EBF Ref.: D2237e
Brussels, 05.03.2012

Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of almost 5000 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU only.

Ways to address worsening funding conditions in export credit markets.

Export finance supports complex trade transactions of high value, and requiring medium and long term credit. The EBF's member banks are active in this market as lenders and financial intermediaries. To maintain trade conducted by their exporters, national governments in the EU support the bulk of this business. Their support takes the form of insurance or guarantees provided by national Export Credit Agencies (ECAs). The current financial and economic crisis is having serious, and worsening, repercussions in this market. Although public support covers much of the risk, the current main impediment is banks' difficulty in providing (medium and long term) funding for the credit, and the high cost associated with it. The European export credit market is now under severe pressure.

The latest statistics published by the Berne Union (BU), the association for export credit and investment insurance worldwide, show the importance of this business for global trade flows, much of it in favour of developing countries. The combined exposure of its members to medium and long term (MLT) export credit insurance was close to USD 600 billion[1] at the end of 2010, or about 4% of total world export trade in that year (USD 14.9 trillion, WTO data)[2]. OECD data for its member ECAs show strong net operating cashflow on the MLT business every year from 1999 to 2010.

In addressing the current problems, there can be no single solution. The crisis has hurt national markets in the EU to different degrees, and institutional structures differ between EU Member States. This paper therefore limits itself to identifying a range of policy tools which could alleviate the current difficulties, some of which are already in use in some markets.

Developments of concern

In recent months, most European banks have been experiencing difficulty in funding medium and long term export finance. A number of parallel developments are responsible for this.

Acute uncertainty in the financial markets, weak economic prospects and the perception of increased risk have put **pressure on bank liquidity, particularly in US dollars**, which is the currency denominator for most large trade transactions.

In addition, banks need to accommodate **the requirements of the new "Basel III" banking regulations**. In some banks, balance sheets are shrinking to bring capital ratios to required levels. Some other banks need to reduce the size of their balance sheet and their loans to deposits ratio. Choices must be made by the management of commercial banks as to which businesses to undertake: relatively low return

[1] http://www.berneunion.org.uk/
[2] This percentage rises with the value of trade in capital goods as the denominator.

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business such as export credit might become less attractive if a bank has to reduce the size of its balance sheet.[3] Although the EU's implementing legislation for the Basel rules, the "CRD IV" allows for assessment periods before the introduction of key new ratios, European banks are already implementing the new rules. As a consequence, some are significantly reducing their export credit business, and others are withdrawing from it.

These factors, and the crisis-led refocusing of banks' activities, are causing **margins to rise**, in turn reducing the competitiveness of Europe's exporters.

More recently, the **sovereign debt crisis** has rendered the guarantee or insurance of the government-backed ECA significantly less marketable in some cases, further hampering banks' ability to offer export finance.

Possible funding solutions

In Europe, most countries do not have a direct lender for export credit, and recourse to a commercial bank is required to extend any export credit. Today, in a good number of countries, the main obstacle for commercial banks to entering into new export credits is the lack of refinancing solutions.

A number of tools could be used to resolve the funding problems, some of which are already being deployed in individual Member States.

Among the tools that may be considered useful are the following:

- **refinancing vehicles**;
- vehicles enabling the issue of **covered bonds** (to refinance banks);
- for some specific transactions, the possibility to issue "**ECA-bonds"** (issued by the final borrower with an ECA guarantee);
- **securitization guarantees** (to ease the issuance of covered bonds, the recourse to investors for a direct refinancing or the eligibility to a Central Bank for loans which are ECA-insured as assets supporting short-term liquidity cover);
- inclusion of export credits on the list of **eligible collateral at Central Banks**.

Detailed comments on these options are given below.[4]

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[3] In May 2011, the EBF issued a paper pointing to the likelihood that the implementation of the Basel III rules would create difficulties in funding export credits, especially for loans with ECAs established in countries where there are no alternative funding solutions or a public lender.
(http://www.ebf-fbe.eu/uploads/documents/positions/EconomyBusiness/14%20May%202011-D0900-2011%20-%20EBF%20position%20Export%20Finance%20and%20Basel%20III.pdf.)

[4] Full explanation of the acronyms used for ECAs in the EU, and website addresses, are provided at http://ec.europa.eu/trade/creating-opportunities/trade-topics/export-credits/#_agencies

1) Refinancing vehicles

Some European countries already offer some solutions to finance their ECA-covered loans:

- In the Nordic countries, national vehicles (Eksportfinans in Norway, until recently, FEC in Finland and SEK in Sweden) can refinance export credits.
- In Denmark, the Central Bank is refinancing export credits under the ELO scheme administered by the national ECA, EKF.
- In Germany, the development bank KfW – Kreditanstalt fur Wiederaufbrau – can offer refinancing to commercial banks on a temporary basis (currently available to end-2012, and subject to approval by the European Commission). In addition, banks can use a securitization guarantee issued by the ECA, Hermes, to refinance more easily their export credits (see point 3).
- In Austria, the ECA OeKB can refinance some Austria-related export credits.
- In Italy, the CDP - Cassa Depositi e Prestiti – a financing body funded by the Post Office has recently implemented a refinancing scheme.
- In the Netherlands, instead of a direct refinancing scheme, banks have the possibility to use a guarantee from the Dutch State/Ministry of Finance to cover obligor non-performance under a loan insured by the national ECA, Atradius DSB. [5]

In other countries, such as France or Spain, banks are asking for refinancing solutions, especially for the final installments of export credits (as existed many years ago in France, with BFCE – Banque Française du Commerce Extérieur – funding installments falling due after 7 years).

