Australian Government

EFIC
Export Finance
& Insurance Corporation

Australia's Export Credit Arrangements

Public Inquiry

Submission to the Australian Productivity Commission

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Overcoming financial barriers for exporters

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1. Introduction

EFIC has been in the business of helping Australian exporters since 1957. As Australia's export credit agency (ECA), EFIC provides finance and insurance solutions to help Australian exporters and companies investing overseas overcome financial barriers.[1] It does so by complementing the support provided by the private market. EFIC was established in its current form as a statutory corporation wholly owned by government under the *Export Finance and Insurance Corporation Act 1991* (EFIC Act).[2] EFIC has an independent board which imposes a strong commercial discipline on its risk management and governance. The majority of the Board is from the private sector, with the Secretary of the Department of Foreign Affairs and Trade (DFAT) sitting as the Government representative.

EFIC is regularly reviewed – previously in 1997, 2000, 2003 and 2006. In the five years since the 2006 Review, EFIC has provided facilities worth A$3.1 billion, supporting Australian export contracts and investments of A$11.4 billion across a diverse range of sectors from construction to manufacturing, agriculture, water, engineering, defence, mining, oil and gas, shipping and services. EFIC has considerable international reach and currently supports the activities of small to large exporters in 28 countries.[3]

EFIC is a profitable agency making an average profit of A$33 million a year and returning A$106 million in dividends to Government since the last Review. The balance of profits is retained to increase EFIC's capital base to support more exports. The average annual return on equity over the period was approximately 8.9% compared to the ten-year government bond rate over the same period of 5.7%. EFIC's cost to income ratio is consistently below that of the regional banks which despite differences in mandate, are comparable in size to EFIC. Affirming these solid results, EFIC's clients are highly satisfied with the quality and type of services EFIC provides and the professionalism of its officers, with almost 95% of clients stating they would recommend EFIC to other exporters.

EFIC is a relatively small ECA operating at the commercial end of the spectrum of ECAs internationally. ECAs are significant players in export credit markets and other ECAs including those outside the OECD Consensus, are growing and becoming more active in Australia and in the region.[4]

The last review of EFIC was undertaken in the relatively benign market conditions that prevailed before the global financial crisis (GFC). Following the GFC trade volumes and trade finance flows recovered to pre-crisis levels. However, risk appetite and credit availability are now in decline with the onset of the eurozone crisis. In view of these difficult conditions, EFIC has increased support for exporters. Equally important from a policy perspective, EFIC has provided advice to Government regarding market developments and where appropriate has advised against re-entering markets that would more rapidly return to commercial norms.

The last review recommended the EFIC Act be simplified and a 'national benefits' test be added. This was in response to the changing nature of Australian exporting, which increasingly involved expansion through overseas supply and distribution chains. The trends which underpinned this recommendation are as relevant today as they were then, and in fact trends have accelerated given

[1] For further information please refer to EFIC's website.
[2] EFIC Act: http://www.comlaw.gov.au/Series/C2004A04223
[3] As at 30 June 2011 EFIC has exposures of A$2.4 billion distributed across 28 countries.
[4] Australia is a 'participant' to the Organisation for Economic Cooperation and Development's (OECD) Arrangement on Export Credits, which is also known as the Consensus. The Participants include: Australia, Canada, the European Community, Japan, Republic of Korea, New Zealand, Norway, Switzerland and the United States. See: http://www.oecd.org/department/0,3355,en_2649_34169_1_1_1_1_1,00.html

the strong Australian dollar in recent years. Simplification of the EFIC Act would generate significant process efficiencies both for EFIC and its clients. The introduction of a national benefits test would enable EFIC to provide greater support for small and medium-sized enterprises (SMEs) planning to internationalise their distribution and supply chains.

2. Rationale for government involvement

Exporting brings both risks and rewards to Australian companies. Research has shown that, on average exporting companies are more profitable than their non-exporting counterparts. Exporting exposes firms to new ideas, management practices, technology and ways of competing. This increases productivity and lifts firm competitiveness both domestically and internationally. It also provides an opportunity for exporters to diversify from a single market and achieve economies of scale.[5]

There are inherent risks and challenges associated with cross-border trade that do not necessarily exist, or exist to the same extent, in non-export operations such as a lack of information about risk counterparties and inherent political and country risks associated with foreign markets.

