Productivity Commission Inquiry into Australia's Export Credit Arrangements

ANZ Submission
December 2011

1. *Introduction*

Australia's extensive financial and capital markets provide a broad range of options for Australian businesses; these will always remain the first source of finance for Australian business.

However, the private sector has limited appetite for lending related to some countries or markets, particularly developing markets. The private sector also has limited appetite to support smaller but expanding exporters. In these cases, EFIC plays an important role in supporting exporters wanting to tap into international markets.

In Australia, EFIC operates under a 'market gap' mandate, and is only able to provide services to viable projects where the private sector is unwilling or unable to provide support. EFIC (or any ECA) involvement in lending to developing countries markets assist with facilitating private sector lending. EFIC involvement reduces risk for commercial banks and can be the catalyst for private sector participation. ANZ considers the 'market gap' mandate is appropriate.

In order to support our customers, ANZ works with EFIC through our Trade Finance (short term lending) and Structured Export Finance (medium to long term lending) businesses. EFIC provides a range of products and services, including credits for exporting firms, guaranteeing repayment of a loan by a financial institution to an overseas buyer, insuring against non-payment of a credit extended by an exporter to an overseas buyer, and providing direct loans or credits to overseas buyers. In our experience, EFIC's pricing is commercially appropriate given the risk involved.

While we support the continuation of EFIC's broad market gap mandate, we would also support increasing EFIC's flexibility by considering changes to the National Interest Account and the one obligor rule.

ANZ considers that what constitutes "National Interest" should be for Government to determine. However, we would welcome greater transparency in the process and basic assessment criteria. We would also like to see more transparency about EFIC's risk appetite. More information in these areas would allow the private sector to have more certainty and assist ANZ in its role as an adviser to its customers.

For example, the formation of a permanent, "open-door" committee to provide a transparent process for the determination of whether the Government supports National Interest applications. ANZ notes this model operates in Germany via the Euler Hermes Inter-Ministerial Committee process.

ANZ also suggests that, as an alternative to the National Interest Account process, EFIC's one-obligor limit be increased. Currently, under the one-obligor rule, the maximum assistance EFIC can provide is $150 million. Increasing this limit would allow EFIC to have the flexibility to support a wider range of transactions. This would have particular importance in light of the significant pipeline of domestic projects in Australia, often involving financing of many billion dollars, that the private sector will not be able to fund on its own.

ANZ would be pleased to provide further information about this Submission as required and can be contacted as follows:

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2. ANZ's existing relationship with EFIC

ANZ operates in 32 markets with representation in Australia, New Zealand, Asia Pacific, Europe, America and the Middle East. ANZ has, in particular, significant operations in the Asia Pacific region, including representation in 14 markets across Asia and 12 markets across the Pacific, where we provide a full range of banking products and services to ANZ's retail and business clients.

As a result of our growing presence in the Asia Pacific region, we work closely with EFIC to provide risk mitigation and short-term trade finance solutions as well as structured medium to long term lending. EFIC's primary business dealings with ANZ are in two areas, Structured Export Finance and Trade and Supply Chain.

Structured Export Finance provides medium to long term funding for cross border capital goods flow using Export Credit Agency (ECA) cover. ANZ is particularly active in Natural Resources, Infrastructure, Utilities and Telco sectors. The Export Finance team works with EFIC on outbound transactions (financing offshore buyers of Australian manufactured capital equipment and services) and with EFIC and all other ECAs on domestic or inbound transactions (financing export-oriented domestic projects and/or Australian buyers of offshore manufactured capital equipment and services).

Trade and Supply Chain (TSC) provides short term funding and risk management facilities to support trade flows, also on occasion using ECA cover products to enhance structures. TSC is active across all industry segments and primarily supports the cross-border movement of goods with tenors typically less than one year.

EFIC sales teams have regular contact with ANZ. This includes regular meetings to discuss EFIC's product suite, transactions already in place and joint customer visits.

