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The ongoing relevance of Export Credit Agencies

SUMMARY

In the wake of the global financial crisis (GFC), corporates and banks continue to experience difficulty funding medium and long-term export finance.

In this context, export credit agencies (ECAs) will continue to play an important role by providing a range of financial products to support international trade.

Importantly, ECAs will inevitably need to continue to provide support for both day-to-day trade flows and the longer term financing needs of large-scale projects, in all geographies.

BACKGROUND

Before assessing the role of any individual export credit agency (ECA) in today's market, it is perhaps appropriate to first discuss the role that ECAs have provided historically.

Like all institutions, ECAs have been forced to adapt to market conditions. The past 5 years have perhaps seen the most turbulent market conditions in recent history with the Global Financial Crisis (GFC) which began to manifest itself half way through 2007 and by 2008 was in full force. The GFC caused unprecedented upheaval in the world's financial markets. The impact of this upheaval and associated regulatory changes are still emerging.

Prior to the GFC, the main role of ECAs was to support exports into emerging markets or to weaker credits where political or credit risk elements were not deemed strong enough by lenders or indeed the debt capital markets generally to facilitate the buyer/ borrower gaining access to sufficient liquidity to fund the purchase of the goods or services. ECAs provided a vital facilitation role in allowing emerging markets to access developed market financing for tenors and amounts. In turn, this allowed the purchase of big ticket items of capital equipment and services.

ECAs have proven particularly relevant for large project financings, where, prior to the GFC, they supported projects in emerging markets where the borrower typically comprised a special purpose vehicle (SPV) set up on a non recourse or limited recourse basis to the project sponsors (who provided the initial equity to the SPV). The importance of ECA support for project financing manifested itself in a special appendix to the OECD Consensus Rules, which comprise a specific set of guidelines relating to project financings, allowing for extended tenors and sculpted repayment profiles. Such specific frameworks also exist for large aircraft financing, ships and renewable energy projects.

The GFC added a new dimension to the role of the ECAs. They continued to provide support to emerging market borrowers and indeed faced even greater demand to fulfil this role.

However, they also became providers of liquidity to borrowers in developed markets as the interbank lending market broke down.

The increased importance of the role of the ECAs can clearly be seen by the table below that sets out the sizeable increase in the annual amount of new business insured or lent under the medium and long term Export Credit Insurance programs by members of the Berne Union. In 2006, prior to the GFC, these programs covered new business of USD127bn, by 2009 just after the peak of the GFC the amount of new business covered in a year had risen to USD190bn.

MLT New Business - insured during each year USD Millions	2006	2007	2008	2009	2010
Sovereigns	13,904	12,765	11,385	24,157	11,115
Other Public	23,828	27,180	23,608	30,345	26,336
Banks	6,330	8,790	6,799	6,091	5,708
Corporates	21,870	42,073	45,622	51,541	50,435
Projects	5,588	2,613	3,419	7,300	13,771
Unspecified	47,802	39,101	51,393	44,604	53,829
Lending	7,570	9,599	11,366	26,552	11,864
TOTAL	126,891	142,120	153,591	190,589	173,056

Source Berne Union web site Statistics www.berneunion.org.uk

REFORM INITIATIVES

ECAs responded to the GFC by increasing their credit lines and with the introduction of new programs. For instance, listed below are a selection of the initiatives that were “under consideration” at a Special Meeting of the Berne Union Asian Regional Cooperation Group, according to a joint statement issued on 19 November 2008:

1. Measures being or to be taken by the government

KEIC - Korea

- Possible additional capital injection to be decided in December 2008 – -US\$ 260 million for 2009)
- Increase of the annual export insurance limit from \$130bn for 2008 to \$170bn for 2009.

TEBC - Taiwan

- Establish a separate fund for additional reinsurance capacity in November 2008.

2. Measures under consideration by the government

EFIC - Australia

- Consideration of specific transactions on the Government National Interest Account.

NEXI - Japan

- Considering that the new special company, into which NEXI will be converted, will have adequate capital so that the new company can respond to increasing demand from its clients.

3 Measures under consideration by the multilateral agencies

ASEI - Indonesia

- Multilateral institutions operating in Indonesia to set up funds together with local banks (pool of funds) to support trade finance/ loans for exporters. ASEI will act as the insurer.

4 Measures suggested by the ECA to the government

ASEI - Indonesia

- To add capital to enlarge underwriting capacity of ASEI.

ECGC - India

- To offer financial assistance to small and medium exporters, providing 100% indemnity instead of present 90%, with a support of US\$25 million.
- In respect of large exporters, additional indemnity over the present level of 90%, with a support of US\$50million.
- Provide larger protection from 75% to 85% in respect of cover for bank advances for exporters (both pre-shipment credit/ post-shipment cover).

ThaiEXIM - Thailand

- Proposed to the government to set up "National Export Credit Insurance Fund".
- This fund will function as a reinsurance fund to partially indemnify claims from the customers of ThaiEXIM.

OUTLOOK

While these types of initiatives were being considered by Asian ECAs, the main European and North American counterparts were also contemplating similar initiatives, at the height of the GFC.

More than four years on, the ramifications of the GFC are still being felt. Today, the consequences are impacting the economy more indirectly, through planned and implemented regulation and through various regulators' desires to prevent any chance of a recurrence of such a crisis.

Today banks continue to struggle with issues of liquidity, partly due to the Eurozone crisis but also due to the requirements that they meet certain Tier 1 capital ratios that, in many cases, require banks to reduce their balance sheets or increase equity by share issuance or through internally generated funds and often a combination of all three funding strategies. The result is that many banks are forced to restrict lending to their core clients. As a result, it is possible that large projects may not be able to access the liquidity that they require from the bank market.

Many ECAs have already recognized these issues and risks. They also understand the potential risks under the current draft of the proposed Basel III requirements, which make it unclear whether ECA covered loans will continue to receive the beneficial RWA treatment currently afforded to them. As a result, ECAs around the world are now focused on potential refinancing solutions such as:

- Vehicles enabling the issuance of covered bonds;
- The ability to issue ECA bonds which are issued by the borrower but wrapped with an ECA guarantee;
- Securitization guarantees; and
- Inclusion of export credits as eligible collateral at Central Banks.

In a recent draft position paper titled "Ways to address worsening funding conditions in export credit markets" (dated 5 March 2012), the European Banking Federation sets out quite succinctly the issues faced and some of the solutions proposed or already enacted in order to address the issue of refinancing. A copy of this paper is attached for your reference.

In summary, we expect the role of ECAs will need to continually evolve, in order to ensure that there is sufficient liquidity and risk appetite to support the day to day flow of trade and the longer term financings required of today's "mega projects". ECAs will need to respond to both the challenging market environment (and continuing Eurozone crisis) and to changes in

regulation. While it is difficult to foresee how the financial crisis may evolve, ECAs have already proven their worth as a critical tool in a government's armoury, to help facilitate and stabilize the financing of trade flows around the world.

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16 March 2012