed by DoD must be denominated and payable in U.S. currency. The Defense Department reserves the right to disallow a lender for a particular transaction, even if that lender is otherwise qualified and has signed a Defense Export Loan Guarantee MGA.

## **Application Process**

The DELG program offers both a letter of interest and a final commitment. The lender, borrower or suppliers/exporters may apply for a letter of interest. Only the lender or the borrower may apply for a final commitment. Applicants for a letter of interest will be charged a processing fee of \$1,250 and applicants for a final commitment will be charged a processing fee of \$25,000. Applications will not be processed without the appropriate processing fee. A letter of interest is not a prerequisite for application for a final commitment.

**Letter of Interest.** The Defense Department issues a letter of interest to indicate that a proposed loan may be eligible for a DELG guarantee. The letter of interest is based upon a limited review of the proposed transaction for which a loan guarantee is sought, and provides an estimate of the guarantee terms and DELG program fees. Terms and fees stated in the letter of interest are subject to change. The letter of interest is valid for six months and may be renewed. The letter of interest does not obligate DoD to provide a guarantee. A letter of interest may be sought before the details of the transaction are fully defined. Accordingly, it is acceptable for the applicant to provide estimates on its application. However, the accuracy of the DELG program fee estimates depends on the accuracy of the information provided by the applicant.

**Final Commitment.** The final commitment is a firm indication that DoD will guarantee the loan for a particular sale or lease, subject to satisfaction of all conditions specified in the commitment letter. A final commitment is issued upon extensive review of the application and the documentation that must accompany it. Prior to issuance of a final commitment, DoD must receive a copy of a valid export license or other evidence of compliance with the AECA. Additionally, DoD must receive written notice from the appropriate authority of the borrower that it will accept the loan as sovereign debt.

## Fees

The Defense Department is required to fund all program costs through the assessment of fees. These fees are assessed at various stages of the process to cover these costs. They are subject to change without notice. The major fees are as follows:

- **Processing Fees:** The processing fee for a letter of interest is \$1,250. A fee of \$500 will be charged to renew or update a letter of interest. The processing fee for a final commitment is \$25,000.
- **Exposure Fee:** The exposure fee covers the expected future cost to the U.S. government of a potential default by the borrower. The exposure fee is paid proportionately as the guaranteed loan is disbursed. The exposure fee must be paid by the borrower and shall not be included in the guaranteed loan amount. DoD will calculate the exposure fee based upon the loan's repayment term (up to 12 years), its disbursement schedule (up to 5 years), the country's risk ratings (1 to 8, with 1 representing the least risk), and the guaranteed loan's interest rate. The country risk ratings are determined by schedules and agreements set by the Interagency Country Risk Assessment System (ICRAS). The Office of Management and Budget (OMB) requires that all U.S. credit agencies use the same country risk factors and methodology to calculate the subsidy (in this case, the exposure fee) inherent in a sovereign credit transaction. These fees change periodically based upon changes in the ICRAS ratings and other factors. The exposure fee schedule for different risk ratings is available from the DELG program or the DELG internet site at [www.acq.osd.mil/icp](http://www.acq.osd.mil/icp).
- **Administrative Fee:** The administrative fee covers the cost of servicing the guarantee during the disbursement and repayment period. The administrative fee shall be paid at loan closing and shall be three-eighths of one percent (3/8%) of the guaranteed amount. The parties to the transaction must decide who will pay the administrative fee and notify DELG at the time of application.

- **Commitment Fee:** The lender or borrower shall pay a commitment fee of one-eighth of one percent (1/8%) per annum on the undisbursed balance of a guaranteed loan. Commitment fees begin to accrue 60 days after DoD issues the final commitment letter, and will be computed on a 360-day year basis.
- **Other Reimbursable Costs:** Parties to the transaction will reimburse DoD for any legal fees and for any other transaction costs required for loan closing and issuance of the guarantee. These fees must be paid at loan closing.

## **Disbursement and Repayment Terms**

The loan disbursement period shall not extend beyond the receipt of operational capability or completion of services, and in no case shall it extend beyond five years. Interest will accrue on the outstanding balance of the loan during the disbursement period. A DELG guarantee is available for fixed or floating-rate loans and covers 100 percent of the interest on the guaranteed amount. The repayment term on a transaction supported by a loan guaranteed by DoD can be no more than 12 years. The DoD will determine the repayment period based on the contract value, the useful life of the item, and the purchasing country. Major defense equipment generally will be allowed a maximum repayment term of 12 years and all other defense end items generally will be allowed a maximum repayment term of 10 years. The term of the loan shall never exceed the expected useful life of the item, as determined by DoD. Repayment of principal must commence within six months of the end of the disbursement period as defined above. Before any disbursements can be made under a DELG guaranteed loan, parties to the transaction will be required to satisfy all conditions set out in the underlying loan documents, including payment of all fees due and any other applicable transaction closing costs and expenses.

## **Recent Program Activity**

In its quarterly report to Congress for the fiscal quarter ending September 30, 1997, the Defense Department noted that Defense Export Loan Guarantee program had issued, during FY1997, four Letters of Interest for contracts, amended one, executed two Master Guarantee Agreements, and issued one Final Commitment. The Final Commitment was for a loan guarantee to support the sale of Unmanned Air Vehicles to Romania through a licensed, direct commercial transfer by a U.S. defense manufacturer. This Final Commitment was made by DoD to the qualified lender on September 5, 1997.

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