In economic terms, government intervention in export finance and insurance markets is justified where there is some market failure i.e. that a problem or set of problems exist in the market which causes an under-supply of finance or insurance to profitable exports and investments. In these cases government intervention, for example the creation of an ECA, to fix the market failure is justified if that ECA brings about net benefits to the community and can be shown to most directly and effectively target the failure.

There are at least four problems, or failures that exist in export finance and insurance markets, which have been recognised as justifying government intervention:[6]

Credit rationing. Banks may engage in non-price rationing of credit to would-be borrowers. Collateral quality and levels are essential hurdles for any given credit in the SME sector, and price (interest rate) is used as a subsidiary rationing device. Credit is rationed towards applicants with an established credit and export performance, with newly established and growing businesses often experiencing even greater hurdles. Applicants will also experience difficulties in raising credit where risks are unusual and outside the normal skill set of the lender. In EFIC's experience this is particularly the case with understanding country risks, given that bank delivery channels serving SME customers are often focussed on the delivery of a product set for domestic businesses. This experience is consistent with the theory of credit rationing advanced by Stiglitz and Weiss.[7] This demonstrates that in the presence of asymmetric information between borrower and bank, banks will set a less than market-clearing interest rate and ration credit by non-price means. Unfortunately, in this process, many 'good borrowers' (Stiglitz & Weiss's term) with prudent and profitable deals get rationed out.

Information. The Government's April 2011 Trade Policy Statement recognised that a lack of access to information on international markets can impede Australian businesses from identifying foreign commercial opportunities and entering new markets.[8]

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[5] See Austrade http://www.austrade.gov.au/How-to-export/default.aspxt and the Review undertaken by D Mortimer AO and J Edwards, Winning in World Markets: Review of Export Policies and Programs, 1 September 2008.
[6] See Appendix A, Q3 for detailed discussion of these points.
[7] See the seminal paper by JStiglitz and A Weiss, Credit Rationing in Markets with Imperfect Information, *American Economic Review*, 71(3), June 1981, pp. 393-410.
[8] See the Gillard Government Trade Policy Statement: Trading our way to more jobs and prosperity, April 2011.

One of the biggest impediments to providing insurance for medium to long-term export credits is the uncertainty associated with quantifying probability of loss into the future.[9] This difficulty can cause a bank or insurance company to deny an export that it would actually assess as profitable if it knew the 'true' risk. Accordingly, potentially profitable export and investment deals are not done.

Similarly, information about overseas markets can be difficult for an individual exporter to obtain. This information is a type of public good: once produced it can be made freely available at no extra cost, but when left to the private market to produce, the cost for individual firms is prohibitively high.

Cross border contracts. In international trade an added element of contractual uncertainty and enforcement arises. It can be difficult to write water-tight contracts covering all possible future contingencies. As a result, an overseas investor may be wary of being drawn into legal proceedings in unfamiliar courts applying unfamiliar rules and conclude that doing the underlying business is too difficult; accordingly profitable investment opportunities are foregone.

Financial crisis. During a financial crisis trust between exporters, importers and financial intermediaries collapses. Information about foreign counterparty risk can become especially difficult to obtain. In this environment banks become cautious, or refuse outright to accept and discount foreign bank letters of credit or promissory notes from foreign importers.

The short term nature of much trade finance can also cause failures. Despite trade finance generally being recognised as relatively safe thanks to its short-term and self-liquidating nature, banks that are desperate for liquidity, or seeking to reduce exposures may cut short-term maturing trade credit lines.[10] As a result trade credit can be unfairly singled out during a financial crisis, with the potential for large impacts on trade and the wider economy.

Features of EFIC support

As an ECA, EFIC has a number of unique features that enables it to address market failures in a targeted and effective way. These features may address one, or a combination of the above market failures that appear in export finance and insurance markets.

Information for exporters

As noted above, the Government recognised that Austrade should provide free information on emerging and frontier markets on the basis that this information was a public good.[11] This argument applies to EFIC as much to Austrade. It could be argued that it applies more strongly to EFIC when it involves country risk assessments. Austrade has expertise in assessing business opportunities in emerging export markets, and EFIC has expertise in assessing the risk associated with these opportunities. This expertise arises out of institutional experience and knowledge as well as access to information through government, networks of international ECAs, international fora including the Berne Union and the OECD, as well as the private market.

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[9] NERA noted this point in their report on the UK ECA ECGD, 'The rationale for the public provision of export credits', 2000.