EFIC also regularly presents to broader groups within ANZ to promote what they do and explain how their product set works. Through this interaction, market or product gaps are identified and can lead to new product development initiatives by EFIC. In addition ANZ and EFIC often participate in public forums presenting to exporters on risk mitigation and funding alternatives, highlighting the importance of working with both organisations to achieve synergistic results.

EFIC is an active partner of ANZ. Not only does EFIC support transactions where a market gap appears but it also introduces new business opportunities in situations where a company's existing banker may not be able to assist due to a lack of understanding of trade finance or it has not signed up to EFIC's product set.

3. Presence of a "market gap"

The market gap manifests itself in a number of ways: risk capacity (i.e. bank capacity to take the borrower risk), liquidity capacity (i.e. bank capacity to provide the liquidity), tenor appetite to mitigate refinance risk (i.e. bank's capacity to provide the tenor long enough to match the project profile so as to avoid refinance risk), and regulatory impost (such as prudential requirements). These will vary across projects, exporters, importers and obligors.

The size of the market gap also changes in line with the economic cycle. We have seen a transition from a relatively stable financial situation prior to the GFC, to a period of significant uncertainty during the GFC in 2008-09. In late 2011, we are returning to more uncertainty, as a result of the European debt crises, as well as the difficult economic climate in the United States. We are also witnessing a shift in Australia's economic structure, with increasing pressure on exporters created by the strong Australian dollar and relatively high labour costs. This is creating potential liquidity and growth challenges for companies, particularly SMEs, which are reliant on export markets.

In these instances, it is important that EFIC continues to operate in this market gap. In some circumstances EFIC involvement reduces risk for commercial banks and can be a catalyst for private sector participation. In particular this arises because:

- Private sector has limited appetite to support smaller but expanding exporters
  - On the short term lending side, this has been met by the Working Capital Guarantee product
  - An example in respect of medium to long term lending is EFIC's facilitation of the growth of the fast ferry manufacturing business in Australia (for borrowers such as Austal, Incat and for smaller manufacturers such as Thornycroft)
- Private sector has limited appetite for lending in some countries/markets, particularly in developing markets and for longer tenors,
- EFIC is at times able to resolve issues in a more timely manner through government to government contact
- EFIC can extend support for short-term exporter transactions into markets where the private sector sovereign risk appetite is limited. This includes, for example, commodity exports into Pakistan
- Private sector appetite for corporate risks and most project risks is generally limited to 5 – 7 years (giving rise to re-finance risk) and capital market alternatives are prone to extreme volatility in terms of access and volume

EFIC support can therefore be fundamental to ANZ's preparedness to offer extended tenors for certain obligors that would not otherwise be available without EFIC support, or with support from private sector insurers

4. EFIC's response to the market gap during the GFC

The following observations note the difference in short, medium and long term finance difficulties faced by Australian exporters.

Trade Finance Market

There have been several instances over recent years where EFIC effectively filled the gap that was left by banks and insurance companies (insurers withdrew totally from some markets and segments, such as wine).

EFIC acknowledged the changed risk profiles in particular countries so business was not unduly exposed. This was particularly important in the market gap associated with business deals that advance the national interest. As the market gap grew, EFIC proactively worked to meet that gap. ANZ appreciated that EFIC became more innovative and entrepreneurial during this period, particularly in relation to their short term trade mandate.

In particular, ANZ notes the following examples that demonstrate how EFIC became more innovative to fill the market gap:

1. Introduction of the Export Working Capital Guarantee Facility

The Export Working Capital Guarantee Facility is a credit support arrangement provided by EFIC for small-to-medium-sized businesses that need credit over and above their current borrowing capacity to support their export finance needs.

The product recognises that it is difficult for fast growing small-to-medium-sized exporters to find the working capital needed to support growing international sales contracts. This could include, for example, a shortage of funds to hire more staff, buy raw materials, manufacture their product for export or send their goods or services to the buyer. ANZ provides the facilities to our client against the cover of an EFIC guarantee.

