26 March 2012

Productivity Commission
Locked Bag 2 Collins Street East
Melbourne VIC 8003

Dear Presiding Commissioner

RE: Productivity Commission Draft Report, *Australia's Export Credit Arrangements*, February 2012 ("Draft Report")

ANZ has reviewed the Productivity Commission's Draft Report for its inquiry into Australia's export credit arrangements. We wish to provide our observations on a number of recommendations in the Draft Report in addition to the submission of 20 December 2011.

ANZ's Structured Export Finance business is a global business responsible for arranging, structuring and executing transactions for customers supported by OECD and non-OECD export credit agencies (ECAs). These transactions are delivered via a team of 20 professionals based in Sydney, Singapore, Beijing, Tokyo, London and New York with extensive Export Finance experience. ANZ itself has been engaged in the Export Finance market for more than 20 years, and over the past 12 months has closed 21 transactions for customers in 9 different markets (including Australia) working with 10 different ECAs (including EFIC).

Our observations are based on our recent experience of market conditions and the operations of ECAs in the market.

A. General Comments

The Draft report recommends a significant contraction in EFIC's mandate, namely that:

- EFIC should not provide finance to medium and large corporates nor support their exporting activities
- EFIC should not continue to provide finance for domestic resource projects on the commercial account
- EFIC's commercial account objective should be to address the information-related failures in financial markets that affect newly exporting SMEs, and
- EFIC's commercial account product range should be limited to guarantees

We believe that the Draft Report does not adequately consider the imbalance in credit/liquidity capacity and demand which has arisen out of the current global economic and financial market environment. We also believe that the Draft Report does not fully assess the activities of other ECAs globally which ANZ believes is relevant when considering the scope of EFIC's mandate.

Supply & Demand

At present there is severe economic instability in Europe, the world's most developed economies are undergoing significant de-leveraging (particularly in the financial institutions sector), and the banking sector globally is facing significant regulatory change via Basel III. At the same time, however, the demand for capital in Australia remains intense with project finance requirements alone increasing nearly 600% from A$15.2b in 2010 to A$102b in 2011[1]. The scale of this demand is stretching private sector capacity and we are seeing ECAs "cornerstone" large project finance deals to overcome this issue.

ECA Activity Globally

The Draft Report includes a discussion on the "Approaches of other ECAs" (Section C). This mainly assesses eligibility criteria and the basis of incorporation of ECAs in different countries. The discussion should be supplemented with further assessment of the activities of other ECAs globally (e.g. in Europe, the US and North Asia).

Almost all ECAs globally have expanded their operating mandates, developed new products and programs and supported significantly higher business volumes. This has occurred to address the "gap" that has emerged in the provision of private sector credit, liquidity capacity and export finance and insurance as a result of the Global Financial Crisis ("GFC") and the prevailing economic and financial markets uncertainty.

These enhancements have been designed to support international competitiveness in/from those foreign markets and shore-up domestic economic and broader national interests. However, the Draft Report recommends a significant curtailing of EFIC's/Australia's own export credit operations, against this global trend. The impact of this would be that foreign exporters and investors have greater access to financing to support the supply of manufactured goods and capital into Australia, potentially putting Australian companies at a competitive disadvantage. Likewise, Australian exporters of capital goods will be at a disadvantage vis a vis their international competitors who can call on ECA support for buyers of their product.

With the onset of the GFC, ECAs – particularly in Europe and the US – emerged as critical economic policy tools for financing (the buyer's of) exports. Likewise in North Asia, ECAs have become significant economic policy tools serving the national interest by providing financing arrangements to support offshore equity investment and surety of resource supply. In ANZ's view, EFIC's preparedness to support domestic projects was a response to the GFC commensurate with that of ECAs in Europe, the US and Asia.

