berneunion

YEARBOOK
2017


NAVIGATE TRADE
CREDIT RISK.
CONFIDENTLY.
Trade credit insurance
protection from an
insurer who shares your
passion for effective
risk management.
zurichna.com/
tradecredit
ZURICH INSURANCE.
FOR THOSE WHO TRULY LOVE THEIR BUSINESS.
ZURICH®

Contacts

Published by TXF Ltd on behalf of the Berne Union.

About TXF

TXF is a media, technology and events group, set up to service the corporates, traders, financiers and deal-makers that encompass the trade, commodity, export and project finance communities. TXF has a contemporary and innovative approach to delivering these markets with specialist news, high profile networking events, online and offline training and data intelligence services.

TXF now offers a unique subscription package, TXF Essentials, combining critical industry deal data, and cutting edge news and insight. For more information on how to sign up to this exclusive business information solution, visit www.txfnews.com/essentials.

About tagmydeals

TXF has pioneered an online platform that connects individuals, teams and companies to financial deals. tagmydeals collates accurate, up-to-date public deal information. It's credible, transparent, unbiased, and totally free of charge: www.tagmydeals.com

TXF

Editor-in-chief
Jonathan Bell

Editor
Sean Keating

Head of content coordination
Lucy Palfreeman

Sub-editor
Carl Morris

Production editor
John Smith

Managing director
Dan Sheriff

Co-founder and director
Dominik Kloiber

Chief technology officer
James Petras

Head of communications
Katy Rose

Operations manager
Louise Stanley

Business development
Alex Sheriff

Data analyst
Ana Jovanovic

Published by
TXF
Canterbury Court
Kennington Park
1-3 Brixton Road
London SW9 6DE
United Kingdom

Tel: +44 (0) 20 3735 5180
Email: team@txfmedia.com

www.txfnews.com
www.tagmydeals.com

International Union of Credit & Investment Insurers
Including Berne Union Prague Club
1st Floor
27-29 Cursitor Street
London
EC4A 1LT
United Kingdom

Tel: +44 (0)20 7841 1110
Fax: +44 (0)20 7430 0375

www.berneunion.org

Contents

1 Introduction

Berne Union elected officials, committees and secretariat 6

Foreword 11
Topi Vesteri, president, Berne Union

SG's report: three challenges for the industry 16
Vinco David, secretary general, Berne Union

2 Data and Statistics

Berne Union totals 22

Short-term export credit insurance

Medium- and long-term export credit insurance

Investment insurance

Prague Club Committee

Review of a year full of unexpected turns 29
Laszlo Varnai, associate director, Berne Union and Paul Heaney, associate director, Berne Union

3 Expert Analysis

MEDIUM- AND LONG TERM EXPORT CREDIT INSURANCE

OeKB: introducing Austria's more flexible national content policy 37
Ferdinand Schipfer, managing director of export guarantees, OeKB

Ten years of SERV: achievements and challenges 41
Swiss Export Risk Insurance (SERV) reports

EXIM Hungary: supporting small and large 43
Zoltan Urban, CEO EXIM Hungary

LOCAL CURRENCY FINANCING

Local currency finance: local support in a global marketplace 45
Paul Radford, chief economist at UK Export Finance

CGIF's construction period guarantee: kick-starting greenfield project bonds 47
Kiyochi Nishimura, CEO at the Credit Guarantee and Investment Facility (CGIF)

Innovative ways to invest in India 51
Bill Brown, regional vice president, Asia, Export Development Canada (EDC)

A GUIDE TO POLITICAL RISK

How political risks have disrupted trade across the MENA region 55
Karim Nasrallah, general manager of LCI

Growth opportunities high for political risk and credit insurance providers 59
Daniel Riordan, president of global political risk, credit & bond insurance at XL Catlin

The new normal of higher political risk 61
Rouben Nizard, economist for sub-Saharan Africa, from Coface's Economic Research Department

SMALL AND MEDIUM-SIZED ENTERPRISES

A new model for driving Italian SMEs worldwide 65
Alessandra Ricci, chief underwriting officer, SACE

Reaching out to exporting SMEs 67
Carl-Johan Karlsson, head of the SME business area at EKN

Taking SME support to the next level 71
Katja Keitaanniemi, executive vice president responsible for SMEs at Finnvera

3 Expert Analysis *continued*

Building and operating an MSME export credit insurance facility in Brazil 73
Marcelo Franco, CEO at ABGF, and co-author Pedro Carriço, ABGF´s credit underwriting & international relations executive manager

The importance of credit insurance for national SMEs 76
By COSEC

PRIVATE CREDIT AND POLITICAL RISK INSURANCE MARKET

Time to stand up and be counted 77
Peter Sprent, head of global financial risk at Liberty Specialty Markets and Audrey Zuck, director, A2Z Risk Services

The global opportunities for insurers prepared to embrace change 79
Jérôme Pezé, CEO and founder, Tinubu Square

Surety market developments - from local market players to ongoing globalisation 81
Rob Nijhout, executive director - International Credit Insurance & Surety Association (ICISA)

BUSINESS OPPORTUNITIES, CHALLENGES AND CHANGES

The new landscape of sovereign debt restructuring 84
Paola Valerio, head of international relations at SACE (Cassa depositi e prestiti Group)

Iran: sanction-related uncertainty is still hanging in the air 88
John Blackwell, senior communication and marketing manager at Atradius

A Cinderella story: Côte d'Ivoire 91
George Otieno, CEO, African Trade Insurance Company (ATI)

The Mozambique debt crisis – how it is unfolding and potential resolutions 95
Benoit Fugah, head of the political, economic analysis and research unit at ECIC South Africa

Argentina: opportunities for business and cooperation next door 99
Pedro Carrico, executive manager, ABGF

Introducing the BECI Local Contractors Programme 101
Bonani Dube, marketing manager, BECI

A new approach to mitigating offtaker risk in African power 103
John Lentaigne, chief underwriting officer, ATI

Oil price developments and prospects 108
Dr Rouben Indjikian, Webster University, Geneva

Risk aversion, financing and real services 111
Professor Andreas Klasen, Offenburg University, and Dr Simone Krummaker, University of Westminster

4 Member Directory

Berne Union members 118

1

Introduction

The Berne Union: Who's Who 2017

Berne Union Leadership

The Management Committee consists of:

- President
- Vice President
- 4 Committee Chairs
- 13 Member Organisations

The 13 Member Organisations are institutional positions, held by the two largest volume members from each of the ST, MLT and INV Committees, plus seven additional members drawn from amongst all four Committees on a voluntary, rotating, basis. All positions are held for a term of two years.

President:
Topi Vesteri (FINNVERA)

Vice President:
Mandisi Nkuhlu (ECIC SA)

Short Term Committee Chair:
Verena Utzinger (SERV)

Medium/Long Term Committee Chair:
Beatriz Reguero (CESCE)

Investment Committee Chair:
Christina Westholm-Schroder (SOVEREIGN)

Prague Club Committee Chair:
Chris Chapman (NZECO)

Institutional Members:

- ATRADIUS
- COFACE
- EULER HERMES
- BPI FRANCE
- NEXI
- SINOSURE
- ECGC
- ECIC SA
- EXIMBANKA SR
- SOVEREIGN
- UKEF
- SERV
- HBOR

Elected Officials

President, Topi Vesteri
FINNVERA Finland | Deputy CEO, Group Chief Credit Officer

Topi Vesteri joined Finnvera in 1998 as Executive Vice President responsible for running Finland's officially supported export credit and guarantee system. Having managed Finland's state backed ECA business for almost 17 years, Topi assumed the position of Deputy CEO and Group Chief Credit Officer responsible for credit and analysis functions of both Export Credit Agency (ECA) as well as domestic SME financing business of Finnvera, in October 2015.

Topi is Chairman of the Board of Finnish Export Credit Ltd, the subsidiary of Finnvera responsible for providing funded export credit solutions as well as Finnvera's venture capital subsidiaries Veraventure Ltd and Seed Fund Vera Ltd. Topi also served as Board Member of Finnfund (Finnish Fund for Industrial Cooperation Ltd), Finland's official development finance agency and as a board member of Finnish Credit Insurance Ltd.

Before joining Finnvera, Topi had a 17-year banking career in Postipankki, one of Finland's leading commercial banks. During this period he held various managerial positions in Helsinki, Tokyo and London covering debt capital markets, corporate banking, leasing, international network and lending as well as general management of the bank's overseas and domestic subsidiaries and business units.

Within the Berne Union, Topi was appointed President in 2015, was Chairman of the Medium and Long Term (MLT) Committee in 2009 – 2011 as well as Vice President of the Union in 2003 – 2004.

Topi holds a Master's Degree in Law (LL.M.) from the University of Helsinki.

Vice President, Mandisi Nkuhlu
ECIC South Africa | Chief Operating Officer

Mandisi Nkuhlu holds the position of Chief Operating Officer at the Export Credit Insurance Corporation of South Africa SOC Limited ("ECIC").

ECIC is the official Export Credit Agency of South Africa and provides political and commercial risk insurance to facilitate export trade and investments outside South Africa.

Mandisi has worked for various financial institutions involved in the financing of infrastructure development. He spent five years at the Development Bank of Southern Africa ("DBSA") as the legal advisor to the Project Finance team responsible for cross-border private sector projects. During his stay at DBSA, he was seconded to Masons in London, a law firm specializing in Public Private Partnerships.

Later on, Mandisi worked for the Industrial Development Corporation of South Africa Limited ("IDC") in the International Finance Department dealing with export finance transactions. Prior to re-joining ECIC in February 2011, he was a Director of Export Finance at Standard Bank of South Africa.

Mandisi has worked on numerous infrastructure and mining projects. He cut his teeth in the Mozal I and Mozal II projects and worked on the Nelspruit Water PPP Concession, the first bank financed water PPP Concession in South Africa.

Mandisi holds a B Iuris and the LLB degree from the University of the Western Cape. He is an admitted attorney. He furthered his studies at Wits Business School – Management Advancement Programme, Senior Executive Programme and at the UCT Graduate School of Business – Executive Leadership Programme.

Short Term Committee

ST Committee Chair, Verena Utzinger
SERV Switzerland | Senior Relationship Manager

Verena Utzinger has been working for Swiss Export Risk Insurance 'SERV' since Spring 2000. Initially she joined the underwriting department, with responsibility for key accounts, financial and various other institutions in French-speaking Switzerland, as well as Ticino and a part of German-speaking Switzerland.

Verena is now responsible for relationships with financial institutions, new customers and bilateral chambers of commerce, as well as coordinating collaboration with the private insurance market within the framework of reinsurance agreements.

Verena is a Member of the Board of SABC Swiss African Business Council in Switzerland.

As the Head of the Swiss Delegation at the Berne Union, she represents SERV at various Berne Union meetings and also appears regularly as a speaker at other external events.

ST Committee Vice Chair, Chunyi Xiao
SINOSURE China | Deputy General Manager of Export Trade Credit Underwriting Department

Ms. Xiao Chunyi, Deputy GM of ST Export Trade Credit Underwring Dept, in charge of large credit approval. She has been working in Sinosure since its establishment in 2001.

Medium / Long Term Committee

MLT Committee Chair, Beatriz Reguero
CESCE Spain | Chief Operating Officer

Beatriz Reguero joined CESCE, the Spanish Export Credit Agency (ECA) in 1999 as Deputy Director of the Country Risk and International Relations Department. In 2012, she became the COO (Chief Operating Officer) of the State Account Business at CESCE. Between 1992 and 1999 she held different positions in the Spanish Public Administration, mainly within the Ministry of Economy, related to Trade responsibilities.

Within the Berne Union, she was appointed Chair of the Short Term Committee for the period 2010 – 2012.

Beatriz graduated in Economics from the University of Madrid in 1989.

MLT Committee Vice Chair, Hendrik Holdefleiss
EULER HERMES Germany | Head of Division Underwriting & Risk Management

Dr. Hendrik Holdefleiss studied economics at the Universities of Regensburg, Barcelona, Muenster and holds a PhD in international economics of the University of Kaiserslautern. He started his career at Deutsche Bank AG and joined Euler Hermes in 1999. In the State Export Credit Guarantee Division Hendrik Holdefleiss headed the Economic Research Department carrying out analysis of trade policy and country risk.

He has been in charge of international relations and cooperation in international institutions (EU, OECD) for several years. Later he was in charge of Public Relations of the Export Credit Guarantees at Euler Hermes. Since 2011, as Head of Underwriting and Risk Management, he is responsible for the global business of the German ECA.

Investment Insurance Committee

INV Committee Chair,
Christina Westholm-Schroder
SERV Switzerland | Senior Relationship Manager

Christina is responsible for all aspects of Sovereign's transactional underwriting, with particular focus on capital markets and financial institution business. Christina is also relationship manager for a number of Sovereign's ECA and Multilateral Agency clients. Christina has worked in the political risk field for more than 30 years. Prior to joining Sovereign, she was with the Multilateral Investment Guarantee Agency (MIGA) for 11 years.

She joined MIGA as one of its first employees in 1988 and worked in several capacities, including regional manager for Asia and Latin America and most recently as manager for syndications and business development. In this capacity, she was also responsible for the Agency's re- and coinsurance activities.

Prior to MIGA, Christina worked as a political risk insurance broker in the Bank of America's global trade finance department in New York and as manager in the political risk department at AB Max Matthiessen in Stockholm, Sweden. Christina has an MBA in international business from Stockholm School of Economics and Business Administration and an MBA in finance from New York University.

INV Committee Vice Chair, Nuria Gorog
ZURICH Switzerland | Senior VP – Head of Credit & Political Risk, Continental Europe

Nuria Gorog joined Zurich in January 2007 as Senior Vice President and Regional Manager for Continental Europe – Credit & Political Risk. Prior to joining Zurich, she served seven years as Chief Underwriting Manager in Continental Europe for Unistrat Coface (Coface Group). Previously, she was Business Development Manager -Credit & Political Risk- in the in house insurance broker of Natixis (Cauri).

Ms. Gorog holds a Master's Degree in Law from the Universidad Autonóma of Madrid, a Postgraduate Degree ("DEA") in International Prospective from the University of Paris V and a specialisation in International Trade from the "Ecole Européenne des Affaires"/EAP in Paris.

She is fluent in French, Spanish and English. She is a former Chairman of the Single Risk Committee of the International Credit Insurance & Surety Association (ICISA) 2014-2015 and an active participant in the Bern Union.

Prague Club Committee

PC Committee Chair, Chris Chapman
NZECO New Zealand | Head of New Zealand Export Credit Office

Chris joined New Zealand export credit agency 10 years ago, when it was in its formative stage, and has supported NZECO's growth both in terms of an expanded product range, as well as increased exports and exporters supported. Chris has previously practiced law in New Zealand and holds a Masters in International Business, as well as a law degree, from the University of Otago.

Berne Union Secretariat

Vinco David
Berne Union | Secretary General

Vinco David was appointed Secretary General in 2017. A Dutch national, he has over 30 years' experience in various aspects of credit and investment insurance, including more than 20 with leading international credit insurer Atradius, in diverse roles across strategy, product development, economic research, project finance, underwriting and claims management.

Most recently Vinco served as a Management Team Member of Atradius Dutch State Business, the Export Credit Agency of the Netherlands. Prior to this he has held positions at the Berne Union Secretariat and the Netherlands Ministry of Finance. He holds an MA in political science and international relations and a BA in economics and Italian language and literature from the Free Reformed University of Amsterdam.

Laszlo Varnai
Berne Union | Associate Director
(MLT Committee Support)

Laszlo joined the Secretariat in June 2015, to advise it on legal matters and to support the Committees (primarily the ST Committee) and Specialist Meetings. Since April 2017, Laszlo has been supporting the MLT Committee.

He gained focused experience in policy analysis as he worked for EXIM Hungary for more than 5 years, leading the ECA's international relations (OECD, EU and Berne Union) and ensuring compliance with WTO, OECD and EU regulations, as well as the international sanctions.

Laszlo graduated in law from Peter Pazmany University, holds a DipHE in Law of England and Wales and the European Union from the University of Cambridge, and a diploma of economic diplomacy from the Károli Gáspár University in Hungary.

Johannes Schmidt
Berne Union | Associate Director
(INV Committee Support)

Johannes joined the Secretariat in April 2016. He is responsible for supporting the chair and vice chair of the INV Committee as well as its members (public, private and multilateral insurers) with regards to their membership. In his role Johannes is also supporting the INV Technical Panel, a subcommittee where technical underwriting issues are discussed amongst INV Committee members.

Before joining the Berne Union, Johannes was an underwriter in political risk insurance and untied loans for Berne Union member PWC, managing the German Government's Investment Insurance and Untied Loan Guarantee Programmes.

Johannes holds a Masters Degree in International Business of Macquarie University Sydney and a Diploma degree in Economics at the University of Ulm.

Paul Heaney
Berne Union | Associate Director
(Media & Outreach)

Paul manages internal and external communications at the Secretariat, having joined in July 2016. His responsibilities include managing the production of the 'BUlletin' Newsletter and coordinating the Secretariat's involvement with the Berne Union's Outreach Task Force.

He has 7 years of experience working in communications, events and publications relating to the trade finance and export credit insurance industry.

Prior to joining the BU, Paul worked as a Conference Producer for Informa, one of the world's largest events and publications companies, listed on the FTSE 100.

Paul holds a BA in Philosophy from Trinity College Dublin and an MA (also in Philosophy) from King's College London.

Nicole Cherry
Berne Union | Team Assistant
(Logistics and Business Administration)

Nicole joined the Secretariat in July 2016. Nicole provides assistance to the Secretariat Team, manages the office and is a key player in the events and logistics management of the Berne Union meetings.

She moved back to the UK in December 2015 after living in Tanzania for six years working with NGO's and running a volunteer organisation.

Nicole holds a Bachelor of Arts Degree in Film Production from Roehampton University, London.

Foreword from the Berne Union President

Topi Vesteri, Berne Union President, Deputy CEO and Group Chief Credit Officer at FINNVERA, reviews the developments through the past year and looks to increased growth in business for 2017.

2016 might well have zipped past as quickly as a contactless payment.

A lot has happened, and a lot is still happening, both in the Berne Union and in the wider world.

As is traditional for the President's contribution to this Yearbook, I will take the opportunity to briefly survey the current infrastructure of international trade, comment upon the major themes influencing the business of our members and provide a summary of some recent Berne Union initiatives.

I shall start slowly and close to home, however, with updated business figures and a rough account of the 'state of the industry' according to the Berne Union.

A sanguine 2016 marked by rebounding growth in new business but caution concerning claims

2016 year-end results paint quite a healthy picture for our industry overall.

All Berne Union committees bar MLT[1] reported growth in new business: a welcome return from 2015's dip – which was largely a consequence of the crash in commodities prices, and corresponding fall in the value of world trade.

$1.9 trillion of new business underwritten by Berne Union members in 2016 means that we continue to provide support equivalent to over 11% of world trade.[2]

Prague Club Committee (PCC) members showed particularly impressive growth in 2016, increasing almost 40% on 2015 levels. While new business of $38.7 billion is tiny in comparison to the other committees of the Berne Union, this reflects the positive development of PCC member companies, as well as the business they support.

At the same time, 2016 saw high levels of claims across all Berne Union Committees – over $6 billion in total – sustaining the trend of 2015.


Topi Vesteri

Paying claims is of course a natural process for insurers, and indeed rather a good advertisement for the value of our products. It is important however that the levels of claims are sustainable relative to the premium income which supports these payments.

