21 March, 2012

Export Credit Arrangements
Productivity Commission
LB2 Collins Street East
Melbourne, Victoria, 8003

Dear Commissioners,

Commentary on the Draft Report on Australia's Export Credit Arrangements, 22nd February 2012

1.0 Overview

Commonwealth Bank of Australia (the "Bank") is Australia's largest financial institution. The Bank also operates in a range of International markets including, Hong Kong and Greater China, Indonesia, Japan, New Zealand, Singapore, Vietnam, the UK and the USA.

Through this network the Bank actively seeks to support Australia's wholesale and SME exporters domestically and offshore.

Export Finance and Insurance Corporation ("EFIC") has been a key player in this market and often forms part of the discussions that we have with exporters. EFIC has raised the profile of the broad exporter community through its involvement with the Australian Export Awards which Commonwealth Bank is also proud to be associated with and sponsor.

We are pleased to provide this commentary for the Commission's consideration.

The Bank's involvement and engagement with EFIC is across a number of key bank areas including its Trade and Working Capital Finance, Corporate Finance, Client Relationship, Risk Management, and Loan Markets divisions. Engagement is regular and interactive including marketing, educational sessions and collaborative work on identified transactions from SME to larger corporate and infrastructure opportunities.

The Bank and EFIC both aspire to building Australia's export industries by working closely with customers to deliver on their needs in tackling challenging export markets. Our mutual focus on the customer also ensures that our differing capabilities are matched to ensure maximum benefit to the exporter.

The following commentary touches on the Bank's assessment of the Australian loan market for large scale projects associated with Australia's export trade and more traditional export financing.

2.0 Current Loan Market Environment

We have worked with EFIC's support on a range of key projects.

To allow a greater level of perspective, the Australian syndicated and club loan market in 2011 recorded a total loan volume of US$115,677m (source: Thomson Reuters LPC). This quantum excludes bilateral lending, often undertaken at the SME level.

The 2011 loan volumes were the highest over the last decade, with the quantum driven by a high level of refinance activity (55% by volume) and significant activity in project financing (>12% by volume).

For greenfield project finance, bank lending continues to be the primary source of debt capital. Whilst the four Australian major banks actively and consistently provide large volumes of development debt funding across the project finance sectors, the Australian market is highly reliant on foreign lenders.

Across the broader project finance, infrastructure, utilities, energy and natural resources sectors the Bank estimated primary involvement from more than 45 banks, more than 4 institutions and at least 4 Export Credit Agencies ("ECAs") in 2011. A large portion of funding came from European and Japanese banks, and in the resources dedicated mining sector and LNG development, ECAs played a key role. Chinese lender involvement is more selective, primarily supporting transactions with Chinese sponsors or those with a strong Chinese export focus.

The realignment of European lenders to a more European focus, pressures on individual bank balance sheets and the high cost of USD and AUD funding have seen a number of European banks exit or reduce coverage of the Australian market. We expect that in 2012 the universe of banks lending in the Australian market will continue to contract as was the trend observed throughout 2011.

A potential liquidity shortfall will add a significant layer of complexity as to how to deliver the large pipeline of transactions across the infrastructure, energy and mining sectors. Whilst some sponsors have access to additional equity or seek on balance-sheet debt, this is not the case for a large portion of Australian projects. As such, ECAs, including EFIC, are needed to ensure that these transactions can be funded.

Sufficiency of private capital to fund the natural resources and infrastructure pipeline in Australia

The forecast number and size of developments being contemplated across the infrastructure, natural resources and gas sectors is unprecedented.

The capacity of the private sector to meet the debt requirements for these expected volumes is limited. There are a range of constraints which we touch on below:

A **small universe of banks** has demonstrated consistent appetite, capacity and willingness to lend significant debt volumes in the relevant sectors. Lending to greenfield developments in Australia has been provided primarily by Australian, Japanese and European lenders. With many European banks (French, German and UK) withdrawing from the Australian market or downscaling operations, we have not observed sufficient replacement capacity from the Canadian entrants or from Chinese, Indian or other South East Asian lenders.

The long lead times, construction and commissioning periods for these projects will **restrict the ability of borrowers to tap into the capital markets** and (in any meaningful way) the institutional investor base.

Whilst the existing lenders to these sectors continue to demonstrate strong support with significant dollar commitments to these complex projects, each **bank's capacity to lend is limited** by prudential and internal limits on single exposures, aggregation policies (including across subcontractors, equity investors, individual projects which share common probability of default). For projects which require dedicated infrastructure (rail and/or port) aggregation limits will likely apply across the production chain through to export thus constraining liquidity further for these large integrated projects.

