Australian Government

EFIC
Export Finance
& Insurance Corporation

Australia's Export Credit Arrangements
Public Inquiry

EFIC Response to the Productivity Commission Draft Report

Supplementary Submission

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Overcoming financial barriers for exporters

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Executive Summary

EFIC comprehensively repudiates the core Draft Findings and Recommendations contained in the Productivity Commission's Draft Report:

- Over the past decade, EFIC has supported over $15 billion of Australian exports to 65 countries from SMEs and large companies in diverse industries.
    - In the past six years, EFIC's support for SMEs has grown from $26 million of facilities to $137 million, representing 89% of the number of facilities provided, and facilities are forecast to exceed $200 million this year.
    - EFIC's recognised experience in project and export finance has been needed for some of the largest, most complex projects undertaken globally over this period, and currently is required for the development of Australian resource projects and related infrastructure given capacity constraints in the commercial markets.
- EFIC directly supports the Government's 2011 Trade Policy priorities by assisting internationally competitive Australian companies to create high wage jobs for high-skilled workers through pursuing export opportunities. EFIC's commercial responsiveness in providing that support is evidenced by independent research: 94% of EFIC's clients would work with EFIC again or recommend EFIC to another exporter based on their experience.
- EFIC has been profitable in 19 of the past 20 years, earning in excess of $460 million in profits and paying more than $214 million in dividends to Government. Our risk management systems have been tested and found resilient and prudent by successive economic and financial crises. EFIC's governance and reporting have been consistently found as rigorous and transparent by unqualified independent audits. Against any external benchmark EFIC is a sound, profitable, well-managed and well-governed institution.
- EFIC works in close cooperation with private financial institutions and insurers. Through over $1.6 billion of export finance guarantees, EFIC has been the catalyst to attract bank funding for Australian exports. EFIC also has arranged more than $1.4 billion of private reinsurance to help Australian exporters. Our partnership with private sector institutions demonstrates that EFIC is a commercially responsive public sector agency, appropriately pricing risk to draw in private market capacity.
- The Commission's thesis is that financial markets are perfectly efficient and rational; therefore, EFIC must either be subsidising its support or competing with private capital. The Commission ignores relevant research on market failure and recent global financial market disruptions, which continue to have material implications for Australian companies. The Commission also ignores the unequivocal support given to EFIC by major Australian and international financial institutions, and substantive evidence offered by clients, legal firms and industry associations on the need for EFIC's services. EFIC operates on the principle that public sector institutions should not compete with private capital. This also is the Commission's underlying concern, and there simply is no evidence that this has been or is the case with EFIC.

- The Commission argues that restricting EFIC's role would represent a better economic outcome. Yet had EFIC not been in existence over the past 20 years, then significant export transactions would not have taken place and Australian activity would have been forsaken to overseas competition. Better still, these profitable exports have been accompanied by profitable results at EFIC. In making its recommendations the Commission offers no assessment of the probable consequences of EFIC withdrawing from its current markets, nor of the net benefit to the economy. Its argument is particularly tenuous at a time when regulatory and economic uncertainty is restricting credit capacity, and Governments globally are aggressively supporting their banking systems and exporters.

- Finally, EFIC could clearly do more. With simplified legislation and the enhanced mandate that EFIC sought in 2006, EFIC would have had more capacity and product flexibility to help Australian companies to adjust to the structural changes in Australia's economy, and also would have been more profitable. EFIC is ready to do more to support the Government's trade agenda, but the outcome from the Commission's Recommendations taken as a whole would be an EFIC that cannot deliver on its mandate: an EFIC that would be restricted to a narrow base of exporters, less commercially responsive to their needs, less capable of supporting SMEs, and likely to become a financial burden to the Government.

1. EFIC response to the draft report

EFIC is fulfilling its mandate

Over the past decade, EFIC has profitably supported over $15 billion of exports and investments in 65 countries in every region of the globe.

EFIC supports SME exporters facing financial barriers. In the past six years, EFIC's support for SMEs has grown from $26 million of facilities to $137 million, representing 89% of the number of facilities provided, and that level is forecast to exceed $200 million this year. In this period we have entered into 21 framework agreements with banks, financial service providers and development banks to use different products to help SMEs to overcome financial barriers. These SMEs are delivering innovative technologies and building on Australia's comparative advantage to compete overseas. But since 2008 the challenges facing SME exporters of all sizes have been growing.

EFIC supports Australia's largest companies working in emerging and frontier markets globally. These companies deliver some of the best expertise and technology Australia can supply. When these companies enter new markets, in EFIC's experience they bring along Australian SME sub-contractors. But Australian companies are competing against equally large or larger foreign companies in these markets, and if the private market is not capable of providing the total financing required, then sponsors seek ECA support for their exporters. As an illustration, in 2011 approximately 30% of the $215 billion global project finance market was provided by ECAs and multilateral agencies[1]. In developing markets, the concentration of agency finance was even higher at almost 65%. In 2012, the pipeline for transactions is greater still. There are a number of very large projects coming to market including Oyu Tolgoi in Mongolia, and Ichthys and APLNG in Australia.

Presently, EFIC's support is needed even for infrastructure and resource projects within Australia. These projects are exceptionally large even on a global scale and require funding at a point when credit globally is scarce. ECAs and particularly Asian ECAs are filling that gap and supporting their leading companies working in Australia. Publicly available data shows that foreign ECAs and development banks have provided more than $6 billion to Australian corporate and project financings since the GFC[2]. The composition of Australian debt syndicates in 2011 shows a strong and growing trend towards ECAs helping to fill the gap created by the European banks who withdrew more than $7.5 billion in the September 2011 quarter alone[3].

EFIC's commercial responsiveness to shortfalls in capacity or in crises is valued by our clients and by financial institutions. The public submissions to the Commission spoke to EFIC's role and its capacity to supplement what the private market can offer. Our 2011 client satisfaction survey undertaken by an independent agency recorded a Net Promoter Score of 94% - that is, a net 94% of our clients would work with EFIC again or recommend EFIC to another Australian company given their experience. This is a level many times greater than most financial institutions. Yet some of the Commission's draft recommendations go to the heart of our ability to be an effective commercial partner in delivering an efficient, flexible service.

Being an effective commercial partner also means having a sound risk management system. Since November 1991, we have earned over $460 million in profits and paid more than $214 million in dividends to Government. Our risk management systems have been tested and found resilient and prudent by successive economic and financial crises.

[1] Project Finance International (PFI) January 2012
[2] PFI and Basis Point
[3] Bank of International Settlements Data, March 2012

EFIC is supporting exporters by working with the private sector

Our SME strategy focuses on delivering EFIC's support through our clients' existing banking relationships. This strategy allows us to inform and support a broad client base through the bank channel without building a costly retail network, and to make exports happen by providing our support selectively in taking on the risks those financial institutions do not accommodate.

For example, EFIC recently supported TTG Transportation Technology Pty Limited (TTG) through a £379,000 export working capital guarantee to TTG's bank, Westpac. TTG is an Australian train technology development company specialising in energy optimisation software. EFIC's guarantee enabled Westpac to lend the funds TTG needed to meet the costs associated with the delivery of a UK contract.

We have extended that strategy to work with specialist financial services providers so SMEs can better manage their currency exposures. In the wake of unprecedented A$ appreciation and currency market volatility, SME exporters are concerned with the implications of currency movements for their viability. With EFIC's foreign exchange guarantee facility, financial institutions providing foreign exchange risk management services to SMEs will extend their cover that much further to help SMEs to manage that risk.

For example, EFIC recently provided a foreign exchange facility guarantee to Australian film production company Drift International to enable it to manage foreign currency risk. Drift were concerned that currency fluctuations during the production of their feature film could potentially leave them short of funds in their production budget. Backed by EFIC's guarantee, foreign exchange provider HiFX was able extend the trading limit on its facility so Drift could manage the risk.

Our work with banks extends beyond SMEs. Current market conditions have impelled EFIC to step up to support Australian companies - large and small - working in infrastructure projects, either by supporting their tenders and working capital needs or with the funding of these large projects in Australia and overseas.

For example, EFIC supported Lean Field Developments to win their first major Australian pipe laying contract for the installation of gas and water pipelines in Queensland's Surat Basin. Without a long trading history in Australia, it was unable to obtain traditional bank finance for performance bonds. EFIC provided a bonding line for Lean Field to draw on as required, enabling it to meet performance and warranty bond obligations under its contracts, and an export working capital guarantee facility to support their cashflow needs.

EFIC has also worked with ANZ and BNP Paribas to finance Leighton's acquisition of the equipment necessary to undertake mining contracts in Indonesia and Mongolia; provided performance bonding facilities for companies like McConnell Dowell, Clough and Macmahon Holdings, either in their overseas operations or domestically for the development of export related infrastructure; and provided a guarantee to Sumitomo Mitsui Banking Corporation (SMBC) to fund, along with commercial banks and EDC of Canada and German, Korean and Chinese Development Banks, the development of the Wiggins Island Coal Export Terminal in Queensland.

EFIC's focus has directly supported the Government's 2011 Trade Policy priorities by assisting internationally competitive Australian companies to create high wage jobs for highly-skilled workers through pursuing export opportunities. These exporters are developing opportunities where Australia can build on its comparative advantages and they are achieving export success in diverse fields: the design and manufacture of specialised equipment; food and agriculture; services; resources and LNG; and engineering and mining-related equipment.

To deliver that support EFIC has relied on a long-running strategy to 'crowd in' private insurers to support Australian exporters, and to help EFIC manage the risk concentrations on its balance sheet. Rather than competing with private capital, EFIC has attracted over $1.4 billion of private reinsurance to help Australian exporters over the past 13 years. Beginning in 1999, EFIC was one of the first ECAs globally to use private market insurance to manage risk – in that first instance, taking the initiative to reduce the risk to Government on its National Interest Account. Our success in this strategy has prompted one insurer to establish a team here to work directly with Australian exporters and banks. We continue to attract new capacity, most recently with the ACE Group, a global leader in insurance and reinsurance.

EFIC is supporting exporters by working with the public sector

EFIC is one of two Federal agencies focused on implementing Australia's trade policy. We complement and work closely with Australia's other dedicated trade agency, Austrade. The offshore networks and in-market knowledge of Austrade officers, combined with EFIC's financial services expertise and financial and insurance products can catalyse additional export contracts. EFIC and Austrade also provide a range of complementary export advisory information delivered online and through workshops and events, with EFIC focusing on the risks and Austrade on the opportunities for exporters.

EFIC works closely with State and Territory trade agencies to develop awareness and understanding of trade finance, and the solutions available to mitigate the risks of exporting. State and Territory export advisors are directly in contact with exporters and their networks are important for ensuring regional Australian exporters have knowledge and access to EFIC's services.

EFIC promotes Australian arts and culture overseas too. Working with Screen Australia, EFIC established a loan program to finance eligible Australian films, documentary and television productions with international distribution agreements. These loans from EFIC complement the Australian Government's Producer Offset incentive by helping SME film producers with the cash flow they need to complete production.

For example, EFIC recently supported BUNYA Productions' indigenous family movie, "Satellite Boy", with a Producer Offset loan of approximately $850,000. Satellite Boy tells the story of a young Aboriginal boy from the outback town of Wyndham, Victoria, who travels to the city with his best friend to save his home from developers. The film is the latest in a number of Australian productions being made about indigenous and local community issues in regional Australia. These stories have resonated strongly with the local communities for their positive messages.

We are working with other Federal Government agencies including DIISRTE and ICN to support initiatives like the Government's Resource Sector Supplier Advisory Forum. We are helping Australian firms access the benefits of the mining boom and in doing so, facilitating both domestic and international competitiveness. EFIC is looking to ensure that finance is not the obstacle that restricts these companies from competing for these opportunities.

EFIC has a role protecting Australian interests in global trade. We provide technical support to the officials responsible for negotiating framework agreements for public sector support of trade. We monitor market conditions to inform Government of issues that may impact Australia's trade interests, particularly in times of crisis. EFIC was a leader in the establishment of the Australian Trade Finance and Insurance Association for this reason – to create a forum to sound the market on issues confronting trade finance. And when required EFIC supports Government by providing a commercial perspective on companies and industries experiencing distress.

EFIC is supporting exporters by working with other ECAs

With strong results and over 50 years of experience, EFIC has credibility with our counterpart agencies overseas.

For example, EFIC, with substantial reinsurance from Canada's EDC, was able to assist Brookfield Rail access support from a Chinese bank to finance a rail upgrade project for a new iron ore mine in Western Australia; and Santos turned to EFIC and ECAs from Italy and Canada and Malaysia to fill the gap in commercial bank capacity for term debt to finance the development of the Gladstone LNG project. EFIC is stepping in to fill these gaps, securing Australian jobs and expanding Australia's exports and exporting capacity.

EFIC's credibility enabled us to lead the development of framework agreements within the Asian Eximbank group for jointly funding projects involving Australian suppliers and third-country supply from Asia. Our recognised experience allowed EFIC to lead discussions on the PNG LNG project to ensure that best practice environment systems would allow ECAs to monitor the project's performance.

EFIC was appointed by the sponsors of a major gas project as one of six leading ECAs, in recognition of our understanding of Australian legal and environmental framework in which the project will be developed and operated, and our extensive experience in project finance. EFIC's participation in this group helps to 'crowd in' five other ECAs who, collectively, will provide up to 50% of the debt necessary to develop this massive project.

Australia's experience provides our team with a platform to work effectively in international fora to improve the governance and environmental approaches of ECAs globally. Through workshops and exchanges EFIC is engaging with environmental practitioners and senior executives at these institutions to promote Australia's interests. This is an increasingly important public good as agencies from emerging Asian economies play a larger role in financing projects globally and particularly in Australia.

EFIC is pursuing best practice environmental standards

In 2010, EFIC initiated a review of its Environment Policy. EFIC first introduced its Environment Policy in 2000, three years before the OECD reached agreement on a global framework. We reviewed and amended that policy in 2005 using outside expertise. The 2010 review continues EFIC's long standing commitment to upholding best-practice environmental and social standards in the transactions we support. To provide our stakeholders with increased confidence in EFIC's adherence to this commitment, EFIC has agreed to the independent audit of the application of its Environment Policy every two years. EFIC also has also established a semi-annual multi-stakeholder forum, the first of which was attended by four Civil Society Organisations.

Through these measures, we believe EFIC is providing its stakeholders with greater transparency on the application of its Environment Policy, exceeding our international obligations whilst providing competitive service to Australian exporters as they seek to win overseas contracts.

EFIC could do more

At the time of the last EFIC Review, EFIC proposed two things: simplification of EFIC's legislation to improve client service and reduce costs; and an expansion of EFIC's mandate to support SMEs.

In 2006, EFIC proposed an expansion of our mandate to support Australian SMEs in their efforts to establish global supply chains. As the Government's 2011 Trade Policy Statement states, "The build-and-ship model of production and exchange is giving way to the creation of regional and global supply chains for both goods and services. Consequently, flows of investment are becoming more important in many industries than flows of finished goods. For example, a local manufacturer might lose comparative advantage in the production of a finished product but become internationally competitive in the supply of components. Or instead of shipping finished goods, a business might supply the expertise it has accumulated to a foreign-based manufacturing operation."

From the perspective of financing supply chains, small Australian companies will struggle to get local bank support in most overseas markets until they have a track record, and Australian banks are not focused on supporting the development of SME supply chains given the complexity of taking security overseas. But supply chain management is a strategic issue for many Australian SMEs responding to structural change in the Australian economy. It is reflected in the Government's focus on facilitating trade to create high-skill, high-wage work, and increasing Australia's international competitiveness. EFIC's proposal goes to the heart of this trade policy priority and is consistent with our mandate and experience working with the private sector to create commercial funding options.

In 2006, EFIC also proposed a simplification of the 1991 EFIC Act. In the past 20 years there have been significant changes in both financial products and global markets. For example, there is no basis to mandate EFIC to use a guarantee and not a loan product from the perspective of supporting Australian exports, even more so now given the uncertainty of bank funding capacity overseas. Giving EFIC the flexibility to provide the most suitable financial product will result in the lowest transaction costs, the most effective outcome for the exporter and a better return for EFIC.

Successive Governments since 2006 have accepted these proposals as policy but the process of legislative change has yet to advance in 2012. EFIC's proposals would greatly increase our capacity to help Australian firms to adjust to structural change.

The need for evidence-based policy

The evidence is that the private market sees the need for ECA support.

Globally, ECA support for trade and project finance is growing in response to shortfalls in private market capacity, a volatile risk environment and ever larger projects. Demand for EFIC's support has grown dramatically over the past three years too. And the support for EFIC is too, as evidenced by the Submissions made to this Review.

The evidence is that EFIC is achieving its mandate.

We are operating in the 'market gap' where the private market's capacity is insufficient. Submissions to the Review have backed EFIC's role in supporting Australian exporters, including from those financial institutions the Commission is concerned EFIC might 'crowd out'.

We have consistently delivered profits and dividends. Since November 1991, through a series of global and regional economic shocks, EFIC has been profitable in 19 of the past 20 years. Since 1991, we have generated in excess of $460 million in profits and paid dividends of more than $214 million to Government. Our risk management systems have been tested. Our pricing for risk has been demonstrated by results and our success in 'crowding in' the private market. Our flexibility to provide loans, guarantees and insurance has delivered the support needed by Australian exporters and banks.

The evidence is that a guarantee-only model as proposed by the Commission has a fundamental weakness in a credit and liquidity crisis.

The Commission is advocating that in 2012 EFIC's products be reduced to only guarantees while since 2008 European Governments have been attempting to emulate EFIC's flexible product model. ECAs that provide only guarantees and insurance have been struggling to establish funding vehicles in the context of a credit market collapse. When banks cannot lend, insurance policies are ineffective. Other ECAs have been seeking to learn from EFIC's experience of managing a loan portfolio and treasury operation. The

Europeans have learnt that instituting a funding and loan management framework in any environment takes considerable time. In a crisis, it is almost impossible.

From another perspective, even Government Departments have sought EFIC's assistance in understanding the mechanics of managing a loan portfolio for policy initiatives relating to the GFC and Clean Energy. And EFIC's insight into treasury markets, particularly offshore funding markets, has been critical to our risk management capability.

EFIC's response to the Productivity Commission Draft Report

Attached you will find a summary and detailed assessment by EFIC of the Report's Findings and Recommendations. It presents a comprehensive repudiation of the Report, but there are a few points to emphasise:

The Commission:

- Finds that there are no market failures that would warrant EFIC's support;
- Finds that EFIC is likely to be competing with the private sector;
- Finds that EFIC's return on equity is less than the Australian banks, and suggests the cause is that EFIC is under-pricing for risk;
- Recommends that EFIC restrict whatever support it provides to SMEs with turnover less than $25 million, preferably with limited credit history and no export experience; and
- Recommends that EFIC's support be restricted to a guarantee product.

The lack of commercial understanding and judgement demonstrated by these Findings and Recommendations go to the heart of EFIC's concern with this Report.

- **The 'market gap' rationale that underpinned EFIC's establishment has never been more evident.** The level of ECA activity in Australia and overseas demonstrates that the implications from the GFC and Euro-zone crises continue to play out in credit markets. Even from the narrow perspective of 'market failure', there is considerable academic research that the Commission has not cited in its Report that identifies the economic rationale for trade and export finance.
- **EFIC's work with the private sector – not in competition – has never been clearer.** Across our product range we are working with banks and financial service providers to support Australian exporters, and using private insurers to create the capacity to provide that support. The unanimous support of these institutions through the Review is evidence of EFIC's success.
- **Our success in cooperating with the private sector is underpinned by a market-based pricing strategy**. Appropriate risk-based pricing gives banks confidence that EFIC is not competing, and generates the income needed for EFIC to 'crowd in' private insurers. EFIC's return on equity reflects a substantial capital base generated by EFIC's profitable operations, which is the buffer protecting Australian taxpayers.

The Commission's proposed business model is not a commercially viable proposition.

The Commission recommends that EFIC's mandate be restricted to 'demonstrating to the private sector that providing export finance to newly exporting SMEs can be commercially viable.' The Commission does not demonstrate that this proposition is true. Yet it acknowledges that this is without precedent in any ECA in the world.

In EFIC's experience, small firms with limited credit history and no export experience represent a very high risk for credit providers. Small firms also represent a limited premium pool; that's why banks target them with homogenous credit scoring products. It is remarkable that the Commission recommends that EFIC's mandate be restricted to a likely loss-making pool of very small firms at the same time as the Commission recommends that EFIC achieve a rate of return on equity comparable to an Australian 'Big 4' Bank.

In EFIC's view, this recommendation alone would turn EFIC from a commercially oriented and profitable institution into a narrowly based loss-making entity. EFIC's capital buffer from years of profitable operations would be significantly eroded and consequently, our capacity to support exporters of any size.

EFIC's capacity to fulfil its mandate will be diminished not enhanced

The Commission gives no consideration to the practical implications of its recommendations. Much of EFIC's existing business would, in effect, be closed. An institution directed to lend to a narrow loss-making market segment will not retain the skills and experience that have successfully taken on complex risk management challenges in the past. EFIC's strong positioning, performance and risk management culture would be undermined, exposing taxpayers to increased losses.

The Commission ignores the prevailing need for the funding of large Australian projects that are clearly being funded by foreign ECAs. Restricting EFIC from domestic financing as an option to 'level the playing field' is at odds with the evidence and contrary to the recommendations of the Australian banking sector.

Finally, EFIC's effectiveness would be further eroded if the Commission's recommendation to offer only guarantee products was adopted as policy. This flies in the face of ECAs globally converging on an 'EFIC model' to mitigate the impact of credit and banking crises on export credit.

Conclusion

The following sections and appendices present in detail EFIC's response to the Report. In our assessment, there are 33 unsubstantiated Draft Recommendations or Findings which rely on theory or assertions rather than evidence or analysis.

EFIC is working well in practice, consistently delivering against its mandate. It operates on the principle that public sector institutions should not compete with private capital. This also is an underlying concern of the Commission, and there simply is no evidence provided that this is the case with EFIC. Our adherence to this principle is demonstrated by the unequivocal support given EFIC by major Australian and international financial institutions, and evidence offered by clients, legal firms and industry associations.

The Commission offers no assessment of the probable consequences of EFIC withdrawing from its current markets, nor of the net benefit to the economy. Its argument is particularly tenuous at a time when regulatory and economic uncertainty is restricting credit capacity, and Governments globally are aggressively supporting their banking systems and exporters.

EFIC could clearly do more. With simplified legislation and the enhanced mandate that EFIC sought in 2006, EFIC would have had more capacity and product flexibility to help Australian companies to adjust to the structural changes in Australia's economy, and also would have been more profitable. EFIC is ready to do more to support the Government's trade agenda, but the outcome from the Commission's Recommendations taken as a whole would be an EFIC that cannot deliver on its mandate: an EFIC that would be restricted to a narrow base of exporters, less commercially responsive to their needs, less capable of supporting SMEs, and likely to become a financial burden to the Government.