There is no indication so far that they are not, but since we are still in a rather soft pricing phase of the insurance cycle, with high competition in the private market, a sustained period of high-claims without a corresponding rise in premium levels, could see loss-ratios rising to a level which affects the insurers' businesses.

This is something members of the Berne Union will keep a close eye upon in the coming months.

Anticipating more growth in new business for 2017

Looking into 2017, we can observe some indications of the direction of travel, on the basis of initial reporting of results for the first half.[3]

New MLT commitments reported for the first half of 2017 are around $70 billion – some 27% higher than in the same period last year. Since second half results tend on average to be 20% higher than first, we may see MLT volumes for the full year reach $160 billion – back up to the levels of 2013/2014.[4]

Volumes of new INV cover provided so far look relatively stable and on current indications we expect to see similar results to 2016.[5] The majority of growth in INV over the past two years is reported under the INVO category, indicating (predominantly) cross-border medium/long-term export credit insurance provided by private members of the Berne Union.[6]

Short Term business is the most fluid, and in some ways the most indicative of the immediate health of the global economy. With credit terms of 12 months or less, it is also less easy to draw inference from deal-pipelines ahead of time.

Prague Club Committee members showed particularly impressive growth in 2016, increasing almost 40% on 2015 levels.

The fact that turnover business covered is only calculated at year end makes it difficult to compare half year results in short term business. Combined with recent changes to some of the definitions used for Berne Union data reporting – more on this later – we don't yet have a clear picture for new short term business. However, based on initial reports of aggregate credit limits, combined with the results of the other committees, there is certainly some indication of growth also in the short term space.

Claims still high, but manageable

2017 so far is showing a continuation of the high claims seen in 2016:

In MLT, $1.4 billion for 2017 H1 is 13% up on the same period last year, indicating that we may well exceed $3 billion for full year once again. Similarly, $200 million INV claims paid in the first half of 2017 is a full two thirds of the $300 million total paid in 2016 – again suggesting another elevated year, with respect to claims.[7]

However, it should be noted that claims arising from business with the longer tenors of MLT/INV are conspicuously 'lumpy' and it is difficult to make any accurate inference from the results for a 6-month period only.[8]

One notable trend, also following on from what we have seen in 2016, is that the vast majority of MLT claims relate to commercial (as opposed to political) risks. In 2016 90% of MLT claims paid related to commercial risks and 2017 is showing a similar ratio for the first half.[9]

In short term, indications are that claims levels will remain historically high, but still lower for 2017 H1 than for the same period last year – a positive development. A rough expectation from figures seen so far is that they might come in somewhere around $2.5 billion by year end.

2017 so far then, appears to show a natural continuation of the trends seen in 2016: positive growth in new business, healthy demand and a continued appetite for risk from our members, despite an elevated claims environment.

Trade infrastructure, trade barriers and political risks

Taking a step back for a moment to assume a more external view, there is a corresponding mix of positive and negative factors at play.

With respect to trade, at least, the banking industry and broader infrastructure for international finance is in a fairly robust state at present and there is generally good availability of funding.

Some new markets have opened (or re-opened, rather) and many of us have been looking with interest at opportunities arising from renewed access to economies like Argentina and Iran.

Welcome news in banking regulation has seen (some) ECA-supported transactions granted an exemption to the Basel-mandated Leverage Ratio and positive steps at The International Working Group on Export Credits are moving us at least a few small steps closer to establishing a set of universal guidelines for export credits, beyond the OECD framework.[10]

Despite this, however, there are a number of real and concerning barriers to trade which give us pause:

Political shocks, leadership changes and the emerging threat of nationalistic protectionist forces in several countries all present significant challenges for harmonious international trade.

Iran's reintegration into the global trade system has faltered due to uncertainty surrounding remaining sanctions. As well as this, in some places political risks have increased substantially:

Nuclear threat, and the gulf between North Korea and the international establishment is as wide and as tense as it has been at any time since the 1953 armistice; sectarian conflict and terrorism in the Middle East and in Europe disrupt ever more lives, occupy greater resources and feed more headlines.

The degree to which this environment indicates or produces an increasing demand for political risk insurance cover is debatable. As ever there is a delicate balance between the forces driving demand and those setting capacity.

Despite these challenges, most Berne Union members have been relatively optimistic about the near future; a sentiment underpinned by the early figures we have seen, outlined above. Indeed, ours is an industry which is more resilient than most and while there is currently a lot of uncertainty, the value of credit insurance in an uncertain environment is well understood.

> **Some new markets have opened (or re-opened, rather) and many of us have been looking with interest at opportunities arising from renewed access to economies like Argentina and Iran.**

Perhaps one of the most telling indicators of the health of our industry – and the importance of credit and investment insurance in the current environment – is the number of governments and institutions currently expanding or setting up new export credit facilities. In the past year, The Berne Union's Prague Club Committee (our seedbed for nurturing smaller and emerging export credit insurers) has accepted three new applicants and granted guest status to a further two institutions just on the cusp of establishing their export credit business.[11]

Bringing together this global network of industry practitioners is the raison d'être of the Berne Union, and the more we invest in the collective understanding of the industry, the more resourceful we all ultimately become.

Advances in technology

Global partnerships and knowledge sharing make more sense now than ever. The unprecedented pace of technological change and the immediate impact of this on everything from high-level business practice to the behaviour and expectations of end-consumers, have a huge impact on trade.

Digitisation, fintech, insure-tech, blockchain etc. are both exciting and taxing at the same time. As we are now beginning to see global banks and the biggest financial institutions stepping in to take the lead on development of these technologies in a serious way, it is clear that the so-called 'disruptive' trends are now very much in the mainstream; setting a standard for the future of all of our businesses.

As ever, there is a need to keep up with the curve and a great opportunity to improve business flow and efficiency through some of these developments, but also a serious challenge – such changes come with considerable costs in terms of time, money and other resources and it is important to ensure these investments achieve their objectives.

The inextricable symbiosis of trade and technology also brings other risks. Cyber security may well turn out to be the supreme challenge of our times and one we must take serious heed of, both as insurers of trade risk and as financial institutions ourselves. As business leaders, even as we look to the future, we must also be prepared for the present.

Creative approaches to supporting SMEs

With its adroitness for efficiency and cost-reduction, one of the challenges this kind of new technology is set to tackle is the market-gap facing smaller business who, in a globalised world, often find themselves caught between the need to expand externally, to export and to trade on global horizons, and a paucity of finance in an environment where exigent compliance and narrow margins make small transactions unprofitable for lenders.

Providing better support for SMEs is a critical objective of many Berne Union members, especially those with a mandate to fill market gaps, and several colleagues have contributed thoughtful essays on the subject within this publication.

New technology certainly helps improve efficiency, and there is some great progress being made in this area. But it is also important that we find new ways of working. To better understand and better serve these clients we must first educate them to better understand us, and the environment they compete in.

Many ECAs are now actively originating business – stepping in to cover the gaps in financial infrastructure which are usually denied to these sorts of clients.

Direct lending is one way to circumvent the challenge for clients beneath the threshold for reasonably-priced bank finance, and this is an approach taken by more and more ECAs. For growth-oriented SMEs and mid-cap companies especially, where the initial financing stage is so important to their development, this can provide an essential life-blood.

Expedited applications, flexible risk policies, automatic claims processing and integrated products are amongst other creative solutions Berne Union members have been implementing.

Bringing together this global network of industry practitioners is the raison d'être of the Berne Union, and the more we invest in the collective understanding of the industry, the more resourceful we all ultimately become.

The ultimate goal and the likely future of service to these sorts of clients is to become a genuine 'one-stop-shop' for all their exporting needs – bringing together the various moving parts and demystifying the complexities of international trade.

Berne Union projects

These are all important subjects for the Berne Union. Through our meetings, webinars, publications and specialist working groups, we continue to apply our collective efforts towards tackling the biggest issues in trade finance and at the same time, improving access to knowledge and understanding of the industry.

Through the course of the past year the Berne Union has been pursuing a number of substantial initiatives several of which are already bearing significant fruit.

Getting the data right

Data reform – an on-going BU project for a number of years – has gained new momentum under the direction of a specialist Data Task Force, established towards the end of 2016.

The objective of the Task Force has been to improve the detail, quality, consistency and utility of Berne Union data, without significantly increasing the reporting burden for members.

Industry sector reporting will introduce a finer grain of detail and add depth to our analysis of data. By recognising and accommodating the divergence between real-world business lines and the artificial structure of the Berne Union committees, we should be able to present a better overall picture of the industry and the business our members are involved in.

This is a huge undertaking, presenting both technical and pragmatic challenges: refining definitions, database structuring and surveying the capability of members to accurately capture and report the information requested. The progress we have made to date has been excellent and would simply not be possible without the great effort and dedication of both members and the Secretariat – to whom I offer thanks and warm congratulations.

There is still much work to be done in this area, but a proposed structure is ready to be presented to the members for approval at our 2017 Belgrade AGM, and we expect to begin reporting under the new scheme for all data from 2018 onwards.

Communications

Improvements to our data are of course incredibly valuable for Berne Union members directly, but they also add extra colour and credibility to our external communications – another area which has benefitted from high energy and increased activity over the past year.

A project commenced within the Secretariat last year to improve our communications strategy and to engage more directly and more regularly with the wider industry. This has produced a number of positive outcomes so far, including the establishment of a regular Berne Union newsletter, the 'BUlletin', and the launch several months ago, of a brand-new association website.

The BUlletin, we hope, provides a hitherto absent 'voice for the industry', providing a focal point to channel the expertise of our members, share insights from Berne Union data, and present up to date research on important topics for the industry.

For a collective of 82 member companies from 73 different countries across the globe, the Berne Union has up until now existed with a quite minimalistic online infrastructure – perhaps it is a testament to the quality of our meetings that face-to-face communication has sufficed for so long! In any case, the trend of digitisation has not passed the Berne Union by, and as of August 2017 we launched our new online web platform, combining our members only intranet with a revised external website.

The new BU web platform is both a tool of convenience and an instrument of opportunity: a more accessible (mobile friendly!) website makes collecting and distributing information or organising meetings much easier, and at the same time, the ability to connect and collaborate with geographically dispersed colleagues makes for more fruitful and more efficient engagement.

We will continue to work to develop and further improve upon all of these initiatives. The endless objective is to reflect the community and spirit of the Berne Union in all of our output.

Future plans

Next year, the Secretariat will relocate to new serviced office space in London. The physical relocation itself will be the end of a lengthy process of research and deliberation, during which we carefully considered the suitability of a number of potential European domiciles. For the time being, London still offers the most suitable accessibility for both travel and employment, but we are conscious that the unknown outcomes of Brexit may have a great bearing on this in future. The shorter lease terms standard in fully-serviced contracts allow us the flexibility to reconsider this decision in due course, when the facts become clearer.

Since March this year, the Secretariat has been operating under the able direction of a new Secretary General, Vinco David. Vinco was previously the Chair of the INV Committee, and has been an active participate of the Berne Union for many years. Along with Vinco, I would like to give recognition to the whole Secretariat team, who together are the embodiment of the Berne Union ethos: Associate Directors, Laszlo Varnai, Johannes Schmidt and Paul Heaney and Team Assistant Nicole Cherry. As President, and indeed as a Member, I am deeply grateful to all of these colleagues, and all others who support our Berne Union family with great work and dedication.

We have seen a number of personnel changes at the Berne Union in the past year and I would like to also take this opportunity to pay tribute to some of those who have worked towards building, improving and maintaining our rich and unique association:

To Michal Ron, my Vice-President until last year – an exceptionally strong leader who together with my predecessor Daniel Riordan initiated the reforms we are currently enjoying and who led the negotiations for our governance reform; to Kai Preugschat, who in his two years as Secretary General, recruited the current highly motivated and professional secretariat team, and who put the wheels in motion to get our many initiatives to come to fruition; to Laura Lind whose positive energy and tenacity imbued the Secretariat team and MLT committee with a great vitality; to Ella Szukielowicz-Lindon, whose skill and dedication made possible the smooth integration of the Prague Club; and to Massimo Sarti, without whom the data reform project would never have gotten off the ground – indeed to all of the elected officials, management committee, secretariat and active members for helping to make the Berne Union special – thank you!

So, as we head into another year, there will be new offices, new websites and some new faces, but the same Berne Union. I hope you enjoy the commentary from my colleagues in the coming pages and look forward to the view we see in the year ahead. ■

Notes

1 MLT volumes have been declining fairly consistently since a peak in 2011
2 According to WTO figures, total value of cross-border trade for goods and services in 2016 was $-16.94 trillion. Since these WTO figures include intra-company trade (which is uninsurable) the % of cross-border trade for which relevant credit risks are covered by Berne Union members is in fact considerably higher
3 Figures quoted for 2017 are provisional
4 Strong pipelines from several members could push final figures well beyond this
5 2016 cover provided reported by the INV Committee was $112 billion – a record year, and 20% higher than in 2015
6 The same business is reported by ECAs in the MLT committee
7 In context, 2016 showed the highest INV claims in the past 5 years - almost double any previous
8 With MLT claims occurring on average 5 years into the tenor of a given transaction, volumes over shorter periods of time can appear relatively high, or low
9 Historically, the ratio of commercial to political claims paid is usually closer to 50%
10 The work of the IWG is especially crucial when one realises that almost ⅔ of all ECA financing is currently conducted outside of the OECD Framework.
11 BANDEX (Dominican Republic); IE Singapore, ECGC Zimbabwe; AgeRE (Mongolia) and EXIMBP (Pakistan)

SG's report: three challenges for export credit and investment insurance

By Vinco David, secretary general, Berne Union.


Vinco David

The export credit and investment insurance industry is currently in a rather healthy state, both for private and public suppliers of cover. However, there are a number of risks that could change this benign situation. These risks are clustered around three themes: premium levels, claims and regulation.

Positive results for 2016

But first the good news. 2016 was a positive year for most insurers. Business levels increased slightly to $1.87 trillion of insured exports and foreign investments (including guarantees and direct lending from a number of ECAs – export credit agencies). Berne Union members continue to provide support for a significant proportion of world cross border trade: 11%, benchmarked against the $16.9 trillion figure recorded by the WTO for 2016.

Applying a more fine-grained examination however, we can observe some variation in trends between the different categories of insurers.

New trade-related business for 2016 was made up $1.63 trillion in short-term (ST) export credit insurance and $134 billion in medium and long-term (MLT) cover provided by official ECAs. Private members insuring medium and long-term exports and state obligations reported $25.5 billion in new business. Insured foreign investments from all Berne Union members meanwhile rose to $69 billion.

On the one hand, private insurers of trade credit and political risk insurance were able to expand the volume of their business to almost $1 trillion – approximately 9% higher than in 2015 and accounting for the first time for more than 50% of total Berne Union business. Public insurers of short term trade credit, medium/long term export credit and foreign investments, meanwhile, generally saw a small decline in volumes covered. However, at $900 billion, this total volume for 2016 is still a strong figure, and a positive indicator of a healthy industry.

Claims trends

Claims payments decreased in 2016, compared to the previous year. In 2015 the total volume of claims paid as a result of insolvency or political events was $6 billion: last year this figure was half a billion less. While this is a positive adjustment, it should be noted that, in context, these figures are still high – comparable in fact, to the levels seen in 2009, at the depth of the credit crisis. This leads to some observations about the risks the industry is facing at the moment.

Premium levels compared to claims

Premium levels in the private market are historically relatively low, both for short term business and for medium/long term credit and investment business. This is largely due to strong competition between private providers of cover.

Premium levels in the private market are historically relatively low, both for short term business and for medium/long term credit and investment business. This is largely due to strong competition between private providers of cover.

In the short term area this is mainly seen in competition between the world's three largest providers: Euler Hermes, Atradius and Coface, although other private or semi-private insurers also participate.

In the medium/long term credit and investment insurance area we have seen a large increase of capacity over the last few years, while demand has remained stable. There are currently about 60 providers of this type of insurance worldwide. Although this business has certainly proved to be profitable over the last few years, one can doubt whether this is the main reason for growing market participation from both insurers and other capital market investors. Due to the sustained low interest rates for currencies such as the US Dollar and the Euro, investors are looking for investments with higher returns and one option is, indeed, credit and investment insurance.

We can see, then, that it is mainly drivers from the supply side keeping premium levels depressed and once interest rates start to increase one can expect the supply of capacity to wane, which may eventually lead to an increase in premium levels.

Figure 4. shows the total reported premium income for private members of the Berne Union (for both credit and investment insurance) between 2005 and 2016, alongside claims paid for the same period.

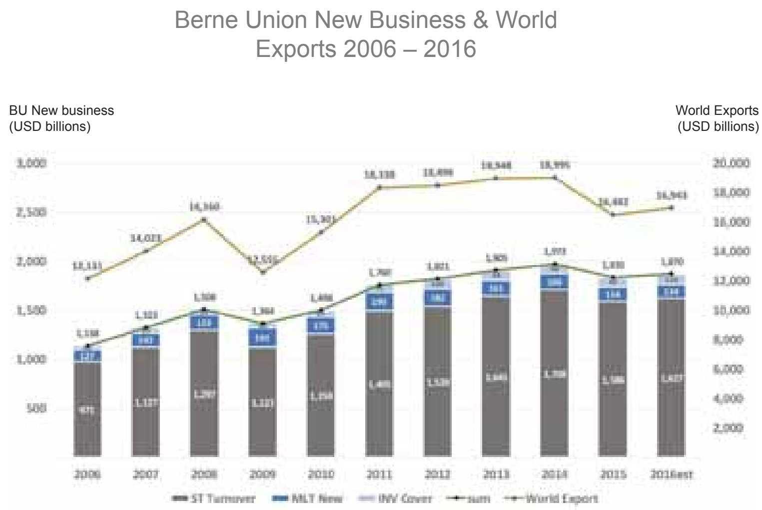
From the graph we can see that total premium income for this business has declined almost 17% between 2011 and 2015. 2016 figures suggest a stabilisation of premium income, but with claims peaking again, the loss ratio for ST business follows suit; current indications put this at around 43%.

While this data only represents a subset of Berne Union members – and does not therefore give a complete picture of absolute volumes – it is illustrative of the general trend towards softer pricing in the private market.

Figure 5. shows the average pricing – calculated as premium income / exposure – for each reporting line within the Berne Union. In this graphic, INVS designates cover for sovereign obligors, while INVO represents credit cover for other private buyers. ST and INVI are the short term credit and investment insurance lines described above.

This illustration confirms the observation that it is pressure from the supply side driving down premium income, through pricing competition, rather than falling volumes of business.

Figure 1



Berne Union figures on new business are seen to track trends in overall volumes of world trade and are regularly benchmarked against WTO figures. Comparing the two graphs also shows the resilience of credit insurance and the tendency for insured volumes to fall less sharply than the overall economy – demonstrating the counter-cyclical function of the industry.