Complexity of projects, completion delivery methods (including the industry preference for alliance contracting) and underlying credit ratings of contractors often result in the risk profile of the project, during the construction and commissioning phase, to be sub investment grade. Internal and prudential policies further limit **banks' capacity to commit debt for sub investment grade assets** and borrowers.

In addition to the large debt requirement to meet the capital and the capitalising of interest costs during the construction phase, the developers also rely on the banking market to provide risk management instruments (interest rate, foreign exchange or commodity hedging). Such exposures require a regulatory capital allocation and will further limit bank capacity.

Contractors, during construction and operation, rely on the banking sector to provide **performance bonding and liquidity facilities**. The demand for performance bonding facilities from well rated commercial banks is high. Many projects require bonding of circa 10% of the capital value. Given Australia's 5 year pipeline of greenfield developments across infrastructure, energy and natural resources this could mean a demand for performance bonds in billions of dollars. With a strong preference for bank bonding (rather than insurance bonds) contractors will need to find alternate providers of bonding lines, such as EFIC.

2.1 Key EFIC role

For large greenfield transactions the Bank has identified the following key roles undertaken by EFIC and ECAs in Australia.

- Providing funding for a project where there is a **funding gap** due to insufficient capacity or appetite from the private sector.
- Providing a **credit enhancement** or wrap for very large developments. Whilst EFIC cannot directly lend in all circumstances to the borrower, it 'guarantees' a portion of the obligations of the borrower. As the recourse of the lender is now partially to EFIC, rather than to the borrower directly, this **allows a lender (or group of lenders) to provide a larger volume of debt to a project**. Typically, the majority of the debt is lent to the borrower directly, with the EFIC 'guaranteed' tranche allowing lenders to provide additional debt capital.
- Supporting key contractors through **performance and environmental bonding facilities**.
- Supporting subcontractors in the provision of **advance payment guarantees**.
- **Mitigating refinancing risk** for large transactions. ECAs ability and willingness to provide long term amortising facilities partially mitigates refinancing risk and better mirrors project cash flows.
- **Facilitating engagement** with non-Australian ECAs.
- Providing comfort for Australian lenders and sponsors in **new or challenging jurisdictions**.

2.2 Terms of EFIC engagement

The Bank has observed that for larger transactions in the LNG and infrastructure sectors, the significant presence of overseas ECAs has impacted on terms and conditions of the debt as well as the total volume of debt being raised.

Offshore ECAs can typically have a more aggressive approach than EFIC to project financing in the Australian resource and infrastructure sectors, and can go further than providing a gap for a bank funding shortfall. Some sponsors have selectively used large ECA funding capacity to reduce the size of the commercial bank funding requirement.

EFIC's mandate and engagement are different. There is a clear and consistent focus on filling a market gap on terms and pricing set by the commercial bank sector.

3.0 Traditional Export Finance

The Global Financial Crisis (GFC) saw a dramatic and sudden change in the operation of export markets. In the immediate aftermath export markets were impacted as banks and credit insurers saw increases in losses across their portfolios, which put pressure on balance sheets, profitability declined, and some insurers /banks were downgraded. There was also an overall market contraction in credit risk and coverage. Limits and maximum exposure levels were reduced. Business development focused on existing customers. Some insurers cut both staff and representation across the country. Australian banks were active with the support of EFIC in looking to step up to support their customers

Whilst there has been a recovery since the GFC, the market has not retraced to pre GFC levels. Banks are growing their export business but there remains a gap as a range of offshore banks have reduced support. There remains a gap in supporting short and medium term export finance for export exposed industries across hard and soft commodities and services /contracting in a range of emerging markets in Asia and Eastern Europe, Africa and parts of the Middle East.

EFIC provides a range of short and longer term financing options independently and in co-operation with multi-lateral agencies (e.g. Asian Development Bank) which support export finance of Australian commodities. As a member of the Berne Union, EFIC co-operates internationally with other members to enhance trade flows by filling a market gap role.

EFIC's, Export Working Capital Guarantee, is an excellent example of a product used to deliver export financing solutions, which has helped the Bank extend support for its customers.

4.0 Summary

From the foregoing, we believe that market gap is evident at all levels of the export cycle and across all participants whether SME or large corporates and projects.

We see EFIC as having a strong role to play in supporting export transactions in the future.

Yours sincerely

J. Rickward

James Rickward

Executive General Manager, Corporate Finance