2. Summary of Draft Findings and Recommendations

This table summarises the major issues relating to the Draft Findings and Recommendations and categorises them as:

- Not substantiated – no evidence or analysis, or inadequate evidence or analysis
- Selective – selective use of data, information or theory
- Error or Inaccuracy – errors of fact, or inaccuracy
- Impractical, conflicting, or unnecessary – significant and unaddressed implementation issues; internally inconsistent with other Draft Recommendations; or redundant in light of existing policies, procedures or structures.
- EFIC response – Supported, supported in-part, or not supported.

Draft Finding or Draft Recommendations	Not Substantiated	Selective	Error / Inaccuracy	Impractical, Conflicting, Unnecessary	EFIC Response
Draft Finding 3.1		X	X		Supported in-part
Draft Finding 4.1	X	X		X	Supported in-part
Draft Recommendation 5.1	X	X			Not supported
Draft Recommendation 5.2	X			X	Not supported
Draft Finding 5.1		X			Supported in-part
Draft Finding 5.2	X	X			Supported in-part
Draft Finding 6.1	X			X	Supported in-part
Draft Finding 6.2	X	X			Not supported
Draft Finding 6.3	X	X			Not supported
Draft Finding 6.4	X	X	X		Not supported
Draft Recommendation 7.1	X		X	X	Not supported
Draft Finding 7.1	X	X	X		Not supported
Draft Finding 8.1	X		X		Not supported
Draft Recommendation 8.1	X	X	X	X	Not supported
Draft Finding 8.2	X	X	X		Not supported
Draft Recommendation 8.2	X	X	X	X	Not supported
Draft Finding 8.3	X				Not supported
Draft Finding 8.4	X		X	X	Not supported
Draft Recommendation 8.3	X			X	Not supported

Draft Finding or Draft Recommendations	Not Substantiated	Selective	Error / Inaccuracy	Impractical, Conflicting, Unnecessary	EFIC Response
Draft Finding 8.5	X		X		Not supported
Draft Recommendation 8.4	X				Not supported
Draft Recommendation 9.1	NO RESPONSE				
Draft Finding 9.1	X		X	X	Not supported
Draft Finding 9.2	X		X		Not supported
Draft Recommendation 9.2	X				Not supported
Draft Recommendation 9.3	X		X	X	Not supported
Draft Recommendation 9.4	NO RESPONSE				
Draft Recommendation 9.5	X			X	Not supported
Draft Finding 9.3	X	X		X	Not supported
Draft Recommendation 9.6	X	X	X	X	Not supported
Draft Recommendation 9.7				X	Not supported
Draft Recommendation 9.8	X	X		X	Not supported
Draft Recommendation 10.1	X	X		X	Not supported
Draft Recommendation 10.2	X	X		X	Not supported
Draft Recommendation 10.3	X	X		X	Not supported
Draft Recommendation 10.4	X	X		X	Not supported
Draft Recommendation 10.5	X		X	X	Not supported
Draft Recommendation 10.6	X			X	Not supported
Draft Recommendation 10.7				X	Not supported

3. Analysis of draft findings and recommendations

Draft Recommendation or Finding	EFIC Response
Draft Finding 3.1. Most products offered by EFIC are also offered by the private sector. The price and conditions of provision may differ.	EFIC supports Draft Finding 3.1 to the extent that most of its products are also offered by the private sector, but disagrees with the Commission's conclusion that differences are limited to 'price and conditions' only. • EFIC's statutory duties include developing relationships with private sector participants to crowd in their support for Australian export trade. • EFIC has deliberately designed its products to integrate with those from the private sector. • This does not mean either that EFIC 'crowds out' the private sector, or that its products are redundant. • EFIC's products differ from their private sector counterparts in their coverage of risks. EFIC has deliberately set out to make products homogenous with the private sector for many reasons including risk transfer, aiding comprehension and transparency. The homogeneity allows clients to understand and compare complex financial products, and EFIC to work in tandem with private providers. EFIC's products are not redundant. EFIC provides financial or risk mitigating support to exporters at the time when, and in the circumstances where, the private sector is unable or unwilling to do so. Demand for this support arises for reasons of counterparty, country, asset, market and industry risk; and insufficient private market capacity. The Commission's statement (p. 47) that differences in the product coverage of EFIC and the private sector primarily relate to 'terms and conditions, including price' is only partly true. The critical difference in EFIC's coverage relates to the risks that EFIC is prepared to assume on behalf of exporters due to an absence of private sector risk appetite and/or capacity availability. The Commission notes, but does not consider in its assessment, the important distinction between availability of short-term and of medium-to-long term financial products. Investors have the reasonable aim to match the tenor of funding with the useful life of assets to be funded. In normal market conditions, the private sector has ample appetite and capacity to support borrowers' needs with tenors of up to five years. During the GFC, in Australia, this tenor appetite was reduced in the syndicated loan market. Beyond that five year horizon, financial transactions tend to be more highly structured, and often related to asset- specific or project finance. This is the market segment in which export credit agency (ECA) financing is more prevalent, as fewer private

Draft Recommendation or Finding	EFIC Response
	market participants have the risk appetite for such assets.
Draft Finding 4.1 There can be sound commercial reasons why private providers do not offer some products or do not cover some types of applicants — in which case there is not a market failure.	EFIC supports the Draft Finding 4.1 that private providers can have sound commercial reasons for not offering some products or covering some types of applicants. The conclusion that market failure must therefore be absent is incorrect. • The Draft Finding is only correct if markets for export finance and insurance are perfectly competitive. • The Commission has not demonstrated that the export finance and insurance markets in Australia or overseas are perfectly competitive. • Extensive research demonstrates that market failures exist for the provision of export and trade finance. As noted by the Commission (p.53), there are several factors that may lead to market failure and the Commission has not demonstrated that export finance and insurance markets in Australia are perfectly competitive – numerous profitable and welfare-enhancing export transactions are left 'unserved' by the private sector because of market failures such as credit rationing, artificially scarce information, cross-border contractual problems, imperfect competition and the externalities resulting from financial market disruption. The Commission dismisses many of these factors as invalid. Extensive research contradicts the Commission's reasoning and EFIC has presented counter-arguments for market failure in the provision of export and trade finance in Appendix A. EFIC exists to fix market failures not only in Australia; it can also combat market failures, including regulatory ones, in overseas countries that inhibit Australian capital goods and service exports and overseas investments. For example, if financial sector-related constraints prevent foreign buyers of Australian products from raising finance to buy those products, EFIC's products – buyer credits, for instance – might be a well-targeted intervention to address this foreign market failure. There is extensive research demonstrating that failures do indeed exist in the markets for export finance and insurance, and that an export credit agency is the most effective mechanism to deal with such failure. Research by the economic consultancy, NERA on the British agency, ECGD (2000)[4]; the Peterson Institute for

[4] http://webarchive.nationalarchives.gov.uk/tna/+/http:/www.ecgd.gov.uk/nera.pdf

Draft Recommendation or Finding	EFIC Response
	International Economics on US Exim Bank (2001)[5]; the Bundesbank on the German agency, Euler Hermes (2006)[6]; and Ragan (2008)[7] on Export Development Canada (EDC) identify that market failures exist in the provision of export and trade finance. Similarly, Minetti and Chun Zhu (2011)[8] conclude 'that credit rationing is an obstacle to export, especially for firms operating in high-tech industries and industries that heavily rely on external finance.' (p.109) Finally, NERA, Peterson and Ragan concluded that an export credit agency is a fitting, 'first-best' response to the failures they identified, not an '*n*th-best' solution that introduces more distortions than it corrects. The Commission does not demonstrate the absence of these market failures. (See EFIC response to Draft Finding 6.2)
Draft Recommendation 5.1 If a proposal is seeking support on the basis of national interest elements, it should be considered in the context of the national interest account, not the commercial account.	Draft Recommendation 5.1 is not supported by EFIC. EFIC notes the proposal is not substantiated, is selective and conflicting: • There is no analysis of the historical patterns of National Interest Account (NIA) usage (portfolio and case studies) and particularly, since the 2003 divestment of EFIC's credit insurance business. • There is no discussion of options including the benefits of the current arrangements. • The Draft Recommendation relies on one example of current NIA activity to underpin the Commission's conclusion that it 'considers it appropriate' for transactions to be limited to the NIA in cases when there is a NIA referral, without identifying the criteria the Commission considered to reach that conclusion. • The text confuses what overseas governments do 'in the National Interest' and the Australian aid programme's disaster relief efforts, which are characterised by the Report as National Interest rather than

[5] According to Hoffenbauer (2001), "Over the past decade, innovation in the private financial markets has moved at a breathtaking pace—but not in the realm of export finance, where the trend has been more retreat than attack. Commercial banks have merged with investment companies and insurance firms, and a whole new menu of financial products has been invented. These innovations have not, however, transformed the world of trade finance, and export credits are nowhere near as perfect a market as home mortgages. Market failures today are different than they were 20 years ago, but they are no less important." See: Policy Brief, 01-3, The US Export Import Bank: Time for an overhaul, accessed 1 March 2012, http://www.iie.com/publications/pb/pb.cfm?ResearchID=71

[6] Bundesbank research finds that political risk (an example of imperfect information in export markets) has a detrimental effect on exports. The findings also confirm the effectiveness of guarantees for export promotion provided by Euler Hermes, the German ECA – the results suggest a multiplier in the range of 1.7 to around 6, i.e. for every additional unit of granted export guarantee exports increase by between 1.7 and 6 units. See, Moser, C., Nestmann, T. And Wedow, M., 2006, Political risk and export promotion: Evidence from Germany, Discussion Paper, Series 1: Economic Studies, No 36/2006, Bundesbank, Frankfurt, http://www.bundesbank.de/download/volkswirtschaft/dkp/2006/200636dkp.pdf

[7] Regan, C, 2008, Filling a shrinking gap: EDC's changing role in the market for export credit insurance, accessed on 1 March 2012, http://people.mcgill.ca/files/christopher.ragan/EDC.pdf

[8] Minetti, R. And Chun, Shu, S., 2011, Credit constraints and firm export: Microeconomic evidence from Italy, Journal of International Economics, 83, 109-25.

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	humanitarian interests. EFIC submitted evidence to the Commission that case history shows NIA exposures develop around two concerns regarding risk: • When a NIA referral represents a risk – commercial or political – too great for EFIC to consider at any level on its Commercial Account (CA) (e.g. GMH working capital facility, the Joint Strike Fighter programme, Incat administration). In those cases the Recommendation represents the current arrangements. • When the risk is acceptable to EFIC on its CA but the amount is more than EFIC can accommodate with its capital base (e.g. the cited PNG example). This is a concentration risk from EFIC's perspective. In this instance, the implication of the Recommendation is the Government will assume a greater level of exposure on the NIA if EFIC's CA is not drawn upon. The benefit to Government from the risk-sharing arrangement with the CA is that the structure mitigates moral hazard in these cases as the exposures are comingled. It also allows for more complex structures e.g. last-on-first-off profiles in the situation where the NIA exposure is drawn after EFIC's and then repaid first. The Commission may intend that by removing risk-sharing the administration of the NIA can be contested at a later date; however, there has been no argument or analysis of the efficiency or effectiveness of the current arrangement (see EFIC's Response to Draft Recommendation 9.5). *Note*: 74% of the current $659 million NIA portfolio represents legacy exposures from the discontinued Development Import Financing Facility (DIFF) offered in conjunction with an AusAID program and this legacy exposure is not relevant to the discussion.
Draft Recommendation 5.2 EFIC's definition of a small to medium-sized enterprise should be limited to firms with annual turnover of less than $25 million.	Draft Recommendation 5.2 is not supported by EFIC. EFIC notes this Draft Recommendation is not substantiated: • The Recommendation is based on a definition used by ASIC for company reporting standards. The Commission fails to explain why this definition is appropriate for EFIC's business model and mandate. • The Commission does not demonstrate that market failures do not exist for the provision of export and trade finance.

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	• The Commission does not demonstrate that annual turnover is an indicator of market failure. • There is no analysis of the widely differing characteristics of SME firms in different industries across the economy and the markets in which they compete. • This recommendation is inconsistent with other Government programmes, most notably those government programs designed to assist exporters. For example, Government defines an SME exporter for its Export Market Development Grant scheme as a company with annual revenue of less than $50 million. For the Enterprise Connect program, a firm's annual revenue or expenditure must be under $100 million. Research indicates that there are market failures in the provision of export and trade finance (see response to Draft Finding 4.1) The Commission fails to demonstrate that market failure is linked to annual turnover. The Commission's benchmark of $25 million turnover is based on an ASIC definition which is unrelated to the research. Even large firms may confront market failure, and large firms use SME subcontractors. See comments on Draft Finding 6.2. This view is also held by Australian exporters (for example see submissions made to the Commission by Wagner and McConnell Dowell). EFIC's segmentation strategy was established for the purpose of grouping risks and clients into a practical structure for client service and risk management. Within EFIC, 'SME & Mid-Market' is defined as companies with a turnover of less than $150 million and clients typically have a turnover between $20 million and $80 million. EFIC has aligned its business model to correspond with the major domestic and international banks, as well as introducing an industry overlay for key industries. SME & Mid-Market clients are serviced from the business banking through to the commercial and corporate lending segments within the banks. Smaller SMEs (turnover of less than $5 million) are less likely to be exporters and if they export they only transact sporadically and for small amounts.[9] SMEs generally need a certain level of critical mass (both in terms of turnover and staff numbers) in order to become regular exporters, to respond to the increased complexity of the business model and logistics. The credit risk of smaller SMEs, especially first time exporters without a track record, is significant and as a group they are not commercially viable both in terms of

[9] EFIC commissioned research carried out by East & Partners 'Market Gap Report' October 2011.

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	transaction costs and potential credit losses. This group generally requires equity rather than debt solutions which does not fall within EFIC's mandate.
Draft Finding 5.1 EFIC is unlikely to be the most effective mechanism for addressing any distortions created by poor regulation	EFIC supports Draft Finding 5.1 to the extent that: • If there are regulatory distortions of the Australian market for export finance and insurance , the best way to tackle these is directly, through removal of the distortion; however, • Until such distortion is removed, EFIC can remain an efficient and effective solution for regulatory imperfections in export and trade finance in Australia, and • EFIC can be a fitting, 'first best' response to cases of regulatory distortion of overseas financial markets (which is not addressed in the supporting discussion for this Draft Finding in the report). EFIC understands that in economic terms the 'first best' policy to fix a 'distortion' or 'imperfection' or 'failure' in a market, is to tackle the failure directly. However, the relevance of much of the discussion by the Commission in relation to this Draft Finding is unclear. EFIC may not be the most effective mechanism for addressing regulatory barriers that exist in the banking system generally, but can be the best mechanism to address regulatory distortions overseas in the provision of export and trade finance. As noted in Draft Finding 4.1, the Commission overlooks that EFIC does not exist solely to fix market failures in Australia; it is also there to combat market failures, including regulatory ones, in overseas markets that inhibit Australian capital goods and service exports and overseas investments. Please also see EFIC's response to Draft Finding 4.1 and 6.2 – extensive research demonstrates that market failure exists in the provision of export and trade finance, and that an ECA is the best mechanism for addressing such failure.

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Draft Finding 5.2 The decline in the provision of trade finance during the global financial crisis was primarily due to lower demand for traded products. As such, government policy aimed at addressing the decline through the provision of export finance and insurance would not have been successful.	Draft Finding 5.2 is consistent with EFIC's advice to Government in 2009. However, there is no substantive analysis provided by the Commission on which to draw broader policy conclusions. • EFIC agrees with the Commission's comments regarding the impact of the Global Financial Crisis (GFC) on Australian trade finance; however, globally the evidence is mixed. • The impacts of financial crises experienced since 1991 suggest that the lessons from the GFC are not applicable in every instance of financial or market crisis. • The Commission has not considered that the immediate implications of a financial crisis for trade finance and Australian exporters are different to the extended structural changes that might occur in project finance, for example. This is a level of complexity that should be considered in a policy response at the appropriate time. As EFIC informed the Commission, EFIC consistently recommended to the Minister for Trade not to intervene in short-term trade finance during the depths of the GFC[10]. This was also EFIC's advice to senior officials in Department of Foreign Affairs and Trade (DFAT), Department of the Treasury (Treasury) and the Department of Finance (Finance)[11]. EFIC reached this conclusion given the relative stability of the Australian banking system and the relative strength of our major trading partners, as well as the need for price discovery and rationalisation in the commercial trade finance markets. The research undertaken subsequently, and cited by the Commission, endorses EFIC's recommendation to Government; however, the evidence regarding the GFC's impact on trade finance globally is mixed. It is still the view of some researchers that a shortfall in trade finance was, at least, a moderate factor in the 2008-09 world trade slump.[12] Moreover, it has been argued that were it not for the intervention of export credit agencies in 2008-09, the trade finance crunch could have been considerably greater than it turned out to be.[13] As the IMF researchers, Asmundson et al note, 'ECAs may have played an important role in cushioning the downturn. They may have

[10] Letters dated 6 February 2009, 15 April 2009, 12 June 2009 and 17 July 2009.
[11] Meetings 21 May 2009, 9 July 2009, 28-29 July 2009
[12] Chauffour, J.P and Malouche, M. 2011, 'Overview', in Chauffour, J.P and Malouche, M (eds), Trade Finance During the Great Trade Collapse,' The World Bank, Washington D.C., p. 1-23
[13] A detailed account of the measures taken by OECD ECAs can be found at the OECD's website: http://www.oecd.org/document/19/0,3746,en_2649_34169_42396243_1_1_1_1,00.html

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	also played an important signalling role by reassuring the private sector that official institutions stand ready to back up at difficult times.[14]'(p.33) The Australian Government was sufficiently concerned to support a G20 initiative to extend $250 billion in trade finance during the GFC. The Commission does not cite this research although it cites another paper by Asmundson et al (2011a)[15]. From a general policy perspective, the Draft Finding does not incorporate evidence from the 1997-98 Asian financial crisis. Some studies such as that by Wang and Tedesse suggest that trade finance availability declined considerably in this period.[16] This was EFIC's experience: during the course of the Asian financial crisis in 1997-98, acceptance and discounting of Asian bank letters of credit came to an almost complete stop given the prevailing uncertainty. As a result, exports from Australia to Korea and other Asian countries came under severe threat, for example, Citibank refused a $3 million risk on iron ore exports to POSCO. To curb that threat EFIC gathered the major trade finance institutions and proposed a 50:50 risk-sharing arrangement, which increased markedly its short-term insurance limits. EFIC took this initiative given the length of time needed for National Interest consideration, which eventually followed. As a consequence exports continued and our exposure to Korea soared from $76 million in 1996-97 to $835 million in 1997-98 and $1.09 billion in 1988-99. EFIC made a significant profit from this activity. The Draft Finding accords with the view that while trade finance is arguably less risky due to its short-term self-liquidating nature, it is still very vulnerable to bank deleveraging and higher risk aversion, as banks can readily terminate this line of business should they urgently need to scale back their financing operations in the face of funding constraints or rising counterparty risk. This remains an issue post-GFC, in trade finance but particularly medium to long-term project and export finance. (See chart below). In the wake of the GFC, major European financial institutions continue to scale back their project financing limits, even in stable markets like Australia. There is an extended structural change underway in the European banking system that has impelled EFIC to provide capacity for onshore resource projects. (Please see EFIC response to Draft Recommendation 10.1)

[14] Asmundson, I., Dorsey, T., Khachatryan, A., Niculcea, I. and Saito, M. 2011b, 'Trade and trade finance in the 2008-09 financial crisis', IMF Working Paper, WP/11/16, International Monetary Fund, Washington DC.
[15] Asmundson, I., Dorsey, T., Khachatryan, A., Niculcea, I. and Saito, M. 2011a, 'Trade finance in the 2008–09 financial crisis: evidence from IMF and BAFT-IFSA surveys of banks', in Chauffour, J. and Malouche, M. (eds.), Trade Finance During the Great Trade Collapse, The World Bank, Washington D.C., p. 89–116.
[16] Wang, J-Y and Tadesse, M.G., 2005, 'Overview', in J.-Y. Wang and M. Ronci, eds., *Access to Trade Finance in Times of Crisis* (Washington: International Monetary Fund), pp.1-15.

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	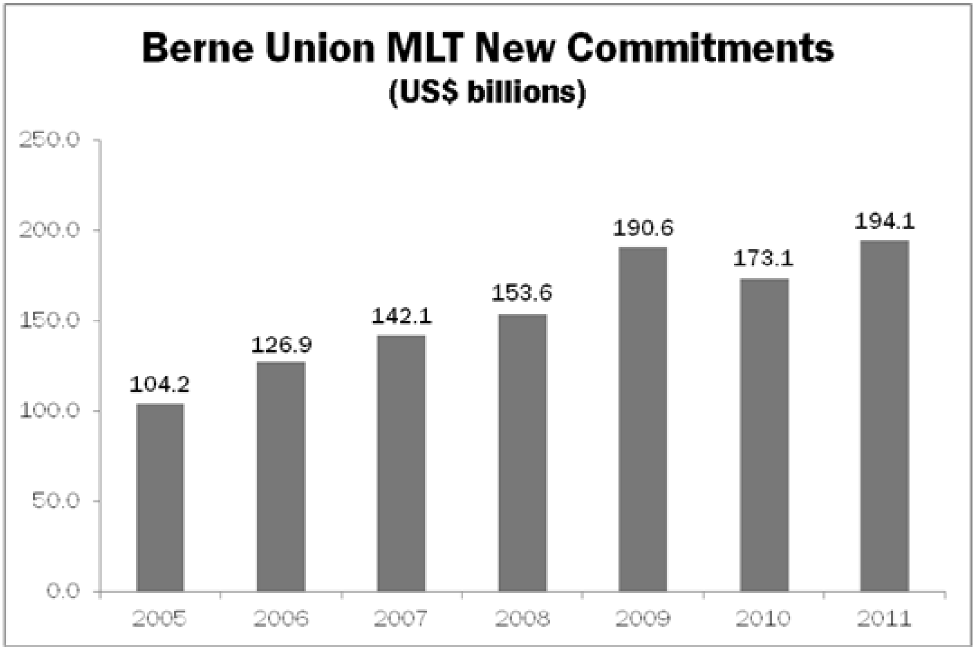 Source: Berne Union 2011 This chart shows the level of new commitments by 29 ECAs who are members of the Berne Union Medium-Long Term Committee. The level for 2011 demonstrates the call for ECA support has not abated. It should be noted that figures do not include the EXIM Banks, which based on anecdotal evidence on their untied support in Australia alone, would mean this number is significantly higher.
Draft Finding 6.1 The concept of the market gap can cover circumstances where there is no market failure that would warrant EFIC support.	EFIC supports Draft Finding 6.1 to the extent that the concept of market gap may be broader than market failure. However, EFIC considers that the conclusion that its support is therefore unnecessary or unwarranted is not substantiated. EFIC considers that the Commission's discussion relating to this finding contains a number of errors and inaccuracies, as noted below: • The criteria presented by the Draft Report in Box 6.1 and referenced in the text were agreed by Government in the 2006 Review of EFIC. Before EFIC proposed criteria for the 'market gap', none existed.