Figure 2

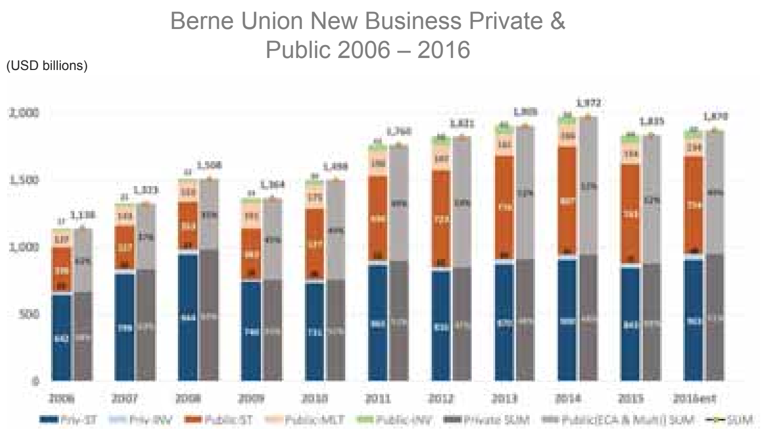
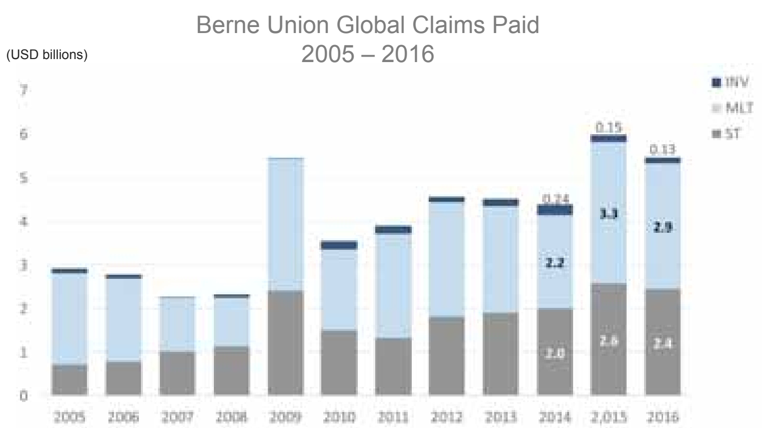


Figure 3



Claims levels

The industry is currently profitable because claims levels are under control. For the business as a whole, average loss ratios are stable at around 30%, keeping risks manageable and appetite high. However, as we have seen above, strong competition and the resulting soft market (for private insurers) has the potential to disrupt one side of this equation and the current, relatively benign, situation may change if high volumes of claims remain sustained. If premium levels continue to fall, as claims rise, the resulting situation would not be financially sustainable for insurers.

We have seen this situation before, i.e. during the credit crisis from 2008 and although a new crisis is not expected, claims payments have been markedly high in both 2015 and 2016. Indeed, combined claims reported by Berne Union members across all lines of business – including both private insurers and ECAs – are higher for these years than at any time since 2009, as shown in the graph above.

Due to the relatively low prices of almost all commodities on the world market over the past few years, countries in Africa and Latin America, dependent on those commodity exports, are especially at risk. This situation has a negative impact both on companies active in these sectors, as well as on the economies of these countries as a whole. Indeed, the top country for claims in 2016 was Brazil, where Berne Union members paid a total of $860 million in claims last year – around 16% of all claims paid worldwide.

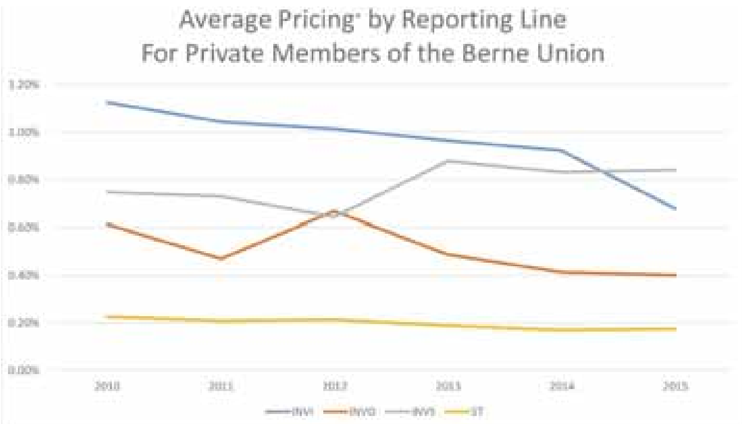
Figure 6. also neatly illustrates this trend, with claims in the Americas showing high growth in 2016, especially for MLT business, which is generally speaking more closely correlated with the economic health of emerging markets.

But there are of course also risks in high income countries and despite a mild economic pick-up at the moment, claims here are still significant. The agenda of the US administration and Brexit will certainly impact international trade flows, but to what extent and in which sectors is not yet known.

These lead to the third theme: regulation.

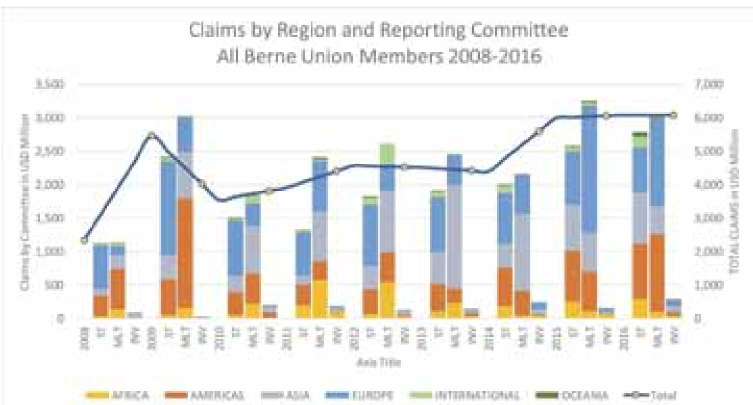
Figure 4

Figure 5



* Average pricing is calculated as premium income / exposure

Figure 6



Regulation

Trade barriers have never been good for trade. There is an abundance of evidence that, on its turn, international trade is good for prosperity. Self-evident as this may sound, not all politicians enshrine this ideal in their policies and calls for protection of national industries are common these days. While there are sometimes good reasons to temporarily protect selective national industries in their cradle phase; or a very limited number of industries deemed as strategic for a particular country; in general, protectionist measures eventually lead to a decline in productivity.

Typically, these kind of political measures rather lead to a misallocation of resources and ultimately harm the competitiveness of those industries they sought to protect. Good examples are the US shipbuilding industry or the so-called 'zombie companies' in China. But also, of course, exporters to countries that build trade barriers are affected. If, for example, the US administration would implement trade barriers, then certainly countries like Mexico and Vietnam will feel the impact, given the large proportion of their exports bound to the US.

Worryingly, the number of calls for protectionist measures has increased of late, and notably in high income countries where previously such sentiments have been rather exceptional.

As said, protectionism is not good for trade, and hence not good for export credit and investment insurers. Cross-border trade may decrease, impacting on the topline of insurers. But it may also lead to a riskier environment with more insolvencies. There are at the moment no signs yet that this is already happening, but this is certainly a development for our members to monitor.

Another area of regulation relevant to our industry is that of banks. Banks are essential for the financing of trade and exports, and for providing working capital to exporters and their suppliers.

For very good reasons, this bank regulation – now Basel III (some say Basel IV) and its implementation at national or regional level – has become stricter, partly as a consequence of the credit crisis. Banks have become better capitalised and in general this is a good thing. But implementing these regulatory measures with a broad brush could lead to less capital being available for the financing of export and trade. That would, obviously, not be a good thing for export and trade, and thus, eventually, for prosperity and, more mundane, the topline of credit insurers.

Banks, in particular European banks, have to some extent – and with support of the Berne Union – been able to demonstrate to regulators that the financing of export and trade is not such a risky business at all; certainly if covered by (public) insurers. The European Commission, for example, has recently launched a proposal for the implementation of Basel III whereby the financing of trade and export covered by public insurers will attract lower capital requirements than originally proposed. This is a laudable development, but may not tackle all areas of insured export and trade financing. It is primarily up to the banks – as the institutions that are regulated – to see whether a broader capital relief is needed to fully continue financing trade and export, but as insurers of trade, members of the Berne Union continue to stand behind the risk transfer products they provide.

We can see, then, that it is mainly drivers from the supply side keeping premium levels depressed and once interest rates start to increase one can expect the supply of capacity to wane, which may eventually lead to an increase in premium levels.

On a more positive note: in the course of tackling these regulatory challenges, banks have become more aware of the positive impact credit insurance can have on their balance sheets – not only for capital requirements reasons, but also by enabling them to better manage their aggregates.

In summary

The export credit and investment insurance industry has recovered remarkably well after the global credit crisis. It is currently reasonably profitable, largely due to the fact that claims are under control. But this may change if claims were to continue at elevated levels for longer periods. Claims levels can be expected to rise if commodity prices remain low (affecting commodity exporting countries) and if more trade barriers are put up, affecting countries with large exports to countries implementing these protectionist measures.

Stricter bank regulation, too, can impact trade and, hence, the results of our industry. However, both exporters and members of the Berne Union have shown quite some resilience and adaptability to a changing environment and despite these challenges, there are compelling reasons for an optimistic perspective on the future of the industry. ■

2

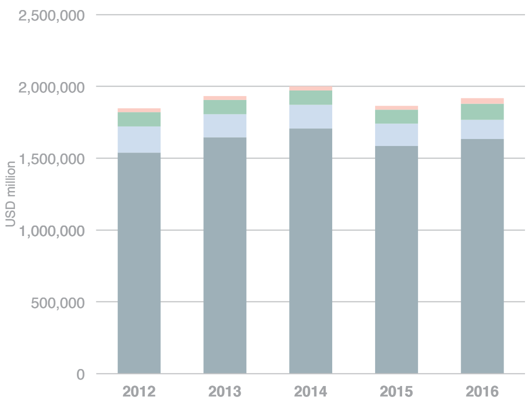
Data and Statistics

Berne Union: Totals

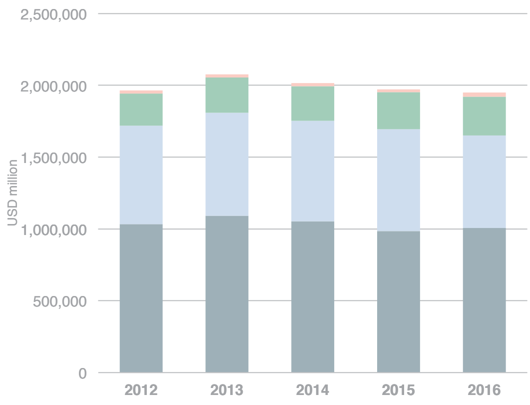
Key

PCC – Prague Club Committee
INV – Investment Insurance
MLT – Medium/Long Term Export Credit Insurance
ST – Short Term Export Credit Insurance

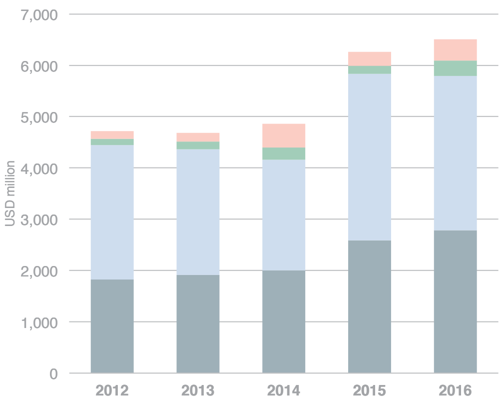
New Business – during each year



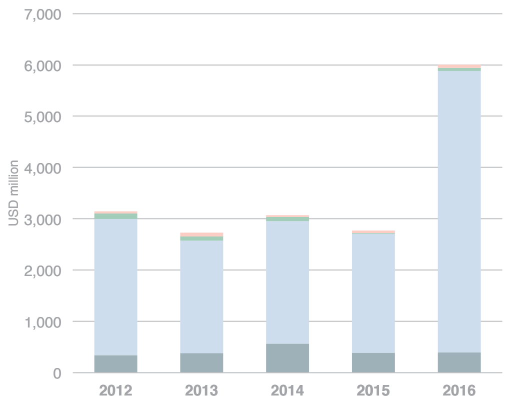
Exposure – at year end



Claims Paid – during each year

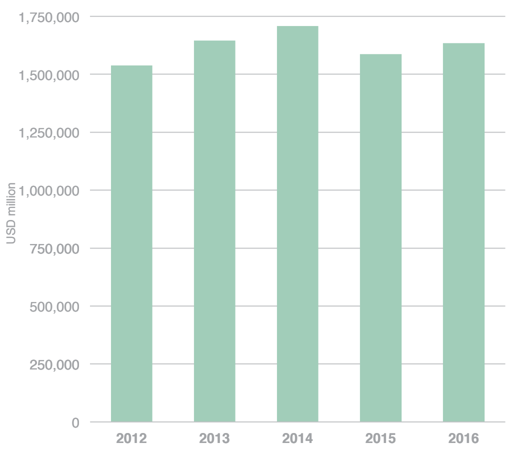


Recoveries – during each year

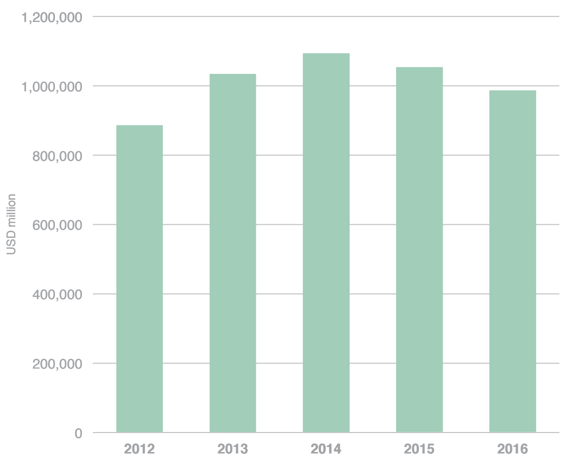


Berne Union: Short-Term Export Credit Insurance

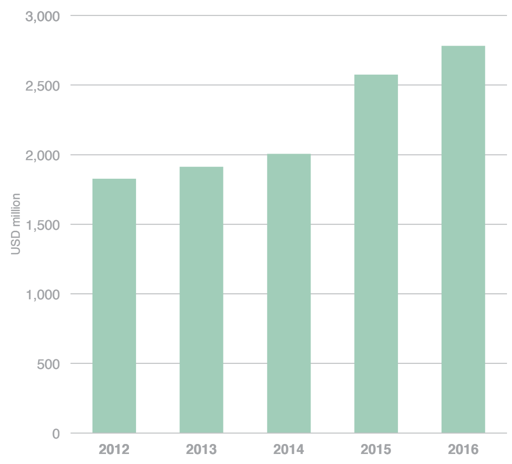
ST New Business – insured during each year



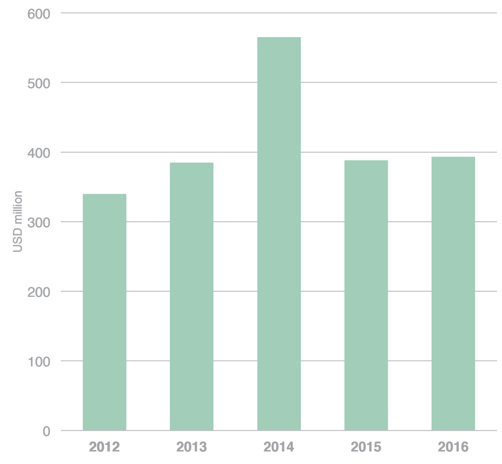
ST Credit limits – at year end



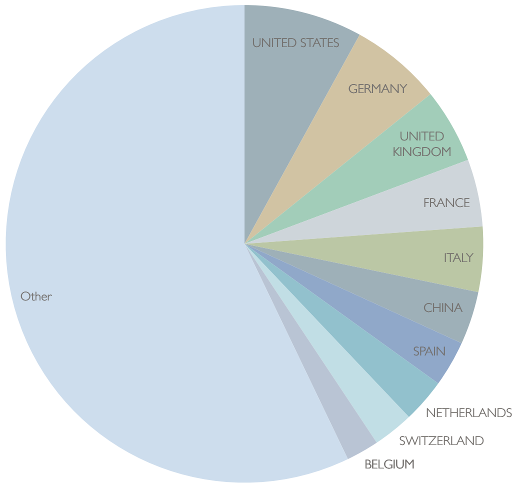
ST Claims Paid – during each year



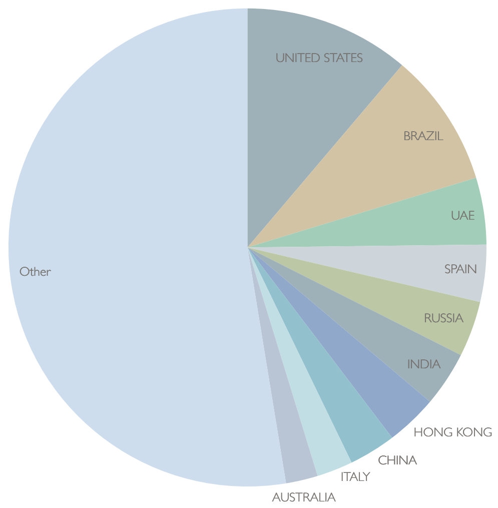
ST Recoveries – during each year



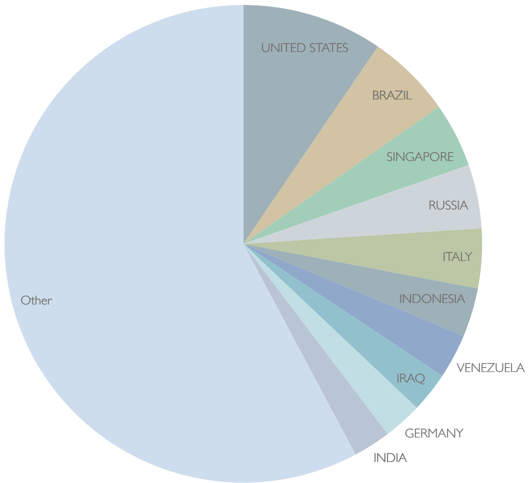
ST Credit Exposure Paid 2016: Top 10 countries



ST Claims Paid 2016: Top 10 countries

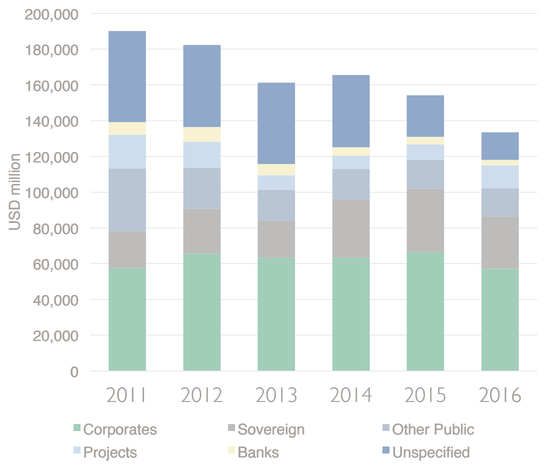


ST Claims Recoveries 2016: Top 10 countries

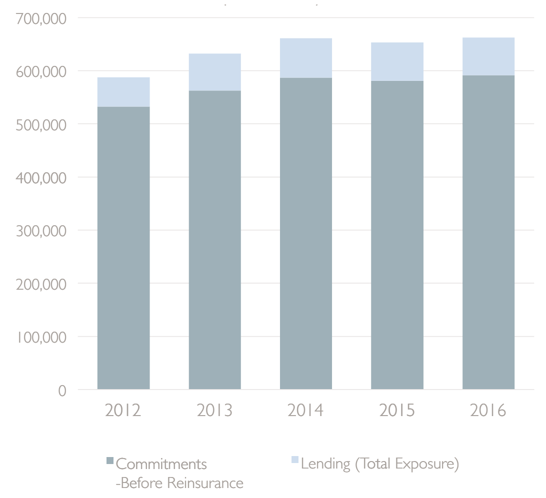


Berne Union: Medium/Long-Term Export Credit Insurance and Lending

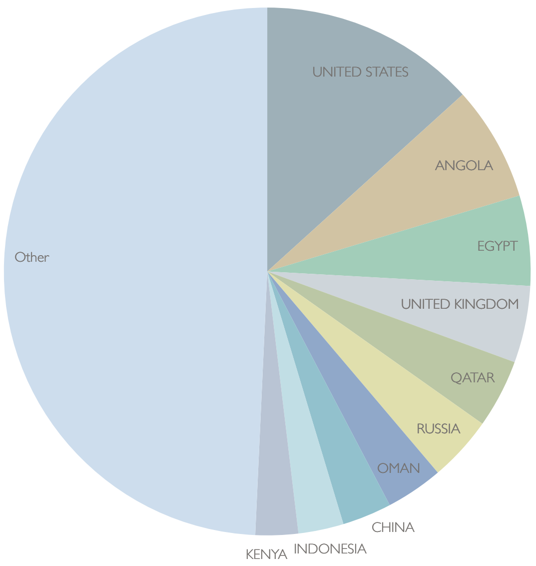
MLT New Business – insured during each year



