Australian Government
Department of Foreign Affairs and Trade

Inquiry into the Export Finance and Insurance Corporation Amendment (Direct Lending and Other Measures) Bill 2014

Submission to the Standing Committee on Foreign Affairs, Defence and Trade

16 January 2015

Submission of the Department of Foreign Affairs and Trade to the Inquiry into the Export Finance and Insurance Corporation Amendment (Direct Lending and Other Measures) Bill 2014 by the Standing Committee on Foreign Affairs, Defence and Trade

Introduction

The Department of Foreign Affairs and Trade (DFAT) strongly supports the Export Finance and Insurance Corporation (EFIC) Amendment (Direct Lending and Other Measures) Bill 2014 ('the Bill') which will increase the number of exporters eligible for EFIC assistance and reduce the time and excess paperwork required for many transactions EFIC conducts with small- and medium-sized enterprises (SMEs), thereby making a real and material contribution to the growth prospects of many Australian businesses.

About the Export Finance and Insurance Corporation

EFIC was established by the *Export Finance and Insurance Corporation Act 1991* (the 'EFIC Act') to act as Australia's export credit agency. It is a self-funding statutory authority under the *Public Governance, Performance and Accountability Act 2013* (the 'PGPA Act'). EFIC exists to support the growth of Australian businesses internationally. It does this by providing financial solutions, risk management options and professional advice when the private market is unable or unwilling to do so. This is referred to as EFIC's market gap mandate.

EFIC provides financial support to exporters on one of two accounts: the Commercial Account (CA) and the National Interest Account (NIA). The CA operates on a commercial basis, with EFIC's Board determining whether or not to support particular transactions. The NIA is managed by EFIC on behalf of the Australian Government. Decisions about transactions on the NIA are made by Government and then managed by EFIC.

EFIC's core business is the provision of financial support to Australian SMEs and it continues to improve its practices to enhance SME access to its services. The vast majority of Australian exporters are SMEs. Market data sourced by EFIC shows there are 44,000 exporters in Australia. Most of these exporters (37,000) have sales of less than $10 million per annum and 34,000 have sales of less than $5 million per year. Due to the small size of most SME ventures, the dollar value return on a bank's investment is often considered too low for them to become involved in the transaction.

EFIC has a specialist director of SME origination and staff in Austrade offices in Melbourne, Perth and Brisbane to enhance its service delivery to SMEs around Australia. Recent measures to simplify documentation and streamline the SME application process are expected to deliver further growth in EFIC's SME business. In 2013-14, EFIC supported 210 transactions to SMEs out of a total of 219 transactions.

The EFIC Board and management assess all requests for assistance on the basis of the commercial viability of the exporter as well as evidence of the market's inability to provide the financial solution required. Due to its market gap mandate, EFIC's business tends to be concentrated in emerging economies such as Papua New Guinea, Sri Lanka and Mongolia. In 2013-14, the majority of transactions supported by EFIC were for trade with emerging markets.

The EFIC Board consists of nine members, including a government member, the Secretary of the Department of Foreign Affairs and Trade. All Board members, apart from the Managing Director, are appointed by the Trade and Investment Minister. The Managing Director is appointed by the Board. The Board brings a strong commercial perspective to the oversight of EFIC while understanding that EFIC is a statutory body, answerable to the Australian Parliament. EFIC Board members have expertise and experience in finance, banking and a range of relevant industry sectors. They are well connected within the domestic market and have strong international experience.

Under section 56 of the EFIC Act, the Board is required to ensure that the capital and reserves of EFIC at any time are sufficient. Although not an authorised deposit-taking institution, EFIC bases its assessment of capital adequacy upon best-practice prudential standards and calculations used for regulating banks. Generally, the Board aims to maintain a ratio of 16 per cent of risk-weighted assets, including callable capital. EFIC ended the 2014 financial year with a capital adequacy ratio, including callable capital, of 22.5 per cent.

EFIC's commercial account operations are entirely self-funding and the pricing of EFIC's products and services do not undercut the private sector, nor undercut pricing for comparable risks when private sector support is absent. Section 55 of the EFIC Act requires the EFIC Board to make a recommendation on the level of dividend EFIC should pay to the Commonwealth for that financial year. The Minister may approve the recommendation or direct EFIC to pay an alternative amount. Since its inception, EFIC has consistently made a profit and returned a dividend to the Commonwealth. A dividend of $18.15 million was paid to the Government in December 2014 which was equivalent to 75 per cent of EFIC's commercial account profit for the financial year 2013-14.

Australia is a participant in the OECD Arrangement on Officially Supported Export Credits, a framework for the orderly use of export credits. The Arrangement aims to foster a level playing field by ensuring that competition between exporters is based on the quality and price of goods and services, rather than the most favourable officially supported financial terms and conditions.

About the EFIC Amendment (Direct Lending and Other Measures) Bill 2014

The Export Finance and Insurance Corporation Amendment (Direct Lending and Other Measures) Bill 2014 (the 'Bill') removes the word 'capital' from capital goods in the definition of an eligible export transaction in Section 3(3) of the EFIC Act. This will increase the number of exporters eligible for EFIC assistance by allowing EFIC to lend directly for the export of all goods, not just capital goods.

Under the current EFIC Act, EFIC can only lend directly in support of capital goods exports. This means EFIC cannot lend for exports of many of the products in which Australia excels, like pharmaceuticals, or consumer goods like food and wine. ABS data shows that only five per cent of Australian goods exports are capital goods. The amendment enhances EFIC's capacity to support SMEs by allowing it to lend for the other 95 per cent of goods exports, thus improving the export potential of Australian SMEs.