Consistent with this, Berne Union statistics show that in 2009, ECA guaranteed business increased by 24% on the prior year. (This understates the global ECA community response to the market gap as it excludes direct loan programs). For example, US Exim more than doubled its total level of authorisations in the 3 years following 2008 – from USD14.4bn to USD32.7bn in FY2011.

Recognising that liquidity was a constraint in addition to risk capacity, ECAs either expanded their direct lending capability, the role of direct lending ECA "affiliates" became more prominent (e.g. SEK in Sweden) or certain ECA's developed new funding programs, e.g. "ELO" in Denmark. We note the recommendation

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[1] ANZ Research, Australian Major Project Update: 13 February 2012

contained in the draft report for EFIC to cease its direct lending operations is inconsistent with this global trend.

Export Sector pressures

Australian exports tend to be more concentrated within the larger companies, particularly major resource and agricultural sector businesses. At the smaller end, the export sector has been hard hit in recent months by the highly competitive manufacturing markets overseas and the strong Australian dollar. Australia's small exporters are struggling to remain competitive in this environment.

Furthermore, an SME typically relies on its asset base for funding and is constrained by the level of security that it is able to offer. This limitation may prevent a company entering into emerging export markets or supporting a large export contract which it otherwise has the operational capability to meet. This circumstance appears more in the SME space and can be a constraint on Australian companies' ability to win major export contracts. This pressure has also been evident in companies bidding for work for the major infrastructure projects, which by definition are large, requiring the provision of bonds and guarantees, again potentially beyond an SME's 'traditional' borrowing capacity.

B. Observations on Draft Findings & Recommendations

1. **Draft Finding 6.2:** ***EFIC is likely to be crowding out private sector provision of export finance and insurance.***

   ANZ and other commercial banks generally use EFIC and other ECAs only when necessary in order to complement their own appetite for risk (credit, industry, project specific), counterparty capacity, tenor and liquidity appetite. Furthermore, there is a disincentive for banks to use ECA support (unless to address those aspects mentioned above) because of the consequent reduction in absolute returns and higher transaction costs/complexity due to the involvement of a 3rd party

   Therefore, ANZ does not consider that EFIC crowds out private sector export finance and insurance activity and nor does the presence of EFIC or other ECAs preclude the private sector from developing capacity in the market – the bank market globally has demonstrated a lack of appetite for long-term lending in developing markets and increasingly, also in developed markets.

   ANZ does not view EFIC as a competitor, whether it's providing guarantees, insurance or direct lending. EFIC, like all other ECAs globally, complements ANZ's risk, capacity and tenor appetite.

2. **Draft recommendation 5.2: limit EFIC's role to SMEs with turnover of no more than A$25mln.**
   Draft recommendation 10.4: remove EFIC's ability to provide direct loans.

   ANZ understands that the consequence of these recommendations will be to prevent EFIC from offering medium and large size corporates the "classic" ECA product: the "Buyer Credit". Under a Buyer's Credit, the ECA supports an exporter's push into foreign markets by part-financing the foreign buyer's purchase of the exporter's product.

   As a result, medium and large Australian exporters may be unable to compete against offshore competitors when the importer asks for ECA-supported finance. This approach to finance on the part of the buyer/importer is a frequent occurrence in developing markets such as most Asian markets (and is increasingly seen in developed markets) and as mentioned above, at the present time some foreign ECAs are aggressively supporting such activity.

Case Study – in the past decade, ANZ (with EFIC's support) has provided commitments of over A$300 million in 5 separate transactions, supporting Australian exporters in winning supply contracts for infrastructure for the governments of Sri Lanka, Indonesia and Trinidad and Tobago. These countries do not have sufficient access to medium – long term private sector provided export finance for the purchase of equipment and services from Australian suppliers. They rely on ECA-supported loans to develop infrastructure and typically scrutinise ECA support when evaluating the tenders of various suppliers. Suppliers from other countries offer Buyer Credit ECA-supported loans.

The recommendations would also preclude EFIC from leveraging its knowledge of difficult markets for the benefit of Australian companies turning over more than A$25M.