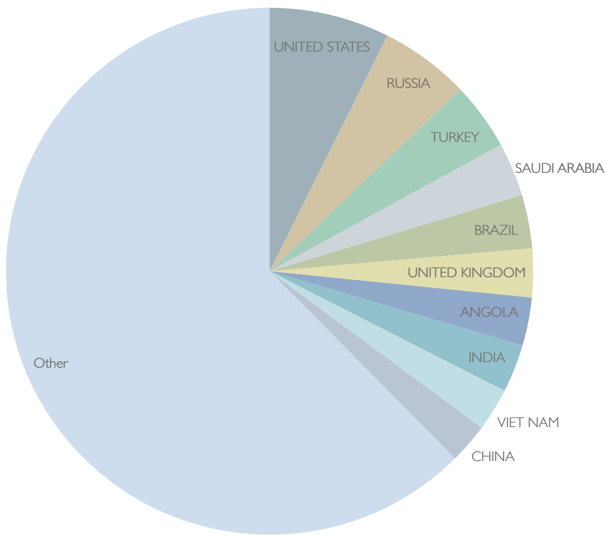
MLT Exposure – at year end



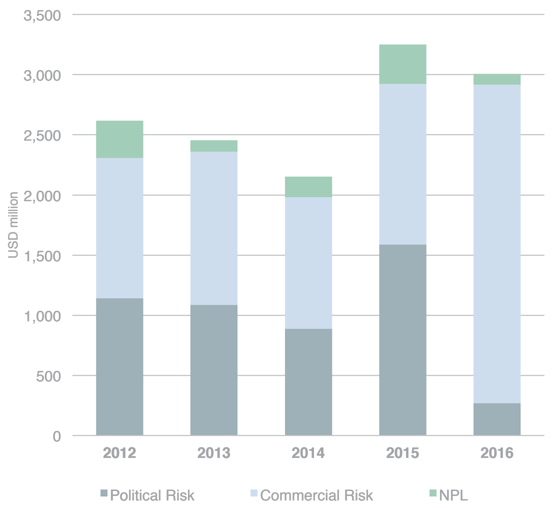
MLT New Business 2016: Top 10 countries



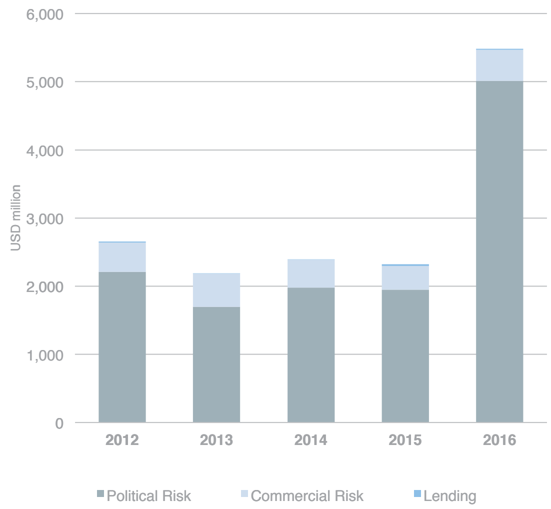
MLT Exposure 2016: Top 10 countries



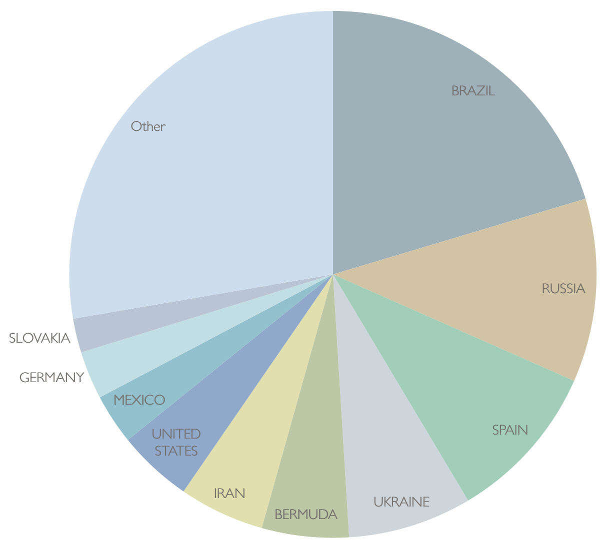
MLT Claims Paid – during each year



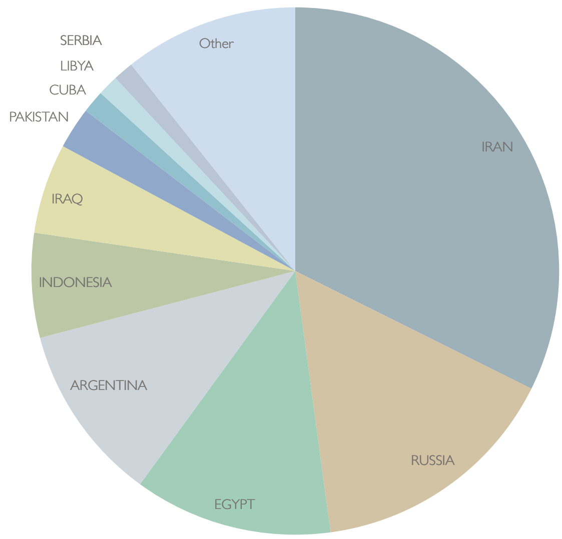
MLT Recoveries – during each year



MLT Claims Paid 2016: Top 10 countries

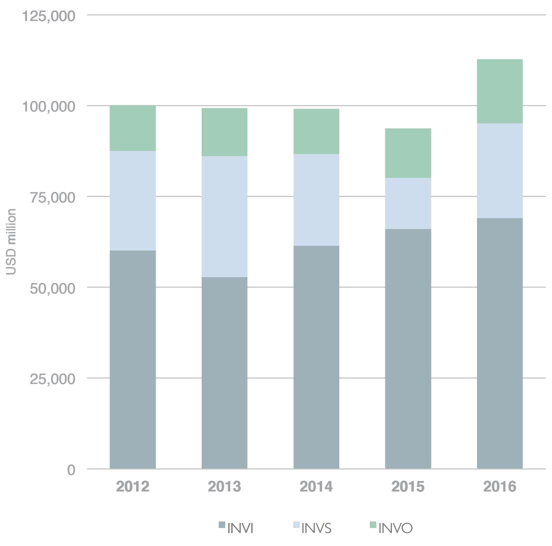


MLT Recoveries 2016: Top 10 countries

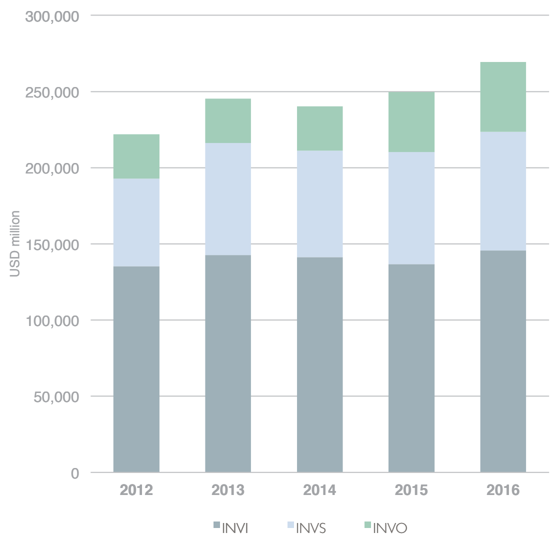


Berne Union: Investment Insurance

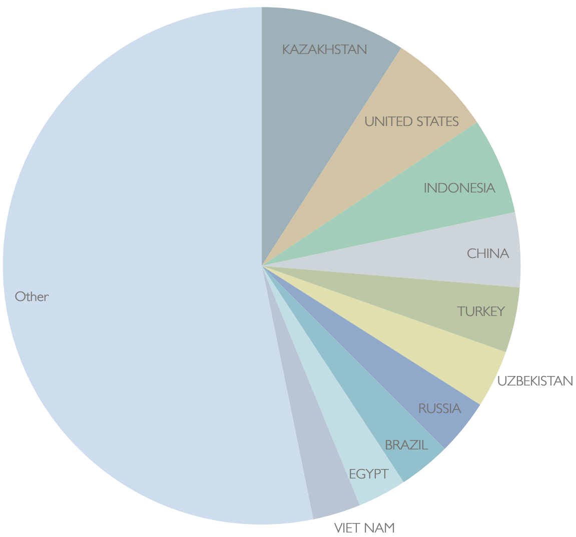
INV New Business - insured during each year



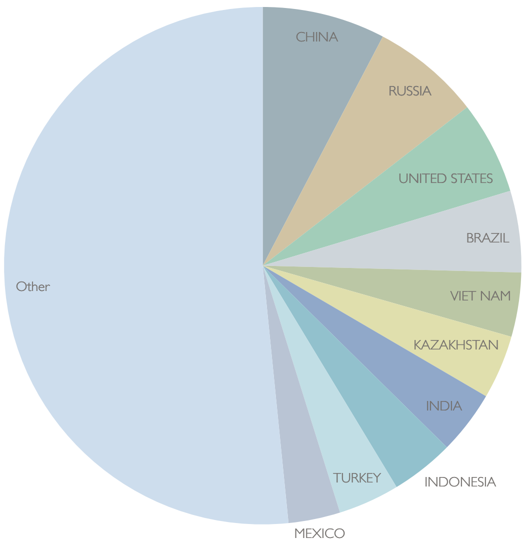
INV Exposure - at year end



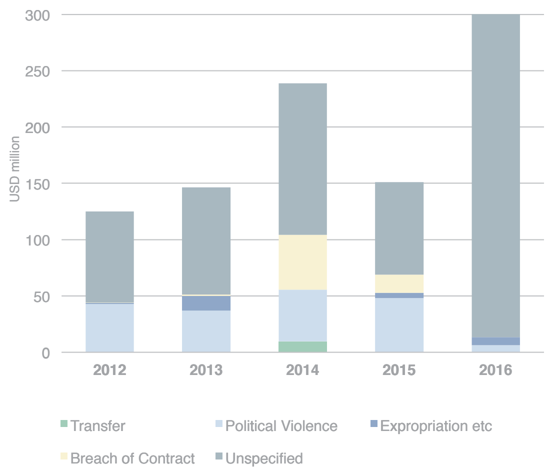
INV New Business 2016: Top 10 countries



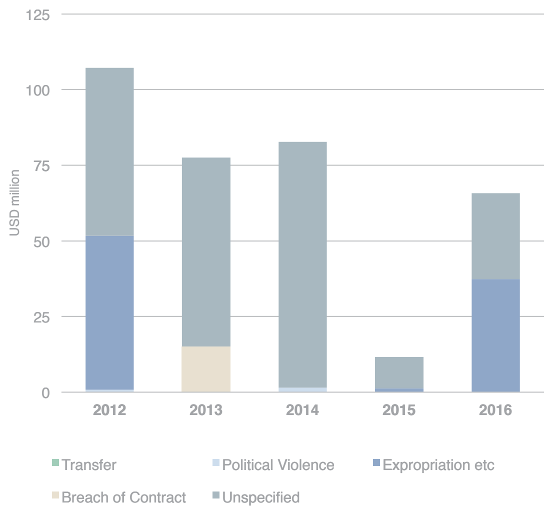
INV Exposure 2016: Top 10 countries



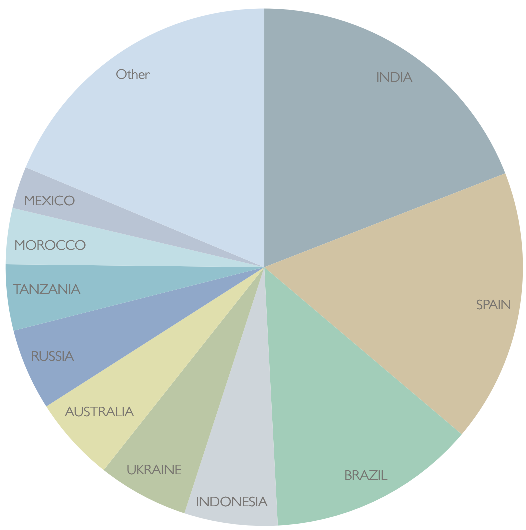
INV Claims paid – during each year



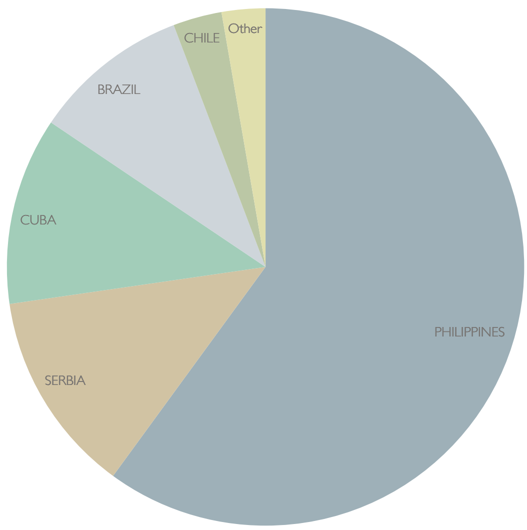
INV Recoveries – during each year



INV Claims Paid 2016: Top 10 countries



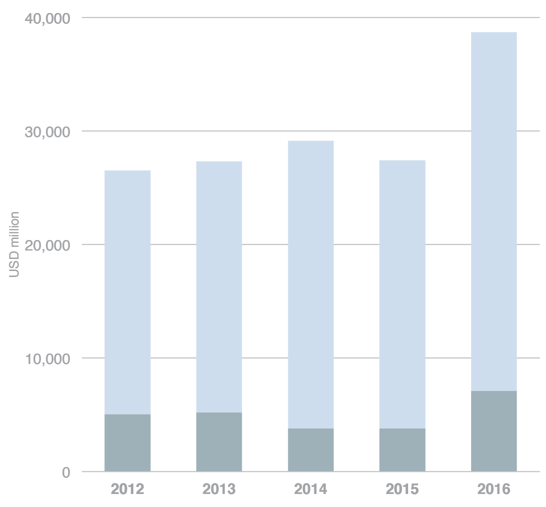
INV Recoveries 2016: Top 5 countries



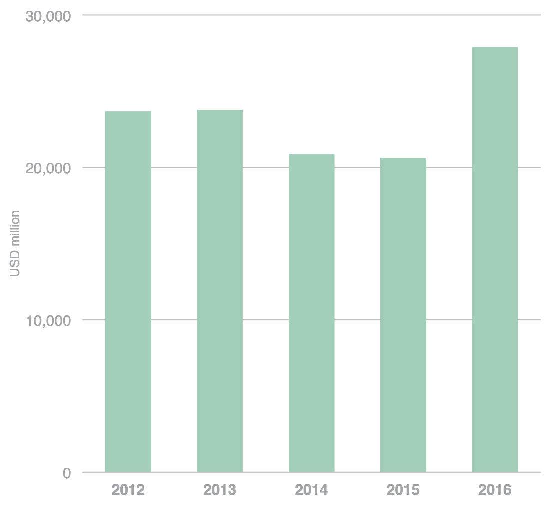
Berne Union: Prague Club Committee

Key
MLT – Medium/Long Term Export Credit Insurance
ST – Short Term Export Credit Insurance

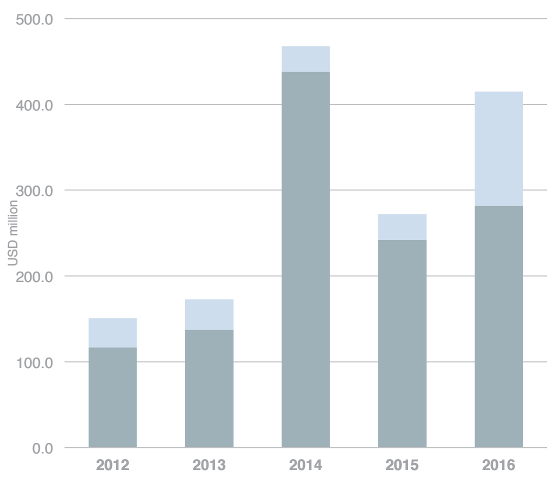
PCC New Business - insured during each year



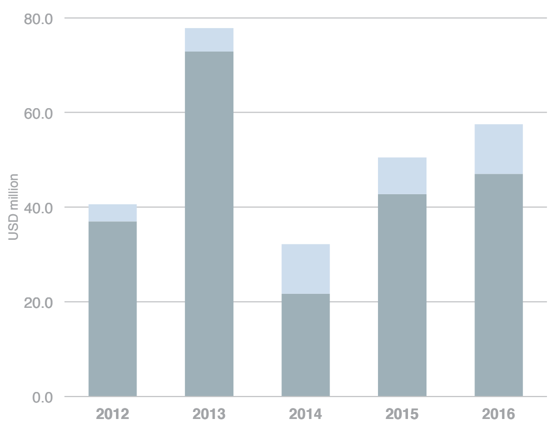
PCC Exposures – at year end



PCC Claims Paid - during each year



PCC Recoveries - during each year



DATA AND STATISTICS

Review of a year full of unexpected turns

By Laszlo Varnai, associate director, Berne Union and Paul Heaney, associate director, Berne Union


Làszlò Varnai


Paul Heaney

2016 was a year marked by a number of major political and economic events. Low commodity prices (especially record low oil), political shifts (Brexit, US elections, impeachment in Brazil) and currency volatility in both developed and developing countries have all left their mark on world trade. Global trade recorded its lowest volume growth rate in the last decade (just 1.3%) – well below the 4.7% average since 1980, with merchandise trade reaching just $15,284 billion.

And yet, even in such a challenging environment, following a general decline in 2015, Berne Union Members grew their business again in 2016; supporting trade and investment of $1,919 billion – an increase of more than 3% compared to their 2015 performance.

This improvement was mainly on account of increasing business underwritten by members of the Short-term Export Credit Insurance (ST) and Investment Insurance (INV) Committees, as well as the short and medium term trade credit insurance cover provided by Prague Club (PC) Committee Members, for trade between and projects in developing countries. Medium/Long-Term Business of the ECA members of the MLT committee, on the other hand, bucked the new upward trend, as it continued pattern of decline set in previous years.

The aggregated figures of new business covered give an indication of the broad trends in the activity of Berne Union members within each reporting committee over the course of 2016:

- The value of cross border trade supported by short-term trade credit insurance was $1,634 billion
- The reported value of new medium and long-term commitments was $134 billion
- New investment insured was $113 billion
- Prague Club Members reported $38 billion new cover issued

Berne Union Members collectively paid $6.5 billion claims in 2016 – a historically high figure, and a 4% increase over 2015. At the same time, this was matched by $6 billion recoveries collected – a significant improvement, and more than double the result for 2015.