[10] Jean-Pierre Chauffour and Thomas Farole, 'Market adjustment versus market failure', *Trade Finance During the Great Trade Collapse*, Jean-Pierre Chauffour and Marriem Malouche eds, World Bank, 1991

[11] See page 15 of the 'Gillard Government Trade Policy Statement: Trading our way to more jobs and prosperity.' http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.pdf

EFIC can and does disseminate this information to the market in a number of ways. It can do so by freely publishing country risk assessments and briefings.[12] It can also 'signal' to the market through its cover policy on a country. Most persuasive of all, it can put its money behind a project. In doing so it signals to exporters that it has done a thorough and objective country risk assessment, and in addition signal to a foreign government or buyer its assessment of the performance-worthiness of the exporter. Through these signals, EFIC can induce profitable exports that the market itself would not support.

Case study – Lumwana project

In 2006 EFIC provided a loan of US$52.5 million as well as political risk insurance (PRI) cover of US$240 million to support the Lumwana mine project in Zambia owned by Equinox Minerals Limited (Equinox). EFIC's finance and insurance supported Australian content of A$70 million by underpinning the participation of Ausenco Limited for the engineering, procurement and construction contract for the project. EFIC involvement provided comfort to the private market around the contractual, country and project risks. Insurers then reinsured almost 80% of EFIC's PRI exposure. As the mine's performance was established, EFIC's facilities were entirely refinanced in March 2010 by commercial lenders on more favourable terms to the borrower. EFIC support enabled additional exports and further benefits flowed to Australia through a A$5 billion increase in shareholder value realised by the mine sponsor Equinox when it was acquired by Barrick Gold Corporation of Canada in 2011.

In addition to assisting with export transaction specific risks EFIC has developed an online educational resource with support from Austrade called *Export Finance Navigator* (Navigator).[13] Navigator was developed in response to a recommendation by the Mortimer Review to develop an independent source of advice and information on export financing, including referrals to commercial service providers as well as to other sources of government financial assistance.[14] EFIC continues to develop its online presence and to help exporters quickly assess whether a product is suitable for them; for example, EFIC recently launched an online pre-qualification tool.[15]

Overcoming barriers to export

Assessing the credit risk of an export transaction requires a significantly greater effort, involving analysis of country risk, client quality and deal risk, than a 'vanilla' domestic finance application.[16] The time and resourcing required may not offer a sufficient return on effort for the private market, particularly for smaller exporters. The private market may prioritise simple, high-volume transactions such as a secured loan over a more complex export finance transaction.

EFIC utilises its expertise and international networks to understand country and transaction risks. It also takes time to understand business models and is willing to lend against cashflow rather than security only. By doing so EFIC can promote additional profitable exports, and in doing so often 'crowds-in' the private market to support transactions the private market otherwise would not.

[12] See EFIC Country Analysis.
[13] See Export Finance Navigator.
[14] The Mortimer Review found that a common problem for new exporters and businesses investing overseas was a lack of understanding about the financial products available and where to obtain finance. D. Mortimer, and Dr J. Edwards, op.cit, pp. 126-127.
[15] See EFIC website.
[16] See East & Partners trade finance study results discussed in Appendix A, Q17.

Case study- Environment Systems & Services Pty Ltd

In 2011 Environment Systems & Services Pty Ltd (ES&S), an advanced technology company won a A$2.3 million subcontract to provide equipment and training on weather forecasting and meteorological warning systems in Samoa. Under the subcontract, ES&S was to receive periodic payments from its Samoan customer, but the lag between when ES&S incurred costs and received payments from the buyer meant that the company faced a working capital shortage. EFIC provided a six-month A$500,000 export working capital guarantee (EWCG) to ES&S's bank, providing it with the comfort to lend more to ES&S. Successful completion of this contract will demonstrate ES&S's ability to compete against major international players and win further work.

Counter-cyclical role

An ECA can perform a particularly important service during a financial crisis. It can step forward with support of exports as the private sector steps back, thereby cushioning a slump of exports.

Case study – Crisis response capability

During the GFC of 2008-09, the Latin American financial crisis of the early 2000s and the Asian financial crisis of 1997-98 EFIC provided support when private market capacity was temporarily restricted or missing. Most recently in response to the GFC, EFIC increased its support for exporters in response to a number of market gaps that arose during and following the GFC. It also modified its existing products to reflect the private sector's reduced risk appetite and constraints on exporter credit. It provided documentary credit guarantees on letters of credit for export contracts with shorter payment terms down to 180 days. It initiated a reciprocal risk participation scheme with regional ECAs to streamline risk participation among members of the Asian Export-Import Bank group and support efforts to maintain the flow of trade finance in the region. EFIC also supported Government with advice regarding discussions at international level on improving the availability of trade finance and limiting the impact of the GFC on trade.