The amendment will also support the Government's deregulation agenda and benefit exporters by reducing the time and paperwork required to access EFIC support. The new direct lending arrangements will remove the need for exporters of non-capital goods to obtain a guarantee from EFIC before they can secure funds from a bank, halving the due diligence processing time and eliminating the need for two sets of documentation and legal fees.

The ability to lend directly for all types of goods will also open up EFIC support to small businesses seeking smaller sums of finance. The current guarantee arrangements limit the pool of businesses EFIC can assist to those a bank has appetite to fund, regardless of EFIC's credit assessment. However, banks are often unwilling to fund smaller export finance transactions, even with a guarantee, thereby excluding many smaller exporters from accessing EFIC support.

A 2014 survey by the Export Council of Australia found that one third of respondents who needed export debt finance were either still obtaining finance or had failed to do so. More than 75 per cent of respondents found the ease of accessing finance was moderate to difficult. The ability to lend directly for all goods will therefore make EFIC support more accessible for smaller SMEs.

To ensure the direct lending changes do not bring EFIC into direct competition with private sector financiers, the Government has decided to apply competitive neutrality principles to EFIC. Consistent with this, the Bill amends Sections 61A and 63A of the EFIC Act which currently refer only to tax-equivalent payments and debt neutrality charges in respect of the short-term business that EFIC sold off in 2003.

Competitive neutrality is an arrangement that aims to promote efficient competition between public and private businesses by minimising the net competitive advantage government businesses have over their private sector competitors simply by virtue of their Government ownership. To achieve this outcome, EFIC will pay a debt neutrality charge or guarantee fee, and a tax equivalent payment. The Minister would determine the appropriate arrangements that are to apply in respect of those payments.

Context of the Proposed Changes

EFIC's mandate and role has been examined through various reviews, including the 2012 Productivity Commission review. When providing EFIC with $200 million in additional capital in the 2013-14 Budget, the Government took the opportunity to review EFIC's mandate and operations in the light of developments in the Australian economy and the Government's economic agenda. In doing so, the Government took into consideration the findings of the 2012 Productivity Commission review, the Commission of Audit and the preliminary findings of the Murray Financial System Inquiry.

The Government particularly identified the important role EFIC can play in addressing the limited access Australian SMEs have to export finance. SMEs make a vital contribution to the Australian economy. They facilitate productivity growth and often pioneer new technologies and work practices before these innovations spread more broadly through an industry. The vast majority of Australia's exporters are SMEs, but traditionally they find it more difficult to secure export finance through banks, particularly when exporting to emerging markets.

The amendments to the EFIC Act proposed by the Government are aimed at sharpening EFIC's focus on SMEs and ensuring EFIC has the capacity to support Australian businesses operating in a highly dynamic and competitive international environment. The amendments should be considered alongside the Minister for Trade and Investment's annual Statement of Expectations, which is a key document for expressing the Government's vision for the role and responsibilities of EFIC.

EFIC's Environmental and Social Assessment is World Class

EFIC has a comprehensive and rigorous process for environmental and social assessment, detailed in its Policy and Procedure for Environmental and Social Review of Transactions. Drawing on standards set out in the OECD Recommendation on Common Approaches on the Environment and Officially Supported Export Credits, the International Finance Corporation Performance Standards and the Equator Principles, the Policy and Procedure is at the forefront of international best practice.

EFIC's transparency and disclosure procedures are also of a very high standard. EFIC discloses publically all possible future involvement in projects that carry the potential for significant adverse environmental and/or social impacts outside Australia (Category A disclosures). EFIC also publishes key details of all significant transactions, including the name of the client, a brief description and location of the project, the type of facility being provided and its value and the environmental category of the project on its online transaction register and annually in EFIC's Annual Report.

Aid Considerations

While some exports or projects supported by EFIC may contribute to developmental outcomes, the financial solutions provided by EFIC on its commercial account are not part of Australia's aid programme. Decisions to provide financial solutions on EFIC's commercial account are based on commercial assessments by EFIC, in line with EFIC's Credit Guidelines and Policy and Procedure for Environmental and Social Review of Transactions.

Part 2, Sect 7(c) of the EFIC Act provides that one of EFIC's functions is to administer payments under export contracts with respect to overseas aid projects. This provision relates to the ongoing management of long-term exposures generated under the Australian Government's Development Import Finance Facility which was introduced in 1980 and discontinued in 1996.

The Government has announced a reduction in development spending over the next three years from 2015-16. However, Australia will remain a significant global donor and will remain the 10th largest donor in the OECD this year.

Conclusion

With total assets worth around $640 million, EFIC's capitalisation is much smaller than that of our traditional and regional trade competitors. For example, at the end of 2013, Canada's export credit agency held assets of CAD 41.5 billion (AUD 42.19 billion) and Korea's Exim bank held assets of USD 58.2 billion (AUD 70.77 billion).

Given its limited resources, EFIC must be positioned in other ways to be able to assist Australian exporters to compete and capture a share of burgeoning regional growth. One such way is to ensure EFIC has the flexibility to develop new product offerings in response to the evolving needs of exporters.

The increased flexibility in EFIC's lending arrangements that this amendment provides will benefit small- and medium-sized Australian exporters, a key driver of economic growth. The competitive neutrality amendments will ensure EFIC continues to operate in the market gap and crowd in, not crowd out, private sector financiers.

The proposed changes will have no effect on the Government's aid budget or programming.