Even in such a challenging environment, following a general decline in 2015, Berne Union Members grew their business again in 2016; supporting trade and investment of $1,919 billion – an increase of more than 3% compared to their 2015 performance.

Short-term
Export credit insurance business

Short-term business represents insurance of exports with repayment terms of less than one year – often 30, 60 or 90 days. These transactions typically relate to shipments of consumer goods, with the movements of short-term export credit insurance are closely linked with the ups and downs of the broader global economic environment.

Short-term export credit business continues to be the dominant activity reported by Berne Union members, generally accounting for more than two thirds of overall volumes of new business. As such, changes within the short-term figures have the largest impact on aggregated totals, and taken alone, most accurately reflect the response to global, regional or domestic events.

With this in mind, it is encouraging to see the volume of short-term cross border trade under cover returning to growth, and at $1,634 billion, a positive increase of 3% over 2015's drop. Recorded 'commitments outstanding' – an indication of the risk appetite of members – followed the same positive trend as for new commitments, rising back to over $1,007 billion.

The majority of growth seen relates to credit limits approved for American and European buyers, with increases of $4 billion and $12 billion respectively. 73% of credit limits were issued by private Members and 27% shared among ECAs and multilaterals.

These positive changes seen in volumes of business supported and commitments in the past year give an encouraging indication of improvements in existing members' business. The figures have also benefitted from the addition of four new and very dynamic Members of the Committee: CHUBB, LIBERTY, PICC and XL CATLIN.

Berne Union Members indemnified exporters for defaults on their trade receivables up to $2.8 billion in 2016; a 7.7% increase on 2015 levels. At the same time, the overall default to turnover ratio (0.17%) as well as claims to exposure ratio (0.28%) remained low. In 2016, the highest volumes of short-term claims were paid for buyers located in the United States ($311 million), Brazil ($253 million), UAE ($125 million), Spain ($107 million) and Russia ($104.8 million).

Recoveries on outstanding claims remained stable at around $400 million, similar to the pattern of the last five years, and very evenly distributed amongst buyer countries.

Despite these dynamic business trends, pressure on premium levels has remained intense: Overall premium income reported at 2016 year-end decreased by $24 million to $3,434 million. Thus, the average premium to turnover ratio decreased from 0.218% to 0.21%, and the premium to exposure ratio from 0.351% to 0.341%.

The majority (ST) of growth seen relates to credit limits approved for American and European buyers, with increases of $4 billion and $12 billion respectively. 73% of credit limits were issued by private Members and 27% shared among ECAs and multilaterals.

There are indications that these low rates of premium income are beginning to put pressure on capital and reserves as well. The loss ratio[1] grew from 74.7% in 2015 to 81% in 2016. This is barely balanced by the high recoveries for an adjusted loss ratio[2] of 72.7% (a significant increase from 67.2% in 2015). These figures confirm the cyclical trend in pricing visible over the last 10 years.

Through the course of 2016, members have continued to invest in digital solutions and automation (of underwriting and claims handling) which will help to boost profitability by lowering operational costs, resource requirements and administrative burdens, as well as improving standardisation and accessibility for policyholders.

Further improvement is anticipated within this business line over 2017, both in terms of written business and operational developments.

Medium and long-term Export credit insurance business

Medium and long-term trade and export finance has faced a number of significant challenges over the past year, and these are simultaneously reflected in the insurance and guarantee market.

The continuous phasing-in of new banking regulations and the clear interpretation of these, has affected both the banks' appetite and capacity for new business, as well as demand for ECA cover of transactions.

The unknown impact of changes to ECA premium guidelines, as well as lengthy processes of underwriting (or lack of a quorum in the case of US EXIM), combined with fierce competition between exporters in some sectors (e.g. aircraft sector) has resulted in an overall sluggish market.

The medium and long-term business statistics capture export support (insurance, guarantees and lending) provided by official state-backed ECAs only, with a year or longer tenor.

In 2016, support provided for new export of capital goods and projects decreased by 13.3% (to $133 billion) compared to 2015. This is a continuation of a consistent downward trend since a peak in 2011. Among the different obligor types, almost all have decreased within the insurance line, with the exception of project finance transactions, which increased again by 52% to $13 billion, mainly due to new contracts in the oil, gas and energy sectors in the United States, Canada and Uruguay. Overall, the volume of new policies issued dropped by 28% to $119 billion.

In contrast to the insurance prospects, reported lending activity of ECAs indicated a promising turn, reaching a 4-year high (+38%, $14.6 billion), driven primarily by corporate obligors (84%), with most growth seen in Canada, Chile and Colombia.

Unsurprisingly, given the five-year decline in new business, the portfolio commitments of ECAs has begun to shrink, with insurance and lending together losing 2% in 2016, down to a total outstanding exposure of $645 billion. This drop of $12.7 billion occurred mainly in the insurance activity and could have been higher still, without the boost provided by new African commitments. Loan exposures meanwhile decreased by a relatively small $480 million.

The overall level of indemnification by ECAs remained similar to 2015 at around $3 billion. However the division between political risk and commercial risk shifted from 49:51 to 9:91 ratio, doubling the volume of claims paid for commercial causes.

The top five countries for claims was topped by Brazil ($612 million – including a large claim in telecom sector), followed by Russia ($ 338 million), Spain ($297 million – mainly in the energy sector), Ukraine ($228 million) and Bermuda ($160 million).

The unknown impact of changes to ECA premium guidelines, as well as lengthy processes of underwriting (or lack of a quorum in the case of US EXIM), combined with fierce competition between exporters in some sectors (e.g. aircraft sector) has resulted in an overall sluggish market.

Comparing year-end recovery volumes, 2016 was a great year: ECAs recovered $5.5 billion; the highest amount in the last nine years. Most of the recoveries (91%, $5 billion) were gained from political risk claims paid previously, primarily in Iran and Iraq.

Information on offers outstanding indicates quite strong pipelines for 2017, especially in Asia and members have also confirmed that the unusually low level of new cover provided was partially due to transactions concluded but waiting for approval.

Last but not least, a comment on data: in consultation with the data experts of Berne Union Members, we have been engaged over the past year in a project to revise our process for data collection and reporting. This will improve the accuracy and consistency of information currently reported, as well as adding further layers of information – such as sectors of exposure – which will in future provide more a detailed and more colourful picture of members' business. These changes are still subject to adoption by the Membership, but will most likely take effect from 2018 onwards.

Investment insurance and other cross border risk insurance

Under the INV reporting line, Berne Union members report insurance of overseas investments against political risks[3], as well as non-honouring of sovereign obligations[4] and all other typical credit insurance protection against political and commercial risks for bonding, untied loans and such.[5] This includes medium to long-term trade credit insurance provided by private insurers.

The overall volume of new cover provided under INV grew by 20%, reaching an all-time record of $113 billion, mainly recorded in the categories other cross border insurance (INVO) and state obligations (INVS). This substantial increase is partly due to the additional business reported by new members joining the committee[6], but would have achieved a not insignificant 7% increase, even without the inclusion of those institutions.

In 2016, both ECAs and private members reported significant increases in business in the INV category, with most new business underwritten in Kazakhstan, followed by the US and Indonesia. Improvement in all lines resulted an 8% increase in the INV portfolio.

Overall, claims paid under INV doubled during 2016, again resulting an all-time high of $300 million. Of this $254 million was recorded in the 'other cross-border insurance' (INVO) category, with the largest claims paid in India, Spain and Brazil.

Recoveries followed suit, primarily relating to investments recovered after wrongful expropriations in the Philippines.[7]

Looking in more detail at the different insurance categories within INV:

Investment insurance (INVI) cover provided showed a very minor decline in total volumes for all regions with the exception of Africa which is booming at $14.8 billion new business – launching it past Europe to sit as the second highest region for new business, behind Asia. This unprecedented demand (+48% in African business), meant that INVI ended the year the year with $69 billion worth new policies globally (+4%). Other growth areas include oil and gas projects in Russia and Egypt.

Portfolio exposure for the INVI category followed the lead of new business, ending 2016 at $145 billion. The largest exposure remains in China ($17 billion), Russia ($15 billion) and Kazakhstan ($9.7 billion).

At just $17 million, claims paid in this category in 2016 were actually considerably lower than a year before (-78%). These occurred as a result of expropriation (Venezuela) and political violence (Libya). As mentioned above, the only noteworthy recovery came from the Philippines ($37 million) after an expropriation case.

Concerning **trade credit insurance of state obligations (INVS)**, Members underwrote 30% more business in 2016 ($17.7 billion). This is mostly business underwritten by private Members with the majority relating to Asia (China, Vietnam and India).

Much of this business tended to come in large chunks: 2016 totals include a large transaction of over $700 million in South Africa in support of ESKOM and besides that, as an ongoing trend, in Turkey there were a series of non-honouring transactions totalling close to $1 billion.

The $28 million in claims paid for INVS during 2016 related to transactions in Tanzania and Puerto Rico. In terms of recoveries, private members successfully recovered $7.3 million from Cuba.

Other cross-border trade (INVO), showed the most growth of all of the INV sub-categories – up 87% (or around $ 12 billion) to $26 billion new policies issued in 2016. Notable demand came from: USA ($3 billion increase), Bahrain, Japan and Guinea

These high levels translate also into growth of the portfolio as a whole: up by almost $4 billion, reaching $80 billion at the end of 2016.

In a continuation of the trends elsewhere, the INVO was also the largest contributor of claims to the INV category: $254 million

Investment insurance (INVI) cover provided showed a very minor decline in total volumes for all regions with the exception of Africa which is booming at $14.8 billion new business – launching it past Europe to sit as the second highest region for new business, behind Asia.

throughout the year, with the top five countries responsible: India ($57 million), Spain ($51 million), Brazil ($38 million) Indonesia ($17.5 million) and Australia ($16 million).[8] Within INVO claims were recovered from Serbia ($8 million) and Brazil ($6 million).

In line with the data revision in the medium and long-term business reports, the INV reporting line is also subject to a thorough cleansing, separating and later detaching the pure political risk insurance of foreign investments from the export credit insurance and other cross-border insurance products.

Prague Club Committee Members

In 2016, the Prague Club was integrated as the fourth Committee of the Berne Union. Home to the emerging export credit insurance companies, it is the most dynamic and fastest growing committee. Prague Club Committee reporting is much simpler than for the other three committees, dividing business into short-term and medium and long-term, but without a comparable level of detail as seen in the specialist committees. As part of on-going data reform at the Berne Union, greater derail for PCC data will also be introduced in the upcoming years.

The overall activity of Prague Club Members for 2016 was impressive. Members underwrote a record level of new short-term business volumes, reaching a total of $31.6 billion (+34%). Even more outstanding is the growth of medium and long-term new business; up 87% to a total in excess of $7 billion. This takes the total contribution of PCC business to Berne Union totals from 1% to 2% of the overall support provided – a small figure, but a noteworthy change.

The level of commitments outstanding before reinsurance also increased to $28 billion. On account of this, Prague Club members earned $431 million premium written for covering short-term trade receivables a high multiple of the $78 million 2015 income.

In line with the higher business being underwritten, claims also jumped to $414 million, almost twice the total for 2015. However, the short-term export credit loss ratio for the Prague Club Committee actually fell to 30%, which is below the Berne Union members' performance during the same period.

In case of complex medium and long-term transactions, the earned premium followed the risk level of the new transactions, doubling for the second year in a row, from $258 million in 2015, to $518 million in 2016. In the same time, claims levels for medium and long-term business have barely increased, up just under $40 million to $281 million in 2016.

What do we expect from 2017?

2017 has already brought with it significant changes in both political and economic arenas. Further political disruption, election outcomes and on-going local and regional conflicts will play a role. As will regulatory developments and new pricing principles for Category 0 or High Income countries under the OECD Arrangement, amongst others.

Based on the Members forecast, further expansion is anticipated in short-term business, but with continuing pressure on premium levels. Approval of delayed transactions in the medium and long-term pipelines, will likely bring positive changes to recorded business levels in the MLT committee, as well as within the investment insurance sphere.

But, if Leicester City can win the Premier League, anything can happen! ■

Notes

1 Calculated as claims / premium.ºº
2 Claims / (premium + recoveries).
3 'INVI' including: political violence, expropriation, currency transfer and convertibility risks.
4 'INVS' – credit insurance products, providing cover against the inability or unwillingness to pay by sovereign and sub sovereign obligors.
5 'INVO' or 'Other'.
6 CHUBB and LIBERTY.
7 More detail on these claims and recoveries within the individual categories, outlined below.
8 The underlying reason for claims is not identified in this business line.

Based on the Members forecast, further expansion is anticipated in short-term business, but with continuing pressure on premium levels. Approval of delayed transactions in the medium and long-term pipelines, will likely bring positive changes to recorded business levels in the MLT committee, as well as within the investment insurance sphere.

3

Expert analysis

OeKB: introducing Austria's more flexible national content policy

In this article Ferdinand Schipfer, OeKB's managing director of export guarantees, ponders national content considerations from an ECA's point of view. Here, he outlines the motives, developments and impacts of Austria's policy now in place.

As globalisation progresses and international production sharing is deepening the share of foreign inputs in exports increases all over the world.

At the same time and in spite of its relatively small economy, Austria is a very active participant in the international exchange of goods and services.

It therefore was not too surprising that – in view of OeKB's foreign content rules applied until recently – an ever increasing number of Austrian firms started to face difficulties with pursuing and participating in potential export projects.

As a consequence we changed our policy in mid-2016. Under the new rules a lower minimum national content may be required: to benefit from OeKB's unrestricted cover, a project's Austrian value added only needs to exceed 25% of the total export contract value, instead of 50% previously.

Our customers more than welcome this decision: several projects have already been realised and covered that would not have been possible under the old rules.

This change in policy is in line with international trends and developments starting from a 'made in'-concept, moving to 'made by' and ending up in 'made for'. Changes are making clear that political guarding authorities and ECAs today put less emphasis on their trade account balances or on the national value added in single export transactions but focus more on long-term welfare gains and improving locational quality of their respective economies.

Is there a one-size-fits-all solution?

We are well aware of the fact that the Austrian approach is not applicable to all economies. Starting positions and frameworks in countries are different, thus it is not possible to develop universally applicable standards and rules. We hope, however, to provide colleagues and decision makers in our industry with interesting ideas or even to inspire them when designing or modifying their own programmes.


Ferdinand Schipfer

Before turning to the rules we apply in Austria today, I want to pick out some aspects worth considering by most ECAs, although their importance may vary considerably between individual countries.

History

A potential 'active' colonial past and trade-tradition can impact a country's current position in world trade considerably. Taking the ratio of active foreign direct investment relative to GDP as a proxy for the extent of globalisation, it is apparent that maritime and trading nations such as the UK, France or the Netherlands show large values, whereas countries such as Austria or Germany are faring more modest.

Thus, a nation's economic structure today is heavily determined by the starting point and the extent of a country's industrialisation and internationalisation processes.

Traditional trading nations are favoured by several factors: in particular a bigger number of large companies are located in these countries. They are facing less difficulties going abroad than SMEs do. Furthermore relationships to their former colonies including their influence on language, communication, technical standards and a better access to natural resources were and still are advantageous. Therefore, in these countries a more liberal approach towards national content in exports seems appropriate as they also benefit indirectly, e.g. by being present in local markets.

The size of a country

It goes without saying that small economies – like Austria – are less vertically integrated than bigger nations. In case of a necessary outsourcing of production phases, companies in these economies cannot easily find domestic low-cost suppliers. As a consequence they need to procure internationally, which results in a general recommendation towards a more liberal national content approach.

Geography

Landlocked countries tend to face higher transportation costs than maritime economies as economic research into this topic has shown. Furthermore countries that are surrounded by a number of neighbours with a similar industrial structure and a comparable specialisation cannot afford to insist on a high degree of national content in their exports than geographically somewhat isolated countries such as the US or Australia.

Globalisation

International production structures are constantly changing. A trend towards a global distribution of competence centres including regional specialisation on different product lines can be observed. Classical manufacturing activities are relocated to low-labour-cost economies and the share of services in exports of advanced economies is increasing.

Additionally, governments in a growing number of emerging countries require an increasing involvement of local firms as a precondition when awarding contracts for large scale infrastructure projects to foreign suppliers. These policies (e.g. Iran, Brazil) are regarded as a means to foster the domestic economic development and local employment. Admittedly, involvement of local firms has also become easier due to the increase in foreign direct investment activities in many areas, including the resulting transfer of know-how.

There are of course many more factors determining a specific country's 'optimal' policy towards national content in exports, but let us now come to ...

... the situation in Austria

Austria is a small open economy in the centre of Europe, surrounded by competitors of a similar degree of industrial specialisation.

OeKB, as the official Austrian ECA, is providing a non-standard institutional ECA-design with a broad range of products and services. OeKB is a bank, owned by commercial banking institutions and has been mandated by the Austrian Federal Government to manage the export promotion scheme on the government's account. The bank therefore is a kind of 'front-office' for Austria's official export promotion activities to support national exports and FDIs.

Until mid-2016 OeKB applied rather conservative national content rules compared to other European ECAs:

- while comparatively liberal regulations were applied to short-term contracts on exports to low-risk countries, and;
- while sub-supplies from a subsidiary to their Austrian parent company were considered as 50% Austrian content, and;
- while there was a special rule for 'small' projects with a volume not larger than EUR 10 million, which was quite popular among

International production structures are constantly changing. A trend towards a global distribution of competence centres including regional specialisation on different product lines can be observed. Classical manufacturing activities are relocated to low-labour-cost economies and the share of services in exports of advanced economies is increasing.

firms (after a comprehensive overall assessment of a company's activities national content was not evaluated on a single-project- basis, but on the basis of the annual turnover),

we most typically expected the Austrian content in mlt projects to be at least 50 %.

New policy rules

In a joint effort with the Austrian Federal Ministry of Finance, we have further liberalised our respective rules close to one year ago. We can now fully support certain medium and long-term export credits as long as the national Austrian content is at least 25% of the export contract value. Stronger emphasis than on the national content in the individual transaction is now put on economic aspects such as locational implications or other features that increase the future prospects of an export company.

In spite of this change in policy, we continue to be interested in a high national value share in every single export deal. However, we had to accept the trends mentioned above.

Moreover, many other European export credit schemes such as those in Italy, the Netherlands, Belgium, Scandinavian countries or in Switzerland have embarked some time ago to be more liberal regarding national content requirements, resulting in a potential loss of competitiveness for Austrian firms.

For us, when discussing this issue the most relevant question is: which companies in Austria will most likely be relevant for the Austrian economy and therefore for the welfare of Austrian society in 10 years from now? If there is some evidence on the firm level and – ideally – also on the level of the project that a company positively contributes to the development of Austria as an attractive location for industry, then even projects with a higher share of foreign inputs can be fully supported.

Firm-specific criteria include domestic employment effects, current and planned investment projects in Austria, R&D intensity, social and ecological conduct, the regional importance of a company or corporate taxes paid in Austria.

Project-specific criteria include the potential of future contracts triggered by this particular project or a project's possible reference character in a country/region. A good reason also could be the non-availability of certain components in Austria which are crucial for a project's viability.

When selecting the measures proving a company's importance for the Austrian economy, it was particularly essential for us to find simple and clear criteria that can be compiled and provided by companies without any difficulties and in-depth analyses.