Risk-bearing role

ECAs are generally able to finance much larger and longer term transactions than the private market principally because they have government backing, face limited threat of bankruptcy and typically have built up expertise in assessing these types of risk over a number of years. While EFIC is a relatively small ECA it can risk share with other ECAs, or private insurers to extend support to large and long term projects. While not used often in recent years, the National Interest Account (NIA) also gives EFIC the ability to support profitable exports and investments that the market alone could not support.

Case study – PNG LNG project

In 2009 EFIC provided a US$350 million loan to the PNG LNG project; a circa US$15 billion liquefied natural gas project in Papua New Guinea being developed by an international consortium of companies led by ExxonMobil. The financing raised for the project was and remains one of the world's largest project finance transactions.

The market gap for this transaction centred on risks at the country and project levels and insufficient commercial market capacity due to the large debt requirements and long tenors required. EFIC was unable to meet the total financing amount sought on its commercial account (CA) and referred the transaction to the Minister for Trade for consideration on the NIA. The Australian Government supported the project with the result that EFIC provided a loan on both the NIA and CA, alongside a large syndicate of ECAs from the US, Japan, Italy and China, commercial lenders and debt funding from Exxon Mobil.

EFIC support helped to ensure significant Australian content in the project, in the form of Australian civil and mechanical engineering and project management services during construction. Measured Australian content was circa US$500 million, with actual Australian content estimated at over US$1.0 billion in contracts, and including sub-contracting and owners' costs, is estimated to be over US$3.0 billion. This is well in excess of the loan provided by EFIC. EFIC participation ensured that Australian procurement was not lost to other countries as a result of their ECAs requiring higher levels of procurement from their respective countries at the expense of Australian suppliers. ASX-listed companies Oil Search and Santos are major investors in the project (at 29 per cent and 13.5 per cent respectively) and dividend repatriation by Oil Search and Santos over the 25 year operating life of the project is expected to be substantial. The project will have a transformational effect for the Australian companies, particularly for Oil Search, as its reserves base has increased by 505 million barrels of oil equivalent to 567 million barrels.

The LNG project has the potential to add considerably to PNG's Gross Domestic Product and economic growth, and will provide significant dividends, royalties, jobs and work for local business.

Risk control

It has been argued, including by NERA and the Bundesbank that an ECA can better control the country risk than a private sector counterpart, thanks to the diplomatic and financial strength of its government owner.[17] A government can take steps to reduce country risk, or can be better placed to recover money through international fora such as the Paris Club. By reducing risk an ECA can promote profitable trade and investment above and beyond what the private sector can achieve and make money in the process.

Reputation

Exporters and private market financiers may take comfort from the presence of an ECA in a transaction. An ECA brings with it the reputation and financial standing of its Government and the reputation of its own operations built over many years. As a Government agency there is an expectation that it will not reject claims on insubstantial grounds, or be unable to pay a claim.

Existing infrastructure

EFIC represents an investment in 'soft infrastructure' built up over 50-plus years. This soft infrastructure includes export and financial markets knowledge and expertise, international networks of private and government export credit providers, policy expertise through contributions to OECD and Berne Union forums, and up-to-date knowledge of pricing benchmarks and terms and conditions of support. The exact value of this soft infrastructure is difficult to determine, however it enables EFIC to provide support profitably where the

[17] NERA report, op cit, and see also the Bundesbank study of German ECA, Euler Hermes, Political risk and export promotion: evidence from Germany.

private sector cannot. It is also critical, particularly in times of crisis, to assist in maintaining the flow of credit to exporters, and to provide Government with valuable information on market dynamics and developments. While this is not a unique feature of ECAs it does imply that careful consideration should be given before deciding to disband an established ECA and thereby lose these capabilities.

3. The market gap mandate

EFIC supports Australian exporters and overseas investors where the private market is unable or unwilling to provide credit and insurance services. This mandate, commonly referred to as the 'market gap', was referenced in the Second Reading speech for the *EFIC Bill 1991*.