In implementing any scheme similar to the above, it would be important that a refinancing vehicle benefits from a most favourable rating (if possible that of its sovereign) and is granted special treatment as equivalent to a sovereign entity under the CRD IV (such as applies to Finnvera or KfW) in order to accommodate a concentration risk on some banks. Some vehicles without this special agreement, such as EksportFinans, are today almost prevented from considering new business.

It should be noted that export credit loans which are offered by the commercial banks as security:

- enjoy very low default rates from their primary borrower according to data of the Berne Union[6];
- are backed by ECAs which are fully supported by their Sovereign;
- have, for banks, an extremely low final default rate, as a final default would be linked to a double default (default of primary borrower, followed by default of insuring ECA).

The commercial bank's handling of the refinancing of its export credits will vary. In some cases, the commercial bank is keeping the loan in its balance sheet but obtains back-to-back refinancing; while, in other cases, the bank sells the loan to a refinancing vehicle and keeps an agency role as well as the residual risk on the portion that is not covered by the ECA through a guarantee. [The impact on the leverage ratio is then totally different: in the first case the whole amount would be considered in the leverage ratio, while in the second case, only the residual portion would be considered. The second scheme might be preferred by some banks, for some ECAs considered as high consumers of risk-weighted assets.]

[5] No transactions have yet taken place under the scheme. Discussions are underway on the status of the guarantee.
[6] See note 1.

2) Vehicles enabling the issue of covered bonds

If not funded by a refinancing vehicle, export credits might be used as collateral for the issue of covered bonds.

- In Germany, ECA-covered export credits are eligible for Pfandbrief (German Covered Bonds[7]) provided they are subject to a securitisation guarantee.
- In France and the UK, Export Credits are eligible for Covered Bond programmes launched individually by some banks through in-house Special Purpose Vehicles (SPV).

It would be very important that ECA-covered export credits also become eligible for covered bond programmes of other EU Member States, and that the functioning of these markets is enhanced.

3) Possible issue of "ECA-bonds" (issued by the final borrower with an ECA guarantee)

Following today's practice in the aircraft sector, the issue of bonds by a private entity, such as the borrower under an export credit, with the cover of an ECA guarantee could offer the attraction of pricing that reflects the government risk. In particular, large transactions could be financed by such a tool.

4) Securitization Guarantee

Euler Hermes, the German ECA, offers a Securitization Guarantee (VerbriefungsGuarantie[8]): this 100% guarantee enables a bank which already benefits from government insurance for a buyer credit (at 95%) to obtain refinancing on the capital market via a SPV or a mortgage bank. From the viewpoint of the beneficiary (refinancing institution), it is a 100% guarantee callable on first demand. In the internal relationship between the Federal Government and the lending bank, the terms and conditions of the buyer credit guarantee remain applicable.

Such a solution might be of interest to some investors who would only accept 100% guarantees from ECAs (instead of partial guarantees or insurance) and are not interested in covered bonds.

Switzerland now has a similar scheme, and Japan is considering one.

5) Recognition of export credits at Central Banks to serve as short-term liquidity buffer

Currently, US Ex-Im (Export-Import) bank loans are eligible at a Federal Reserve Window. Similarly, the Central Bank of Denmark is, via ELO, accepting export credits guaranteed by EKF. In Europe, credit claims are only eligible to national Central Banks (NCBs) as well as the ECB if the debtor is established in the euro area. The same applies to the guarantor, unless a guarantee is not needed to establish the high credit standards for non-marketable assets. [9]

In order to enhance the provision of liquidity to counterparties to Eurosystem monetary policy operations, the ECB decided on 14 December 2011 that "an NCB may accept as collateral […] credit

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7 http://www.pfandbrief.de/cms/_internet.nsf/tindex/en.htm

8 http://www.agaportal.de/en/aga/produkte/verbriefungsgarantie.html

9 Guideline of the European Central Bank of 20 September 2011 on monetary policy instruments and procedures of the Eurosystem, chapter 6.2.2.1 (d).

claims that do not satisfy the Eurosystem eligibility criteria. (2) The NCBs shall establish eligibility criteria and risk control measures for accepting credit claims […]. Such eligibility criteria and risk control measures shall be subject to prior approval by the Governing Council."[10]

Based on this decision, the Banque de France and Banca d'Italia made a statement on 9th February 2012 indicating that they are ready to consider Coface and SACE loans, respectively, as eligible collateral. Similar discussions are going on in other EU countries.

The eligibility of export credits at the Central Banks is, due to its short-term nature, by no means a normal and stable refinancing solution but it would give a special value to export credits for bank Treasurers, as they need assets eligible at Central Banks to face exceptional needs in emergency situations to comply with the CRD IV proposed Liquidity Cover Ratio. In addition, if the CRD IV finally includes in the proposed Liquidity Cover Ratio more (or all) loans eligible to a Central Bank, export credits would be more valuable assets for bank Treasury departments.

Conclusion

Around the EU, policy-makers are faced with the challenge of trying to maintain the flow of finance for international trade, which is of vital importance as an engine of economic growth.

Each country's approach will reflect its cultural and institutional history, and no single solution is the most appropriate. Indeed, in some countries a variety of solutions are being applied. In issuing this paper, the European Banking Federation hopes to spread awareness of the ways in which funding problems are being addressed, and encourage debate at national level about what may be suitable and helpful in that marketplace.

This paper was prepared with the assistance of the European Banking Federation's Export Credit Working Group, comprising experts from the different Member States of the EU.

[10] Decision of the European Central Bank of 14 December 2011 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral (ECB/2011/25), Art. 4.