Finally, it should be mentioned that in case of bigger multisourcing deals with only a few third-country partners supplying large portions, or in case of country-specific portfolio restrictions, we will continue – as in the past – to outsource high foreign content parts by asking other ECAs or the private insurance market for re-insurance.

Summarising...

Export finance is often regarded as a dry and dispassionate topic. In reality, however, we are working in a complex and demanding industry jointly with challenging partners from different cultural backgrounds. We have to be familiar with global political contexts as well as with the micro-economic project aspects and we should have a grasp how people from other professional backgrounds, how technical engineers and how lawyers think and communicate.

This mixture of skills enables us to assess country risk and risks associated with customers in our daily work, to evaluate social and environmental aspects, to understand the strategy of our competitors and also to pursue a sensible approach towards the question of national value added content in exports.

Despite its technical flavour, the topic of 'value added' is an interesting and immensely important political issue. Being aware of different aspects is essential to decide on a policy that best fits the needs of a given country's economy.

Collaborating closely with the Austrian Ministry of Finance, OeKB tries to make up for the disadvantages in international trade that arise from the small size of the economy, the high share of SMEs, a low degree of political power and only a small number of domestic firms with investments abroad. We are striving to serve our business community by taking decisions fast, by adapting the policy framework to mega-trends – such as in the question of national content –, by flexibility, innovation as well as by a dedicated customer orientation.

Having been awarded recently by TXF the Exporter's Choice award 'Best Performing ECA 2016', we are confident that we are on the right track for the future. ■

Ten years of SERV: achievements and challenges

This year, Swiss Export Risk Insurance (SERV) is celebrating 10 years in business. The milestone is the perfect opportunity to review its most important innovations and challenges.

The export industry is in a state of constant change and public export credit agencies (ECAs) are always having to react to new market requirements. Switzerland, as an export nation, also faces a steady stream of challenges. Reacting appropriately to these changes is the primary task SERV must accomplish to fulfil its mission.

SERV must grapple with changes that are taking place at different levels, in different areas of action and are determined, first and foremost, by the activities of SERV's customers. Its focus is therefore primarily on the exporter's perspective when trying to recognise trends and challenges as early as possible. This is achieved by continually observing the markets, regularly evaluating customer needs, and systematically following economic and political risks.

Proven support

Export Risk Guarantee (ERG), which was founded as a measure against unemployment in 1934, has proven itself to be a means of aiding economic growth. The changing needs of customers, however, demanded a reorganisation. That is why SERV superseded the ERG as of 1 January 2007.

The change meant more than just a different name. It was a turning point. The organisational structure of SERV was oriented towards efficient company management. Customer orientation remained SERV's highest priority – aiding the Swiss export economy in an even more targeted manner. The possibility to insure private buyer risk (PBR) was introduced. The figures today demonstrate that this change was necessary: SERV achieved positive results the year it was founded and, today, the PBR business accounts for three quarters of the total commitment of SERV.

SERV's importance was demonstrated after the financial and economic crisis of 2008/2009, when many Swiss exporters experienced a slump in demand and their liquidity situation worsened. The abolition of the franc's floor against the euro by the Swiss National Bank on 15 January 2015 placed the Swiss export industry under increased pressure. SERV, through the temporary introduction of products to improve exporters' liquidity management, helped ease the pressure, especially for Swiss SMEs. Josef Troxler, CEO of the Swiss SME Ampegon AG, states: "SERV is vital to us. Thanks to its support, we are able to take commercial risks that may break our neck."

The new products – working capital insurance, counter guarantee and refinancing guarantee – proved successful. Their period of validity was extended by four years in 2011 and transferred into the permanent product range in 2016. Their success is evidenced by their increasing demand, which accounts for 33% of new business.

New trends

New trends have become apparent in recent times. SERV wants to accommodate these developments through different lines of action to fulfil its mission for the benefit of the export economy.

Globalisation is continuing. In addition to traditional exporters that produce on a grand scale in Switzerland, there are more and more enterprises in SERV's customer base concentrating on their management, research and development, financing and marketing functions. That is why SERV also made its requirements concerning Swiss exporters' content eligibility more flexible, as the previous demands were no longer productive.

SERV still adheres to the Swiss content principle, but it will cover export transactions even if the Swiss content of the deal is less than 50% of the insured amount. The condition is that exporters can show that their activities in Switzerland are worthy of support in keeping with SERV's business policy objectives. Above all, service exports demand an adequate interpretation of the content, which must be decoupled from ideas of classic machinery- or installation-based transactions.

Once-solid states have lost a considerable amount of creditworthiness because of their high level of debt, ongoing economic problems, or political tensions. Government risks are sometimes greater than private buyer risks in these countries. Swiss exporters are also forced to enter new and difficult markets because of the stagnant demand from these countries.

On the one hand, large regions such as Eurasia, MENA, and South America – which had been established as target markets of the Swiss export economy or considered to be promising – were rejected due to political tensions, military conflicts and collapsing commodity prices, and they generate only a minimal volume of demand. On the other hand, Swiss exporters are facing increasing international financing competition and are confronted with competitors that are strongly supported by their export credit agencies. SMEs are reaching their limits where financing their export activities is concerned, and banks cannot always overcome this.

SERV has also seen a rise in projects with more complex sourcing and financing structures. These require lots of time to process and a vast amount of know-how. In addition, there is a growing demand for digitalised business processing.

SERV must be able to guarantee the best possible cover and be able to deal with special regulatory and technological risks, as well as elaborate financing and cover structures. These efforts must not be made at the expense of the high standards that SERV maintains in the area of sustainability and will further develop in accordance with national and international regulations. "It is now up to SERV to develop new solutions and to tackle these new challenges, so that SERV will continue to be a customer-oriented, reliable instrument for Swiss exporters in the future", Peter Gisler, director of SERV, explains. ■

Globalisation is continuing. In addition to traditional exporters that produce on a grand scale in Switzerland, there are more and more enterprises in SERV's customer base concentrating on their management, research and development, financing and marketing functions.

"Customer orientation remained SERV's highest priority – aiding the Swiss export economy in an even more targeted manner. The possibility to insure private buyer risk (PBR) was introduced. The figures today demonstrate that this change was necessary: SERV achieved positive results the year it was founded and, today, the PBR business accounts for three quarters of the total commitment of SERV."

EXIM Hungary: supporting small and large

Smaller ECAs like Hungary EXIM have a key role to play in both supporting SMEs and partnering with other ECAs on large scale project financings. By Zoltan Urban, CEO EXIM Hungary.

According to the World Bank's Economic Complexity Index, Hungary was the 14th most complex economy in 2015, while according to IMF statistics it was the 57th largest economy in the world with $265.037 billion of annual output. The country's gross domestic product (GDP) totalled $121.72 billion in 2015.

Hungary is clearly an export-oriented market economy with a heavy emphasis on foreign trade. It is the world's 35th largest exporter, selling close to $110 billion overseas in 2015. These exports accounted for 90% of GDP. It also has a substantial trade surplus of $9.003 billion, of which 79% went to EU markets, according to Central Statistical Office data.

Hungary's key foreign trade partners are Germany, Austria, Romania, Slovakia, France, Italy, Poland and the Czech Republic. Breakdown of Hungarian exports by main product group is as follows: electronic equipment (approximately 20% of total exports), machines, engines and pumps (18.9%), vehicles (13.9%), pharmaceuticals (4.7%), medical and technical equipment (4.2%), plastics (3.9%), oil (3.5%), rubber (2.4%), furniture, lighting and signs (1.8%), and iron or steel products (1.6%).

The EXIM Hungary mandate

Hungarian Export Credit Insurance and Hungarian Export-Import Bank (EXIM Hungary) is both an insurance company and a bank. The insurance activity of EXIM Hungary typically supports short-term deals that essentially require export credit insurance only. EXIM Hungary as a bank also occasionally finances medium- to long-term (MLT) transactions based on Organisation for Economic Co-operation (OECD) rules as buyer's credit and tied aid facilities. Although their value can be higher, the number of the transactions is significantly lower.

Zoltan Urban

The fact that the structure of global industry has dramatically changed over the last few decades should not be neglected. Consequently, companies do not keep production in one country but rather invest in production facilities abroad to benefit from lower labour costs, tax incentives, etc. This trend has also resulted in foreign trade transactions becoming more complex, often now requiring the support of multiple ECAs.

The recently signed deal between General Electric, Indonesian power utility PLN (Perusahaan Listik Negara), EXIM Hungary and Export Development Canada (EDC) is the best example of international cooperation between two ECAs.

Given the relatively small size of Hungary's economy and the lack of companies with sufficient scale, many Hungarian companies – and as such EXIM Hungary –cannot participate in large-scale transactions alone. A joint approach with international partners however provides an opportunity for smaller economies like Hungary to participate in large-scale projects. This may open many opportunities in the future for smaller ECAs and EXIM Hungary plans to take advantage of these as much as possible. We trust that a smaller ECA like EXIM Hungary will also have the chance to play a significant role in a large-scale transaction, which is a promising prospect for the future.

The recently signed deal between General Electric, Indonesian power utility PLN (Perusahaan Listik Negara), EXIM Hungary and Export Development Canada (EDC) is the best example of international cooperation between two ECAs.

PLN's EXIM Hungary/ECD-backed loan

The overall project value is in excess of $575 million, of which $453 million is co-financed by EXIM Hungary (50%) and EDC (50%) with a 12-year loan. The transaction includes the installation of eight General Electric mobile power plants in regions with low electrification rates in Indonesia. As a result, the installed capacity has been increased by 500 MW, meaning that electricity will be delivered to approximately 4 million Indonesian homes. This project also contributes to the Indonesian government's goal of installing 35GW of new power capacity by 2019, which will result in a 99.7 % electrification ratio in the country.

The deal proves that Hungary plays an important role in the global value chain of the energy sector, and that EXIM Hungary, with its biggest ever participation as co-lender with EDC, is strengthening its presence in international export financing markets.

This deal is not only beneficial for Hungary's export relations but for its national economy as well. The exports generated by this deal are worth more than $276 million, and it directly and indirectly adds more than HUF27.21 billion to Hungary's GDP.

With this deal, EXIM Hungary has proven that a small economy is able to compete with more developed economies and provide an adequate level of service. To further accelerate Hungary's export activity in the future, EXIM Hungary plans to participate in similar projects with domestic companies and, as a result, enhance the international competitiveness of Hungarian exporters with a special focus on SMEs. To help these companies succeed in their export activity, financing would be provided by EXIM Hungary up to the proportion of the Hungarian content of the given projects.

Due to global changes, we believe that the role of smaller ECAs can increase in the future and we trust that a key factor in our success will be developing our international network and building new relationships. ■

Creating a competitive edge for Hungarian exporters

Local currency finance: local support in a global marketplace

Paul Radford, chief economist at UK Export Finance, talks about why – and how – the UK's export credit agency is allowing overseas buyers to buy British and pay local.

A major part of the role of an export credit agency (ECA) is to ensure that its country's exporters are able to meet the demands of an overseas buyer in a competitive global market place. As the world's first ECA, with its centenary coming up in 2019, UK Export Finance (UKEF) has always seen this as its guiding mandate.

One of our strategic priorities is therefore innovation and flexibility. This is evident in a number of our recent major transactions. These include the hybrid project finance/reserve-based lending structure for a GE Oil & Gas contract with Ghana's Offshore Cape Three Points project, and the first ever ECA loan to the Kurdistan Regional Government of Iraq in support of a Biwater contract.

Widened support

The UK Government's 2016 Autumn Statement was another major milestone. The Chancellor of the Exchequer not only doubled our risk appetite limit to £5 billion and increased our capacity for individual markets by up to 100%, he also announced UKEF's significantly widened local currency financing offering.

So why is this important? One of the main ways ECAs support exporters is by guaranteeing loans to an overseas buyer/borrower to finance the purchase of capital goods and/or services. Traditionally, these loans tend to be in the main trading currencies, such as US dollars, sterling and euros.

Paul Radford

However, many major projects, for example water, power infrastructure, and local transport, do not generate foreign currency revenues, meaning that the overseas buyer or borrower may prefer a loan in its home currency.

Local currency financing (LCF) helps to fill this gap. Under a local currency scheme, the ECA guarantees the loan in the overseas buyer or borrower's home currency. This helps the buyer or borrower reduce foreign currency risk and eliminate a source of uncertainty over the cost of servicing the loan. Furthermore, the OECD permits premium discounts of up to 20% from its set minimum premium rate (MPR) for transactions in local currencies, under certain conditions.

That is why UKEF has expanded its local currency offering, quadrupling the number of pre-approved currencies supported from ten to 40. Local currency financing is now available as standard for buyer credit loans where the value of the contract is at least £5 million. And we are constantly looking to update our list of eligible currencies; indeed, we can consider any currency on a case-by-case basis if it satisfies our risk standards.

Many major projects, for example water, power infrastructure, and local transport, do not generate foreign currency revenues, meaning that the overseas buyer or borrower may prefer a loan in its home currency. Local currency financing helps to fill this gap.

Local currency financing in practice

The attractiveness of this offering is evident when you look at some of the transactions we've supported.

Take, for example, UK coach manufacturer Alexander Dennis's delivery of 90 buses to Mexico City's transport authority Metrobus. These lightweight, fuel-efficient buses will drive along the Paseo de la Reforma, the iconic 'Champs-Élysées' of Mexico City, easing overcrowding in a city of 20 million people.

Earlier this year, UKEF was able to guarantee a loan in Mexican pesos (MXN) to support the MXN 1 billion contract. This is the first transaction UKEF has supported in Mexican pesos, and helped ensure that the buyer looked to the UK to procure the buses.

In 2015, UKEF became the first non-Chinese ECA to guarantee a loan in offshore renminbi when it supported an aircraft delivery to China Southern Airlines. The offshore renminbi is one of the most used currencies in trade finance. This capability supports the UK Government's wider ambitions to strengthen trade ties with China and consolidate London's position as the largest offshore renminbi centre outside Asia.

So UKEF's local currency financing offering is clearly good news for UK exporters.

Managing the risk

However, from a risk perspective, it poses some interesting questions. Just like a standard ECA-backed guarantee, there is the risk of default – something we analyse, take a decision on and manage as a matter of course.

Risks around the currency play a role, such as currency convertibility and currency volatility. We have to consider whether there is a suitable bank that can fund and lend in local currencies for the required term and whether there is sufficient stability and liquidity in the banking sector in the overseas buyer/borrower's country. There are also the usual considerations around any political risk in the country.

To manage these risks we can take a number of factors into account. For example, we can use the country's local currency creditworthiness to assess the risk of default. Appropriate due diligence, including consideration of the credit ratings of the banks helps us to identify the stability of the banking and financial sectors as well as identifying organisations that have the capacity or capability to lend for the terms and amounts required. The World Bank's Rule of Law Index can provide a good indication around governance indicators and information on currency convertibility is readily available.

Finally, to mitigate the risk of currency volatility, we can include a crystallisation clause as a condition of support. This clause is used to convert outstanding claims into the ECA's host currency at a pre-determined fixed exchange rate. However, it can be difficult to verify beforehand whether or not a corporate or bank in the overseas country will accept such a clause. Furthermore, it might not be possible for the overseas borrower to incur foreign currency denominated debt, meaning that we would not be able to include a clause. Regardless of how volatile the currency is, it may be prudent to add a crystallisation clause if legally possible.

Earlier this year, UKEF was able to guarantee a loan in Mexican pesos (MXN) to support the MXN 1 billion contract. This is the first transaction UKEF has supported in Mexican pesos, and helped ensure that the buyer looked to the UK to procure the buses.

Despite these additional technical considerations, we believe our local currency support can help UK exporters make their overseas offering even more attractive, and we look forward to supporting transactions in everything from the Brazilian Real to the Zambian Kwacha.

Conclusion

The UK Government has been clear in its ambition for the UK to be a champion for free trade, addressing barriers and advocating for as frictionless a global trading environment as possible. By offering financing in any of 40 currencies at the buyer's choice, UKEF is playing its role in helping the UK's exporters access a truly global marketplace. ■

CGIF's construction period guarantee: kick-starting greenfield project bonds

Construction risk has long been an impediment for the use of project bonds to finance greenfield infrastructure projects. The Credit Guarantee and Investment Facility (CGIF) recently introduced an innovative solution to mobilise long-term savings in local currencies in developing Asia to finance greenfield infrastructure projects through project bonds, discusses CGIF's CEO, Kiyochi Nishimura.

The challenges of financing infrastructure with local currency savings

Developing Asia, like other emerging economies, faces a daunting challenge to meet its huge infrastructure investment needs. Developing Asia will need to invest $26 trillion from 2016 to 2030, or $1.7 trillion per year, in order to maintain the region's growth momentum, eradicate poverty, and respond to climate change, according to the Asian Development Bank (ADB)'s latest forecast. To meet this challenge, private sector participation is now more crucial than ever. The ADB estimates private sector financing in 24 Asian developing countries will have to increase from $63 billion a year today to $250 billion a year during 2016-2020 to fill this gap.

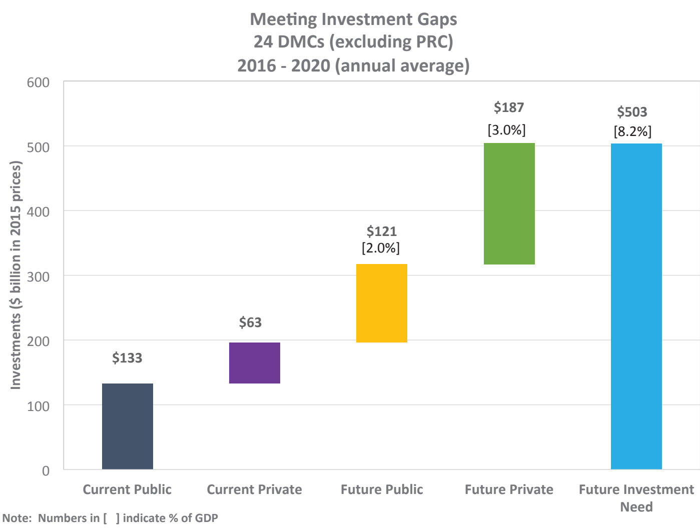
Furthermore, a bulk of private sector financing will need to come in local currencies to avoid the currency mismatch, because many of the infrastructure projects rely on local currency revenues to pay back their debt. Even when foreign currency indexation mechanisms are available for revenue streams, the sustainability of such mechanisms is questionable in the event of a currency crisis, as some Asian countries learned the hard way during the Asian financial crisis in the late 90s. The real solution should be to fund infrastructure investment in local currencies.

CGIF is a new multilateral institution established by 13 Asian countries comprising of all ten member countries of the Association of Southeast Asian Nations (ASEAN), and their 'Plus 3' partner countries which are China, Japan and Korea, together with the ADB to help overcome these challenges. The CGIF provides guarantees to local currency bonds issued by corporates and projects mainly in the ASEAN countries to help facilitate their access to bond markets.

Kiyochi Nishimura

While the CGIF can support corporates or projects in a wide range of sectors/industries, its guarantee support is particularly useful for

Figure 1: Infrastructure investment gaps



Source: ADB

infrastructure projects. This is because one of the solutions to overcome the challenges above is to facilitate the channeling of domestic long-term savings in emerging economies to finance infrastructure projects directly via project bonds, particularly at the greenfield stage. On the back of steady economic growth, and the rise of income levels with growing middle income population, many ASEAN countries are now witnessing rapid accumulation of local currency long-term savings in their pension and insurance funds. These long-term savings invariably need long-term investment opportunities, and the stable cash flows of infrastructure projects would be ideal for them.

