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Export Credit Arrangements
Productivity Commission
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Dear Sirs/Mesdames

Australia's Export Credit Arrangements - submission on Draft Report

Having reviewed the Commission's draft report on Australia's Export Credit Arrangements ("**Report**"), we believe the Commission would benefit from an independent practitioner's perspective on the activities of EFIC and other ECAs in the Australian market. As lawyers practising in project finance, asset finance and related areas, we work regularly with EFIC and other ECAs, with their customers, and with the commercial banks which operate alongside them in ECA financing transactions.

1 Summary

ECAs play a key role in a wide range of financing transactions. Many of the major project financing and asset financing transactions we advise on in Australia now include some level of ECA involvement. Since the global financial crisis, we have witnessed a significant increase in ECA financing activity, corresponding (at least in part) with a decrease in the volume of commercial bank lending.

Although EFIC is considerably smaller than many European, Asian and North American ECAs, in our experience it and the staff we deal with operate at a level of sophistication, professionalism and commerciality which equals or exceeds many other ECAs we deal with.

The role suggested for EFIC in the Report (in particular, the proposed limitation to newly-exporting SMEs and the numerical transaction limit) would in our view place EFIC well outside the mainstream of global ECA activity. In our experience, no ECA from any other OECD country operates subject to such limitations. On the contrary, many foreign ECAs are actively seeking to expand their activities and products in the current climate of heightened caution in the commercial financing markets.

Whilst we agree that EFIC should support SMEs, we are of the view it should also support all Australian business within its mandate. To constrain EFIC's activities at such a time, as the Report seeks to do, risks tightening further the difficult credit conditions under which many Australian businesses and major projects are currently operating. Further, the effect may not be limited to EFIC's own financing activities: many foreign ECAs derive significant comfort from having EFIC providing ECA financing alongside them on major export projects in Australia. If EFIC were to cease to be able to support major Australian energy and resources export projects, then a likely side effect would be to exacerbate the funding gap for these projects as it becomes more difficult to bring in some of the foreign ECAs.

2 EFIC's role and reputation compared with other ECAs

Despite its outstanding reputation based on its sophisticated and professional operation, EFIC is increasingly falling behind other ECAs in terms of its scope of involvement in the domestic export market and development strategy. The role suggested for EFIC in the Report will further jeopardise what should be a critical role in leading and facilitating the involvement of private lenders in the post-global financial crisis era.

We have set out below a few examples of other major ECAs around the world which currently appear to be expanding their roles, rather than contracting them.

2.1 US

With the primary focus on the US job creation, the US Export-Import Bank (**"Ex-Im Bank"**) has recognised the importance of continuing to play a critical role in responding to the global financial crisis. In their words, the ongoing contraction of liquidity in trade-finance activities combined with the increased demand for US exports makes Ex-Im financing more critical than ever.[1] This responsive approach has led to the Ex-Im Bank reporting a third consecutive record-breaking year of more than $32 billion in export financing in FY 2011, up 127% from FY 2008. In FY2011 alone, the Ex-Im Bank approved all-time record of $32.7 billion in total authorisations, which includes approximately $6 billion to small-business export sales.

2.2 UK

With its mandate of complementing the private market by providing assistance to exporters and investors, Export Credits Guarantee Department (**"ECGD"**) saw a 33% increase in the volume of business underwritten by ECGD on behalf of British exporters as compared to the previous year, supporting in total £2.92 billion of new business.[2]

2.3 Canada

Export Development Canada (**"EDC"**) has recognised the important role of EDC in "escalating both business confidence and capacity to expand abroad" and placed particular importance on the need to accelerate expansion in non-traditional markets. This has resulted in EDC handling a record volume of business in partnership with other financial institutions in FY 2011 - $28.7 billion, or 70% more than the previous year. Further, EDC has substantially increased its overseas presence by opening three new representations in emerging markets in 2010 and increased its business volume in emerging markets by more than 32%.[3]

As evident from the comparative analysis above, we believe that EFIC in its current form, let alone the form recommended by the Report, simply will not be able to compete with other ECAs going forward and that as a result, Australian exporters, our manufacturing industry and employment will

1 US Ex-Im Bank, *Annual Report* 2011
2 ECGD, *Annual Report and Accounts* 2010-2011
3 ECD, *Annual Report* 2010

be placed at an unnecessary disadvantage, especially in light of the lack of private funding available in the financial markets.