> *"It will continue to fill a market gap by providing services which are not normally available from the private sector … EFIC will continue to work with the financial sector and not in competition with it, to provide Australian exporters with access to competitive credit insurance and export finance facilities."*

Previous reviews of EFIC, corporate plans and most recently the Minister of Trade Dr. Craig Emerson in EFIC's Statement of Expectations – all have reiterated that:

> *"…EFIC is to manage its activities so that it does not compete directly with existing commercial sector providers of insurance, reinsurance and financial services and products which support Australian exports and foreign investment. Each transaction considered by EFIC must be assessed on this basis and information which shows that EFIC is not competing directly with existing commercial sector providers must be included in any Board paper seeking approval for a transaction. EFIC is not to compete with the private sector operators as this is the basis of EFIC's current exemption from financial services and banking Competitive Neutrality legislation…"* [18]

The market gap concept is clearly of fundamental importance in guiding EFIC's activities in export credit markets and justifying its exemption from competitive neutrality legislation.

What is the market gap?

As discussed above the market gap recognises instances of market failure. It also recognises other commercial conditions such as a temporary lack of market capacity, or more structural issues affecting SMEs that means that profitable projects are denied finance, or 'good' borrowers are turned away.

Identifying the market gap

As agreed in the context of the 2006 Review, when presented with a potential transaction EFIC forms a view on whether there is a market gap based on considerations of:

- risk: for example country or project-specific risks.
- size: whether the project's size affects commercial market participation; it may be too small or too large relative to commercial market limits.
- term: a facility with a longer term will be more likely in the market gap than shorter tenors.

[18] See EFIC website.

- industry: for example a developing industry or green-field development, or an industry with an inherent high risk profile, such as those involving concessions or contracts with emerging market host governments.
- firm size: whether the firm's size or experience creates a barrier for commercial providers, or the firm's experience heightens their perception of risk in a particular market.
- private market capacity: whether current country or project limits, term constraints or lack of relevant experience affect the extent or quality of coverage provided, or the consistency or reliability of private sector support.

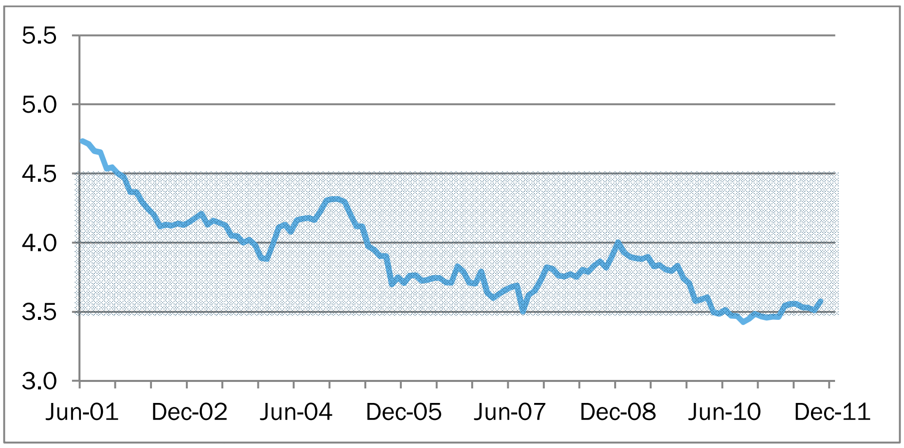
EFIC's consideration of the market gap is informed by a range of sources, including:

- Bank and insurer contacts: including from both domestic (informally and also through bodies such as the Australian Trade Finance and Insurance Association (ATFIA)) and foreign sources. When considering whether an export is in the market gap EFIC may crosscheck information from other private market sources.
- Clients: EFIC receives information from clients regarding the availability of finance; information is corroborated with the private market.
- Berne Union: data and reporting as well as informal discussion amongst members.
- OECD reporting: data and discussion as well as informal discussion amongst members.
- Other information sources: EFIC is a member of Asia Pacific Loan Market Association and contributes to the Project Finance committee.

A further test of whether EFIC is operating in the market gap, and not encroaching or crowding out the private sector is whether there are any complaints from the private sector. Since the 2006 Review, EFIC is not aware of any such complaints and understands that there is no record of complaints to the Australian Government Competitive Neutrality Complaints Office.[19]

EFIC also assesses the market gap on a portfolio basis. For each transaction EFIC applies a risk score EFIC Risk Score (ERS) which captures the mix of risks for each transaction including various country and industry risks. On a portfolio basis, EFIC aims for a weighted average risk rating in the range of 3.5 to 4.5 ERS.[20] Operating in this band gives EFIC an indication of whether EFIC is operating outside the market gap. If the weighted average ERS grade of EFIC's portfolio falls below 3.5, EFIC may be straying into less risky markets where private sector financial services could be available and conversely where a score exceeds 4.5, EFIC's portfolio may be assuming too much risk.