The CGIF has been working with the ASEAN governments, regulators, rating agencies and bond investors for several years to boost the flows of domestic currency funding into infrastructure projects in the ASEAN countries, in particular green-field projects. Mobilising long-term savings in pension and insurance funds in these countries may be the most efficient model of financing infrastructure by long-term local currency funds, only a few countries in the region have successfully pursued this capability. A critical impediment against mobilising long-term savings is the low risk appetite of pension and insurance fund managers and, in particular, their aversion to construction risks.

Construction Period Guarantee Facility (CPG)

The CGIF's Construction Period Guarantee (CPG) facility is aimed at allaying domestic bond investors' concerns about construction risks. It ensures the completion of construction works and the commencement of the operations phase in a project, which will be financed by project bonds issued in the local currency bond market in the region.

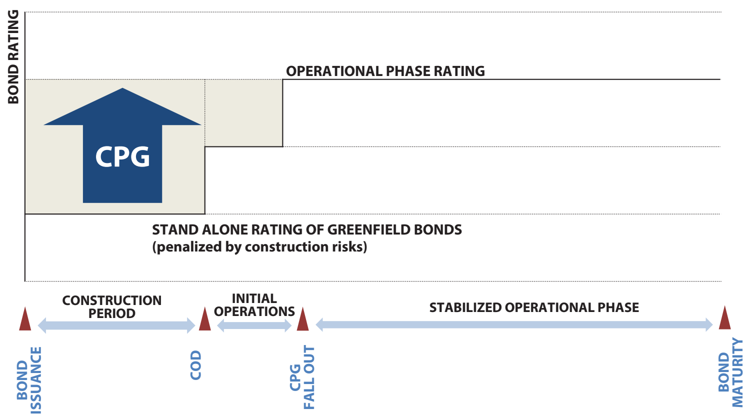
Under this facility, the CGIF irrevocably and unconditionally guarantees non-payment of scheduled payments for the project's bonds occurring prior to the commencement of commercial operations. If a project's completion is delayed, the CGIF shall ensure that the project bonds are adequately serviced on a timely basis. In the unlikely event that it cannot be completed, the CGIF shall accelerate the guaranteed bonds and pay in full the principal and accrued interest amounts to bondholders.

Developing Asia will need to invest $26 trillion from 2016 to 2030, or $1.7 trillion per year, in order to maintain the region's growth momentum, eradicate poverty, and respond to climate change, according to the Asian Development Bank.

Generally, the CPG facility will cover the construction period as well as a reasonable buffer period to allow for possible delays in the project's construction. Therefore, the tenor of the CPG facility is expected to be for a three to five year period or so at the outset, but if the construction is further delayed, the CPG cover will continue until the project meets the completion milestone. Depending on the nature of the project (e.g. the initial ramp-up period is necessary before being fully operational) and investors' requirements, the CPG facility could also be extended to cover the initial operation period until the project actually demonstrates its ability to generate stable cash flows. Such flexibility embedded in the CPG facility is important to address bond investors' concerns about possible construction delays.

When the ratings agencies assess greenfield infrastructure bonds, their ratings

Figure 2: CPG's Rating Uplift



can be seriously constrained by construction risks. This is despite the fact that the projects may have stable and robust cash flows during the operational period, and even though the construction period is far shorter than the operational period.

There are many elements of risks during the construction period which are highly complex to assess. The investors, therefore, need pricing of the bonds that ultimately reflects these risks. This generally makes bond financing for such deals economically unviable when the long-term bonds are priced considerably higher based on risks which are likely to be overcome in a relatively short period of time. By removing risks during the construction period entirely from the transactions, the CGP facility eradicates any rating penalties arising from such risks, allowing bond investors to focus only on the operational risks of the projects, and enabling lower fixed interest rates to be applied from the onset.

. . . a bulk of private sector financing will need to come in local currencies to avoid the currency mismatch, because many of the infrastructure projects rely on local currency revenues to pay back their debt.

Changing project financing landscape in ASEAN

The CPG facility is anticipated to boost the use of local currency project bonds for new projects in the region by eliminating construction risks for bondholders investing in greenfield projects.

While local bank lenders in the ASEAN countries are liquid and usually very keen to finance infrastructure projects, even on a project financing basis often at attractive pricing, bond finance can bring certainty to project sponsors with fixed interest rates, which is a common feature of bond finance. Moreover, while local banks can lend for up to 12 years or so, bond investors can provide longer tenors of up to 20 years or even longer in some countries.

Stretching a finance tenor will improve the project's economics and create room to reduce the tariff levels. Finally, project sponsors will be able to diversify their funding sources. This is especially vital to overcome single group exposure limits imposed on bank lending In the Philippines. For example, there are only a small number of leading domestic conglomerates engaged in a wide range of infrastructure projects, and single group exposure limits hinder the development of greenfield infrastructure projects. The CPG facility will unlock a great variety of benefits of bond finance to green-field infrastructure projects.

In the developed economies, major institutional bond investors such as global insurance companies and leading pension funds, have their own internal expertise and manpower to supplement the project finance banks in funding greenfield infrastructure projects. But in the emerging economies of the ASEAN, there is little internal capacity among domestic bond investors, such as pension and insurance fund managers. It will be very costly and time-consuming to develop expertise in-house.

The CGIF has developed a comprehensive assessment framework that allows these risks to be measured and managed. Components of this framework will allow for expert judgement of the various risk factors relating to the construction works as critical inputs in the assessment. Risks are also managed by the CPG's boilerplate requirements for the various contractual agreements and risk mitigants that are consistent with international project finance practices.

While domestic bond investors in the ASEAN countries may first rely on the CPG facility, the CGIF plans to share its assessment tools with these bond investors. Replicating the CGIF's assessment framework, they will become familiarised with the assessment of construction risks and will develop their own capacities in the future to understand, evaluate and mitigate construction risks to acceptable levels. This will allow them to invest in greenfield bonds independently even without the CPG's support. If this happens, it will fundamentally change the landscape of project financing in the ASEAN countries. This may take some time but CGIF is committed to bring this change to the region. ■

Innovative ways to invest in India

For the first time in its history, Export Development Canada provided a loan to an Indian infrastructure leader, in India's own currency. Bill Brown, regional vice president, Asia, Export Development Canada (EDC) talks through the achievements and challenges of the loan, and if there is more to come.

India's economy is booming and is forecasted to do so for the foreseeable future. The growth of the middle class - and the massive urban transformation that comes with it - creates unprecedented opportunities for international business in the infrastructure sector. The country needs about $1.5 trillion of investments in the infrastructure sector in the next ten years, according to the The Economic Times Indian Infra Summit. The opportunity is undeniable, but how can an export credit agency help its companies tap into that business? The only way is by finding innovative ways of being relevant to the market and giving those businesses what they need.

EDC, the Canadian crown corporation mandated to provide financing, insurance, bonding, trade knowledge and matchmaking connections to Canadian companies seeking to export and invest abroad — wanted to help its customers gain access to this growing market. In November, EDC took the unusual step of providing the rupee (INR) the equivalent of $50 million in financing to Mumbai's Infrastructure Leasing & Financial Services (IL&FS), one of India's largest infrastructure developers. The deal is known by both parties as the Masala loan, so named for an Indian spice mixture.

Bill Brown

The loan is considered an external commercial borrowing (ECB) loan. These are loans made by non-resident lenders. They are common in India as a way to facilitate much needed access to foreign money by Indian corporations and public-sector entities, which are the lifeblood of India's explosive economy. ECBs are broad and can include commercial bank loans, buyers' credit, suppliers' credit, securitised instruments such as floating rate notes and fixed-rate bonds, credit from official export credit agencies and commercial borrowings from financial institutions. Some sources say ECBs have been responsible for between 20% and 35% of India's total investment flows into the country.

This deal stemmed from a regulatory change in ECBs by the Reserve Bank of India for transactions in the infrastructure segment. The bank imposed a minimum tenure of ten years on transactions, a tenure considered by EDC and most commercial banks to be too long as its own average

India's economy is booming and is forecasted to do so for the foreseeable future. The growth of the middle class - and the massive urban transformation that comes with it - creates unprecedented opportunities for international business in the infrastructure sector.

standard transaction length is generally five to seven years.

The other challenge was that EDC did not have an Indian rupee bank account, which limited the ability to raise rupees through its bonds. As a foreign lender, EDC had to create a unique structure with an embedded derivative to allow it to do a currency swap, converting its US dollar accounts for rupees and thereby reducing currency risk. EDC succeeded in doing this by partnering with the Bank of Nova Scotia. It was a solution that overcame both obstacles EDC faced in its efforts to help Canadian companies access lucrative infrastructure contracts in India.

Entering uncharted territory

Once it came together, it was a deal of firsts: it was the first time EDC had dealt with IL&FS; it was EDC's first rupee deal, and the first ECB deal under the revised guidelines in India.

As smaller Canadian suppliers compete in this globalised industry, they have increasingly asked EDC to help them make new connections with foreign buyers. The goal with the IL&FS deal was to respond to the needs of Indian companies and make it easier for Canadian suppliers to win new infrastructure business. Canadian companies are well known for their capabilities in infrastructure projects of all kinds and sizes and IL&FS can give them a foothold in the lucrative Indian market. Now that this deal is done, the broader goal is to effectively develop the solution so EDC can offer it to a wider customer base.

IL&FS, with its large global supply chain and base in growth-rich India, was at the top of the wish list of those companies. This was partly because it has a strong interest in working with Canadian companies. IL&FS's distinct mandate involves catalyzing the development of infrastructure in the country. It has focused on the commercialisation and development of infrastructure projects and the creation of value-added financial services.

Since 2013 – long before the new financing from EDC – IL&FS has procured approximately $2 million in goods and services from Canadian companies. With EDC's financing help, it is hoped that this number will skyrocket to more than $4 million per year.

Once it came together, it was a deal of firsts: It was the first time EDC had dealt with IL&FS; it was EDC's first rupee deal, and the first ECB deal under the revised guidelines in India.

Nathan Nelson, EDC's former chief representative in India, noted at the time of the deal that IL&FS had met with more than 50 Canadian companies over the previous two years and was planning to meet with another 25 in November when the group was to travel to Canada for a trade mission. He said IL&FS was part of an important value chain in the Indian market with a clear interest in doing more business with Canadian companies, particularly those that have expertise in surface transport, power and urban infrastructure and mapping.

Ramesh Bawa, IL&FS's CEO and managing director, said EDC's loan has showed confidence for his company. He noted that EDC's support through the Masala loan was crucial as it enabled IL&FS to eliminate currency risk entirely and deploy funding directly into the various requirements for its infrastructure projects without having to convert foreign funds to Indian rupees. He

EDC's support through the Masala loan was crucial as it enabled IL&FS to eliminate currency risk entirely and deploy funding directly into the various requirements for its infrastructure projects without having to convert foreign funds to Indian rupees.

said having a reputable institution such as EDC, partner with IL&FS, on not only its first Masala ECB, but also its first funding from a Canadian institution, speaks to the importance of the work that his company does in India.

EDC targets companies such as IL&FS, whose procurement needs match up naturally with Canadian expertise. Once EDC has a detailed understanding of a company's supply chain and business goals, its agents provide introductions to qualified Canadian companies with well-matched expertise. IL&FS is specifically interested in Canadian companies that can help it innovate and reduce costs in upcoming road, port, power, sanitation, waste management and water projects.

A winning contract

Canada's IBI Group was one such company to succeed in getting a contract: "IBI saw India as a tremendous growth market," said Deepak Darda, director, India and South Asia lead, IBI Group, Canada. "It provided us huge opportunities where we could actually bring our Canadian expertise into the market, whether it was the national highway programme in India, or the tremendous growth that the Indian cities were experiencing."

Darda said they learned about the IL&FS opportunity when they approached EDC for connections with large-scale infrastructure players." As a result, we have been awarded a contract where we are providing our advisory services to evaluate a toll highway asset for IL&FS," he said.

Anita Ferreira, head of International Business Group at IL&FS Financial Services Group India, said her company is delighted to be working with Canadians. "The thing that set the Canadian companies apart is that level of professionalism and their area of expertise and that they were willing to tailor the solution to our requirements," she said. "You need solutions that work for the project you are doing. There was a lot of outside-the-box thinking that they were willing to do."

Another foreign currency deal

Based on the success of its experience in India, EDC opened a local peso account that offers new opportunities in Mexico. Until this year, when an EDC customer was doing business in Mexico needing to complete a transaction in Mexican pesos, it had to go to England. EDC responded to that quandary by opening its first peso account in Mexico. This marked the first foreign currency account to be located within its local territory, outside the major international financial centres.

The account was opened in partnership with Scotiabank Inverlat Mexico and represents an important milestone for EDC Mexico to establish new relationships and diversify its borrowing base.

Having an account based in the exporting market facilitates existing business and opens the door to opportunities that may previously have been missed. By providing the same borrowing currency as local banks with a same-day settlement period, EDC can better serve current and future customers who need that flexibility. To remain relevant in an increasingly competitive market, it needs to be able to match local bank financing and respond to Mexican customer and prospect needs.

If the peso account is successful, EDC may look at exploring other local currency accounts in markets, such as Singapore, Chile, and India. The bottom line is that to remain relevant in today's global economy, financial institutions and export credit agencies must be creative with their offerings in order to meet the needs of its customers and foreign markets. ■

Based on the success of its experience in India, EDC opened a local peso account that offers new opportunities in Mexico. . . . If the peso account is successful, EDC may look at exploring other local currency accounts in markets, such as Singapore, Chile, and India.

How political risks have disrupted trade across the MENA region

Karim Nasrallah, general manager of LCI assesses the evolution of political risks and trade disruption in the MENA region.

In a geographical zone where oil and exports dominate inter-regional trade figures, the global fluctuation in oil prices and decreasing demand have dampened the economic outlook of many countries in the MENA region. However, the ripples of change are not solely tied to oil, or oil rich nations per se. The MENA region has experienced a wave of transformations in the past few years and the repercussions are still surfacing. From political turmoil in numerous countries, ongoing wars which have resulted in a growing regional, and to a lesser extent, international, refugee crisis, along with the boycotting of one country (Qatar), the business climate is being tried and tested. All industries have been impacted and risk management strategies are evolving on a day to day basis, adapting to a new wave of changes.

On an international scale, markets can no longer function in solitude, rather, a global market place has surfaced and occurrences in remote areas now impact businesses across continents. This interconnected marketplace has both advantages and disadvantages. Today, risks that companies are exposed to are diverse and are shared by all entities and must be proactively dealt with to preserve business interests.


Karim Nasrallah

In terms of trade, trends have both arisen and disappeared within the same week in some cases. The flow of trade has also diverged, with disruption happening at numerous phases in the cycle. Accordingly, credit insurers are paying close attention to both safeguard their clients' businesses and mitigate risk.

At present, the global outlook on trade remains uncertain. Brexit's repercussions are coming into the spotlight, with companies moving their headquarters out of Britain. Gulf Cooperation Council (GCC) nations are shifting from being oil-dependent economies to diversified ones, and indications made by the current US administration that the country is shifting towards protectionism are making headlines. Political transformations in numerous countries along with the questionable state of security – all these factors impact trade in different ways.

For companies operating and trading in such a dynamic and challenging marketplace, tailoring solutions as well as diversifying the

On an international scale, markets can no longer function in solitude, rather, a global market place has surfaced and occurrences in remote areas now impact businesses across continents. This interconnected marketplace has both advantages and disadvantages.

spread of risk to create a well-balanced portfolio are required.

When it comes to the MENA region, the most notable changes over the past few years that have disrupted trade, are the boycotting of Qatar and the dampening of the economy in Saudi Arabia. Egypt too has witnessed a currency devaluation that has dampened trade and the economy. Each of these shifts has brought about political risks that have impacted the way companies are trading.

In the case of Qatar, in mid-2017, tension began to rise between Saudi Arabia, the United Arab Emirates, Bahrain and Egypt – against the small oil rich nation, with an economy that relies heavily on global demand for petroleum and liquefied natural gas (LNG). Qatar is the world's top exporter of LNG, with key markets including Asia and Europe. Qatar also depends heavily on food imports, due to unfavourable agricultural conditions locally. Nearly 40% of Qatar's food imports were from Saudi Arabia before the boycott, with a total of 80% of Qatar's food requirements coming from other Arab nations.

However, tensions intensified due to political pressures. Within 48 hours, the entire dynamic of the GCC region had changed. Qataris were given mere hours and days to leave the United Arab Emirates, and Saudi Arabia ceased all shipments to the country. Qatar Airways was banned from flying over certain airspaces. Qatar responded by exploring other routes to obtain resources.

This incident has impacted Qatar in numerous ways, with local companies experiencing slow collection rates to obtain their trade receivables from the aforementioned countries that formed a coalition against the nation. Banks in the UAE, Saudi Arabia, Bahrain and Egypt now enforce tighter due diligence before any transfer is made, when dealing with Qatari companies. This measure went as far as banks checking and verifying if the transaction was made before the date of the embargo. In one case, companies in the UAE were transferring funds via other countries, in smaller installments, to avoid the banks blocking the transfer.

Along with the importing of foodstuffs to Qatar, other shipments were also prohibited from entering the small nation. Companies that have clients in Qatar responded by shipping via other nations that were not impacted by the embargo. Businesses operating in Qatar have been heavily impacted by this move, in particular, those exporting goods to GCC nations, and cash flow issues have been at the forefront of their challenges.

The repercussions of the political risks that have made headlines of late, are expected to surface over the coming months. Businesses across the region have adopted a 'wait and see' approach and are taking conservative measures, provisioning for any future disruptions.

Shifting to the West, Saudi Arabia perhaps witnessed the greatest transformation, from an oil-rich economic player, to one with a dampened economy and negative economic outlook. The country's credit rating was cut by Standard & Poor, with the agency indicating that the decline in oil prices will increase the budget deficit in a country that

When it comes to the MENA region, the most notable changes over the past few years that have disrupted trade, are the boycotting of Qatar and the dampening of the economy in Saudi Arabia. Egypt too has witnessed a currency devaluation that has dampened trade and the economy.

relies heavily on energy exports, which make up around 80% of its revenues. The Kingdom brought in top consultants from the world over, to work on a 2030 version, the goals of which are focused on diversifying its economy.

Prior to the decline in oil prices, the Saudi Arabian government became both directly and indirectly involved in two wars, the growing turmoil in Syria, in addition to igniting a war in neighbouring Yemen. Both cases heavily impacted the country's economy due to mounting costs related to sustaining / fueling these wars.

These changes have impacted the number of overdue and claim notifications in 2016, as well as early 2017, spiking figures. In addition, this repercussion reflects the cost cutting strategy that the Saudi Arabian government implemented to salvage the economic downturn.

In the United Arab Emirates, and particularly in Dubai, an emirate that made unfavourable headlines in the 2008 economic crash that brought its economy to a near standstill, many changes have been recorded in recent months. Whilst some positive movement has been reported in specific sectors of the economy, not all the news is good.

On the one hand, the number of defaulting and runaway cases, which became the norm when the financial crisis swept through the country, decreased in the first half of 2017. However, the Emirate is still exposed to have more runaway cases that will result in significant losses in the coming months.

Moving to the most populous country in the Arab world, with a population of over 90 million, Egypt witnessed trade disruptions as a result of growing political risks in recent years. Having the third highest GDP in the MENA region, just over $336 billion (2016), the country has been facing many ongoing economic challenges.