3 EFIC's role in major energy and resources projects

3.1 Availability of private funding

We believe the Report overstates the current ability of financial markets (including non-traditional sources of private funding) to meet the unprecedented financing demands of Australia's energy, resources and infrastructure pipeline. For example, the Report suggests that superannuation and bonds (including retail bonds) are potential sources of private sector funding for such projects. Although some larger superannuation funds are becoming more active in direct lending to infrastructure projects, volumes are still insufficient to meet the demand.

Similarly, bond structures present particular difficulties for long-term greenfield projects and large assets. The issues include the following:

- long construction periods and phased drawdown of funds in projects to meet periodic construction invoices – bonds can be problematic because they are typically issued in one lump-sum;
- bond investors are often uncomfortable with taking completion risk on greenfield projects, hence bonds tend to be a more suitable financing option for post-completion refinancings rather than upfront development funding;
- given the inevitable need to obtain consents and waivers under financing documentation, it is easier for project sponsors to work with a well-defined group of relationship lenders and ECAs than it is with a disparate group of bond investors; and
- the superannuation market and bond market is not currently sophisticated as suggested to invest in large assets.

The recent experience of our clients in this area is that EFIC and other ECAs are one of the few real alternatives to traditional bank funding. As noted above, long-tenor bank funding is scarcer than it has been for some time, while the capital demands of the pipeline of large export projects and large assets have increased markedly. This observation is not new, and has been widely reported – see for example John Geddie's article, "Export credit urgency", in Project Finance Magazine (March 2012), where he quotes ANZ's head of export finance:

> *'...commercial bank appetite for long-dated debt is shrinking. Paul Richards, global head of structured export finance at ANZ, explains that the situation in Australia is even more acute, with the withdrawal of European banks. Says Richards: "Certain European banks are withdrawing from the local corporate syndicated loan and project finance markets. So while there is less supply, there is greater demand, with a long list of very large projects coming up. It is a bit of a double-whammy."'*

3.2 Links with other ECAs in projects

The Report does not mention EFIC's institutional links with foreign ECAs. In our experience, these links play a vital role in facilitating foreign ECA financing for Australian projects. For many foreign ECAs, Australia is a relatively new market. In this context, we have seen firsthand how the support of EFIC for a particular project can give significant comfort to European or Asian ECAs who are in the process of deciding whether or not to provide development funding to that particular project.

EFIC's role in helping to attract further debt funding from foreign ECAs, and to bridge the divide between domestic banks and foreign ECAs, should not be understated. Without this funding from other ECAs, some of the larger Australian energy and resources projects would struggle to get off the ground. This would in turn have a knock-on effect in terms of lower exports, fewer employment opportunities, and lower revenues from taxes and royalties generated by these significant projects.

4 Conclusion

We believe the Report's draft recommendations put EFIC's continued existence at risk. We question whether EFIC would be viable as a self-funding organisation operating under the restricted mandate the Report proposes (and we would urge that this question be fully explored before any such recommendations are finalised or implemented). Irrespective of this, it seems clear that Australian exporters would suffer as a result of the proposed restrictions on EFIC's mandate, as would many domestic energy and resources projects and large asset users (which are themselves major consumers of Australian goods and services).

On the basis of our day-to-day experience of working in the project finance and asset finance sectors in Australia, we believe that, if implemented, the Report's draft recommendations will result in detriments to Australian industry.

On the other hand, any benefits flowing from such recommendations would appear to be contingent on several factors outside the Australian government's control, and ultimately more theoretical than practical. We would recommend utmost caution before embarking on a course which would put EFIC, and Australia, at odds with the export finance community globally.

We thank you for considering our submission and we hope it is of assistance in finalising your recommendations.

Yours faithfully

King & Wood Mallesons