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	EFIC sought, in the 2006 Review, to establish a conceptual framework with Government to agree what factors might be used to evaluate a 'market gap' to give greater certainty to both Government and EFIC's clients. • The Commission was informed that EFIC also took the initiative to establish a portfolio risk band measurement in 2001 to provide a quantitative risk-based measure for EFIC's activities (i.e. a portfolio that was too risky could result in losses, or a portfolio of too high quality might suggest EFIC's activities were intruding on the market – either outcome inconsistent with EFIC's mandate of working in a 'market gap'). • EFIC and the Government also relied on the public submission process in periodic Government reviews to determine whether EFIC's activities were intruding on commercial activities. • It cannot be assumed that the profit motive will always ensure private financial institution support for all worthwhile exporters and transactions. Firstly, from a practical perspective financial institutions consider more than individual transaction returns. For example, from the perspective of an Australian bank, overseas transactions in emerging or frontier markets may not suit their credit model or business operations; and from the perspective of overseas banks (particularly now), allocating capital to transactions for Australian companies is unlikely to be a priority unless a broader commercial relationship exists. Business models are 'sticky' whatever the level of profitability in an individual transaction. Secondly, as explained in Appendix A, the markets for export finance and insurance are marked by asymmetric information that prompts financial institutions to engage in credit rationing. In the process, businesses which are denied credit can be identical in all observable respects to businesses that obtain credit. There is a clear market gap that also constitutes a market failure. • The Commission writes that 'risk is most efficiently borne by those best able to manage it…' and that Government intervention 'potentially increases the number of bad loans made'. The reader is left to infer that these arguments apply to EFIC. The discussion in this section lacks analysis to demonstrate that these concerns are inherent in EFIC's risk management practices and performance, particularly given an abundance of data to the contrary. • The Commission reports that 'the private sector appears to offer the same types of products as those offered by EFIC', which is true: financial products are deliberately homogeneous with those offered by the private sector for many reasons including risk-transfer, aiding comprehension and transparency, as was

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	noted in EFIC's response to Draft Finding 3.1. It allows clients to understand and compare complex financial products, and EFIC to work in tandem with private providers. From the Commission's Draft Recommendation 10.4 that EFIC offer only guarantees, for example, it would not follow for EFIC to offer a non-standard guarantee product.
Draft Finding 6.2 EFIC is likely to be crowding out private sector provision of export finance and insurance. At present EFIC's relatively small size limits the economy-wide consequences of this. Some transactions are of sufficient size to pose a non-trivial financial risk to the Commonwealth.	Draft Finding 6.2 is not supported by EFIC. • EFIC notes the Draft Finding is not substantiated. It is based on selective reference to academic studies and evidence has not been presented to support the conclusion that EFIC is likely to be crowding out the private sector. • The Draft Finding provides no evidence that market failure does not exist. (See EFIC's response to Draft Finding 4.1 and 5.2). • Markets for export finance and insurance, especially for emerging and frontier markets are subject to market failure. • EFIC crowds *in* public and private sources of export finance and insurance to the transactions it supports. The Commission's analysis is a theoretical assessment, and not supported by evidence. Firstly, it assumes market failure does not exist. Based on this critical assumption, the Commission asserts that private financial markets provide an ideal level of support to exporters – and that EFIC either subsidises transactions that the private market has declined or crowds out private debt and equity financiers from worthwhile transactions. The Commission findings are based on selective reference to academic studies and do not present conclusive evidence that market failure does not exist for large Australian firms. As EFIC argues in response to Draft Finding 4.1 and 5.2, the market for export finance and insurance is subject to failure. It follows that if market failure is present and an ECA such as EFIC is a fitting response to those failures, EFIC does *not* crowd out other more valuable projects, or private financiers. To the contrary, EFIC serves to crowd *in* finance and insurance to worthwhile projects that otherwise wouldn't gain support, and is thereby improving the efficiency of resource allocation in the economy. The Commission has not presented evidence that private sector finance has been crowded out by EFIC's activities. In fact, EFIC steps back when other lenders are willing and able to participate — *forestalling*

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	crowding out. **How does EFIC crowd in?** In three main ways. First, EFIC has access to broader information sources than private sector participants to enable it to make more informed decisions (EFIC initial submission p.5). This signalling impact is particularly effective for countries where EFIC's expertise is perceived to be greater than other participants in the lending syndicate, such as Australia and Papua New Guinea. Second, due to its Australian Government ownership, EFIC is perceived to have leverage that can either deter actions that would be prejudicial to Australian exporters, or resolve prejudicial actions that have already arisen with a view to minimising losses. Third, other financiers can take comfort from EFIC being an OECD-compliant ECA with established credentials in undertaking assessments of environmental and social issues. EFIC's ability to 'crowd in' other ECAs is consistent with studies that find that contract enforcement, business networks, and trust are important drivers of international trade and investment. According to Rauch, 'Numerous statistical and case studies provide evidence that transnational business and social networks promote international trade by alleviating problems of contract enforcement and providing information about trading opportunities.'[17] (p. 120). Similarly, Guiso et al found that bilateral 'trust' between two countries was an important determinant of the level of trade and investment within the European Union.[18] Because the European Union is fairly culturally homogeneous, this would suggest that trust may be an even greater hindrance to trade and investment between countries where historical and cultural differences are greater, such as between Australia and emerging or frontier markets. As noted in EFIC's initial submission (see p. 12), there are clear signs of funding capacity constraints for large domestic resource and infrastructure projects, with over $400 billion of projects either planned or under development according to the Bureau of Resources and Energy Economics (BREE) (see EFIC's response to Draft Recommendation 10.1). EFIC has sought to augment the ability of private sector lenders and other export credit agencies to fund these projects. It has played a catalytic role in three such transactions - Wiggins Island Coal Export Terminal, Brookfield Rail and Gladstone Liquefied Natural Gas (LNG) as discussed below. The Commission supports its claim that EFIC is crowding out private sector capacity in funding large domestic

[17] Rauch, J., 2001, 'Business and social networks in international trade,' Journal of Economic Literature, 69, p.1177-1203
[18] Guiso, L. Paola, S., Zingales, L., 2009, 'Cultural biases in economic exchange,' The Quarterly Journal of Economics (2009) 124 (3), p.1095-1131.

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	export focused infrastructure projects by citing a draft energy white paper, by the Department of Resources Energy and Tourism's (DRET) statement that the 'call on capital will be split across a range of different components of the market (generation, networks and gas infrastructure)…and is within the capabilities of Australian and international capital markets to support if investment settings are appropriate and stable'. The DRET paper refers to investment required in the Australian energy sector to meet energy security needs while supporting the transition to clean energy, including power generation and regulated, monopoly, utility assets, which have stable revenue streams, long economic lives and predictable capital expenditure requirements. These are not the types of assets which EFIC has financed, and which the Commission has cited as examples of 'likely crowding out'. By contrast, the three transactions in which EFIC has participated share common characteristics such as green-field developments with technical, reserve, completion and operating risks and price and/or volume risks. These assets are not subject to price regulation and lack monopoly market positions. The Commission refers to three resource-related onshore projects (Box 6.2 p.101, Box 6.4 p.105) which are considered below: **Wiggins Island Coal Export Terminal (WICET)** EFIC's participation arose as a consequence of the limited availability of private sector debt to fund the project. EFIC explicitly advised that it would be prepared to consider the transaction if, and only if, the funding could not be successfully completed in the market without EFIC's assistance. The syndication closed some months later than scheduled. EFIC's participation in the lending syndicate, and its detailed due diligence and documentation process provided other ECAs and state development banks with confidence. The Commission has overlooked the involvement of several other parties – one other ECA, EDC from Canada; China Development Bank (CDB) and Korea Development Bank (KDB); and government owned German export bank KfW-Ipex Bank. Of the 19 lenders, 5 were government-owned, and their contribution to the total financing represented 26% of the senior syndicated facilities **Brookfield Rail** Brookfield Rail sought assistance from EFIC and Canada's EDC, to insure the credit risk on a letter of credit issued by a state owned Chinese bank with a tenor of 10 years. The private market in Australia did not have

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	appetite for this risk. The letter of credit was issued on behalf of a mine owner to support its take-or-pay commitments to Brookfield Rail associated with the approximately $565 million rail upgrade. Brookfield Rail borrowed $350 million from a syndicate of banks to meet part of the rail upgrade costs, to be serviced from the payments due under the take-or-pay obligations of the mine owner. The balance was funded by equity. Brookfield and its lenders were unprepared to accept risk on the Chinese bank with mitigation of this risk being a requirement for the investment to proceed. EFIC's involvement crowded in rather than crowded out both debt and equity. This in turn facilitated the development of long life privately owned infrastructure and opened an export channel. The Commission suggests that Brookfield Rail's parent company would 'have had other options to secure finance, including raising equity from shareholders, rather than seeking financial support from EFIC' (p.101). Not so. Brookfield Rail was seeking to mitigate a counterparty risk. The mix of its debt and equity would not have changed the nature of this counterparty risk. The Commission contrasts the credit rating of the issuing bank to that of the Commonwealth Bank of Australia. It fails, however, to acknowledge that the bank is a non-OECD bank and the credit rating of the issuing bank is tied directly to the credit rating of the sovereign owner of that bank; however the sovereign government does not guarantee the obligations of the issuing bank. The Commission also does not acknowledge that the standalone credit rating of the bank issuing the letter of credit is not comparable with that of the Commonwealth Bank of Australia. **Santos GLNG** EFIC provided support to Santos to help finance its contribution to Gladstone LNG, only after the company had used other sources of finance – a capital raising, a hybrid debt issue, equity sell down and an extension to the duration of other bank facilities. EFIC's involvement, it's detailed due diligence and documentation processes gave confidence to other ECAs providing finance (Italy's SACE, Malaysian Exim and Canada's EDC) totalling US$830 million. The Commission has failed to mention data provided to it on steps taken by Santos to finance their capital contribution obligations to the Gladstone and Papua New Guinea Liquefied Natural Gas (PNG LNG) projects which included:

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	• issuing new ordinary equity of $3.5 billion; • raising EUR1.0 billion by issuing a hybrid instrument; and • selling down its interest in the Gladstone LNG project in two phases, first from 60% to 45%, and then from 45% to the present level of 30%, raising in total $1.3 billion; • and extending the duration and increasing their bank bilateral commitments to $2 billion - measures were in addition to earlier issuance of long term debt in the US private placement market. The facility in which EFIC participated is notable for several reasons. Though this detail was provided to the Commission, none is contained in the Commission's report. Specifically: • though EFIC understands that the number of commercial banks approached is greater, at least seven were offered the opportunity to participate in the seven year non-amortising tranche, yet committed only $170 million, leaving EDC to provide $500 million of the $670 million raised; • four banks provided $170 million in total, the largest commitment being just $50 million; and • the participating banks competitively bid for the guaranteed tranches. The Commission quotes Santos's Chief Financial Officer (described as the Chief Executive Officer) on p.105 of the Draft Report as claiming that the company will have more than $7 billion of available funding capacity. The Commission provides no context for this amount of liquidity, beyond the reference to the $4.8 billion investment in the GLNG project. Santos is also funding the development of the PNG LNG project in which it has a 13.5% interest, in addition to the large scale, existing operations in Australia and offshore, which require constant development and maintenance expenditure. It is clear that EFIC's participation comes only after other sources of finance have been utilised.

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Draft Finding 6.3 Some financial market participants have a partnership relationship with EFIC, being able to benefit directly from EFIC's involvement in transactions, both through risk transfer and higher returns	EFIC supports the Draft Finding, but NOT the implication that such relationships with financial institutions are improper. • EFIC's statutory duties include developing relationships with private sector participants to crowd in their support for Australian export trade. • Sustainable relationships with the private sector must be mutually beneficial. • All such relationships are conducted on commercial terms - EFIC does not subsidise private sector participants and steps back from the market when capacity is available. EFIC's establishment of commercial partnership agreements with other financial market participants is consistent with EFIC's demonstration role and 'crowding in' other financial institutions to transactions. Indeed, EFIC's statutory duties require EFIC to 'encourage banks, and other financial institutions, carrying on business in Australia to finance, or assist in financing, export contracts or eligible export transactions.' (Part 2, 7(1) (b) EFIC Act). EFIC conducts all its relationships on a commercial basis. As the Commission would understand, the essence of market exchange is mutual benefit: a reallocation of risk to the financial institution that has the greatest willingness and greater capacity to bear that risk. EFIC transactions are priced to earn a commercial rate of return (see EFIC's response to Draft Finding 7.1). EFIC does not provide a subsidy to financial institutions. EFIC steps back if alternative sources of finance are available (see response to Draft Finding 6.2) with its homogenous products facilitating the transfer of risk to the private sector when capacity becomes available. The Commission notes that EFIC has relationships with 'some' market participants, but EFIC has minimal dealings with other active participants in the trade finance market. If EFIC was under-pricing risk, all market participants would have strong relationships with EFIC or be complaining that they do not.
Draft Finding 6.4 There are reasons why there may be no complaints about potential under-pricing from	Draft Finding 6.4 is not supported by EFIC. EFIC notes this Draft Finding is not substantiated, is based on selective evidence and contains inaccuracies. • Private sector participants have not complained that EFIC is either under-pricing or crowding out the

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EFIC, including its partnerships with other export credit agencies and some private sector providers.	market. • Reasons presented by the Commission to explain why complaints have not been received about potential under-pricing by EFIC do not stand up to scrutiny. • The experience of private sector providers and ECAs in overseas markets also contradicts this finding – Past events show banks will complain loudly if ECAs crowd out the private sector. • Banks are well resourced and very proactive in protecting their commercial interests. The Commission has received submissions from the Insurance Council of Australia and conducted visits to the Australian Bankers Association in addition to a number of banks and insurers, but has not received complaints that EFIC's activities under-price or crowd out the private sector. In fact, these market participants have confirmed that EFIC is *not* crowding out the market (see Insurance Council of Australia submission and ANZ submission). Three submissions to the Commission received from exporters have also criticised the high level of EFIC's pricing (see submissions by Ferra and TTG and Wagner). Despite the available evidence, the Commission has identified five possible reasons why there have been no complaints. These are responded to below: • *'EFIC may service a market that is not cost effective to service.'* If this were true, then the transactions facilitated by EFIC would be unprofitable and its expenses high. This is simply not supported by the evidence – EFIC is profitable and its cost-to-income ratio is in line with other Australian financial institutions (see EFIC's initial submission, p. 2-3, Appendix A). • *'EFIC's mere presence may deter the private sector from developing capacity to move in.'* This is contrary to EFIC's experience in that EFIC's presence contributes to a 'crowding-in' effect – see EFIC's response to Draft Finding 6.2. Given EFIC's small size it does not have a presence so significant in any market to deter entry. EFIC does not impose any cost penalties on the prepayment of its loan or guarantee facilities, which combined with its complementary product suite, facilitates the replacement of EFIC's support when the private sector determines that risk is acceptable. • *'Some firms may fail to complain because it is not costless to a make a complaint.'* The suggestion that large, well capitalised organisations, further represented by industry lobby groups cannot afford to complain to protect their commercial interests is questionable.

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	• ‘*Banks may benefit from a mutually beneficial relationship between EFIC and other ECAs*’ whereby a bank can lower the risks and increase returns associated with a transaction. It is expected that commercial enterprises will pursue mutually beneficial relationships. The reasons why these relationships are appropriate and indeed beneficial for exporters are detailed above. • ‘*Strategic behaviour by some private sector providers.*’ The Commission argues that banks could engage in strategic behaviour such that as long as the overall outcome is beneficial to the bank concerned, including receiving subsidy on some transactions, then it would tolerate EFIC and not make any complaints. EFIC does not subsidise transactions – see EFIC’s response to Draft Finding 7.1. The Commission suggests that EFIC has ‘partnership arrangements’ with some private sector providers, but does not acknowledge that EFIC has minimal dealings with other active participants in the trade finance market who would complain if their competitors were engaging in such strategic behaviour with EFIC or would seek such relationships with EFIC.
Draft Recommendation 7.1 An independent audit should be undertaken to determine if EFIC systematically understates or overstates its expected losses from default, as this will affect whether EFIC is pricing risk appropriately.	Draft Recommendation 7.1 is not supported by EFIC. EFIC notes that this Draft Recommendation is not substantiated; contains inaccuracies and is unnecessary. • The ANAO and their appointed agent Ernst and Young undertake annual audits of EFIC’s expected loss from default methodology. • The Recommendation implies incorrectly and inappropriately that EFIC may have understated or overstated expected losses to influence EFIC’s pricing and this has been consistently disproved by independent audits. • EFIC took the initiative to establish a process using independent data that can be independently audited, precisely to enhance transparency and avoid any concerns with valuations. EFIC’s financial statements are audited by the Australian National Audit Office (ANAO) and their appointed agent Ernst & Young (EY). Both the ANAO and EY (collectively, the external auditors) are required to confirm they have complied with all the professional regulations relating to Auditor Independence. Since 1991, most recently confirmed in the December 2011 review of EFIC’s interim financial statements, the external auditors have confirmed their

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	independence. The audits and reviews performed by the external auditors specifically examine EFIC's expected loss from default methodology ('the allowance for credit risk'). The allowance for credit risk is a key component in EFIC's overall profitability. The process EFIC has adopted to calculate the allowance for credit risk is on the public record (web and annual report). It is consistent with the methodology adopted by financial institutions globally and reflects the principles established by the Basel Committee on Banking Supervision and the Australian Prudential Regulation Authority (APRA). It has been discussed extensively with Central Agencies in EFIC's annual results presentations. A key variable element in the allowance for credit risk calculation is the probability of default (PD). EFIC uses independent external data from Standard and Poor's and Moody's to calculate PD as EFIC's loss history is too narrow to be statistically sound. In the December 2011 review of EFIC's interim financial statements the external auditors stated, 'We have performed analytical review procedures and updated our understanding of EFIC's valuation process and methodology… Nothing has come to our attention to suggest that EFIC's fair value adjustments of loans and guarantees are materially misstated at 31 December 2011'.[19] It is misleading and inappropriate to imply that EFIC 'systematically understates or overstates its expected losses from default'. EFIC's Board consists of professional independent Directors with extensive corporate experience from financial institutions such as CBA, ANZ, and Macquarie, who have overseen a robust valuation process and methodology for assessing expected losses from default, which is based on independent market based data and is independently reviewed by the external auditors. EFIC took the initiative to develop this process precisely to avoid concerns with valuations. With regard to their impact on pricing, expected losses are an important factor but they are not the only consideration. Expected losses are based on historical data and used primarily to value the portfolio at a point in time from an accounting perspective. To the extent that past performance is helpful in predicting the future, PDs are useful for pricing. They are included in EFIC's ROE and pricing calculations for that reason. However, other factors need to be incorporated into pricing, including current market pricing by the private sector, current pricing by other ECAs, our obligations under the OECD Arrangement and EFIC's own assessment of the possible impact of future events.

[19] Ernst & Young Report to the EFIC Audit Committee, 31 December 2011, p4.

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Draft Finding 7.1 Not all of EFIC's transactions are priced to earn a commercial rate of return. The expected income from some transactions does not cover their full economic costs, including the cost of capital. These transactions are effectively being subsidised by taxpayers. The beneficiaries of these subsidies likely extend beyond the exporter concerned and may include financial institutions, other export credit agencies, and the buyer of the exports.	This Draft Finding is not supported by EFIC. EFIC notes that the Draft Finding is not substantiated, selective and contains errors and inaccuracies. • The Commission acknowledges that it 'was unable to robustly determine whether EFIC's loan portfolio was under-priced, given the risk incurred,' (p.130) yet the Draft Finding assumes that 'some transactions' are under-priced (i.e. does not cover the full economic costs) and therefore concludes that these transactions are being subsidised by taxpayers. • The Draft Finding does not put into context or quantify the proportion of EFIC's business that, in the Commission's view, does not achieve a commercial rate of return. • No methodology or guidance is provided to compare EFIC's existing returns against a commercial benchmark. • The Commission has omitted evidence that across every category of transaction EFIC has been successful in seeking reinsurance by the private sector at or below the price established by EFIC. **Pricing and ROE Model** EFIC's approach is to price transactions to earn a commercial rate of return, as measured by the ROE on each transaction determined through EFIC's ROE model. It is evidenced based, and draws direct or highly correlated market comparisons, for the risks being undertaken. Often, EFIC draws on specific private market benchmarks, and particularly where EFIC's return is identical to that of private market providers for identical risk. EFIC's ROE model focuses on accounting outcomes by measuring the amount of fee and interest income generated on a particular transaction and dividing that by the amount of capital required. A small number of sovereign risk transactions are priced according to an OECD pricing model. The OECD Arrangement, to which Australia is bound, establishes, amongst other terms and conditions, a minimum risk margin or premium based on duration, type of covered offered (e.g. a guarantee is priced higher than an insurance), level of indemnity covered and frequency of principal repayment. Where there is competition between suppliers from different countries, ECAs typically provide financial support at the minimum premium levels determined by the OECD MPR.

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	Despite these constraints, of the eight transactions EFIC concluded over the past 10 years priced at the OECD Minimum Premium Benchmark, EFIC has reinsured 50% in the private market within the premium earned and is confident it could reinsure the balance if the portfolio requires. There is no evidence to suggest that EFIC deliberately underprices some transactions in order to subsidise exporters or other financial institutions. **Economic Profit and ROE** The Commission uses two measures to assess EFIC's financial performance; economic profit and return on equity (ROE). The market definition of economic profit is: income – expenses – opportunity costs, where opportunity costs are the alternative returns foregone. The Commission makes a number of statements regarding benchmark rates of return: • EFIC 'needs to earn an economic profit to provide a real benefit to taxpayers. That is, the income generated from a transaction must exceed reported expenses, including taxes, plus the opportunity cost of its funds' (Draft Report p. 116); • 'The opportunity cost reflects the benefits foregone by taxpayers from having their funds used by EFIC compared to alternative activities.'(Draft Report p. 21) • 'The opportunity cost reflects the benefits foregone by taxpayers from having their funds utilised by an ECA compared to other public sector programs (Boyd 1982)'[20] (Draft Report p.116); and • EFIC's return on equity is 'slightly above the 10 year government bond rate' but concludes 'given that EFIC's rate of return is lower than that achieved by comparable private sector providers it could be subsidising its products or have higher cost structures (or a combination of both factors).' (Draft Report p.132) These statements contain a number of issues, which will be dealt with below. There are several reasons why banks are not directly comparable to an institution like EFIC. Australian banks typically are measured against Return on Equity (ROE).