Figure 1: EFIC Weighted Average Risk Grade



[19] See Australian Government Competitive Neutrality Complaints Office website
[20] Where 1 is the best rated credit and 9 is a credit loss. A rating of 3.5 equates to S&P BBB- and 4.5 equates to S&P BB-.

The role of pricing

The pricing of EFIC support is closely associated with the market gap mandate of not competing with the private market. EFIC prices its products having regard to the price set by the commercial market for a particular or a comparable risk. In doing so EFIC aims to:

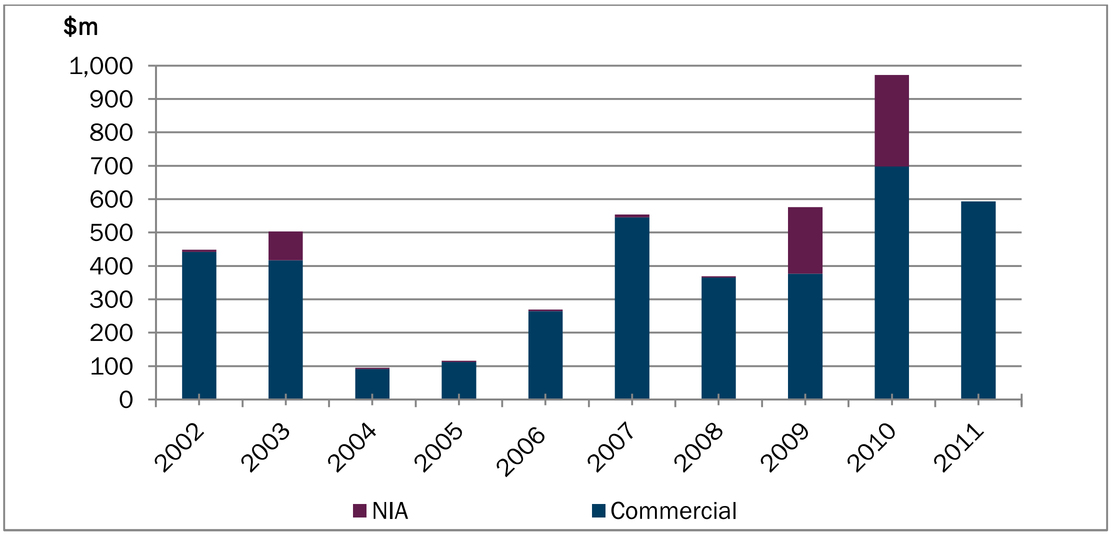
- Achieve an appropriate return for risk.
- Offer pricing that will encourage a borrower to seek private market support.
- Achieve a return sufficient to attract private market risk-sharing partners.
- Encourage the borrower to refinance the transaction.

When EFIC is co-financing or providing a guarantee pricing is provided at or above market rates. When the private market is not directly involved benchmarks are used to determine appropriate pricing. This includes private sector pricing, (for example in a syndicated loan, market data with respect to the borrower, borrowers issuance in capital markets, or market pricing for comparable borrowers), and, where applicable, OECD premium pricing benchmarks are used.

4. Support for exporters

Over the five years since the 2006 Review, EFIC has provided facilities worth A$3.1 billion supporting Australian exports and investments totalling A$11.4 billion. EFIC signings data can be episodic and lumpy (ie one large project finance can skew figures); however, the trend of EFIC's countercyclical role can be seen from figure 2. In the benign credit environment before 2007, EFIC's signings were low, but have grown in response to reduced risk appetite and credit availability and the appearance of new markets gaps in projects and transactions.

