

# **ECAs: Seeing the Forest, the Trees and the Future**

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# Outline

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- 1 Context for ECAs
- 2 Future for ECAs
- 3 Discussion

# The Context

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# No such thing as a typical ECA

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- ❑ While the mandates and roles of all ECAs are broadly similar, there is no perfect model for an ECA.
- ❑ ECA status, objectives, institutional arrangements, and government involvement vary widely from country to country.
- ❑ These differences reflect unique national circumstances and histories.

# Understanding the similarities and understanding the differences

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- ❑ All ECAs share the same basic mandate: support and encourage exports and outward investment
- ❑ ECAs provide credit and political risk insurance, guarantees, and sometimes, direct finance.
- ❑ The basic common function of an ECA is to take (or provide cover for) political and commercial risks of foreign buyers/borrowers.

# Match Four Men and Four Messages

Asking four ECA CEOs what keeps them up at night, the answers could not have been more different.....

	The ECA		The Message
1	NEXI		The competition flood gates have opened up and we need to be more customer focused.
2	USEXIM		I hope we can convince our "political masters" that we are needed for another 5 years.
3	EDC		What are we going to do with this surplus?
4	ECGD		Where has the business gone? How can we maintain these numbers of staff?

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# Different drivers

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- Private-sector risk appetite
  - To what extent is the private sector willing to take risk? And which specific risks?
  
- Attitude towards competition
  - What is the government's attitude towards competition? How does it feel about an ECA operating within a "market gap"?
  
- Other "support mechanisms"
  - Do other government "support mechanisms" exist?
  
- Attitude towards subsidies
  - What is the government's attitude towards subsidies or cross-subsidies?

# Main ECA Business Models

Model	Description	Countries
<b>Private Company acting as an Agent</b>	<ul style="list-style-type: none"> <li>Government has an exclusive arrangement with a private company that issues policies as agent for the Government.</li> </ul>	France Netherlands Germany
<b>Government department/facility</b>	<ul style="list-style-type: none"> <li>Separate department of the government operating under the authority of a government minister, secretary etc.</li> </ul>	UK Switzerland
<b>State-owned Agency</b>	<ul style="list-style-type: none"> <li>Autonomous institution owned by the government (wholly or partially)</li> </ul>	Canada, US, Japan, Finland
<b>Virtual ECA</b>	<ul style="list-style-type: none"> <li>Government is only involved in the risk taking and decision-making but has no underwriting expertise or "bricks and mortar" institution</li> </ul>	New Zealand
<b>Government Provider of Reinsurance</b>	<ul style="list-style-type: none"> <li>Government will not underwrite ST business directly, but will provide contingent reinsurance</li> </ul>	UK, Denmark, Australia

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# ECAs have never been more the same and yet never been more different

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- ❑ In the last decade, OECD ECAs have come together and successfully tackled a number of critical issues – environment, premia, bribery and corruption, product expenditure etc.
- ❑ The success at finding common ground is a testament to the heroic efforts of the OECD and EU negotiators.
- ❑ The extent of the heroism can only be measured against the differences that have arisen in ECAs systems in the past decade.

# Ongoing ECA Challenges

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- ❑ Balancing the need for be financially viable with a declining role vis-à-vis the private market
- ❑ Being able to maintain sufficient expertise to handle the deals when they come.

# The private market to ECAs: competitors, clients or collaborators?

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- ❑ Let's define the private market:
  - Sources of **capital**:
    - ❑ Banks
    - ❑ Capital markets
  - Sources of **risk capacity**:
    - ❑ Banks
    - ❑ Capital markets
    - ❑ Political risk insurers
    - ❑ Credit risk insurers
    - ❑ Surety market
  - Sources of **service**:
    - ❑ Brokers
  
- ❑ Market segments: where is there friction, or overlap?
  - ST credit insurance
  - MLT credit insurance/guarantees
  - PRI
  - Lending
  - Bonding and guarantee facilities

# ECAs are considered by the private market to be all things

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- ❑ Competitors: when ECAs are taking risks that the private sector could to help meet the “break-even” objective or for other reasons, e.g.
  - ST marketable risks
  - Increasingly, MT credit as private insurance capacity expands
  - Lending/funding
  
- ❑ Clients: when ECAs provide cover for deals that otherwise would not get done
  
- ❑ Collaborators: when ECAs provide “catalytic cover” e.g. as part of a syndicate

# Does the private sector think ECAs compete and, if so, is this bad?

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- Private credit insurers are always convinced that more risk can be taken – it is their reinsurers who might think differently
- Private insurers don't like competition based on ECAs' zero-weighting for capital adequacy purposes
- The emergence in the last 18 months of MT credit insurance appetite and capacity is noteworthy
- Under what circumstances is competition more acceptable?

# If ECAs are meant to operate within the market gap, how is this defined?

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- A system approach to defining gaps versus a transaction or product approach yields very different business models, e.g.:
  - In some countries, you can make a broad statement that the commercial banks just don't like taking long-term emerging market risk as a justification for being a direct lender.
  - In the others, you can ask each applicant whether or not they have sought private coverage first before approaching the ECA.

# In any case, market gaps must be regularly reviewed and redefined

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- ❑ Changing exporter requirements leads to different demands.
- ❑ Changing private sector risk appetites and capacity to meet demands leads to evolving market gaps.
- ❑ Just because there is now some increase in MT credit insurance capacity, does this mean that ECAs should now get out of the 3-5 year business?