[20] Boyd, J.H. 1982, 'Exim Bank lending: a federal program that costs too much,' Federal Reserve Bank of Minneapolis Quarterly Review, Winter, p.1-17

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	ROE is defined as: **Net Profit ÷ Average Shareholder Equity for the period** ROE is an important measure for a company because it allows for comparison against peers or competitors. The Commission argues that other ECAs may not be an appropriate benchmark for EFIC. Instead it asserts that the performance of Australian banks is a better benchmark without considering alternatives or identifying the issues with using bank ROEs as a peer measure for EFIC. Firstly, commercial banks do not provide ROE calculations by individual lines of business. These commercial banks are diversified institutions with operations including retail banking, business and corporate banking, funds management and insurance. Published ROE are at an enterprise level; it is a blended ROE across all lines of business. Anecdotally and from EFIC's experience, corporate loan books return a much lower ROE than other forms of lending because of the capital required. By value, EFIC's portfolio is akin to a corporate loan book so a comparison against a broadly based ROE is inappropriate. Secondly, EFIC does not have any of the collateral income sources that commercial banks have. Examples include syndication and agency fees relating to debt products; high revenue/low capital intensive products like foreign exchange and interest rate hedging; advisory fees for a variety of activities; underwriting fees for debt; equity and debt capital markets fees; deposit taking/cash management products, and the stream of very high yielding consumer credit products (credit cards, personal loans, motor vehicle finance); and their mortgage books. In contrast, EFIC's product set is confined to export finance for counterparties that cannot be supported by the private sector. Thirdly, EFIC has a growing portfolio and through its credit provisioning policy has deferred income, which during the drawdown phase of a loan represents a drag on earnings and ROE. EFIC has a prudent and conservative reserve treatment for a small balance sheet and P&L (i.e. this issue is magnified for EFIC as against a Big 4 bank); the alternative is to have volatile earnings for the shareholder. EFIC does not have the ability to leverage its balance sheet in the same ways banks can and therefore to compare the ROE of banks to EFIC ignores this significant component. As at 31 December 2011, EFIC had almost $100 million of credit related provisions and as facilities are repaid, these reserves are released to the P&L and ceteris paribus, substantially increase EFIC's ROE. Finally, in their analysis the Commission has focused on pricing and income i.e. the numerator in the ROE

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	calculation rather than the denominator of capital. EFIC has generated significant capital from its profitable operations, which from a capital adequacy perspective is above APRA requirements but from a client perspective is insufficient capital for large projects and country exposures. EFIC's return on the minimum level of APRA regulatory capital at 30 June 2011 as shown in EFIC's Annual Report was 22.3% by way of comparison. **Commercial Benefit** Rational commercial behaviour would dictate that both the exporter and the buyer expect to derive a benefit from the export contract taken as a whole, including the finance which is integral to the transaction. EFIC rejects the implication that a commercial benefit is a subsidy.
Draft Finding 8.1 A large portion of EFIC's income is earned through its treasury operations, with EFIC's origination business accounting for less than half of its income in each of the past five years.	Draft Finding 8.1 is not supported by EFIC. EFIC notes the Draft Finding is not substantiated and contains errors and inaccuracies. • The Finding aggregates results from different treasury activities. This is misleading as profit from the funding of Australian exporters is unrelated to the income EFIC generates from investing its capital and reserves. • The income attributable to EFIC's treasury funding operations over the past 5 years is approximately $40 million out of $275 million or 14%. This Draft Finding inaccurately presents the composition of EFIC's commercial account income. The principal source of income for our treasury operations is the difference between EFIC's cost of funds and the internal transfer price charged to the origination business for funding assets. Until 1 May 2007, this income went directly to Government. EFIC's treasury also invests, on behalf of the Corporation, the retained cash profits from EFIC's past profitable activities (which were largely not treasury profits as before 1 May 2007 all treasury income went to Government as noted above) and receives investment income which is shown separately in the management accounts. Investment income on EFIC's cash capital and reserves is a corporate result; treasury effectively act as an agent for the Corporation. In the same way that EFIC manages the National Interest Account on behalf of the Commonwealth, EFIC's treasury operations manages the cash capital and reserves on behalf of the

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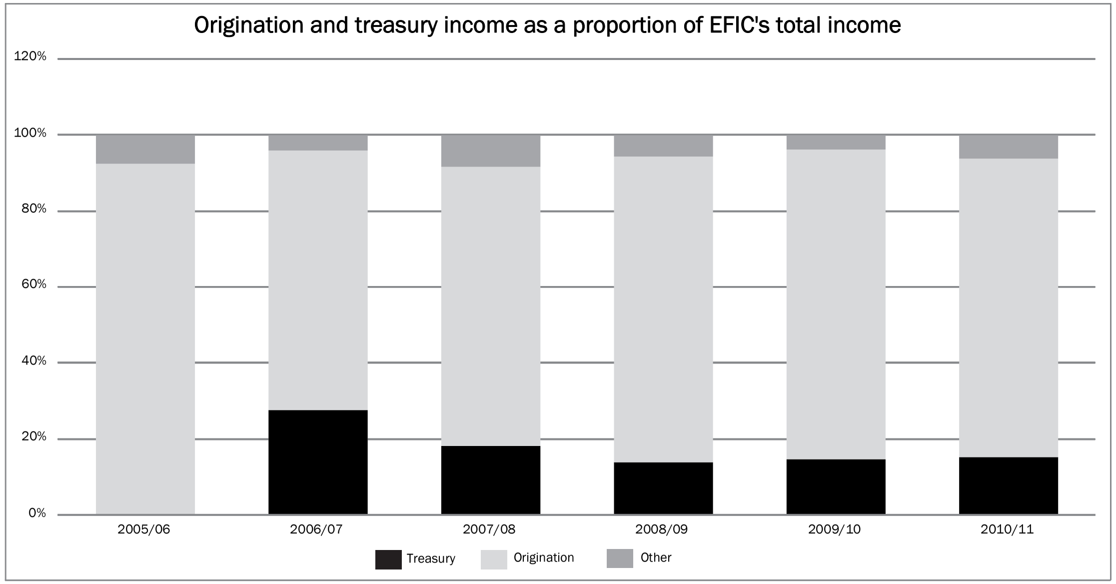
Commercial Account.
Draft Recommendation 8.1 and the Commission’s supporting commentary in Chapter 8 of the Draft Report overstates the contribution of EFIC’s Treasury and understates the contribution of business origination to EFIC’s overall income. Figure 8.1 on page 142 of the draft report pertains to show Treasury’s contribution to EFIC’s total income, however the graph would more accurately show the contribution EFIC’s Treasury operations make to total income as follows:


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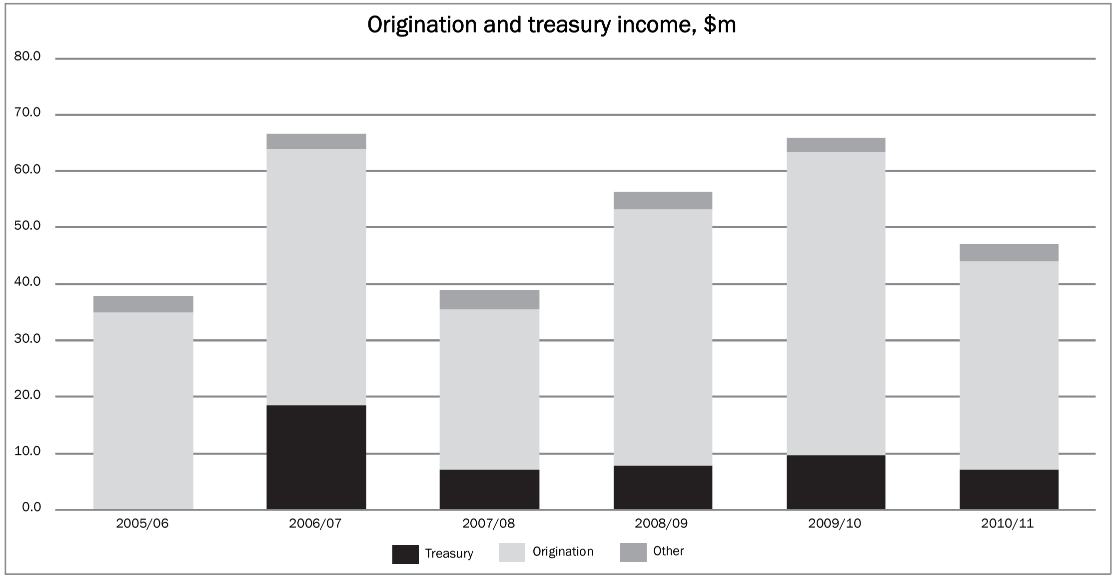
<tr><td></td><td>

These adjusted graphs remove two items from Treasury income - earnings from the Capital & Reserves (CR) portfolio and funds transfer pricing income (refer below). The income is assigned to ‘Origination’.
The graphs highlight that:

Treasury income is a decreasing proportion of EFIC’s earnings;
Treasury income is reasonably constantly under $10million per annum; and
Origination business contributes the largest share to earnings both in absolute and proportional terms.

It is inaccurate to characterise EFIC’s results as largely treasury profits. </td></tr>
<tr><td>Draft Recommendation 8.1

a. The size of EFIC’s treasury operations should be commensurate with the size and product offering of the origination business it</td><td>Draft Recommendation 8.1 is not supported by EFIC.

EFIC notes this Draft Recommendation is not substantiated, includes selective presentation of data and is unnecessary.</td></tr>
</table>

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supports. b. The need for, and the scope of, the treasury function should be subject to regular review by the Treasury and the Department of Finance and Deregulation. This review should include an assessment of EFIC's capital requirements and dividend policy. The first such review should be completed by June 2013	• There is no analysis substantiating either part (a) or (b) of the Draft Recommendation. • There is no recognition of the Board's legislative role in determining whether the treasury function is appropriate. • There is no recognition of EFIC's demonstrated strong risk management framework and adherence to best practice governance principles. See EFIC response to Draft Findings 9.1, 9.2 and Draft Recommendation 9.3. • Based on Draft Finding 8.1, the Draft Recommendation presents options using selective criteria and incomplete or misleading information. There is no evidence or analysis that existing operations are inefficient or inappropriate, or that any changes to treasury operations would improve either performance or risk management. In fact the evidence suggests that EFIC's treasury operation is efficient and appropriate. EFIC's Treasury operations employ 5.4 FTE amongst EFIC's 90 staff, and has been subject to independent review and annual appraisal. Treasury's funding operations are commensurate with the size of the origination business and EFIC's products, and the size and performance of the asset portfolios that it manages. The size of these asset portfolios has been driven by risk management considerations to ensure EFIC's Treasury can support the product offering of the origination business. EFIC actively manages liquidity/refinancing risk through a combination of funding programs approved by the Finance Minister. To this end, EFIC's Treasury manages three main funding programs – one short term and two medium/long term – with maximum utilisation under the programs capped by Regulation. EFIC strongly believes that it is important to retain access to a diversity of funding programs, thereby providing a flexible and robust model that can adjust to developments in global funding markets. There are three core asset portfolios managed by Treasury. First, the 'Surplus Liquidity' portfolio (SL). A basic function of any financial institution is to maintain a level of liquidity beyond what is immediately required. EFIC's mandate does not permit funds to be raised for purposes other than the funding of lending or guarantees. As such, judgements about the size of the portfolio are complex, reflecting the immediate liquidity needs of funding loan commitments, managing prepayments,

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	adapting to delayed loan draw-downs and managing EFIC's debt maturity profile. This all needs to be managed in the context of the market outlook for access to funding – or 'refinancing risk'. EFIC has a risk-averse approach to refinancing risk. This proved a successful strategy during the GFC and the SL portfolio has been deliberately increased over the past two years in anticipation of difficulties in global funding markets. EFIC has a high percentage of long term funding locked-in at positive net interest margins. However, the income generated from the SL portfolio is incidental to its purpose of managing refinancing risk. The second portfolio, the 'Market Recognition' portfolio (MR), exists to actively manage funding risk by keeping EFIC's name in front of investors when EFIC's longer-term funding operations have satisfied EFIC's immediate needs. Short-dated markets are more likely to remain open during times of financial market stress. For this reason, EFIC maintains a presence in the short term Euro Commercial Paper (ECP) market with the proceeds invested in well rated securities in line with the CAC Act. The MR portfolio has been capped at the same level (A$300 million) for the past 20 years, and it is funded entirely by borrowings earning a net interest margin. The return on the MR portfolio remains incidental to its main purpose, however, and the justification for the portfolio has not changed since it was approved in June 1990 by Simon Crean (acting as Treasurer) and reapproved by Jim Short (Assistant Treasurer) in June 1996. There is no evidence or analysis to substantiate the Recommendation that EFIC should outsource the SL and MR portfolios to AOFM. Almost all of EFIC's funding requirements relating to loans and guarantees are currently denominated in foreign currencies. The Commission's Recommendation is misleading from the perspective that the AOFM does not currently raise funds in foreign currencies having systematically exited foreign currency debt and derivative markets i.e. AOFM does not have this core capability required by EFIC and this is not clearly stated in the Report. The AOFM would either need to develop and replicate these functions by EFIC, or EFIC would need to retain a residual treasury capacity to perform those functions or outsource to a third party i.e. incur the inefficiency and costs of two outsourcing contracts. Furthermore, the Commission has not given consideration to the benefits of EFIC's flexible funding model. By limiting borrowings to Australian dollars combined with associated foreign currency hedging (when EFIC currently has little end user demand for Australian dollars), could result in a more costly outcome than if EFIC had a wider range of potential funding currencies to consider. There is no evidence or analysis in the Report to substantiate the Recommendation, which insinuates that a better commercial

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	outcome could be achieved through outsourcing. In fact, for commercial purposes EFIC has considered outsourcing in the past and commissioned expert advice, with the conclusion that there was no commercial basis to outsource this function. The third portfolio represents capital and reserves, or simply EFIC's cash equity, which is comprised almost entirely of retained earnings (and allowances). It has grown steadily reflecting EFIC's profitability. It is unclear whether the implication of the Draft Report is a 'return of capital' to Government, which would be inconsistent with the mandate and principles underpinning an independent body, and would require Legislative change. If the Recommendation is simply that EFIC could outsource investment activity, there is no basis to recommend the AOFM over a competitive tender for this service, but in simple cost-benefit terms it is likely to be uneconomic. Fees paid for management of the funds would conservatively range from 0.10% to 0.30% per annum. On EFIC's portfolios this would amount to an expense of between $1 - $3 million per annum against the current annual cost of $1.5 million to operate all of EFIC's treasury functions. There is also no analysis of the benefits - both from the perspective of cost and risk management - to EFIC from having a treasury function e.g. an enterprise risk management system. While the Commission recognises that "EFIC's treasury is relatively small in comparison to those of other government enterprises" it fails to recognise that it is a sophisticated treasury operation that has delivered strong risk management outcomes. The Commission's "preliminary view" lacks rigour. As noted in Draft Recommendation 7.1: • Annually, EFIC reviews its capital adequacy methodology and the Board – which includes or has included professional Directors with extensive corporate expertise and including from major financial institutions CBA, ANZ and Macquarie – considers and approves the policy; • Annually, the external auditors also audit and endorse EFIC's methodology; and • Annually, EFIC presents its financial results to Central Agencies and reviews its capital adequacy methodology at that session. There have been no concerns expressed about EFIC's policy in the past.

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	There is no analysis or evidence presented to substantiate the Recommendation that EFIC's capital requirements be reviewed by Treasury and the Department of Finance and Deregulation. EFIC's dividend recommendation is subject to the Minister's agreement and it should be noted that in the past two years the Minister has directed the payment of a larger dividend than recommended by the EFIC Board. Central Agencies review the EFIC Board's dividend recommendation each year and provide advice to the Minister on the dividend and accordingly EFIC's level of capital. In light of this it is unclear what this component of the Recommendation is intended to achieve.
Draft Finding 8.2 EFIC's internal auditors found that EFIC has had high exposure to some sectors, notably ship building and operation, and some countries. The Commission considers that EFIC's governance arrangements regarding some aspects of risk management have not always ensured sound prudential management **Draft Recommendation 8.2** EFIC should revise its risk management policies to include a limit on exposures to particular industries.	EFIC does not support the Draft Finding or Draft Recommendation. EFIC notes that the Draft Finding is not substantiated, is selective, contains errors and inaccuracies and the Draft Recommendation is unnecessary. • The Commission has not presented evidence to support the Finding that 'aspects of risk management have not always ensured sound prudential management.' • The Commission's calculations of EFIC's exposures by industry of risk are factually incorrect. • The robustness of EFIC's existing prudential framework has been demonstrated across many business cycles. All financial institutions are exposed to risk concentration in one form or another. EFIC has well developed policies to manage such large exposures. These require that EFIC's aggregate exposure to any counterparty, or a country, is limited to 25% of capital. This is consistent with APRA's large exposure prudential standard (APS 221), although Australian Prudential Regulation Authority (APRA) is not prescriptive about limits for individual countries. EFIC's country exposure to Sri Lanka and Zambia noted by the Commission (pg. XXXIII and pg. 148) has always been well within these prudential limits. The Commission's statement that EFIC's internal auditors 'found' that we had high exposure to some countries or industries is misleading. The auditors noted that EFIC reports large exposures, whether country, industry or counterparty, to EFIC's Board at each of its meetings. Moreover, these exposures were both approved and managed in accordance with EFIC's well-developed governance processes. The auditors concluded that EFIC was 'fully compliant' with prudential limits per APS 221. The auditors suggested enhanced stress testing as a

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	possible process improvement. APRA is not prescriptive about limits for individual industries, but require Authorised Deposit-taking Institutions (ADI) to have policies to safeguard against excessive risk concentrations. Large industry concentrations are not necessarily evidence of imprudent lending: for instance, many ADIs have very high levels of concentration to residential mortgages. Consideration needs to be given to the nature of risk arising from such a concentration. EFIC has well developed policies for management of industry risk. EFIC's industry exposures are considered in conjunction with every credit submission. EFIC's tolerance for exposure to a particular industry will depend on the credit quality of the individual borrowers, the characteristics of the industry and the extent of diversification of risk between borrowers. Consideration is given to factors such as industry competition (local, regional or global), the industry life cycle, industry cyclicality and the geographical diversification of borrowers. A further important feature is the structure of EFIC's exposure: product type; tenor; amortisation; and nature of security. For these reasons, the nature of such analysis is nuanced. As noted above, portfolio concentrations by industry are discussed at each Board meeting. The Commission correctly notes that ship building and ship operation is one industry risk concentration in EFIC's portfolio. But it incorrectly states that Commercial Account exposure peaked at $365.2 million in 2006-07, equivalent to 55.6% of total exposure or 62% of capital. The Commission has included in this figure, exposure where the source of repayment is sovereign and sub-sovereign borrowers and exposure that has been reinsured (where repayment is not linked to shipping industry performance). EFIC clearly noted this distinction to the Commission on multiple occasions in meetings and in written correspondence.[21] Adjusted for these impacts, EFIC's Commercial Account exposure to ship building and ship operation was $238.5 million in 2006-07 – 36.3% of total exposure or 40.5% of capital. EFIC's exposure to ship building and ship operation has been discussed in detail at Board level. Management provides not only aggregate exposure data for this industry, but also by borrower and by the exposure's run-off profile – at each meeting. The decision to support ship building and ship operation to that extent was appropriate, as it was based on reasoned analysis and conformity with our mandate. EFIC was only able to extend to this level due to the significant diversity of the exposure EFIC held by operator, route and locality.

[21] EFIC Ship Sector Exposures 2002-2011 provided on 23/11/11 and updated with 1997-2011 data on 1/12/11; EFIC written response re: historical ship sector exposures on 23/11/11 in answer to Productivity Commission written questions from 9 November 2011; EFIC written response re: industry concentration limits on 11/11/11 in answer to Productivity Commission written questions from 3 November 2011; EFIC Ship Sector Concentration Credit Committee Paper provided 23/11/11; Data on profitability of EFIC's ship sector portfolio 2001-2011 provided t28/11/11.

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	Other mitigants included the amortising nature of the exposure and EFIC's first-ranking security over the vessels being financed. Regardless, by 2010-11, EFIC's Commercial Account exposure to ship building/ship operation had declined to $115.3 million, spread across six borrowers and representing 12.1% of total exposure or 18.5% of capital. The Commission does not present evidence to support its Finding that EFIC's governance arrangements 'have not always ensured sound prudential management.' The Commission in fact seems to reach divergent conclusions. The Draft Report states that EFIC's low level of impairments 'is consistent with its limited appetite for risk' (p.146), but in contrast concludes that EFIC has not always taken a prudent approach to risk management of large exposures. The obvious way to judge the appropriateness of EFIC's risk management framework is through analysis of EFIC's financial results. EFIC has recorded profits in 19 of the past 20 years. Loan losses have been low at only $43 million over the period from November 1991 to June 2011 despite the limitations of EFIC's mandate in terms of client selection. The Commission has does not acknowledge this strong record. The Draft Report includes passages which imply risk and any losses resulting from assumption of risk by EFIC, is directly transferred to the Australian tax payer. The Commission states that '…in the event that the exporter fails to repay their loan and the guarantee is called, the private sector provider will not be significantly worse off (any costs incurred by the private sector provider will depend on the terms of the guarantee). It will still receive repayment of the loan it extended, in full or in part, but this payment comes from EFIC. In this case, it is ultimately taxpayers who are left worse off.'(p.136) Apart from EFIC's low record of losses, and the ability of financial institutions to recover from risk parties, these statements perpetuate the inaccurate assumption that that any losses incurred by EFIC are directly transferred to the tax payer. EFIC is a financial institution with losses written back against profits, not directly to the tax payer. . The only time that a direct call on the Commonwealth (colloquially the taxpayer) would occur was if losses were made that exceeded: firstly, EFIC's revenues for that year; and secondly, EFIC's own capital base of ca. $400 million.