Figure 2: Signings CA and NIA – 10 years

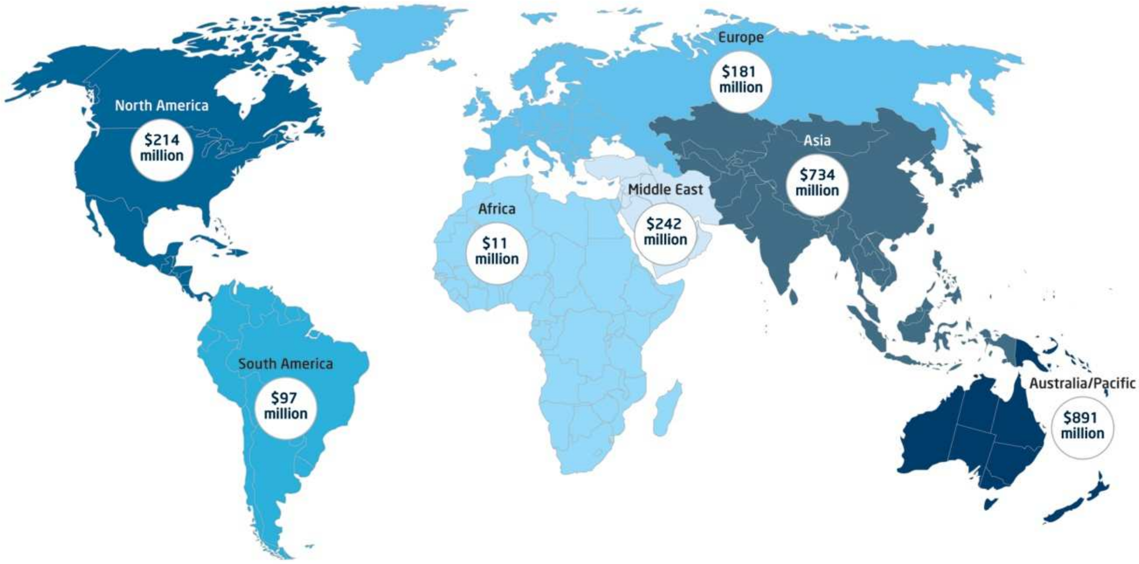


Despite challenging conditions in credit markets over much of the five year period since the 2006 Review, EFIC has remained consistently profitable, earning an average profit of A$33 million a year. The average return on equity over the period was approximately 9% a year.

Global support

EFIC supports Australian exporters across the world and manages exposures of A$2.4 billion across 28 countries.

Figure 3: Exposures by region 2010-2011



5. <u>Market developments – current market gaps</u>

Prior to the global financial crisis cross-border lending was abundant and risk pricing was low. When the crisis became acute in September 2008 these conditions were abruptly reversed. In the 'new normal' conditions, there has been a flight from risk and an impaired ability on the part of many banks, particularly from the North Atlantic, to extend credit. In 2009-2010 there was evidence of some gradual recovery of lending but with the onset of the eurozone crisis, risk appetite and credit availability are again receding. This is creating financing and other risk gaps in projects and transactions, and demands for ECAs to play an enhanced role.

Current market gaps

EFIC's traditional buyer credit business continues to support exports of capital goods and services; however, there is currently a contraction in overseas demand for buyer credit facilities, which reflects constrained capital expenditure internationally.

Demand for EFIC's performance bonds in recent times has been strong, reflecting ongoing shortfalls in supply from commercial banks, particularly in the engineering and resource development sectors.

A new market gap has emerged for domestic export-focused infrastructure projects. Following the GFC, the global banking sector has struggled to provide sufficient capacity for these large, long tenor projects, even with positive expected net present values. EFIC has sought to fill this market gap by intermediating funding from international capital markets and on-lending the proceeds to profitable domestic export infrastructure. The demand for debt to finance these projects is unprecedented and EFIC and other ECAs are providing cornerstone finance for these transactions. EFIC can provide support directly at the 'project level' or indirectly to participants in the 'supply chain', including SME clients, who will be involved as primary or sub-contractors in the development of these projects.

There is a continuing market gap for SME exporters, particularly for those that lack tangible security and seek support based on an assessment of the transaction cash-flow. In response to demand as well as specific issues regarding SMEs, EFIC has introduced the following products:

- Producer Offset loan provided in collaboration with Screen Australia to help finance Australian film and television productions.
- A foreign exchange facility guarantee provided through Travelex and HiFX to assist exporters to hedge their foreign exchange commitments.
- An EWCG with the Australian domestic banks to help Australian exporters with working capital.

EFIC has also established a risk-sharing agreement with the Asian Development Bank (ADB) to expand the Australian banking sector's capacity to support exports in Asia's developing economies, in particular, Bangladesh, Pakistan and Sri Lanka, and shortly Vietnam.

EFIC has selectively taken part in larger commodity receivable and letters of credit confirmation transactions. For these transactions, EFIC's clients are domestic and international banks based in Australia, and EFIC takes part only if the client bank has reached its internal bank, country or counterparty limit and has demonstrated to EFIC that it is unable to further sell down the counterparty risk in the commercial (bank or insurance) market.