Case Study: A NSW based technology company won a contract to supply video streaming to a Malaysian buyer. The contract was short term – less that 12 months – and created a short term working capital gap. EFIC provided an Export Working Capital Guarantee in favour of ANZ (~$800k) against which ANZ provided short term finance.

2. Short-term export risk participation: setting up ADB/EFIC arrangements

EFIC entered into a landmark US$65m risk sharing agreement with the Asian Development Bank (ADB) to share in risk participation of export letters of credit issued in support of Australian export flows to developing markets.

Case Study: ANZ sought EFIC assistance for Australian exporters in covering commodities to Bangladesh, Pakistan and Sri Lanka. Through these discussions, EFIC entered into the agreement with the ADB, which continues to be heavily used by ANZ for Australian exports to these countries.

This continues to be an excellent initiative by EFIC and ADB and one which can be emulated for other countries covered by ADB and potentially could be enhanced by EFIC partnering with other Multilateral Development Agencies such as European Bank for Reconstruction and Development, or the International Finance Corporation

3. Bonding/Guarantee

Similar to the Working Capital Guarantee Facility, EFIC's Bonding/Guarantee arrangements assist banks to issue bank guarantees to support performance bond requirements. These are imposed under supply and/or services contracts where the supplier is required to lodge evidence of their financial or operating capacity to meet their obligations.

Case Study: A small to medium size enterprise (turnover less than $50m) and one of Australia's leading combustion and process engineering companies won a US$6.5m contract to supply and install two fired heaters for the 240 km Taweelah-Fujairah gas pipeline in the UAE. The company could not finance the performance bond the buyer required.

EFIC provided a guarantee to ANZ which in turn provided a performance bond to the buyer thus facilitating the Australian manufacturer to meet the contract conditions.

Export Finance Market

The GFC caused a very significant contraction in export finance risk and liquidity capacity. ECAs globally were responsive in filling the gap in risk capacity so as to meet their objectives to support and grow domestic economic activity. This included manufacturing and manufactured exports.

In this respect, EFIC's preparedness to consider supporting Australian domestic projects is consistent with the response of other ECAs. That is, it supported domestic economic activity through the provision of financing support for projects that trade internationally.

Some ECAs launched liquidity programs to fill the liquidity gap – such as Eksportlåneordningen (ELO - the funding arm of the Danish ECA, Eksport Kredit Fonden). ECAs with direct lending capability continue to see significant growth in demand for this type of support. EFIC's direct lending capability is a critical component of its operations in the current liquidity constrained environment.

5. *EFIC's pricing and service arrangements*

Pricing

EFIC is commercial in its price setting and seeks to derive a market return which is appropriate for the level of risk involved.

In the Export Finance business, OECD rules set benchmark pricing rules that ensure appropriate pricing for medium to long term financings. EFIC support is provided alongside private sector financiers and EFIC does not undercut the private sector.

Risk Assessment

In the Trade Finance/SME, where banks generally take a relatively rigid "scorecard" approach to risk and credit controls, EFIC may sometimes be able to take a more pragmatic view. This is primarily due to EFIC's ability to undertake a high level of due diligence, especially around historical performance, contract terms and management ability. They are able to consider factors other than pure financial matrices, for example, growth prospects and strategic positioning of the industry.

6. Opportunities for deepening existing commercial links, and developing new ones

EFIC is currently exploring the possibility of extending the Working Capital Guarantee into a product offering for the Small Business sector (akin to a micro finance offering for small or fledging exporters). This would follow models successfully delivered in some European countries. ANZ is working with EFIC to see if this can be practically offered to the Australian market place.

Also, there is an emerging trend of Australian exporters shifting their manufacturing and other bases to the Asia Pacific region. This is being fuelled predominantly by the strong Australian dollar and relatively lower offshore labour costs. In recognising this, EFIC has indicated flexibility in defining its export mandate to include cases where it can support Australian business with their banking arrangements in-country. This could be done, for example, through an extension of the Working Capital Guarantee product. In these examples, the type of client is likely to be more credit-worthy than an SME, but still requires additional or complementary credit capacity and support.