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Draft Finding 8.3 EFIC's capital adequacy ratio is currently well above the minimum level specified by Australian Prudential Regulation Authority guidelines and EFIC's internal benchmarks. The extra capital held by EFIC has an opportunity cost that is borne by the taxpayer.	Draft Finding 8.3 is not supported by EFIC. EFIC notes that this Draft Finding is not substantiated. • The Commission does not provide a basis to show that EFIC should operate at minimum levels of capital adequacy to fulfil its mandate. • EFIC's minimum capital adequacy ratio is exactly that. Capital above the minimum is necessary to support concentration in EFIC's portfolio. Importantly, it provides a buffer against EFIC calling on the Government guarantee. • The Commission does not quantify the opportunity costs of EFIC's capital. Since the 2008 financial crisis, the capital adequacy ratio for most Australian banks is 50% above the current minimum of 8%, approaching 12%. EFIC set a minimum 16% ratio which has been deemed appropriate by the Board given the greater risk concentrations in EFIC's portfolio. The decision by the Board to set a higher capital adequacy ratio recognises that EFIC's portfolio is unlike commercial bank portfolios in which risk can be spread extensively across a matrix of products, sectors, industries, geographies and individual counterparties. Capital in excess of 16% is necessary to support concentration risks arising from large export contracts and exposures. The Commission assert that any capital above regulatory capital levels is an 'opportunity cost' to taxpayers and implies that Government could generate a return greater than that which EFIC generates. The Commission states, 'the opportunity cost reflects the benefits foregone by taxpayers from having their funds used by EFIC compared to alternative activities,' (p. 21) and, 'the opportunity cost reflects the benefits foregone by taxpayers from having their funds utilised by an ECA compared to other public sector programs (Boyd 1982).' (p. 116). If the alternative use is simply an investment by Government, it is unclear how Government would generate a greater return if it also complies with the CAC Act to which EFIC is subject and with which it complies. If the alternative use is Government expenditure (against its *investment* in EFIC), then a more rigorous analysis is needed to demonstrate superior 'returns to Government' from that expenditure compared with EFIC's use of that capital as the basis to support large export contracts, for example (e.g. taxes associated with company profits and employment, dividends from EFIC, multiplier effect etc.) If the alternative use is public debt retirement, the 'opportunity cost' is presumably the cost of government debt

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	i.e. the government bond rate (although the Commission specifically rejects the government bond rate as the ‘opportunity cost of [EFIC’s] funds’). As reported by the Commission, EFIC returns above the Government bond rate as an institution, then there also are the returns from the exporting activity. It also must be considered that as EFIC’s capital is reduced, applications for NIA support would increase and EFIC’s activities would be constrained.
Draft Finding 8.4 As a corporation, EFIC has earned a lower rate of return on equity than comparable financial institutions. This may reflect a number of factors including that its transactions are sometimes not priced to reflect their full economic cost (given the risk incurred), a high level of retained capital, and possibly high operating expenses. **Draft Recommendation 8.3** The Minister for Trade’s Statement of Expectations should require the pricing of EFIC’s commercial account transactions to reflect the full economic cost, including a commercial rate of return reflecting risk that is benchmarked against that of appropriately selected private sector providers.	EFIC does not support Draft Finding 8.4. EFIC notes that this Draft Finding is not substantiated, inaccurate and unnecessary; it repeats the arguments of Draft Finding 7.1. Draft Recommendation 8.3, which is based on Finding 8.4, is similarly not substantiated. • There is no analysis of EFIC’s pricing model or evidence provided to substantiate the Draft Finding. • There is no rationale or basis for the Commission’s assertion that Australian banks are comparable financial institutions from the perspective of benchmark returns. • Compelling EFIC to charge above-market prices would disadvantage Australian exporters, and reducing EFIC’s capital would increase the risk to the Commonwealth and taxpayers of a call under EFIC’s guarantee, with either outcome at odds with EFIC’s mandate. In addition to EFIC’s response to Draft Finding 7.1 (which equally applies here), there are some additional points that should be made regarding pricing, ROE calculation and benchmarking. **Operating costs** The Commission suggests that EFIC’s return on equity reflects high operating expenses. As the analysis of EFIC’s operational efficiency at pages 2-3 of EFIC’s submission Appendix A indicates, EFIC measures up well against EFIC’s counterparts. EFIC’s 7% average real return on equity over the past decade measures up well against other government businesses here and abroad, and even well against many private businesses and industries. **ROE Benchmarking** The Government’s Competitive Neutrality Policy Statement (Australian Government 1996) states that: ‘All

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Commonwealth organisations identified as engaging in significant business activities will be required to earn commercial returns at least sufficient to justify the long-term retention of assets in the business, and to pay commercial dividends (i.e. equivalent to the average for their industry) to the Budget from those returns.'(p. 17).
Following this guidance, we can observe that EFIC clears the first (low) hurdle of a positive ROE (i.e. is not a loss making entity) and further to that it's ROE exceeds the 10 year Government bond rate.
In addition to this EFIC also pays dividends back to the Government and in the last three years for example has amounted to 50%, 75% and 100% of profits generated. EFIC is one of only a few ECA's who consistently pay a dividend to their respective Governments. Further, the average dividend payout ratio by the S&P / ASX All Ordinaries over the last 3 years has been around 60% and for the banking sector has been around 70% - EFIC's average dividend payout ratio over the same period is 75%. Even over the last 10 years EFIC's payout ratio has been 59.5% which is above the 10 year average of the S&P / ASX All Ordinaries of 57%.
ROE – post GFC
In coming to its Draft Findings the Commission does not draw on research conducted on bank ROEs since the GFC. The European Central Bank and the Bank of England, for instance, have argued that return on equity may not be the most appropriate benchmark for bank performance.
The European Central Bank (ECB, 2010) suggests that ROE is 'not a standalone performance measure' and 'has not proven adequate in an environment of much higher volatility.'[22] They note three particular limitations of ROE.

It is not risk-sensitive. ROE can be enhanced by gearing the balance sheet and it overlooks risk elements such as asset quality, cost of risk, risk concentration and the entity's solvency. In fact banks allocate capital internally for pricing and product profitability reporting purposes on a basis that reflects risk, and are required to do so by APRA.
It is not forward-looking. ROE does not take account of an institution's long-term strategy and can be easily influenced by one-off events, such as restructurings and consolidations. The ECB notes that in the 2008-09 financial crisis 'in some cases, the banks with the highest ROE were hit by the crisis'.

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[22] European Central Bank, 2010, 'Beyond ROE – How to measure bank performance', Appendix to the report on EU banking structures, European Central Bank, Frankfurt.

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	• It can be misleading through manipulation, particularly if it is used as a benchmark for performance incentives or if seasonal factors are relevant. The ECB recommends that ROE be decomposed or supplemented with further information to identify the origins of developments and distortions over time. Complementary performance measures suggested include risk returns, funding capacity, asset quality, return on assets, and cost of equity and capital allocations across business lines. EFIC has operated for over 50 years in various forms and in its current form since 1991. EFIC has managed its operations prudently and profitably without any call on the Commonwealth guarantee or capital injection through the 1994-95 Mexican financial crisis, the 1997-98 Asian financial crisis, the 1998 Russian default, the 2000-2002 Argentine financial crisis, and the 2008-2009 GFC. In summary, EFIC's return on equity partly reflects a conservative business model. Relative to commercial banks, EFIC holds more capital to reflect its concentration risks, a function of the niche in which it is required to operate. This lowers gearing and return on equity, but gives a high degree of assurance to Government and the taxpayer that EFIC will be financially self-sustaining and will not call on the Government guarantee.
Draft Finding 8.5 EFIC does not pay income tax, is not required to earn a particular rate of return on equity and the Export Finance and Insurance Corporation Act 1991 provides for its liabilities to be explicitly guaranteed by the Commonwealth. This lowers its borrowing costs relative to the private sector, giving it a commercial advantage that may discourage market entry from potential competitors.	EFIC does not support Draft Finding 8.5. EFIC notes the Draft Finding is not substantiated and inaccurate. • There is no evidence provided to substantiate the Draft Finding that EFIC discourages market entry. • EFIC's lower borrowing costs translate into higher dividends to the Commonwealth, not the implied subsidy. • If the Draft Finding was true and EFIC had discouraged market entry, it is highly likely that a potential market entrant would have protested. • EFIC does not subsidise commercial providers. As detailed for the Commission, while EFIC's funding costs reflect its AAA government guarantee, EFIC's business units are charged a liquidity premium above EFIC's borrowing costs and then apply a risk margin based on a market-based pricing model (see response to Draft Finding 7.1). Rather than the benefit of the lower costs being used to subsidise exporters, it is identified separately as Treasury revenue and ultimately

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	paid to government in the form of dividends. The Commission hypothesises 'the reasons why there may be no complaints about potential under-pricing by EFIC'. EFIC has responded in detail to this hypothesis in response to Draft Finding 6.4 above. The argument EFIC advanced in the point immediately above applies here as well. The Commission states that it 'considers that this [existing governance frameworks] is not sufficient to prevent private sector providers from being discouraged from entering the market.' This assertion is simply stated without evidence or analysis.
Draft Recommendation 8.4 EFIC's activity on the commercial account should be subject to competitive neutrality policy. This will require EFIC to earn a rate of return reflecting risk benchmarked against appropriately selected private sector providers, set prices that are commensurate with the level of risk incurred, and pay a tax equivalent charge and a debt neutrality fee.	EFIC does not support Draft Recommendation 8.4. EFIC notes that Draft Recommendation 8.4 has not been substantiated. • The Commission has not substantiated the appropriate basis for EFIC's rate of return (see response to Draft Finding 7.1). • The Commission has not provided evidence that EFIC's prices are not commensurate with risk (see EFIC's response to Draft Recommendation 8.3 and Draft Finding 8.4). • There is no evidence to suggest that EFIC is competing with private sector financial institutions, or crowding them out; the evidence points to the contrary: EFIC crowds-in the private market to provide greater support for exporters (see response to Draft Finding 6.2). • Competitive neutrality charges would simply shift the basis on which payments flow to the Commonwealth. • EFIC is constrained under its mandate to 'one way' credit selection; it can reject bad credits, but cannot seek very good credits which would balance its portfolio. As EFIC noted in its first submission competitive neutrality policies aim to promote efficient competition between public and private businesses. Specifically, they seek to ensure that government businesses do not enjoy competitive advantages over their private sector competitors simply by virtue of their public sector ownership. The application of competitive neutrality is always subject to the proviso that the benefits outweigh the associated costs. Given that Government has given EFIC a specific mandate not to compete, and there is no evidence that it is competing, there is no net benefit of implementing a competitive neutrality regime.

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	EFIC took the initiative to establish measures for Government to assess whether EFIC operated in the 'market gap' (Finding 5.1). There is a comprehensive governance framework in which EFIC operates that ensures that it does not compete with the private market and EFIC has operated according to that framework. There is no evidence of complaint. The Commission prescribes a 'cure' of elements of competitive neutrality policy where there is no evidence that EFIC's rate of return is inappropriate, or that EFIC is pricing inappropriately to the risks incurred or undercutting the commercial market. If EFIC were to be subject to competitive neutrality policy it would follow that EFIC should compete with the private sector. The Competitive Neutrality Guidelines state that: 'CN does not imply that your business cannot be successful in competition with private businesses. Your business can achieve success as a result of its own merits and intrinsic strengths, but not as a consequence of advantages flowing from government ownership.'[23] Under these conditions of competitive neutrality EFIC would seek to balance its portfolio by seeking better credits to balance the more risky credits in its portfolio, and effectively be competing with the private sector for those better credits.
Draft Recommendation 9.1 Consistent with the findings of the Uhrig Review, the Export Finance and Insurance Corporation Act 1991 should be amended to not include Australian public service personnel on the EFIC Board. Where the EFIC Board considers departmental advice beneficial, officials from the Department of Foreign Affairs and Trade should be invited to present to board meetings for the relevant agenda items and to answer questions relating to those items.	EFIC has no response.

[23] Australian Government Competitive Neutrality Guidelines for Managers, page 5.

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Draft Finding 9.1 a. The Commission is not satisfied that the Board is given sufficient information to evaluate whether transactions submitted for approval on the commercial account are meeting the requirements set out in the Minister’s Statement of Expectations with regard to pricing, or determine that EFIC is not competing with the private sector. b. EFIC’s compliance with the operational restrictions in the Minister’s Statement of Expectations and Part 4 of the Export Finance and Insurance Corporation Act 1991 have not had sufficient focus in independent audit reports over the past five years	EFIC does not support Draft Finding 9.1. EFIC notes that **part (a)** has not been substantiated, is inaccurate and **part (b)** is inaccurate and impractical. • The Commission asserts that Board reporting is inadequate based on its assertions concerning pricing and competitive neutrality issues. EFIC refutes these assertions in response to Draft Recommendation 8.3 and 8.4 and Draft Finding 8.4 above. • The Board is fully aware of and understands the Government’s Statement of Expectations and its corresponding obligations in EFIC’s Statement of Intent, and EFIC’s reporting is consistent with that understanding. Statements made in Chapter 9 of the Draft Report are of particular concern. Particularly statements or findings which imply that EFIC’s Board may not, even in some limited circumstances, be properly discharging its duties or may have not been making decisions on a fully informed basis or that management is not disclosing sufficient information to properly advise the Board. EFIC also questions the administrative efficacy of the Commission making such statements and findings in a public document such as the Draft Report. This Finding therefore requires strong public rebuttal, to protect not only the integrity of EFIC’s own governance structures, but also the reputation of the Board. The Board is fully aware of the Government’s Statement of Expectations (SOE) and its corresponding obligations in EFIC’s Statement of Intent (SOI). Board papers and discussions canvass the issues identified in Finding 9.1 (a) thoroughly. The Commission’s assertion that the Board does not comply with and understand EFIC’s mandate to fill a ‘market gap’ is of particular concern. This mandate is articulated, in part, in the Minister’s Statement of Expectations, which in essence confirms EFIC’s requirement to: • Provide services that would not normally be available from the private sector; and work with the private sector and not in competition to it. The Commission argues that the decision making process employed by the Board fails to properly measure, analyse and monitor the ‘market gap’ for the purpose of approving transactions on the commercial account. EFIC strongly refutes this statement.

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	The Commission asserts without substantiation that the Board has not made itself aware of the circumstances surrounding each transaction or the characteristics of EFIC's portfolio. EFIC's Board members are drawn from a wide a range of organisations and industries and bring with them a wealth of private and public sector Board and senior management experience, including individuals with current banking and finance experience. Many current Board members also sit on the boards of some of Australia's largest public companies, or serve in various senior capacities in high profile national and international corporate, administrative and government bodies. The Board clearly has the experience and credibility to judge whether the information available is sufficient to determine that EFIC is meeting its obligations. The Commission clearly disagrees with the measures currently utilised by management and the Board, some of which it details (at page 183), but provides no alternatives to assess EFIC's existing obligations. In reaching its conclusion the Commission: • contradicts the framework established with Government since the 2006 Review, • provides no clear or detailed analysis of the particular measures by which it believes the Board should itself be assessing 'market gap'; and, • does not identify where the Board has, in any particular or specific circumstance, not properly considered the 'market gap' in its approval of individual commercial account transactions. The Commission's criticisms that the data is poor or that decisions are made without proper information, is based in part on the misconception that there is an agreed or generally recognised and independent measure of what 'market gap' is at any point in time. EFIC would argue these decisions reflects the complex judgement required for any assessment of 'market gap', with reference to many moving micro and indeed macro factors, all of which influence a decision whether to support or decline a particular transaction. That was EFIC's purpose in proposing guidelines in 2006, (see Draft Finding 6.1). The Commission's focus on 'market failure', which typically involves a post facto assessment of outcomes, has not accounted for this complexity: EFIC is required to make a judgement in a commercial timeframe based on the information available. Evidence from Submissions and EFIC's results demonstrate that EFIC has been appropriate and prudent in its judgements. In support of this view, EFIC can draw on the Commission's own statements where the Commission has

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	concluded (p. 183) that there is ‘vagueness’ to the market gap concept. On this point EFIC’s view is that the concept of ‘market gap’ is fluid and dynamic rather than vague. Indeed, EFIC would argue that there is purpose to retaining a fluid and dynamic definition of ‘market gap’, as it enables EFIC to respond quickly (as it often has to) to changing economic, regulatory and market conditions based on market signals. EFIC Board and related governance papers demonstrate a strong culture of full disclosure, due diligence and adherence to best practice governance principles. The quality of EFIC’s internal governance framework, systems and procedures is reflected in: • Unqualified financial statements – Since 1991, the ANAO has always issued an unmodified (formerly unqualified) Independent Auditor’s Report. • Rigorous compliance regimes – EFIC’s Compliance Program has been established to be benchmarked against the Australian Standards for Compliance Programs and defines compliance as an outcome of an organisation meeting its obligations. The program demonstrates EFIC’s commitment to compliance with relevant laws, including legislative requirements, applicable industry codes, organisational standards as well as standards of good corporate governance, ethics and community expectations. In addition, EFIC must comply with Ministerial directions, OECD and other international obligations, Commonwealth and State legislation and policies that govern EFIC’s business. Every staff member must complete compliance training annually, with a minimum 80% pass mark for every component. • Internal audit program – the operations, processes and systems of EFIC are subject to internal audit by Deloitte in accordance with the Accounting Professional and Ethical Standards issued by the Australian Accounting Professional Ethical Standards Board. The annual internal audit coverage plan is based on a detailed risk assessment and EFIC’s Risk and Control Matrix and approved by the audit committee. • Control culture survey– Deloitte performed a Control Culture Survey in March 2010. Their report concluded ‘The results achieved by EFIC as an organisation are strong across all aspects of the survey and across all departments. As an organisation relative to others we have tested over recent years, EFIC’s culture represents best in class.’ EFIC is committed to maintaining a culture that identifies risk and adopts processes and procedures to minimise the impact of those risks on the business. • Almost 20 years of unbroken profits - since November 1991, through a series of global and regional economic shocks, EFIC has been profitable in 19 of the past 20 years (the one loss of $9.5 million was in

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	1998 due to credit provisioning for the Asian financial crisis – most of this provisioning was written back in subsequent years). Over the same period EFIC has generated over $460 million in profits and paid dividends to Government of more than $214 million. The implication that EFIC's proven robust governance framework failed to consider the most essential elements of EFIC's mandate is not substantiated. Finding (b) implies that a Terms of Reference for this audit has been considered. EFIC questions how such an audit could be conducted in practice. Both the Minister's SOE and Part 4 of the EFIC Act involve judgements that would be difficult to test in an auditing capacity. Further, it is the role of EFIC's Board, who is independent from management, to assess compliance.
Draft Finding 9.2 There is insufficient clarity in the information provided by EFIC to the Australian Government and this impairs EFIC's accountability.	EFIC does not support Draft Finding 9.2. EFIC notes that this Draft Finding has not been substantiated and is inaccurate. • From the perspective of financial integrity, EFIC has a consistent compliance record. EFIC also has consistently taken the initiative to provide greater insight into its operations through increased reporting and presentations. • There have been no concerns articulated by Departments or Central Agencies with the quality of EFIC's reporting or accountability, directly to EFIC or through the public submissions. • The 'clarity' sought by the Commission relates to changes in EFIC's mandate rather than EFIC's current operation. EFIC has a consistent compliance record. EFIC has unqualified financial statements since its establishment as a statutory authority 1991; compliance with Finance Minister's Orders and CAC Act guidelines since inception in 1997; submitting an annual report comprising a report of operations, financial statements and the Auditor-General's report on those financial statements to Parliament within the deadline established each year. EFIC has a comprehensive corporate governance framework, which includes reporting obligations to the Board, the Minister, Parliament and its other key stakeholders (see EFIC submission Appendix A p37-42). This framework contradicts the conclusion made by the Commission that 'there are no effective mechanisms to ensure that EFIC is meeting its objectives either on a transaction basis, or as a matter of broad strategy.'

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	Government is kept regularly updated by virtue of the Government member of the Board attending EFIC Board meetings and key performance indicators are provided regularly to the Board to inform them of EFIC performance. EFIC makes significant efforts to brief APS staff throughout the year and particularly around EFIC's financial statements e.g. EFIC's CFO briefs interested APS staff at least once a year on EFIC's financial performance (EFIC organised for a Commission representative to attend the most recent briefing on 8 September 2011, along with Treasury and Department of Finance & Deregulation and DFAT officials). There were no concerns with EFIC's reporting identified through those meetings.
Draft Recommendation 9.2 The Minister for Trade should table EFIC's corporate plan in Parliament and, in due course, the Export Finance and Insurance Corporation Act 1991 should be amended to require this. EFIC should provide quarterly reports to the Minister for Trade against the corporate plan, including relevant information on transactions on the commercial account executed during that quarter.	EFIC does not support Draft Recommendation 9.2. EFIC notes that the basis for the Draft Recommendation is not substantiated. EFIC provide a detailed three year corporate plan each year to the Minister with agreed KPI's as set by the Board and consistent with EFIC's mandate. In addition EFIC provides detailed information regarding its operations and transactions signed on its website. In general, there are differing approaches among government departments and agencies with respect to the publication of their corporate plans. Some publish a corporate plan, or publish a summary version, others do not. EFIC understands that Treasury, DFAT, AusAID and Austrade, as well as CAC Act agencies such as the Australia Government Solicitor, Australia Post, Australian Rail Track Corporation do not publish corporate plans. The Department of Finance and Deregulation publishes a summary 8 page plan. Other CAC Act agencies such as the NBN Co Limited and Airservices Australia publish their corporate plans.
Draft Recommendation 9.3 As part of the reforms, the Board should establish a performance management framework for assessing its performance, based on a more clearly defined objective under the Export Finance and Insurance	EFIC does not support Draft Recommendation 9.3. EFIC notes that this Draft Recommendation is not substantiated, contains inaccuracies and is unnecessary. • EFIC has a well established performance management framework consistent with its obligations under the EFIC Act. The integrity of the framework is confirmed by EFIC's results. • The benchmarks are based on the core responsibilities of the EFIC Act, including financial sustainability.

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Corporation Act 1991 (EFIC Act). The framework should use relevant performance benchmarks and indicators, and if retained, include treasury operations. Performance should be reported against this framework in EFIC's annual report and corporate plan. A more formal, documented approach to providing information to the Minister for Trade, the Department of Foreign Affairs and Trade, and other government agencies on EFIC's operations should be developed. There should be regular independent audits of EFIC's compliance with the operational restrictions as set out in the Statement of Expectations and Part 4 of the EFIC Act.	• EFIC's performance is already reported in its Annual Report and Corporate Plan. This statement by the Productivity Commission implies that EFIC does not have an effective performance management framework for assessing its performance. The EFIC Act, CAC Act and the Statement of Expectation from the Minister collectively form a framework for evaluating EFIC's performance. The CAC Act specifically addresses the framework for assessing treasury's operating performance by defining the types of investments through an Investment Approval 2008/01 signed by the Finance Minister. EFIC submit quarterly reports to DFAT and Department of Finance & Deregulation outlining treasury's exposures to various counterparties. Each year, EFIC submits a detailed (2011 Plan was 52 pages) 3 Year Corporate Plan to the Minister, which details a number of Key Performance Indicators including the level of signings and exports supported, profitability, capital adequacy and the average credit risk of the portfolio. Management report against these KPIs to the Board quarterly. EFIC is also subject to regular internal and external audit on a variety of risks that EFIC has identified through its Risk Management Framework. Annually the Board uses a performance feedback tool to evaluate its performance, including from management.
Draft Recommendation 9.4 Analysis of national interest account transactions should include an assessment of whether the proposal is the most cost-effective way of achieving the outcomes intended by the Australian Government. The Government should clearly and publicly articulate the justification for a national interest account transaction after it has been	EFIC has no response.