Basel III regulatory reforms will have an impact on EFIC. ECAs have expressed concern that current Basel III proposals do not reflect common commercial arrangements in international trade; in particular the new rules do not reflect the collateral value and risk mitigation provided by government-backed ECAs. Commercial banks will be required to set aside additional capital for long dated maturities which will discourage banks participating in ECA-guaranteed medium to long term export credits.

6. *EFIC Act – modernisation*

The 2006 Review recommended that the EFIC Act be simplified and a 'national benefits' test be introduced to enable EFIC to effectively provide support to SME exporters' overseas distribution and supply chains.[21] These recommendations were endorsed by Cabinets of two Governments and the Mortimer Review. However, draft legislation has stalled.

The recommendations of the 2006 Review are even more relevant today as the trends that drove those recommendations have accelerated. Prompted by these trends other ECAs have in the meantime changed their mandates. Most recently the New Zealand agency NZECO, has announced it will apply a wider 'benefit to New Zealand' test to support companies operating in international supply chains.[22]

The EFIC Act is now 20 years old and has served its purpose well. However, it is based on a prescriptive formulation of products and eligibility criteria. There is inconsistency of eligibility across products. This causes loss of efficiency due to unnecessary complexity, and higher transaction

[21] To be eligible SME exporters would need to demonstrate that their planned activity will result in a net economic benefit to Australia. In applying the net economic benefit test, a range of factors would be considered including: forecast increases in exports, dividend flows and revenues from overseas, overseas market share and access to new overseas markets.
[22] New Zealand Government Press Release. A 'national benefits' test has been adopted by a number of ECAs including Canada's EDC, Finland's Finnvera, Denmark's EKF, Austria's OeKB, Italy's SACE, China's Sinosure and Belgium's ONDD.

costs. This can place the exporter in a disadvantaged position in competing with ECA-backed exporters from other countries in terms of both costs and timely delivery.

The adoption of a 'national benefits' test by EFIC would allow a wider range of factors, such as dividend flows and improved access to markets to be taken into account in determining EFIC's support. This will align with the strategy of an increasing numbers of Australian firms to provide competitive products and services through international supply chains. A benefits test would enable EFIC to support transactions where there are clear and measurable benefits flowing back to Australia. This is consistent with EFIC's statutory function to 'facilitate and encourage Australian export trade' and its duty to improve and extend the range of products to persons involved in Australian export trade.

There are strong grounds for a return to the recommendations of the 2006 Review in relation to the EFIC Act. These changes would represent a necessary shift from the 'process-based' orientation of the 1990s legislation to the modern 'principles-based' legislation favoured by Government today.

7. Risk bearing capacity and the NIA

EFIC's capital and reserves are limited and circumstances can arise where it is in Australia's national interests to provide support for amounts which exceed the capacity or risk-bearing ability of EFIC's CA. For this purpose, the Government has the NIA. The Minister for Trade can direct or give approval to EFIC to provide support where it is in the 'national interest' to do so. The NIA is underwritten by the Commonwealth, rather than by EFIC. EFIC is responsible for management of the NIA on a day-to-day basis and accepts an administration fee from the Government for undertaking this role.

A major impediment to the effective use of the NIA is the uncertainty and delay inherent in the Government decision-making process. A prescribed process is needed, so that underwriting and commercial deadlines can be aligned with government consideration and approval.

8. Environmental and social assessment

EFIC has a comprehensive and rigorous process for environmental and social assessment set out in its Policy and Procedure for Environmental and Social Review of Transactions.[23] The Policy and Procedure were developed to satisfy the requirements of both the OECD *Recommendation on common approaches on the environment and officially supported export credits* (Common Approaches) and the Equator Principles, the latter of which EFIC has voluntarily adopted.

EFIC extends the requirements of its Policy and Procedure to cover all of its transactions, whereas the Common Approaches and Equator Principles only cover some of the products that EFIC offers to exporters. EFIC adopted a new Policy in February 2011 following a lengthy review period of consultation, including a workshop with interested Civil Society Organisations (CSOs).

EFIC has introduced on its website a register of transactions which EFIC has supported in the current financial year. The register is updated as soon as practicable after a transaction is signed.

In discussion with CSOs EFIC has initiated an ongoing stakeholder forum. The first meeting was held in November 2011. EFIC has also committed to engaging an independent environmental and social

[23] See EFIC website.

expert to audit the application of the Policy and the Procedure every two years. Audit reports will be provided to EFIC's Board and to the public. The first audit will be conducted before February 2013.