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# Responding to market gaps needs imagination and adaptability

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- ❑ *Any* entity operating within the cocoon of government has a hard time picking up and receiving signals from the market.
- ❑ Private sector success or failure is so easy to measure (unlike the public sector).
- ❑ In the public sector, profitability measures are not reliable “messengers” for success or failure.
- ❑ A pro-active approach which means building relationships with private sector players, taking regular market soundings and adapting to the ebb and flow is needed



# It is dangerous to assume that status quo is the best approach

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- ❑ how the world is changing around us
  - Brazil, Russia, India and China (BRIC)
  - the developments in the private market
  - the risk environment
  
- ❑ All these point to the need for the ECA to be adaptable and able to hear and receive signals from the market.
  
- ❑ The OECD countries have learned that to ignore the rest of the WTO members on the issues of export finance is at their peril!

# ECAs are part of the Government's larger industrial and trade strategy

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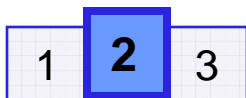
- ❑ It is easy to forget that ECAs are part of the broader government policy context of industrial policy, trade and investment promotion.
- ❑ There is a need therefore to define clearly what companies need to be internationally competitive from “upstream support” for R&D etc. to commercialization to internationalization.
- ❑ ECAs are part of the continuum of government policy support.
- ❑ Finland is by far and away the best at this.

# What do companies need to be internationally competitive?

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- ❑ An ECA, as part of the broader government, plays a role in its nation's ability to compete internationally.
- ❑ As a player, an ECA needs to offer the flexibility its nation needs.

# The Future



# Should ECAs be victims of circumstance or masters of destiny?

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- ❑ Developing a Vision of ECAs in 5 years time requires considering the external factors at play
- ❑ ECAs don't exist in isolation and their ability to influence the future is limited only by their choice to remain reactive to the changes around them
- ❑ ECAs can choose to one of two types:
  1. Those ECAs with direct orders from the government, fulfilling government assignment with diminishing role as markets become more active and with more appetite
  2. Pro-active ECA operating with the rule but "making the ECA market" as vanguards, visiting end buyers, active role with prudent risk assessment and pricing

# What are some of the key factors facing ECAs in the future?

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- The continuing development of the BRIC countries as more active competitors in the “ordinary” capital goods and projects area.
- Civil society not able to catch up with changing business trends.
- The continued hollowing out of the OECD countries’ manufacturing base.
- Basel II putting a sharper focus on the value of zero-weighted credit guarantees for banks.
- Moves towards greater fiscal oversight by OECD governments looking to squeeze out administrative inefficiencies and unsubstantiated subsidies.
- Private sector capacity is here to stay – and grow.

# All of this leads to some possible conclusions

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1. ECAs' classic MLT business will decline and it is therefore questionable whether sufficient premium income can be generated to cover operating costs and losses.
2. ECAs will continue to bump up against the private sector more and more across all business lines.
3. Competition from BRIC countries will be seen more frequently on terms outside the OECD Arrangement.
4. Pressure from NGOs on BRIC will be ineffective and so OECD ECAs will be bound by rules which their competition is not. Talk about an un-level playing field.
5. OECD ECAs still have their AAA status.
6. OECD ECAs will have difficulty maintaining break-even status. Some proactive efforts to find efficiencies will be required.



# What are some possible scenarios for EU ECAs

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- Scenario 1: EU governments withdraw entirely from the export credit business along with US, Japan and Canada
  
- Scenario 2: every effort is made to maximize private sector involvement
  
- Scenario 3: EU governments create a single EU ECA (based of course in Helsinki)



# Scenario 1: Withdrawal

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- ❑ Under this scenario, an OECD consensus is reached to no longer offer export credits
- ❑ Governments of OECD countries say “it is just not worth it anymore” and so European governments reach the conclusion that they can all withdraw and leave the business entirely to the private sector.
- ❑ Governments role then becomes an information provider – offering exporters a list of licensed brokers and insurers.
- ❑ **Effect:** playing field no longer level between OECD and BRIC. OECD countries start unilaterally re-entering sphere and credit war breaks out which can only be arbitrated by WTO.

## Scenario 2: Outsourcing

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- ❑ In this scenario, governments realize that private sector involvement is not all or nothing
- ❑ Every aspect of business from underwriting process to claims to recoveries is tested to see whether it can be outsourced to reputable private sector players.
- ❑ Ideally, whole business areas can be outsourced (e.g. similar to what happened to ST credit insurance in the 1990s).
- ❑ **Effect:** when the winds change and the private sector proves unable to unwilling to do a piece of business, the ECA infrastructure is now gutted. ECAs need to maintain certain level of flow of transactions in order to keep the expertise alive and in-house

## Scenario 3: Unification

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- All EU ECAs form a single ECA, with a multilateral shareholding structure.
- Or, using the existing platform of an EIB or Council of European Development Bank, a new set of product lines is developed.
- Performance measures of national benefit for each transaction must be developed to ensure risk-reward trade-offs of member countries are appropriate.
- EU negotiations as is.
- Effect:** more efficient. Why not?!



# Some comments on the trees

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- ❑ Local Costs and non-domestic content: why is this such a BIG deal?
  - The OECD needs to relax the rule on local cost as it is beneficial for the exporter and for the developing country.
  - If it were the DFI covering this risk, no one would think twice.
  
- ❑ Pricing & premia: time for embracing private sector practices
  - The old fashioned way: min premium benchmark + commercial risk add-ons,
  - The modern way: all in pricing and then checking that an ECA do not undercut agreed disciplines (premia rules)
  
- ❑ CIRRs: who needs them?
  - The market can take care of long-term fixed lending
  - The swap markets are very well developed.
  - Get rid of it!

# Questions / Comments?



# Thank You

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