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approved by the Minister for Trade. Information on the performance of national interest account transactions should be collated and publicly reported.	
Draft Recommendation 9.5 The next review of EFIC should include an assessment of whether the post approval administration of the national interest account should be made contestable.	EFIC does not support Draft Recommendation 9.5. An EFIC note that this Draft Recommendation is not substantiated and is inconsistent with the Commission's own Findings. • No argument or analysis of the efficiency or effectiveness of the current arrangements has been presented. • The Commission suggests that the Departments of Treasury or Finance and Deregulation could be made responsible for NIA portfolio management, but the Commission then recommends it should be contestable • Central policy agencies do not have the skill set to perform this function and have recognised EFIC's expertise in this area in the past. • EFIC has economies of scale in managing such exposures. It is doubtful that central policy agencies such as the Department of Finance and Deregulation and Treasury, would be adequately equipped to manage cross-border loan portfolio on the National Interest Account, particularly those in emerging and frontier markets. No argument or analysis of the efficiency or effectiveness of the current arrangements has been presented. EFIC is confident that any review of the post approval administration of national interest account transactions would confirm EFIC's advantages as the manager of these exposures on behalf of the Government, including low management costs resulting from economies of scale. As EFIC would have originally executed documentation associated with the transactions on behalf of the Government, the knowledge gained in its due diligence can be applied to the management of the exposures. Any private sector party would not have access to the broader data sources (including DFAT) that EFIC is able to utilise and which are beneficial to effective credit management of exposures in emerging and frontier markets.

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	The Commission's Draft Recommendation also seems at odds with the recognition of EFIC's administration and portfolio management expertise within the central policy agencies – Treasury approached EFIC to perform loan administration and portfolio management in the context of policy initiatives relating to the Australian Business Investment Partnership Initiative (ABIP) and Clean Energy Finance Corporation (CEFC).
Draft Finding 9.3 The public disclosure of information relevant to environmental and social impact assessments, including contractual terms to manage and mitigate risk, would increase the transparency of EFIC's operations to the public and to the Australian Government	EFIC does not support Draft Finding 9.3 EFIC notes the actions contemplated by Draft Finding 9.3 are unnecessary and do not acknowledge existing disclosure by EFIC and governance processes relating to environmental and social impact assessments. • EFIC already makes adequate and appropriate public disclosure of information, well in excess of that required by its international obligations. • Independent auditing of EFIC's compliance with its environment policy already provides transparency to the public. EFIC disagrees with this finding as EFIC already makes adequate and appropriate public disclosure of information relevant to the environmental and social impacts of the transactions it supports. EFIC's disclosure and information sharing activities extend well beyond the requirements of its international obligations. Independent auditing of EFIC's compliance with its environment policy provides transparency to the public whilst maintaining client confidentiality. EFIC's disclosure activities extend well beyond the transparency requirements of the Common Approaches and the Equator Principles. The Equator Principles, which apply only to project finance, impose no requirements on an adopting financial institution to disclose potential or actual involvement in a specific project. Equator Principle 5 requires, under some circumstances, that a project must undertake consultation and disclosure activities. The Common Approaches, which apply only to official export credits[24], do not include a 'general principle of disclosure' as referenced on pg. 195 of the Commission's report. The Common Approaches limit an OECD ECA's disclosure obligations to the following:

[24] EFIC's product suite extends beyond officially supported export credits as defined in the Common Approaches.

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	• for a Category A project, of a minimum size (SDR 10 million) and duration (minimum two years), disclose publicly the ECA's potential involvement and certain project information, and • make public at least annually information on Category A and B projects supported during the year. EFIC undertakes a number of disclosure and information sharing activities that extend beyond the requirements of the Common Approaches and Equator Principles and the practices of OECD ECAs. These include: • disclosing on EFIC's website in a Category A register the potential involvement in a Category A project, of a minimum size (SDR 10 million) and duration (minimum two years) located outside Australia. The register provides access to a project's environmental and social assessment as well as a range of other information. EFIC's disclosure extends further than the Common Approaches requirement by providing details of the type of facility requested and an outline of the reasons for the categorisation. EFIC also provides an automatic email notification advice of updates to the register; • maintaining on EFIC's website an archive of EFIC's disclosure of potential involvement in all Category A projects, including whether or not the project was supported; • maintaining on EFIC's website an online register of supported transactions[25] that is updated as soon as practicable after a transaction is signed. The register includes the results of a transaction's environmental and social screening and classification; • providing details of all signed facilities in EFIC's Annual Report, including the results of a transaction's environmental and social screening and classification; • committing to an external audit of the application of the Policy and Procedure at minimum two yearly intervals. Audit reports will be made public; • establishing a multi-stakeholder forum to facilitate regular dialogue between EFIC and civil society organisations (CSOs) on issues related to EFIC's commitment to upholding best-practice environmental and social standards in the transactions it supports. This forum was established by EFIC following a workshop

[25] Foreign exchange facility guarantees and film producer offset loans are not disclosed on the transaction register as they are typically of small value but high volume. Including transactions of this nature would detract from the efficacy of the register. Details of transactions supported by EFIC pursuant to risk participation agreements ("RPAs") with multilateral institutions are not disclosed because EFIC has no direct relationship with the exporter for each transaction under an RPA. However, the dollar value and number of all such transactions are disclosed in the Annual Report.

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	held with CSOs in December 2010 to discuss the review of EFIC's Environment Policy. The first forum meeting was held in November 2011 and it is proposed to have meetings every six months. A forum page has been established on EFIC's website see: http://www.efic.gov.au/corp-responsibility/Pages/multi-stakeholder-forum.aspx
Draft Recommendation 9.6 a. EFIC's prospective involvement in any transaction with potentially significant environmental or social impacts should be publicly disclosed. This includes all category A projects and 'non-projects' where it has been determined that there is potential for significant environmental and social impacts. b. Information relating to the classification and approval of projects on the basis of environmental or social impact should be predictable and disclosed in the annual report and on EFIC's website. This information should include assessment benchmarking and processes, conditions of approval and consequences for non-compliance. Information that is relevant to EFIC's assessment of environmental and social impacts should be made public. c. Where EFIC is involved in supporting projects subject to environmental assessment in Australia, EFIC should	EFIC does not support Draft Recommendation 9.6 This Draft Recommendation has three parts and each is separately responded to. **Part a):** Draft Recommendation 9.6 is redundant, misunderstands the environmental and social impact assessment process and will reduce the competitiveness of Australian exporters. • EFIC already discloses its prospective involvement in Category A projects in line with its obligations under the Common Approaches. • Environmental and social risk evaluations are completed for all transactions including non projects and bonds • EFIC does not disclose its potential involvement in transactions associated with non-projects and bonds, an approach consistent with its international obligations (the Common Approaches and Equator Principles) and the practices of OECD ECAs • Bond applicants (and EFIC) have no ability to influence environmental and/or social management of the underlying project. Issuance of bonds is typically time sensitive and delays associated with disclosure periods could render Australian exporters uncompetitive. EFIC already discloses its prospective involvement in a transaction associated with a project that has potentially significant adverse environmental or social impacts (a category A project) when the transaction is of a minimum size (SDR 10 million) and duration (minimum two years) and the project is located outside Australia. That approach is consistent with EFIC's international obligations (the Common Approaches) and the practices of OECD ECAs. The Equator Principles include no requirement for a financial institution to disclose potential or actual involvement in specific projects. EFIC does not disclose its potential involvement in transactions associated with non-projects and bonds, an approach consistent with its international obligations (the Common Approaches and the Equator Principles)

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<tr><td>make this public.</td><td>and the practices of OECD ECAs.

EFIC’s risk management approach for non-projects and bonds is to undertake an environmental and social risk evaluation and, where necessary, benchmark the transaction using the IFC Performance Standards. This is a basic commitment in EFIC’s Policy and Procedure for environmental and social review of transactions (Policy and Procedure). The Policy and Procedure also states (at paragraph 5) that ‘EFIC declines transactions if it determines that the environmental and/ or social impacts do not satisfy relevant benchmarks.’ As well as managing EFIC’s transaction risk, this approach also manages potential reputational risks.

A “non-project” transaction is not associated with an identifiable end project. The reason for EFIC’s disclosure is to receive our stakeholder’s views on EFIC’s possible association with a project that has the potential for adverse environmental or social impacts. Those views can be taken into consideration when EFIC evaluates environmental and social risks associated with a project and any mitigants for those risks. If there is no project to discuss then there is no rationale for disclosure.

While bonds may be associated with a project there is similarly no rationale for disclosure. EFIC’s client is not the project and is typically providing a service to the project. EFIC’s client (and therefore EFIC) has no influence on the overall environmental and/or social management of the project for which the export is destined. For this reason, EFIC is not able to respond to a stakeholder’s views, for example by imposing conditions on a bond, which defeats the purpose of receiving comment. The decision for EFIC is whether to issue or decline the bond based on appropriate benchmarking. Additionally, exporters seeking to issue bonds would be delayed by a disclosure period, potentially being rendered uncompetitive, while having no ability to influence a project’s overall environmental and social management.

In the case of both non-projects and bonds, EFIC commits in the Policy and Procedure to undertake an environmental and social risk evaluation and, where necessary, benchmark the transaction using the IFC Performance Standards. EFIC’s Policy also states (at paragraph 5) that ‘EFIC declines transactions if it determines that the environmental and/or social impacts do not satisfy relevant benchmarks’.

Part b): The actions contemplated by Draft Finding 9.3 are redundant and do not acknowledge existing disclosure by EFIC and governance processes relating to environmental and social impact assessments.

• EFIC already makes adequate and appropriate public disclosure of information, well in excess of that required by its international obligations.</td></tr>
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	• Independent auditing of EFIC's compliance with its environment policy already provides transparency to the public. • Australian exporters are likely to be disadvantaged if their clients do not have confidence that they will maintain the confidentiality of transaction information. It is unclear what the Commission is recommending. EFIC already publicly provides information 'relating to the classification and approval of projects on the basis of environmental or social impact' and already discloses this "in the annual report and on EFIC's website'. Through its *Policy and Procedure for environmental and social review of transactions* EFIC also already provides general information related to 'assessment benchmarking and processes, conditions of approval and consequences for non-compliance' and 'Information that is relevant to EFIC's assessment of environmental and social impacts'. EFIC does not provide project specific detail on conditions of approval nor the project specific environmental and social risk evaluation completed by EFIC (if that is what the Commission is recommending). EFIC's approach is consistent with its international obligations (the Common Approaches and the Equator Principles). EFIC is generally constrained by statutory and contractual confidentiality obligations from publishing project specific information. The publication by EFIC of project specific information that is confidential to a client would inevitably undermine the confidence EFIC's clients and counterparties have that EFIC is able to keep information confidential. Please see EFIC's response to Draft Recommendation 9.8 for a discussion on the importance of client confidentiality and the requirement under EFIC's *Policy for environmental and social review of transactions* for independent auditing of this policy and the procedure. **Part c):** The Draft Recommendation is unnecessary and redundant. • Australian State and Federal Government approval processes already provide for disclosure and consultation. EFIC makes public its support to projects located in Australia after a transaction is signed. EFIC does not disclose its potential involvement in transactions associated with a Category A project in Australia. Australian projects are subject to the approval requirements of the relevant State or Territory government and, where required, the Commonwealth government. EFIC is a Commonwealth Authority and considers that: • State, Territory and Commonwealth requirements for disclosure and consultation on projects (more

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	particularly projects that could be considered category 'A') provide an adequate avenue for community engagement. Any additional disclosure by EFIC could confuse the statutory disclosure and consultation processes. • EFIC must respect the project approval and permitting regime under the relevant State, Territory and/or Commonwealth legislation. • EFIC does not have the mandate or the resources to assume the role of environmental regulator within Australia, and this role is fulfilled by other Government agencies. EFIC still undertakes its own risk assessment of a project located in Australia, in particular whether any approval or operating conditions that apply to such a project have any implications for EFIC's transaction.
Draft Recommendation 9.7 a. Ministerial directions should articulate which international obligations, including human rights obligations; EFIC is required to comply with. b. EFIC's compliance with those obligations should be subject to independent audit and compliance review every two years, with outcomes publicly reported, including in its annual report.	EFIC does not support Draft Recommendation 9.7 **EFIC notes that Part a):** The Draft Recommendation is impractical and unnecessary. • EFIC's international obligations are complex, subject to change and are detailed on the DFAT website. • EFIC already examines human rights issues as part of its due diligence process. EFIC considers the Draft Recommendation impractical and unnecessary for the following reasons: • As noted in the commentary preceding this Draft Recommendation, Australia's international obligations can change over time. Accordingly, any general direction from the Minister (noting that the Minister cannot give specific directions in respect of a particular Commercial Account transaction by virtue of section 9(5) of the EFIC Act) would need to be updated on a regular basis. • Given the variety of transactions that EFIC supports, the international obligations (particularly international environmental and social obligations) that would be applicable to EFIC's business are many and varied. Articulating all such international obligations in a general direction would not provide EFIC with any information that is not already available on the Australian Treaties Database on DFAT's website. • The international obligations which EFIC itself may be required to comply with (the subject of the recommended Ministerial direction) may differ in scope from the international obligations or standards that are relevant to an underlying project supported by EFIC. Both are relevant to EFIC's assessment of a

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	transaction. • Such a direction would be redundant as EFIC has a statutory duty to 'have regard to…Australia's obligations under international agreements' under section 8(2) (iii) of the EFIC Act. The Draft Recommendation is also unnecessary because EFIC already examines human rights issues as part of its due diligence process. EFIC is informed in this regard by a variety of sources including the IFC Performance Standards (EFIC's benchmark for the environmental and social review of transactions), the OECD Guidelines for Multinational Enterprises, the UN Guiding Principles for Business and Human Rights and EFIC's membership of and participation in the OECD Export Credit Group and the Equator Principles working groups. In examining human rights issues in this manner, EFIC is operating consistently with Guiding Principle 4 of the *Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework.*[26] According to this principle, export credit agencies should conduct human rights due diligence where the nature of business operations receiving their support pose a significant risk to human rights. Furthermore, in the most recent review of the IFC Performance Standards, the IFC decided not to create a separate performance standard on human rights, on the basis that many human rights risks can be effectively addressed through social and environmental considerations that form part of the IFC Performance Standards.[27] **Part b):** The Draft Recommendation is unnecessary. • EFIC already commits to an independent audit process of its Environment Policy every two years. This Draft Recommendation is unnecessary. The Commission's draft report overlooks the fact that EFIC's *Policy and Procedure for environmental and social review of transactions* already commit EFIC to engage "*an independent environmental and social expert*" to audit the application of the Policy and Procedure, every two years. Audit reports are to be provided to EFIC's Board and to the public. As part of this independent audit, the auditor will consider EFIC's risk evaluation processes, including its examination of human rights issues which is integrated into EFIC's Policy and Procedure. EFIC is also unaware of any other ECA that voluntarily commits to

[26] United Nations Human Rights Council, Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie, the "Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework", 21 March 2011 <http://www.ohchr.org/Documents/Issues/Business/A-HRC-17-31_AEV.pdf> at pages 9 to 10.
[27] International Finance Corporation, "The International Bill of Human Rights and IFC Sustainability Framework", <http://www1.ifc.org/wps/wcm/connect/dc3e948049800ad7ac6afe336b93d75f/IBHR_and_IFC_Policies%2BPS-DRAFT.pdf?MOD=AJPERES> at page 1.

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	transparent, independent auditing.
Draft Recommendation 9.8 The secrecy and commercial-in-confidence framework under which EFIC operates should only apply to the financial information of its clients. All other information on transactions on the commercial account should be made public.	Draft Recommendation 9.8 is not supported by EFIC. EFIC notes that the Draft Recommendation is not substantiated, is impractical and selective as the Commission has not consulted some key stakeholders. • The finding is based on submissions which are not considered representative of all of EFIC's stakeholders, including Australian exporters. • The Commission has made 'information requests' in other areas, but has not consulted exporters and banks on a profoundly important issue. • Distinctions between financial and non-financial information are impractical to implement. • EFIC is required to function in commercial markets which require confidentiality undertakings with respect to transaction information. • Confidence in EFIC will be undermined reducing the quality of information provided to EFIC. • Australian exporters may suffer a competitive disadvantage as a result. • EFIC provides appropriate disclosure on the transaction its supports and commits to independent auditing of its environmental and social risk assessment processes every two years. The commentary preceding this Draft Recommendation refers to a 'number of submissions' which have 'raised doubts about whether confidentiality provisions are appropriate'. It is assumed that the submissions the Commission refers to in this context are those made by the two civil society organisations referenced by the Commission (Greenpeace and Jubilee Australia) as well as the submissions of, Oxfam Australia and the Human Rights Law Centre. These four submissions do not necessarily represent a balanced and holistic view of the issues of confidentiality and disclosure in the context of EFIC's business. In particular, these reports and the Draft Recommendation (which appears to be drawn solely on the basis of these reports), do not consider the issue of confidentiality from the perspective of EFIC's clients or the financial institutions with which EFIC transacts.

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The Commission also references the comments made regarding EFIC’s disclosure in the United Nations Independent Expert on Foreign Debt and Human Rights, Dr Cephas Lumina’s report on his visit to Australia and the Solomon Islands in February 2011. The Commission however does not acknowledge the Australian Government’s statement in response to this report (made 31 May 2011) which noted the Government’s concern over a number of inaccuracies in the report, including the report’s conclusion regarding EFIC’s disclosure practices. Please see link to Statement by Australia here: http://www.geneva.mission.gov.au/gene/Statement210.html
EFIC does not support the Draft Recommendation for the following reasons:

No clear reasons or justifications are given by the Commission as to why EFIC’s confidentiality obligations should apply solely to ‘financial information’.
The proposed delineation between ‘financial information’ and ‘non-financial information’ is both unclear and unhelpful. Commercially sensitive information is not necessarily confined to ‘financial information’ (for example financial statements and cash flow projections.) It can also encompass independent reports commissioned in relation to a client’s project, such as technical reports (regarding the technical capabilities of a project) and marketing reports (regarding the marketing strategy for a project’s output).
Aside from EFIC’s statutory-based confidentiality obligations, EFIC is generally required to give comprehensive contractual undertakings that it will keep transaction information (whether ‘financial’ or otherwise) confidential. Such undertakings must be given by EFIC before it can receive any information from a client or counterparty. This is entirely standard in the market for financial services and products and is based, in part, on the well established common law duty of confidentiality that applies to bankers.
The publication by EFIC of information that is confidential to a client (whether it be ‘financial’ or otherwise) would inevitably undermine the confidence EFIC’s clients and counterparties have that EFIC is able to keep information confidential. These parties rely on EFIC’s statutory and contractual obligations of confidentiality. Without that reassurance, there could be deterioration in the depth, frankness and general quality of the information provided to EFIC. This could, in turn, restrict EFIC’s capacity to assess, monitor and manage risk with potential adverse implications for Australian exporters and project outcomes and potential financial losses for EFIC and, indirectly, the Australian Government.
If EFIC was required to disclose transaction-specific information (whether it is ‘financial’ or otherwise),

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	Australian exporters requiring EFIC's assistance may suffer a competitive disadvantage as a result. This is because an overseas firm tendering for goods and/or services is unlikely to award a contract to a party that is unable to maintain transaction information on a confidential basis. As noted in EFIC's response to Draft Finding 9.3, EFIC provides information on transactions it supports well beyond its international obligations. EFIC does not provide project specific detail on conditions of approval nor the project specific environmental and social risk evaluation completed by EFIC. In this respect, EFIC's approach is consistent with its international obligations (the Common Approaches and the Equator Principles). To respond to some stakeholders' concerns that EFIC is not being transparent in this area, EFIC's Policy and Procedure commits to engaging 'an independent environmental and social expert to audit the application of this policy and the procedure. Audit reports are provided to EFIC's Board and to the public.' Audits will be undertaken at two yearly intervals. In determining EFIC's compliance with the Policy and Procedure, the auditor will examine, among other things, specific environmental and social risk evaluation for projects and the use and application of conditions imposed on a transaction. EFIC exceeds the requirements of its international obligations by committing to independent auditing and reporting. EFIC is unaware of any other ECA that voluntarily commits to transparent, independent auditing.