Case study – EFIC's arrangements with the Asian Development Bank (ADB) have allowed banks to support exports of coal from Australia to Pakistan, which has otherwise been off-limits for commercial banks to provide risk cover. There are a number of developing countries throughout the world which are destinations for Australian exports (especially commodities) for which commercial banks have very limited bank and country limit but for which transaction sizes are growing with larger shipments and historically high commodity prices. Banks will look to place this risk with EFIC in order to provide the appropriate cover for the Australian exporter.

ANZ also understands that for Buyer's Credits for SMEs, such financings could only be provided based on the provision of EFIC's guarantee to a bank rather than direct loans. Commercial banks will generally not offer ECA supported Buyer's Credits if the transaction size is <A$25M, on account of the higher transaction costs associated with cross-border, multi-party transactions.

We know of no other ECA that has the constraints recommended by the PC, i.e. limiting support to SMEs and in fact, foreign ECAs most frequently support medium to large sized exporters.

3. **Draft Recommendation 10.1: EFIC's support for onshore resource projects should cease, as there is no clear market failure affecting access to finance for these projects**

The analysis in the Draft Report does not fully take into account the current Eurozone economic crisis and de-leveraging of balance sheets by several of the world's largest banks resulting in lower risk appetite and liquidity capacity in global bank markets, coupled with the increasing demand for liquidity in Australia.

The European banks' deleveraging process is still playing out. Morgan Stanley (Nov 2011) estimates the European banks' deleveraging will total EUR1.5-2.5 trillion over two years. European banks have largely exited the Australian market: 3 of the top 10 lenders in the market in 2010 were European but in 2011 there is not a European bank in the top 10.

This contraction in participants supplying credit and liquidity capacity is occurring at a time when demand is expected to increase exponentially. ANZ research shows the project finance market in Australia was A$10.4bln in 2010 and A$15.2bln in 2011. ANZ expects the Project finance debt requirement to be A$109bln in 2012 (most of which is to come to the market in the second half of the calendar year) and A$120bln in 2013. These requirements exclude other activities requiring bank funding such as corporate capital expenditure, refinancing and M&A activity.

Commercial banks (Australian banks and foreign banks operating domestically) alone cannot satisfy that demand and as risk appetite and liquidity has become constrained and demand in the market increases, ECAs have emerged to fill the gap. Today ECAs cornerstone the financing packages for many major projects.

Case study, APLNG – "Basis Point" (5 March 2012) reports that Project finance for the APLNG project in Gladstone is in documentation stage and that two thirds of the ~7.5bln debt is to be provided by Export Credit Agencies, The Export-Import Bank of China and US Exim. ANZ considers it unlikely that a project financing of this scale and complexity could have been financed by commercial banks and/or other private sector sources alone. Furthermore, ANZ is aware of several other domestic projects in the resources and infrastructure segments, of a similar scale to APLNG, where, for similar reasons, ECAs are set to "cornerstone" the debt packages for those projects.

Projects (in particular) cannot access the capital markets (e.g. because of their progressive drawing profile during long construction periods). They rely on bank market capacity and ECA support. In addition to filling the absolute capacity need, ECAs manage a market "failure" by provide longer-term financing (whether via guarantees, insurances or direct lending) that commercial banks are unable to offer without their support: this serves a vital role in more closely matching the term of the financing with the life of the project.

The Draft Report suggests that "problems attracting finance are related to individual projects characteristics" (p.100). In ANZ's experience the issues regarding access to finance are primarily relate to the imbalance in supply and demand.

It is open to the government to abide by the PC's recommendation and leave the funding gap to foreign ECAs. However, those ECAs will be pursuing their own national interest. In most cases this means insisting on foreign equity in Australian projects and/or that the projects import goods and services from outside of Australia.

ANZ would be pleased to discuss this letter and its earlier submission further with the Commission.

Yours sincerely

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