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Draft Recommendation 10.1 a. EFIC's support for onshore resource projects should cease, as there is no clear market failure affecting access to finance for these projects. A direction to this effect should be issued by the Minister for Trade as soon as possible. b. The Australian Government should not broaden the eligibility criteria under Part 4 of the Export Finance and Insurance Corporation Act 1991 (EFIC Act). Specifically, the EFIC Act should not be amended to allow EFIC to enter into loans for the export of non-capital goods.	EFIC does not support Draft Recommendation 10.1 **EFIC notes that Part a)** of the Draft Recommendation has not been substantiated, is based on selective analysis and contemplates a departure from due Parliamentary process. • The Commission does not acknowledge the funding difficulties facing onshore resource projects especially in the aftermath of the GFC. • EFIC crowds in ECA and private sector funding to onshore resource projects, extending Australia's ability to import capital beyond its limited domestic savings capacity. • In the current circumstances in which Australia finds itself, of an historically unprecedented resource investment boom and impaired markets for cross-border project and structured trade finance, EFIC's retreat from onshore financing would imply slower resource investment and slower subsequent export growth. Contrary to the Commission's view, such deferred investment and exporting would not be a case of the market denying resources to uncommercial projects in the interests of efficient resource allocation. It would rather represent a sacrifice of real economic opportunity in the near term. • The Draft Recommendation circumvents the review process established under the terms of reference, and effectively takes the decision out of the process of Parliamentary review. **Market Failure for onshore resource projects** ECAs and government owned development banks have been significant providers of debt finance for resource projects and related infrastructure in Australia since the Northwest Shelf project. Over the past five years, including before the GFC, examples of transactions completed include: • Woodside's development of the Pluto LNG project (JBIC US$1.0 billion) • Santos's Gladstone LNG (total ECA finance by EFIC, SACE and EDC -US $1.03 billion) • Wiggins Island Coal Export Terminal (total ECA and development bank finance from EFIC, EDC, KfW, KDB and CDB - US$780 million) • Newcastle Coal Terminal (NCIG) (EDC and KfW providing US$234 million) • Queensland Curtis LNG (JBIC US$175 million)

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	• Brookfield Rail (EFIC and EDC US$385 million) ECA activity extends well beyond resource and related infrastructure, to include water desalination plants, wind-farms, aircraft, specialised equipment for pulp mills and private hospitals. ECAs from France, Germany, United Kingdom, Finland, Denmark, Italy, Canada, USA, Japan, Korea, China and Malaysia have been represented in financing syndicates supporting these developments. In an increasing number of cases, ECA financing is dominating the composition of the financing syndicates, reflecting the inability of commercial banks to deliver the volume of debt required, and the inability of the project bond market to make up the shortfall. In other words, ECAs are a vital channel through which Australia imports the capital it needs to supplement its limited domestic savings capacity. This was so before the GFC. It is even more the case now, in the aftermath of the GFC. The underlying assets receiving ECA funding are generally long life assets, and the borrowers often have either a single source of revenue (i.e. from one project) or from the sale of a single commodity. ECAs will adapt their financings to the risk associated with these profiles, and the underlying assets being financed. It is true that the commercial market for financing such assets is highly developed with financing structures, terms and conditions including credit costs and equity returns being appropriate and widely accepted. Yet the issue is volume; the private sector debt market has failed to deliver the quantity of debt necessary to finance these viable projects. There will be an even greater demand for ECA financing of onshore resources projects going forward, with large-scale investment required to meet the continued demand for resources largely from Asia. Australia's pipeline of onshore resources projects are at unprecedented levels, with the Bureau of Resources and Energy Economics estimating record capital expenditure of $231.8 billion for the 102 minerals and energy major development projects at an advanced stage of development, and a further potential expenditure of $224.3 billion for projects at a less advanced stage.[28] These projects are coming to market at a time when private sources of finance are increasingly limited and alternative sources of capital are required. Offshore ECAs, including from Asia, Europe and North America, are increasing their commitment to the

[28] Copeland, A and Stanwix, G, 2011, *Mining Industry Major Projects October 2011*, Bureau of Resources and Energy Economics, Canberra, November.

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	Australian market to support many of these projects. EFIC plays an important role in facilitating foreign ECA involvement and ensuring that commercially viable projects are successfully financed. **Why is volume an issue?** Two reasons stand out. First, the GFC has forced the withdrawal of many participants from the Australian market and many other markets, and severely curtailed the balance sheet capacity of those remaining. While the Commission's report does not recognise the severity and lasting impact of the GFC, the market is in no doubt that the financial landscape has changed dramatically, and will be very slow to recover to the levels of liquidity and credit appetite experienced before those events. This changed landscape includes reduced activity by European banks which have historically been very active in onshore project financings, with European banks withdrawing more than $7.5 billion in the September 2011 quarter alone from the Australian market.[29] Second, and more importantly, the size of the projects currently in planning or under development far exceed the capacity of global financial markets, even in normal (pre-GFC) market conditions. The debt component of the development costs of some projects, even at conservative gearing levels, is as much as $20 billion. In one case with which EFIC is familiar, more than half the debt required will be provided by ECAs, one quarter by the sponsor who will contribute senior secured debt ranking equally with the ECA lenders in addition to their equity contribution, with the balance to be provided by the commercial banking market. Some developments have been undertaken without borrowing on a project basis: Gorgon is one such example. In its case, the three sponsors each had the financial capacity to shoulder the funding requirement. In other cases, where the financial capacity of partners differs markedly (PNG LNG is a good example) limited recourse project finance is the only viable option. Other examples include ECAs making corporate loans to sponsors, with full recourse to their entire operational cash-flows, rather than to the specific project for which debt has been provided. These include examples of "untied" finance to secure a long term supply; or finance intended to direct procurement to the ECAs' national exporters. The constraints of the financial markets is further evidenced by the recent report that the financing for the Origin/Conoco/Sinopec sponsored Australia Pacific LNG (APLNG) project in Queensland will be provided by 12 commercial banks plus Canada's ECA, EDC, with a total commitment of ca. $2.625 billion. Additional loan

29 Bank of International Settlements Data, March 2012

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	commitments are being finalised with US Exim and China Exim, with each of these export credit agencies to provide a loan similar in size to the commercial loan tranche.[30] EFIC is not involved. **EFIC's Catalytic Role** EFIC has provided support for three onshore resource projects. Each of these transactions had substantial ECA or other public finance involvement, a large and increasingly important source of project finance. EFIC's involvement, though often small, was catalytic in mobilising or crowding in the participation of other ECAs. This catalytic impact on each project is discussed in further detail in EFIC's response to Draft Finding 6.2. **Ministerial Direction** The Commission's Draft Recommendation that, as soon as possible, the Minister direct EFIC to cease all financing of onshore resource projects, circumvents the review process established under the terms of reference, and effectively takes the decision out of the process of Parliamentary review. The issuance of such a Direction in this manner, in addition to being inconsistent with general Government processes, disregards the requirements concerning Ministerial directions set out in section 9 of the EFIC Act. It is pursuant to this section of the EFIC Act that the Minister would issue their Direction to EFIC. According to sub-section 9(2), the Minister's power to give written directions to EFIC on the exercise of EFIC's powers must be employed by the Minister only if they are satisfied that 'it is desirable in the public interest that the directions be given.' The Minister's directions to EFIC are based upon Government policy, with the public interest firmly in mind. For example, the Minister has issued Section 9 directions to EFIC not to support trade with, or investments in, Iran, North Korea and Zimbabwe. Such directions are consistent with the Australian Government's policy to implement UN Security Council sanctions towards those countries. The Draft Report, however, does not explain how restricting the exercise of EFIC's powers to support onshore resource projects would, further the public interest. EFIC refutes this proposition. The Commission's recommended Direction is also inconsistent with EFIC's statutory duties to: • improve and extend the range of its financial services and products to persons involved in Australian export trade (section 8(2)(b)(i) of the EFIC Act); and

[30] Thomson Reuters (5 March 2012) *Basis Point* Issue 966 pg. 6

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	• provide its services and products as efficiently and economically as possible (section 8(2)(b)(ii) of the EFIC Act). **Part b):** The Draft Recommendation is not substantiated and inconsistent with increasing efficiency. • Restrictions on the ability to fund directly mean EFIC would incur increased costs while the risk of default remains the same. This Draft Recommendation, if adopted, would simply result in greater inefficiencies and a lower return on capital employed. Such a recommendation is inconsistent with the statutory duties of EFIC described in the preceding paragraph and it is inconsistent with the Commission's criticisms of EFIC's return on equity. The Commission has presented no evidence that EFIC is crowding out private sector providers (See EFIC's responses to Draft Recommendation 10.4 and Draft Findings 6.1, 6.2 and 6.4.) EFIC has broad powers to provide guarantees to support Australian export trade. EFIC is empowered to issue a guarantee in support of a loan to finance an export transaction. Yet the Act is more constrained in the application of the loan powers. This results in EFIC issuing guarantees to banks to fund such export activity, assuming risks and the consequences of borrower default. If EFIC were to be empowered to lend in the same circumstance, the economic consequence of a borrower's default is identical. There is no distinction from a risk perspective. EFIC utilises guarantees in appropriate circumstances considering the export contract or project and the availability of a bank to provide lending against EFIC's guarantee. In some cases the use of a guarantee will provide the most efficient outcome; in other cases a loan (where EFIC is currently able to utilise this product) may produce the most efficient outcome. It should be noted that where, EFIC supports an export transaction with a guarantee, EFIC must engage with a bank to fund that guarantee. This may result in: • higher transaction costs for the Australian exporter (as the exporter bears the bank's fees and legal costs as well as those of EFIC), unnecessary complexity (particularly in terms of documentation) and potentially longer time frames to complete transactions; and • EFIC's returns being diminished as the bank must recover its wholesale funding costs, and charge a premium (albeit small) for assuming risk on EFIC and operational risk. In contrast, to deliver the same cost

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	of debt to the borrower, EFIC would borrow in the capital markets in its own name, and enjoy a substantial cost advantage, which is acknowledged by the Commission (p. 117), with wholesale borrowing costs well below that which even the best rated Australian banks are able to achieve. Further, the risk costs charged by the lending bank would not be payable, further enhancing EFIC's return for the identical risk. Currently, EFIC estimates that for a long term loans the use of the guarantee would represent an incremental cost to EFIC of approximately 1.25% p.a. when compared with providing a loan to the same borrower. To illustrate the cost of adopting the Commission's Draft Recommendation had EFIC been able to make a direct loan to Santos, additional revenue of approximately $25 million would have been earned over the life of the transaction. The Draft Recommendation by the Commission appears to be linked to its conclusion that EFIC should cease support for onshore resource projects. Whilst the inefficiencies arising from these limitations in the Act are greatest in the support of onshore resource projects, EFIC's ability to service the SME sector is also being impacted by these limitations. EFIC is precluded from funding SME borrowers' directly for the export of non-capital goods in the event that the borrower has no bank relationship. On occasions, EFIC has had to decline support to SME exporters where a bank was not interested in funding even against EFIC's guarantee, or an Export Working Capital Guarantee cannot be put in place in a timely manner.
Draft Recommendation 10.2 There is some evidence that there may be market failures in relation to the provision of export finance products to newly exporting small and medium-sized enterprises (SMEs). Until it is next reviewed, EFIC's role on the commercial account should be limited to demonstrating to the private sector that providing export finance to newly exporting SMEs can be commercially viable. EFIC must	EFIC does not support Draft Recommendations 10.2 and 10.3. EFIC notes these Draft Recommendations are not substantiated, are selective in their analysis, inconsistent and impractical. • The Commission is inconsistent in the standards of proof they accept in their analysis. In all cases, theoretical assertions trump evidence; in most instances, unproven is disproved; in this instance, some evidence is sufficient. • The Commission suggests that EFIC is the best agency to address an information failure regarding SMEs across the entire Australian economy. • The Commissions provides no analysis of the costs that would be incurred if EFIC's role were to be limited

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demonstrate that this can be done on the same basis as the private sector — with price covering the full economic cost of provision. This role should be reflected in the Export Finance and Insurance Corporation Act 1991 and in the Minister for Trade's Statement of Expectations. EFIC's operations should be regularly reviewed, internally and independently, for consistency with this demonstration role.	to addressing this market failure. • The logistics of identifying and developing these SMEs would be substantial given that these firms in many cases are not serviced by account managers at banks, so a direct channel approach would be required with implications for EFIC's staff numbers. Costs would be greater. • In EFIC's experience, small firms with limited credit history and no export experience represent a very high risk for credit providers. Loan losses would be greater. • Small firms represent a limited premium pool; hence banks target them with homogeneous credit scoring products. There is no analysis of the premium levels EFIC would experience against higher losses. • The Commission recommends that EFIC's mandate be restricted to 'demonstrating to the private sector that providing export finance to newly exporting SMEs can be commercially viable.' The Draft Report however, lacks analysis or evidence to show that this is the case. It is not EFIC's expectation that this is a commercially viable proposition based on experience. • The Commission recommends that EFIC's mandate be restricted to a loss-making pool of very small firms at the same time as the Commission recommends that EFIC achieve a rate of return comparable to an Australian 'Big 4' Bank.
Draft Recommendation 10.3 Amendments to the Export Finance and Insurance Corporation Act 1991 (EFIC Act) should be made to: • reorient EFIC's objective to addressing information-related market failures in financial markets affecting newly exporting small and medium-sized enterprises (SMEs) seeking access to export finance • specify that EFIC is to demonstrate to the private sector that providing export finance to newly exporting SMEs can be commercially viable • clarify that assistance is only to be provided in respect of export contracts as currently defined in the EFIC Act.	As outlined throughout this document, each Draft Recommendation has a serious conceptual or analytical short-coming, and there is at times limited evidence or analysis supporting the Commission's Draft Recommendations. The Draft Recommendations in the Commission's Report taken in their entirety would result in a loss-making and less effective financial institution supporting a diminishing level of exports without a demonstrable benefit to the Commonwealth from increased efficiencies or improved resource allocation. **EFIC support for large corporates and SMEs** The Commission uses EFIC's signings by value for 2010-11 to support its assertion that EFIC is focused on supporting large corporate clients. The Commission states on that, 'at present EFIC is generally focused on large firms and often repeat customers.' (pg. 5) The Draft Report cites EFIC's signings by value as evidence that it focuses on large clients and not SMEs. This

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	reliance on signings by value is misleading (naturally SMEs will require smaller quantum of financing support compared to large corporate clients) and conversely, EFIC's support for SMEs (even by value) compares favourably with the international ECAs the Commission has cited as examples of ECAs operating with a SME focus: US Exim Bank, EDC Canada, and ECGD of the UK. The Commission also refers to US Exim Bank's mandated focus on SMEs resulting in 85% of its signings by number in 2010-11 benefiting small business directly. The commission also states that 80% of EDC's signings by number in 2010-11 supported SMEs. By way of comparison, in the same year 89% of EFIC's signings by number supported SMEs. As a further comparison, the Commission states that SME business conducted by US Exim Bank constituted 18% of signings by value and 10% of signings by value for EDC in 2010-11. EFIC exceeds both these levels with SME signings accounting for 23% of EFIC's signings by value in 2010-11. The conclusion therefore that EFIC is 'focussed on large corporate clients' as evidenced by EFIC's supposedly 'low' level of support for SMEs and the following Draft Recommendation that EFIC should limit its services to 'newly exporting' SMEs only is incongruous with the reality of EFIC's activities and those of its international counterparts. No other comparable ECAs have undertaken to limit support to SMEs only. This is acknowledged by the Commission itself stating, 'the Commission is not aware of any ECA that explicitly limits its activities to SMEs, but it is common for ECAs to be expected to have an SME focus.' (p.229) **Why banks struggle with smaller firms** Commercial lenders require security from SMEs in order to mitigate the risk of loss in the event of non payment. That security can be in the form of hard assets (landed property and plant and equipment) or soft assets (inventory and receivables). Inventory and receivables are poorer quality security due to uncertain asset values and the many contingencies in a recovery situation. When these assets are located in Australia those contingencies can be mitigated e.g. recovery is carried out under Australian law, access to the asset is easier as it can be located in Australia etc. This is not the case for exports where the asset is held in a foreign jurisdiction outside the reach of the lender and subject to foreign laws. For this reason, as far as financing export contracts for SMEs is concerned, commercial lenders require property or 100% cash backed security to guarantee recovery in the event of non-payment. The critical issue for SMEs (especially those with sales below $100 million) is that they are generally unable to fund and provide

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	security for export transactions. Without this security, the exporter is unable to source commercial finance even if the export contract is commercially viable. This is where EFIC's support may assist, especially for companies that are experiencing rapid growth that strains their liquidity. **Information failure** In relation to 'information related market failure', EFIC currently provides this by means of country risk analysis. Information about buyer risk is available via commercial providers such as Dun and Bradstreet and credit insurers. However, information about country risk or bank risk does not suffice to resolve the bank's concern with adequate collateral security in what is perceived to be a much higher risk transaction than the normal domestic transaction. It is for this reason that Australian banks rely on, for example, EFIC's Documentary Credit Guarantee (DCG) when a letter of credit is raised in a high risk country or by a high risk financial institution. **Changes to product scope** While in the majority of cases EFIC operates by providing guarantees, it is not always the most efficient way to facilitate an export transaction. Buyer Finance is an important example of that. Many ECAs provide this solution to enable the buyers of major capital goods to be able to finance the acquisition from their exporters on payment terms that are outside of normal bank debt, but necessary for the importer to be able to match the funding tenor with the useful life of the assets to be funded (see Draft Finding 3.1). By providing Buyer Finance, EFIC is giving Australian exporters the same opportunity to win an export contract as the exporters in other countries have when their ECA provides the same capability to assist the buyer in funding the acquisition. In this regard, for EFIC to cease this offering would place Australian exporters of capital goods at a competitive disadvantage in the international market. Another direct funding product is the producer offset loan. Due to the small size of the transaction and the high level of documentation involved, it would be difficult and unnecessarily costly for EFIC to provide guarantees to commercial lenders to support these transactions. Unlike less complex transactions involving the export of goods or services, it would not be cost effective or commercially viable to do this via guarantees. In regards to the Producer Offset loan, EFIC disagrees with the Commission's conclusion that this is not the best policy solution for the problem. In fact, the alternate option of changing the producer offset loan program is the least optimal solution. The Producer Offset Program is managed under the Ministry for the Arts. The only possible way to avoid the EFIC loan is for the producer offset rebate to be paid to the producer up front rather

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	than after production is complete. The program was deliberately structured in this way to ensure efficient use of tax payers' funds. If it is paid up front, there is no guarantee that the production will complete. By paying at the end, the Government ensures that funds are allocated only to successfully completed productions that have a pre determined distribution in place thus mitigating the risks associated with the transaction. **The Need for Transparency** In relation to publishing transaction information, while it is feasible to publish some information, some information is highly sensitive and commercial in confidence and which, if disclosed, could cause damage to the exporter by making it publicly available for their competitors to obtain. The Commission has not considered the adverse consequences from EFIC's signalling effect: two firms with different premium rates clearly represents a credit judgement by EFIC. See also EFIC's response to Draft Recommendation 10.6.
Draft Recommendation 10.4 Amendments to the Export Finance and Insurance Corporation Act 1991 should be made to: • limit the financial products offered by EFIC on the commercial account to guarantees • allow for the product range on the commercial account to include the provision of reinsurance cover for sovereign and country risk insurance provided by the private sector in times of disruption in particular markets, and subject to ministerial direction.	EFIC does not support Draft Recommendation 10.4. EFIC notes that this Recommendation is not substantiated, selective and is impractical. • It would lead to inefficient outcomes for Australian exporters in terms of increased costs, greater complexity and slower execution. • The Commission has presented no evidence of crowding out to warrant the Draft Recommendation. (See EFIC's responses to Draft Recommendation 10.1 and Draft Findings 6.1, 6.2 and 6.4.) • This rigid approach reduces the ability of EFIC to structure flexible responses to the increasingly complex demands of exporters. • The evidence from the GFC is that a guarantee only model has a fundamental weakness in a credit crisis. • A reduced product and skill set at EFIC will reduce Australia's ability to respond to future crises. The Draft Recommendation would lead to inefficient outcomes for Australian exporters in terms of increased costs, greater complexity and slower execution. The approach has been recommended by the Commission as it 'limits the scope for EFIC to crowd out the private sector' (p. 206), despite the Commission presenting no evidence of crowding out by EFIC.

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	The Commission is advocating that, in 2012, EFIC's products be reduced to only guarantees while since 2008 European Governments have been attempting to emulate EFIC's flexible product model. ECAs that provide only guarantees and insurance have been struggling to establish funding vehicles in the context of a credit market collapse. When banks cannot lend, insurance policies are ineffective. Other ECAs have been seeking to learn from EFIC's experience managing a loan portfolio and treasury operation. From another perspective, even Government Departments have sought EFIC's assistance in understanding the mechanics of managing a loan portfolio for policy initiatives. (See EFIC response to Draft Recommendation 9.5). EFIC's insight into treasury markets, particularly offshore funding markets, has been critical to our risk management capability. The Europeans have learnt that instituting a funding and loan management framework in any environment takes considerable time. In a crisis, it is almost impossible. The Draft Recommendation reinforces a simplistic notion of exporting, whereas exporting is dynamic and increasing in complexity as exporters manage both new markets and global supply chains. Australian exporters require EFIC to have a flexible product suite to meet their needs. A rigid adherence to one product (i.e. guarantees) would not meet these demands and would potentially create distortions as exporters and buyers may need to restructure the commercial components of an export transaction to attempt to satisfy the product requirements of an EFIC guarantee. This could result in increased costs, complexity and sub-optimal outcomes. The inefficiencies arising from EFIC's inability to provide loans for the export of non-capital goods was discussed in Draft Recommendation 10.1. This Draft Recommendation would further exacerbate those inefficiencies for the same reasons. The capabilities and expertise required to provide EFIC's current product range is not easily found in Australia. Furthermore, in times of market disruption envisaged by the Commission it is too late to build up capability to underwrite previously discontinued product lines effectively and efficiently. The Government would be exposed if it were required to step-in to address the effects of a major trade collapse and slump in exports in the event of a crisis, and the subsequent negative spill-over effects of unemployment and lost capital. With regards to the Commission's Draft Recommendation to include provision of reinsurance to the private sector in times of disruption in particular markets, EFIC already has the capability. The provision of reinsurance is likely to be a scheme of specially tailored arrangement with private sector providers, not a specific product envisaged by the Commission. One example of such a scheme was the activation of the NIA Safety Net Facility

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	to cover wheat shipment to post-conflict Iraq in 2005. The $350 million Iraq facility, however, was never used.
Draft Recommendation 10.5 A limit of three transactions per client should normally apply to EFIC's future operations. Proposals to exceed the three transaction limit should require explicit approval by the Board (and not by a delegate), notified to the Minister for Trade and be included in an independent audit of EFIC's operations to ensure consistency with its demonstration role.	EFIC does not support Draft Recommendation 10.5. EFIC notes that this Draft Recommendation is not substantiated, is inaccurate and impractical. • Three is a completely arbitrary number. The Commission provides no basis for this Draft Recommendation. • EFIC may assist the same firm in one market more than once. If the firm's transaction bank supports the bulk of the firm's activity with the exception of one market, it will be more efficient for EFIC to provide support than the firm to experience switching costs. • EFIC may assist the same firm in more than one market. If the 'market gap' is perceptions of risk in different markets (e.g. five different emerging and frontier markets), or funding issues (e.g. large infrastructure projects or the export of high-value capital goods), there could be demand for EFIC's support. **Why EFIC helps clients more than once** EFIC and its clients share a common objective: the financial standing of any client should improve over time as profits grow. There are many examples of companies that have ceased to use EFIC's services once their banks get comfortable with their credit standing and their export business. However, for small businesses, this cannot happen after just one transaction, or even two or three. It takes time to build equity from profits and develop a relationship with a commercial lender. Once that relationship is established, the cost of having EFIC involved in the transactions necessarily drives the customer to deal directly with the commercial lender to reduce transactional costs. A customer may later need EFIC's assistance again if they go through another rapid growth phase, win an unusually large contract relative to their balance sheet or enter into new, higher risk markets which their bank will not support. However, the majority of EFIC's repeat clients sell to different buyers in different countries, often in emerging markets or frontier markets. This reduces their ability to develop banking relationships with local or international banks to finance this expansion; not helped by the fact that these transactions are often one-off

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	capital exports. EFIC's has already provided the Commission with reasons why some companies have had multiple transactions with EFIC (pers comm. 9 November 2011). These reasons seem to have been largely omitted from the Draft Report. The reasons, and further details of the companies highlighted by the Commission in the report as receiving EFIC support are provided below: **McConnell Dowell** Other than for one transaction involving political risk insurance, EFIC's support for McConnell Dowell has been by way of providing or supporting bonds. EFIC entered into a Bond Facility Agreement with McConnell Dowell in 2006. Under this agreement EFIC issues bonds on behalf of the company when its export contracts requires this. EFIC has supported bonding for McConnell Dowell for six contracts since 2004 - some contracts requiring the issues of more than one bond. The reason McConnell Dowell has requested EFIC's support to issue bonds is that the company has been unable to access all the bonding capacity it requires from the commercial market. This is an ongoing issue for them. **Incat** EFIC has provided support for Incat for five transactions between 2002 and 2011. However, of these transactions only two were to fund or support Incat directly: a performance bond for a contract with the US Military and a construction finance facility to fund a contract with a buyer in Uruguay. The remaining three transactions were buyer-financings to two different buyers where EFIC provided two export finance guarantees (EFG) to finance a Spanish buyer and an EFG to finance a Canadian buyer. Both these transactions allowed Incat to access important export markets. **Shark Bay Salt** The Commission finding that EFIC supported more than 20 documentary credit guarantees for Shark Bay Salt is misleading. (Box 6.6) These 20 transactions underpinned only four separate export contracts. Moreover, EFIC provided a guarantee to Shark Bay Salt's Australian bank to enable it to confirm the letters of credit issued by the banks in Indonesia to guarantee payment for the salt exported. EFIC provided support because the company's Australian bank could not confirm the letters of credit due to its internal counterparty/country limits on Indonesia. The cost to the exporter of moving to another bank was prohibitive due to 'switching costs' and without switching, other banks would have little incentive to support a 'one-off' (relatively small) export

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	transaction. So EFIC stepped in to support the exports to Indonesia, a market EFIC knows well given our previous experience. Without EFIC's support, the export would probably not have occurred. The Commission's finds that 50 companies have had four or more transactions with EFIC between 1992 and 2011. However, this analysis is skewed by the divestment of EFIC's short-term trade insurance business in 2003. Focusing on transactions post-2003, EFIC has supported 30 companies with four or more transactions, accounting for 19% of the total number of companies supported during the period.
Draft Recommendation 10.6 Within a month of execution, EFIC should publish information on the transactions it approves on the commercial account, including the name of the firm, price and other terms of provision. The published information should be sufficient to establish whether the transaction is consistent with EFIC's objective to demonstrate to the private sector that providing export finance to newly exporting small and medium-sized enterprises can be commercially viable.	EFIC does not support Draft Recommendation 10.6. EFIC notes this Draft Recommendation is not substantiated, is impractical and unnecessary. • The Draft Recommendation will not achieve its stated objectives. EFIC's clients have a reasonable expectation of client confidentiality. • EFIC already publishes considerable information on the transactions it supports. • The disclosure of pricing information – which clients should reasonably expect to be confidential – will not achieve the objectives the Commission is hoping to achieve. As previously noted in EFIC's response to Draft Recommendation 9.8, EFIC maintains an online register of supported transactions (excluding foreign exchange facility guarantees, film producer offset loans and risk participation agreements associated with multilateral institutions) that is updated as soon as practicable after a transaction is signed. The register specifies: • the name of the exporter or client • the sector • the goods or services exported • the importing country • the facility type • the amount of the facility (in A$ million equivalent) and

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	• the result of the transaction's environmental and social screening and classification. A link to the transaction register on EFIC's website[31] is attached: http://www.efic.gov.au/corp-responsibility/envr-responsibility/Pages/Transactionregister.aspx The pricing that applies to a particular facility is not disclosed as such information is commonly understood to be commercially sensitive information. EFIC's approach in not disclosing the pricing of individual transactions is consistent with the practice of other OECD ECAs. It is unclear what is meant by 'other terms of provision' in the Draft Recommendation. The commentary preceding this Draft Recommendation states that it is, 'not expected that the publication of this information would generate a significant impost for EFIC's clients.' Aside from there being no attempt at substantiation, this supposition is erroneous. It is precisely this type of information, that is, pricing information, that EFIC's clients expect EFIC to keep confidential. Furthermore, it is not at all clear how disclosing specific pricing data facilitates the two stated objectives on p. 209 of the Draft Report. Firstly, the pricing that applies to a particular facility is determined by reference to a number of factors. Where EFIC is supporting an Australian company's exports by way of buyer finance, the buyer's credit worthiness and the buyer's country of origin is likely to be of greater relevance to EFIC than the Australian exporter's credit worthiness. Accordingly, disclosing the pricing of such a buyer credit arrangement would not serve any demonstration role in terms of the support that the private sector may be willing to provide to the Australian exporter generally. Nor would it indicate to private sector providers '*where EFIC is placed in the market'* given the bespoke nature of EFIC's support. Secondly, it is not at all clear how disclosure of specific pricing data could reduce the transaction costs for EFIC's potential customers and private sector providers. EFIC's support (including pricing) is generally structured with the specificities of a particular transaction in mind. Accordingly, as no two transactions are the same, providing pricing data for previous transactions may potentially mislead (and therefore add to the transaction costs of) EFIC's potential customers and private sector providers. Finally, the commentary preceding the report appears to suggest that because some European ECAs provide

[31] However, some details may be omitted if they, or the fact of EFIC's support, are commercially sensitive for a client: paragraph 4.1 of EFIC's *Procedure for environmental and social review of transactions*. Available online: http://www.efic.gov.au.

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	guidance in the form of online calculators, EFIC should provide actual transaction pricing data. This extrapolation seems ill conceived, particularly as the calculators provide indicative guidance only and are expressly based on a number of assumptions which may or may not be satisfied at the time such ECA undertakes its credit assessment.
Draft Recommendation 10.7 Where possible, the Minister for Trade should give operational effect to the proposed changes to EFIC's operations through a ministerial direction or a revised Statement of Expectations until such time as the Export Finance and Insurance Corporation Act 1991 (EFIC Act) can be amended. EFIC's performance against this new, tighter mandate should be reviewed three years after the amendments to the EFIC Act have been passed by the Parliament.	EFIC does not support Draft Recommendation 10.7. EFIC notes that this Draft Recommendation is inappropriate. EFIC's current mandate was established through an Act of Parliament, with appropriate process. The Commission's rationale for circumventing Parliament is presumably expediency. The Commission's Draft Recommendation to circumvent the legislative process does not accord with principles of due process and consideration by Parliament.

Appendix A – Market Failure Analysis

The Commission acknowledges that some information has public good characteristics that may warrant government intervention.

‘For example, EFIC argues that a lack of information on international markets can impede access for exporters (EFIC, sub. 18). EFIC and other government agencies such as Austrade publicly release information, such as country risk assessments, that assist exporters, importers and private sector providers to assess the risk of dealing in a particular country (Chapter 3 and Box 5.1). In some circumstances, the provision of information by government agencies can be an efficient means of overcoming some market failures associated with its public good characteristics.’ – Draft Report page 73.

However, the Commission then tries to dismiss a list of other possible reasons for market failure – credit rationing, imperfect information, lack of effective competition in financial markets, and temporary disruptions due to market turmoil. The Commission also attempts to disprove the argument that government is an ineffective bearer of risk. The table below summarises the Commission’s arguments, and our counter-arguments.

The Commission fails to disprove all these arguments. We contend that failures do exist in financial markets. We agree that EFIC in not a fitting answer to problems of market power in domestic financial markets.

But we contend that market failures do exist in the markets for export finance – and exist disproportionately – *and* EFIC is the best mechanism for addressing these failures.

This establishes a case for having an ECA like EFIC.

Appendix A – Market Failure Analysis

Failure	Commission's view	EFIC’s view	Implication
Public good Information relevant to exporting can be a public good, and hence under-provided by private sector	Valid argument	Valid argument	A reason for EFIC to provide information – and maybe even to 'signal' its attitudes by providing cover
Credit rationing	Invalid argument	Valid argument	Credit rationing establishes a case for an ECA to combat it.

Appendix A – Market Failure Analysis

Failure	Commission's view	EFIC's view	Implication
Because of information asymmetries, financial institutions may engage in non-price rationing of credit. In the process, promising exporters with lucrative deals are denied support – along with transactions which are not creditworthy.	Information asymmetries, and the credit rationing they spawn, are a market feature, not market failure. It costs financial institutions time and money to gather information. They will incur costs to improve their information only up to the point at which the marginal cost of doing so equals the marginal benefit in terms of extra profitable business this information gathering can generate. This is entirely legitimate and consistent with a smoothly working market.	The Commission acknowledges the logic of the argument first advanced by Stiglitz & Weiss[32] that private lenders, to combat the adverse selection and moral hazard traceable to asymmetric information, engage in non-price rationing of credit. A vital point of the Stiglitz-Weiss model is that borrowers unable to access credit at the prevailing interest rate are identical in all observable respects to borrowers who receive credit. There is a clear 'market gap', in other words, and this gap constitutes a 'market failure'. The Commission's discussion of information costs in no way invalidates Stiglitz & Weiss's point that credit rationing exists and is a market failure. It is an entirely parallel discussion. In addition, the asymmetric information that gives rise to credit rationing is especially prevalent in the markets for export finance and insurance, and still more so in the markets covering emerging and frontier economies. A 2010 study of Italian manufacturing firms by Minetti and Chun Zhu[33] found 'While credit rationing also appears to depress domestic sales, its impact on foreign sales is significantly stronger. The analysis also suggests that credit rationing is	EFIC has an intense focus on finding 'good borrowers' with promising transactions that private lenders have rationed out. It has expertise, e.g. in country risk assessment, and products, e.g. working capital guarantees, especially suited to such a spurned market segment. EFIC's record speaks for itself: it has made money from supporting exporters that the marketplace spurned, and so too have the exporters.

[32] Stiglitz, J., Weiss, A., 1981, 'Credit rationing in markets with imperfect information,' The American Economic Review, 71:3, p.393-410

[33] See: https://www.msu.edu/~zhuc/CreditRationing.pdf

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Failure	Commission's view	EFIC's view	Implication
		an obstacle to export especially for firms operating in high-tech industries and in industries that heavily rely on external finance'. It found that the probability of exporting is 39% lower for rationed firms and that rationing reduces foreign sales by more than 38%.	
Imperfect information Imperfect or missing information may impede the consummation of otherwise profitable export transactions	Invalid argument Imperfect or missing information is a market feature, not market failure. It costs financial institutions time and money to improve their information. They will incur such costs to improve their information only up to the point at which the marginal cost of doing so equals the marginal benefit in terms of extra profitable business. This is entirely legitimate and consistent with a smoothly working market.	Valid argument The Commission's views are not wrong so much as beside the point. It overlooks two pertinent issues. First, EFIC has made a point of developing a comparative advantage in assessing many of the risks that beset exporters, e.g. country risk. EFIC's views are frequently sought on emerging and frontier markets – including by the media, conference organisers, accounting and law firms, financial institutions and exporters. Second, as the Commission acknowledges elsewhere, information might be costly to gather, but it is a public good. Once obtained, the marginal cost of disseminating it to an additional exporter or financial institution is nil or virtually nil. The Commission puzzles over EFIC's claim that it has developed an expertise that the market has neglected. If such expertise were profitable, it asks, why has the market neglected to acquire it?	EFIC can deploy its comparative advantage in export risk assessment to help viable exporters that the private market has passed over. It can also help to better inform the market about many of the risks of exporting through its provision of information, notably country risk assessments. In both ways, it calls forth additional profitable exports that the unfettered market would not have supported.

Appendix A – Market Failure Analysis

Failure	Commission's view	EFIC's view	Implication
		Like the Commission, EFIC is unsure why the private market hasn't taken the pains to develop such kills. But the fact is, they haven't. And that enables us to occupy a profitable and socially beneficial niche in the overall market ecosystem.	
(Lack of) effective competition in finance markets A lack of effective competition could lead to under-provision of export finance and insurance	True enough, but not an argument for having an ECA. 'First best' policy entails tackling any anti-competitive distortions directly, e.g. through competition and regulatory policy. 'EFIC is unlikely to be the most effective mechanism for addressing any distortions created by poor regulation.' – page 87	EFIC agrees. EFIC does not base our raison d'être on the oligopolistic power of private financial institutions. EFIC rests it instead on the other market failures noted above and below.	
Government as a bearer of risk EFIC has argued previously that government provision of export finance and insurance may be justified because governments are better able than the private sector to bear the relevant risk.	Invalid argument 'Applied to the economy as a whole, this logic would suggest that all risk in the economy should be borne by government.' 'As the events following the European debt crisis demonstrate, even governments in large economies are not immune from	Valid argument EFIC argues that it should bear the risk of supporting only those transactions and projects that the private market has spurned because of other market failures. EFIC does not argue for a wholesale nationalisation of export finance and insurance. EFIC believes that the Commission's attempt to discredit our argument through a reductio ad	EFIC has a legitimate role to play in supporting transactions and projects where the risks are large, long-term and positively correlated. Thanks to the government's superior capacity to bear and pool these risks, it is also legitimate for government to earn a lower return on the equity it has invested in EFIC

Appendix A – Market Failure Analysis

Failure	Commission's view	EFIC's view	Implication
'First, those risks are often large, long-term and positively correlated. Second, the government can spread and pool risks more widely than the market can, because it has the government balance sheet, faces limited threat of bankruptcy, and has a first-mover advantage.'	the threat of bankruptcy.'	absurdum is simplistic. It does not follow that targeted intervention in markets – at the margin of private activity – is misguided simply because wholesale intervention would be misguided.	on behalf of taxpayers than private shareholders are entitled to demand of private companies. This is not to argue that EFIC should lose money. It is, however, an argument for us to make less money than a private financial institution.
Systemic failure in global financial markets 'The global supply of financial services is either insufficient or misallocated due to failures in international financial markets and ... ECAs can play a role in addressing these failures.' 'In Australia's case, the argument has been advanced in the context of the availability of finance for large resources projects.'	Invalid argument 'First, the market failure basis of the intervention needs to be established and supported by compelling evidence.' 'Second...even if a failure in financial markets is established, the appropriate response typically involves more targeted policies such as reforming prudential regulation and removing the policy distortions affecting markets.'	EFIC agrees that it may not be the best solution to all financial market failure. However, the point about international financial market failure is that it is not amenable to solution by Australian public policy at source. Needless to say, the reach of Australian policy does not extend to overseas financial regulation.	Because of the existence of overseas market failure and the inability of Australian policy to address it directly, a case can be made for an ECA such as EFIC to address shortfalls of external financing caused by such failure. This argument has special force for a country like Australia, which has a structural surplus of investment opportunities over domestic savings capacity, and therefore needs to import large sums of foreign capital.

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Failure	Commission's view	EFIC's view	Implication
Temporary disruptions due to market turmoil Significant market disruptions caused by financial crises may justify government intervention.	It is unclear whether during financial crises disruptions to export finance and insurance are special problems. The bigger problems exporters face are plummeting demand for their products and general credit crunches.	The evidence is unclear on this point. The Commission cites studies suggesting that, during the recent GFC, declines in trade drove declines in trade finance, not the other way around. But there are other studies suggesting that the causation was also from trade finance to trade. (For detail see EFIC's response to Draft Finding 5.2)	The evidence that 'externalities of financial disruption' do indeed unsettle trade finance markets during financial crises supports a case for an ECA to engage in counter-cyclical activity during financial crises to cushion any downturn in private trade finance. The public benefits of such activity can be large – it heads off the retrenchment of large amounts of capital and labour in export industries plus attendant multiplier effects through the wider economy.

Appendix B – Further errors and inaccuracies in the Draft Report

Draft Report Reference	Correction
The Commission incorrectly lists products offered by EFIC in Table 3.2 ‘Products Offered by EFIC’ - page 34.	The classification of EFIC’s products is incorrect. For the record EFIC only offers three insurance products, not four as illustrated in Table 3.2. EFIC’s Risk Participation Agreement is a guarantee product not an insurance product. The description of EFIC’s ‘Risk Participation Agreement’ should read: ‘Partially *guarantees* the financier in the event of a non-payment.’
‘There are several large multi-national insurance companies that provide insurance services to Australian exporters and importers such as Alliance Insurance Services Pty Ltd, Aon Corporation Australia Limited and PSC Insurance Group (a member of the Wells Fargo Global Broker Network) (Aon Australia 2012; NIBA 2012; PSC Insurance Group 2012). Many insurance brokers also facilitate the operation of these multi-national insurance companies in the Australian market (box 3.3).’ - page 36.	The Draft Report confuses brokers and insurers. The companies identified for example, are all insurance broking firms not multi-national insurance companies.
‘A number of insurance companies offer political risk insurance in the Australian market including Atradius, Beazley, Chartis, Coface and Euler Hermes (Allianz) (Atradius nd; Allianz (2011); Beazley nd; Chartis Insurance nd; Coface ndb.)’ Chapter 3, Private Sector Provision - page 39.	The Draft Report states that Beazley offers PRI insurance in the Australian market. While Beazley is a PRI provider and a London Lloyd’s syndicate insurer, EFIC understands that it is not an APRA authorised insurer to conduct new or renewal insurance business in Australia.
‘In 2009-10 EFIC provided on the commercial account 54 facilities to 41 exporting firms.’ - page XVI.	EFIC’s 2010-11 Annual Report was tabled in Parliament in 28 October 2011 and the Commission has the data.
Analysis presented in Box 7.2 ‘Characteristics of export credit agency loans’ – page 124.	The Commission has asserted in Box 7.2 that ECAs offer more generous grace, drawdown or interest rate than that by the private market and by implication its influence on the amount of subsidy. The Commission is aware that there are disciplines on these terms imposed by the

Draft Report Reference	Correction
	OECD Arrangement. For example, there are disciplines on minimum fixed interest rate (Commercial Interest Reference Rate, CIRR), minimum premium (Minimum Premium Rate, MPR) for credit risks and other financial terms. See Chapter II of the Arrangement: (http://www.oecd.org/officialdocuments/displaydocumentpdf/?cote=tad/pg(2011)13&doclanguage=en). Participants to the OECD Arrangement are required to adhere to and report on these disciplines to demonstrate compliance. In addition, ECAs of World Trade Organisation (WTO) member nations (both OECD and non-OECD) are required to comply with the WTO's Agreement on Subsidies and Countervailing Measures (ASCM), in particular Articles (j) and (k) of Annex I – 'Illustrative List of Export Subsidies.' Article (j) requires ECAs to charge premium rates such that are adequate to cover the long-term operating costs and losses of their programmes while Article (k) recognises the legitimacy of the OECD Arrangement's interest rate provision. Loan principal payment profile (due dates and amount) for fixed interest rate loan is fixed at the on-set of loan signing. Accordingly, drawdown delays do not impact on the payment schedule, i.e. the borrower is still obligated to adhere to the original payment schedule, contrary to the Commission's assumption that the delays extend the maturity (and therefore they assert the quantum of subsidy) of the loan. Also, unlike private market loans which are normally structured with bullet repayments, i.e. relatively long grace period where only interest is payable before one final principal payment is due, ECA loans principal repayments are required to be paid semi-annually to loan maturity. In addition, the analysis in Box 7.2 is overly simplistic in that it assumes a fixed interest rate loan, presumably use of CIRR. The Commission also uses dated research in Appendix B.
'The Department of Foreign Affairs and Trade reviewed EFIC in 2006 and found that: • The divestment of EFIC's short term insurance business had been successful, with the market effectively served by the private sector since the divestment • The 'market gap' in which EFIC operates was shrinking	The selected recommendations give an impression that recommendations from the 2006 Review were aimed at restricting EFIC, when this was not the case. There were 15 recommendations and 82 other findings in the 2006 Review which are not referenced in the Draft Report, some of which recommended expansion of EFIC's activities such as investigating new product offerings and adjusting EFIC's functions accordingly under the EFIC Act to support the expansion of supply chains overseas.

Draft Report Reference	Correction
due to greater private market capacity for export finance and insurance. • The responsibilities of management and the Board of EFIC to operate in the market gap should be set out in the Minister's Statement of Expectations (SOE). The SoE should include a statement of principle that EFIC's pricing is not to undercut the pricing for comparable risks when private support is absent and, where appropriate , that EFIC charge a premium for the additional risk or quality of service it is providing.'- page 2.	EFIC does not suggest that a full account of the 2006 Review should be included in the Draft Report; however, the selective presentation of its recommendations is misleading. The full review can be found at: http://www.dfat.gov.au/publications/corporate/review-of-the-export-finance-and-insurance-corporation.html The Commission also selectively quotes from the Mortimer Review; it does not include reference to the Mortimer Review's Recommendation 8.6 for the expansion of EFIC powers under the EFIC Act on page 130. A full account of the findings of the Mortimer Report can be found here: http://www.dfat.gov.au/publications/mortimer_report/
In the section titled, 'EFIC's past dominance of short-term insurance', the Commission refers to the 2001 Review of EFIC, stating that: 'Moreover the review concluded that EFIC's market dominance is likely to be an important reason why Australia has not seen the level of private sector activity evident overseas.'- page 106.	The Draft Report does not acknowledge that EFIC led the recommendation for privatisation of its short term credit insurance business in order to successfully execute its market gap mandate.
'While the following is not an EFIC transaction, it does illustrate that governments can and do lose from providing loans and guarantees to promising opportunities (opportunities that the private sector had rejected). For example, following the launch of the Stanwell magnesium project in 2000, the Australian and Queensland Governments gave considerable support in the forms of grants and loan guarantees (Lipton, Steinberger, and Ketcher 2003). The Australia Government was very confident about the project (Minchin 2001b). However, despite this government support, AMC faced difficulties with the Stanwell project leading to its termination in June 2003. The collapse of the project	EFIC does not see the relevance of this example to its role of supporting Australian exporters. The case study does not involve EFIC, or ECA support, or any relation to export finance and insurance The announcement of the formation of a Clean Energy Finance Corporation (CEFC) as part of the Government's Clean Energy Future package in 2011 and the recent announcement by Singapore that it will set-up a fund within its Sovereign Wealth Fund Temasek to support Singapore-based companies in emerging markets seem to contradict the Commission's statement regarding trends away from government ownership of financial institutions.

Draft Report Reference	Correction
resulted in significant costs being transferred to the taxpayer.' - page 54. 'There has been a clear trend away from the potentially risky approach of government ownership of financial institutions…'- page 57.	
'Submissions have raised some concerns about the potential for EFIC to displace private sources of private finance and insurance.' - page 102.	The Commission selectively takes language from submissions by the Australian Chamber of Commerce and Industry (ACCI) and Business SA and presents these as 'concerns'. Neither of these submissions, and indeed, none of the submissions posted on the Commission's website express concern that EFIC is displacing the private sector. These two submissions seem to be simply reaffirming EFIC's mandate in this respect.