Egypt's real GDP, as estimated by Standard & Poor's is projected to continue to grow at a moderate rate of just under 4% on average, until 2020. One of the major challenges that Egypt faced was the unavailability of foreign currency, which led to the Egyptian Central Bank devaluing the Egyptian pound, resulting in the slowdown of imports of different types of goods and impacting trade. However, the market still shows great potential in the industrial and agricultural sectors, both major contributors to the GDP. Other key industries in Egypt include textiles, food processing, chemicals and pharmaceuticals.

The Levant region witnessed disruptions in trade as well, due to wars, turmoil and political instability in Syria and Lebanon in specific. Due to the closing of land borders between Lebanon and Syria, Lebanese businesses were forced to ship goods via sea. However, the falling oil prices actually kept shipping costs at bay, which did not dampen exports greatly. However, the outlook for the economy remains unstable, with little growth forecasted in the coming months. Trade in Syria came to a near standstill due to the ongoing war spanning across the country.

The way forward

The outlook of trade in the MENA region, as well as globally, will continue to be uncertain for the foreseeable future. The repercussions of the political risks that have made headlines of late, are expected to surface over the coming months. Businesses across the region have adopted a 'wait and see' approach and are taking conservative measures, provisioning for any future disruptions. Growth in the trade sector is unlikely to be recorded in the coming months and will remain relatively stable well into the near future.

Companies need to work on safeguarding their assets and insuring their trade receivables to ensure they stay afloat in times of turmoil. ■

These changes have impacted the number of overdue and claim notifications in 2016, as well as early 2017, spiking figures. In addition, this repercussion reflects the cost cutting strategy that the Saudi Arabian government implemented to salvage the economic downturn.

Follow us
@TXFMedia
@TXFData
@tagmydeals

What is TXF Essentials?

Taking TXF Premium to the next level, TXF Essentials is your passport to the finest and most extensive source of industry news and data.

TXF Essentials is available in two simple packages: the project and export finance package; or the trade and commodity finance package — each priced at £1,999 per year.

What's included:

TXF Premium
Full access to TXF Premium News including exclusive interviews and alerts, guest articles, blogs, and special feature-length pieces.

The Chronicle
Over 100 pages of insightful, analytical long reads on the most interesting topics to hit all the industries covered. Delivered directly twice a year.

Online Deals Dashboard
A live online snapshot of the market showing deal flow, sectoral strength, structure, and geography.

Smart Data Search
Enhanced search with a range of market parameters to choose from to see the deals and the detailed deal information you need tabulated in just a few clicks.

Bi-annual Market Data Reports
Twice a year TXF compiles the data we collect into market reports covering Commodity Finance, ECA Finance, Country Risk, and DFI Finance, with evaluation and commentary from our analysts.

CIRR End of Month Report
A monthly report on the status of the Commercial Interest Reference Rate to help you plan when pricing deals and laying out project timelines.

Essential Survey Findings
An executive summary of our exclusive surveys, providing you with the latest market sentiment.

Want full coverage?
Are you interested in receiving the full TXF Essentials package covering all sectors, or the corporate package for your whole business? If so, contact Alex Sheriff (alex.sheriff@txfmedia.com).

Want more in-depth data?
TXF 360 offers you full access to TXF Data, our premium data product which includes an Excel add-in as well as bespoke data reports. Contact Alfonso Olivas (alfonso.olivas@txfmedia.com) for more information.

Ask the Analyst
For quick answers on data related requests, contact Sergio Lopez (sergio.lopez@txfmedia.com) and get a taste of what TXF Data has to offer...

Growth opportunities high for political risk and credit insurance providers

Daniel Riordan, president of global political risk, credit & bond insurance at XL Catlin, examines encouraging signs for the trade credit insurance marketplace, and looks at regional opportunities and risks.

Berne Union members know well that opportunities to provide insurance mirror the prevailing trends in global trade. Not surprisingly, demand for credit insurance has diminished slightly in markets where economic activity has slowed down. There are some cracks, such as the still-unknown impact of Brexit on the European Union, but the global economy overall is faring well. Bilateral trade is growing faster than multilateral trade, but the fact that trading activity remains robust is quite encouraging for the credit insurance marketplace.

China and Brazil, for example, previously led demand for credit insurance, but lately their economies have slowed. That reduction is offset, however, by increased demand for projects in countries such as Colombia, Peru and Argentina, and continuing strong demand in South-East Asia. Several areas of Africa, including Kenya, Uganda and nations in West Africa, also are seeing rapid development.

Infrastructure projects, whether they involve replacing aging assets or constructing new ones, are needed worldwide and represent a significant driver of credit insurance demand. That is a major reason for near-term growth opportunities on almost every continent, even in mature markets such as the United States and Canada.

Opportunities and risks everywhere

A cursory glance at the regions of the world shows that risks, as well as opportunities to provide insurance, are everywhere. Instability and uncertainty are present in:

Africa. Various countries in sub-Saharan Africa are experiencing a level of growth and investments not seen in a long time. But South Africa, at one time a model of economic growth and stability in the sub-Saharan region, is struggling.


Daniel Riordan

Asia. Political tensions remain high. China is expected to make leadership changes at its 19th Communist Party congress later this year. Domestic economic pressures and territorial disputes with its neighbours are mounting. Japan's economic future is unclear as relations between two of its largest trading partners, the United States and Russia, evolve. North Korea's military ambitions also continue to create tension in the region.

Europe. The European Union's future is clouded, with Britain's withdrawal ongoing. French voters this year averted a similar withdrawal by electing a presidential candidate who supports the EU. Major economic reforms are needed in areas of Europe to stimulate growth.

Latin America. Brazil is still struggling with an economic recession, though other Latin American nations have made impressive strides with reforms to improve stability and growth.

Middle East. Civil conflicts, a migration of refugees and depressed oil prices are taking a heavy toll on the region's economies.

Despite the widespread distribution of political risk and economic difficulties, opportunities continue to exist for insurers ready to look more deeply at situations that give others pause. Political risk and trade credit insurance are valuable tools, especially now.

Product development needed

With opportunities to provide credit

insurance and project finance protection all over the world, the insurance marketplace must continue to focus on delivering value. It is more important than ever to listen to buyers' needs and provide products that meet those demands.

For example, banks – longtime buyers of credit insurance – are under increasing regulatory pressure. Their capital charges on cross-border loans, for example, are the highest they have ever been. Financial institutions that are involved in financing large and complex projects need and are seeking capital relief. Credit insurance and project finance protection play important roles in providing such relief. Larger capacity and longer tenors from counterparties with robust balance sheets are especially helpful to banks today, even more than in the past.

Infrastructure development is often conducted in stages over a number of years. Such projects generally require more protection over prolonged periods. It is helpful for credit insurers, where possible, to extend protection up to as long as 20 years. This provides capital relief and reduces risk for sovereigns and financial institutions. It also helps communities to realise the projects' benefits, whether it is a new rail line, a port expansion, a toll road, an oil or gas facility, or another form of infrastructure.

Claims environment

The claims environment in credit insurance has been relatively light in recent years. Short-term export credit insurance, where tenors generally are 12 months or less, is where the highest frequency of claims occurs. Berne Union members have over the past three years seen moderate increases in short-term claims paid: $2.0 billion in 2014, $2.58 billion in 2015, and $2.78 billion in 2016. Short-term credit insurance premiums over that period have fallen slightly. If the loss ratio continues to rise without a corresponding increase in premium, that eventually will hurt insurers' results and create changes in the marketplace. The credit insurance market is healthy for the foreseeable future though.

On medium – and long-term export credit insurance and lending, claims continue to be fairly light, on par in dollar terms with short-term claims. What has changed – and is likely to increase further – is the amount of commercial risk claims. In 2015, for example, Berne Union members paid $1.34 billion in commercial risk medium/long-term claims. This nearly doubled in 2016, to $2.65 billion. At the same time, claims paid in political risk and lending fell sharply.

The nature of medium/long-term credit insurance means that claims take some time to develop. Writers of long-term credit insurance usually expect to see claims occurring around the five-year milestone. Although medium/long-term claims are lower in frequency than short-term claims, they can be large. Insurers' ability to select risks, monitor and analyse conditions and to engage with the appropriate parties – such as government ministers – can mitigate much of the loss exposure associated with medium/long-term credit insurance.

How Berne Union can help

The Berne Union has provided a valuable forum for both analysing and promoting global trade since its founding in 1934. It will remain important for Union members to collaborate and pool our vast resources – not just economically but also to share our expertise and help each other – to better understand the dynamics in political and credit risks.

Working together, we can create more relevant products that serve the changing needs of our customers. We can offer real solutions that reduce uncertainty arising from trade and provide capital relief.

There is enormous opportunity for Union members to engage in public/private partnerships that marry government support with expert analytical resources. Combining our strengths in this fashion can help members to identify and mitigate risks before they become claims. Disruptions can amount to much more than temporary inconveniences; they can in some cases jeopardise entire projects.

Political and economic volatility are, ironically, constant forces in the current of global trade. Navigating uncertainty and mitigating risk are vital to sustaining growth in trade. The Berne Union has played a critical role in that for 83 years and will continue to do so. ■

Daniel Riordan is president of global political risk, credit & bond insurance at XL Catlin. Before joining XL Catlin, he held various senior executive roles in political risk, specialty and global corporate property and casualty insurance at a leading global insurer. He has had a long association with the Berne Union, serving as president from 2013 to 2015.

The new normal of higher political risk

Rouben Nizard, economist for sub-Saharan Africa, from Coface's Economic Research Department, discusses the rise in political risk, and how political risk assessment must be sharper in the coming years.

Coface published a study called 'The rise and rise of political risks'[1] in March, presenting a new quantitative model of political risk. But recent developments, both in emerging economies and developed markets, pushed Coface to review its methodology of political risk assessment because of the potential disruptions to business activity that they entail.

In the past 18 months there have been elections or referendums in the United Kingdom, the United States, Italy, Spain, the Netherlands and France, which have grabbed the attention of investors, exporters and country risk analysts. This has fuelled a lot of talk about political risk. These political events are liable to shift radically the economic orientation of the countries involved. But they were often restricted to emerging economies with less robust institutions.

Nevertheless, as a return to growth has failed to offer equal opportunities to all economic participants, the past decade reminded us that social exasperation could grow indistinctively both in developed economies and in emerging markets.

Detecting social frustration, identifying political vulnerabilities

Social frustration can lead to a popular upheaval in emerging markets. It is on this intuition that one key module of the Coface political risk model is built, based on the full scale example given by the Arab Spring demonstrations, both in its violent and non-violent demonstrations.

The model also builds on the assumption that cracks in the foundations of the political system, which may lie in the nature of the regime, in the design of the institutions, in the degree of political freedom or in the cohesiveness of the population, expose all the more a country to risks.

Venezuela, plagued by corruption, inequalities, cronyism and corruption, was

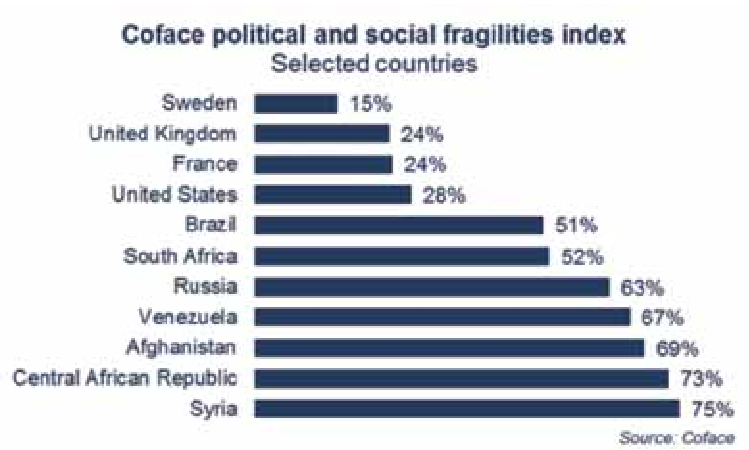
Rouben Nizard

12th in our 2016 ranking of the riskiest countries (see graph 1) in terms of social and political fragilities – behind the likes of Syria, Central African Republic, Afghanistan and Libya.

The constitutional crisis and the constituent assembly elections happened to spark mass protests. The Coface political and social fragilities index indicates that significant emerging countries could also be potential tinderboxes in the near future, including Brazil, Russia and South Africa. Notable events are a general election in Brazil, a presidential race in Russia and Jacob Zuma's succession as the head of South Africa still loom over us.

Much of the literature on political risks stresses that it is unpredictable and poorly designed policies which represent the main threat to business operation. The political and social fragilities pillar in the Coface model aims to detect weak signals leading to this type of

Graph 1



economic mismanagement. It was, indeed, observed in emerging countries. For example officially motivated by the idea of eliminating traces of colonialism, Zimbabwe's 'Fast-Track Land Reform' in the early 2000s, which translated into the violent expropriation of white landowners without compensation, was part of a larger scheme meant to maintain Robert Mugabe and ZANU-PF in power. The Zimbabwean case embodies the idea that nationalisation, burdensome regulations, expropriations, trade protectionism and so on often respond to the only objective of holding on to power. Raising the spectre of these policies might as well serve to cease power.

Why measuring a surge in populist rhetoric became necessary

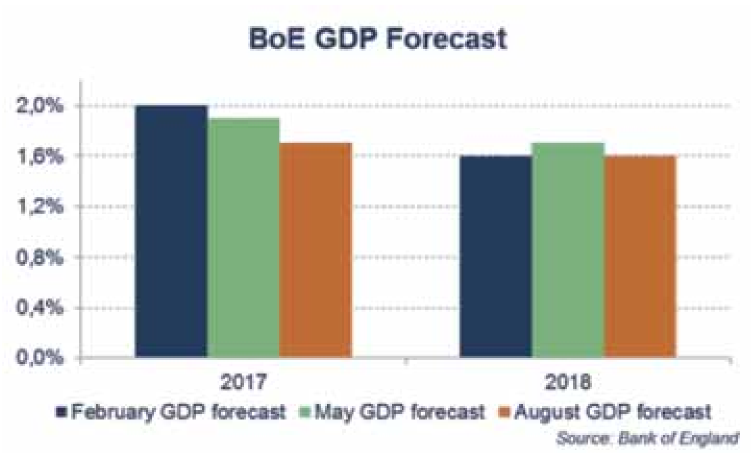
Designed to appeal to citizens in dire straits, flawed policies serve a populist rhetoric. Populism, equally from the far-right and the far-left, often promotes nationalistic policies targeting and, therefore discriminating against, foreign businesses. Donald Trump's protectionist stance during his US election campaign sent chills through the business worlds.

Now in power, he will have to translate rhetoric into actions to please his own electorate. Despite all the checks and balances of the American institutions, the President has the legal means to pursue his economic agenda. This often seem to be dictated by Trump's gut feeling rather than policy effectiveness. Far from reassuring, the few legal achievements registered in the first months of his presidency only fuel uncertainty of the business operating environment.

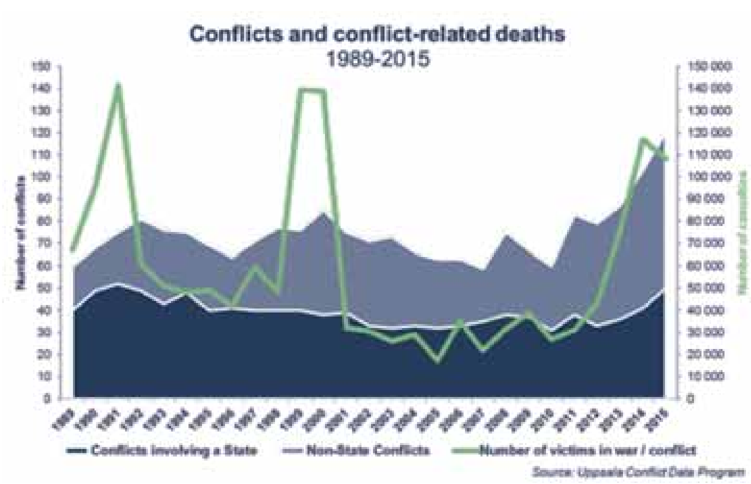
Uncertainty has a price, as demonstrated by the post-referendum United Kingdom. Even though more diffuse than most had anticipated, the impact of the vote in June is now undeniably being felt on private investment and consumer confidence, pushing the Bank of England to downgrade its short-term GDP growth forecast (see graph 2).

One of the most dynamic countries in Europe in the aftermath of the Eurozone crisis, the United Kingdom, is now set to fall in line with its neighbours by 2018. Coface's populism index supplements the collection of risks already covered by the political and social fragilities. Relying on a database derived from the textual analysis of political parties' manifestos in 50 countries (Manifesto Project[2]), our populism index intends to apprehend emerging tensions relating to a populist rhetoric. Such rhetoric can be seen at play in the UK, the US, the Netherlands and France.

Graph 2



Graph 3



At the height of a political violence cycle

A measure of risk relating to political violence is also included in Coface's political assessment. A conflict[3] index and terrorism index has been developed, based on the observation of past events. Strikingly, they both highlight a concurrent surge in conflict occurrences and terrorist attacks.

The number of conflicts multiplied by 1.5 between 2007 and 2015 (see graph 3). Not only does the number of conflicts increase but their intensity, as measured by the losses they incur, is also on the rise. In 2014 and 2015, the 100,000-death threshold was exceeded for the third time in the past 25 years. The current period – with conflicts in Syria, Libya or Yemen – compares with 1991 at the height of the Gulf War or 1999-2000, with the Ethiopia-Eritrea conflict responsible for approximately 40,000 deaths per year. Data for 2016, not yet fully available, suggest this 100,000-death threshold will be exceeded for the third year in a row. Simultaneously, terrorism linked essentially to Islamist terrorism, is spreading as a form of political violence. The global terrorism index compiled by Coface multiplied by 2.8 between 2008 and 2016 (see graph 4), confirming a rise in terrorist activities perceived in Syria, Nigeria, Afghanistan, or Iraq, as well as France, Spain, Germany, Belgium, the UK and the US.

Political violence, while not always considered the main barrier to business operation in the literature on political risks, does raise business concerns. Full-scale conflicts can potentially annihilate the entire economic fabric of a country, meaning they are relevant in a political assessment. Indeed, a surge in political violence can prove undeniably harmful to business activity.

Some are directly vulnerable to political violence: an unequal allocation of the country's oil resources in Nigeria, aggravated by ethnic fractionalisation[4], which is at the core of the conflict in the Niger Delta, targets specifically oil production facilities. Groups such as Niger Delta Avengers (NDA) even declare that they want to reduce Nigeria's oil production to zero. By targeting tourists in Soussa, Tunisia, Paris, or Barcelona, terrorists attacked one of the driving forces of the local economy.

Political risk behind us, political risk before us

The past 18 months were rich in high-profile political risks. This may implicitly send the message that the bulk of the problems are now behind us. But Coface political index indicates that political risks might persist: vulnerabilities remain and upcoming events in the next 18 months might trigger political crisis of great concern for business operation. High-stakes elections in Italy, Mexico and Brazil will draw close attention. Recep Tayyip Erdogan in Turkey and Russia's Vladimir Putin, who will once again be candidate to his own succession next year, embark their countries on an unpredictable authoritarian slope. Conflicts and terrorism will continue to disrupt business activity, not only in the Middle East and Africa but also in Asia, Europe and in the Americas. These observations leave us with no doubt that political risk will linger on and remain a concern for businesses. ■

Graph 4

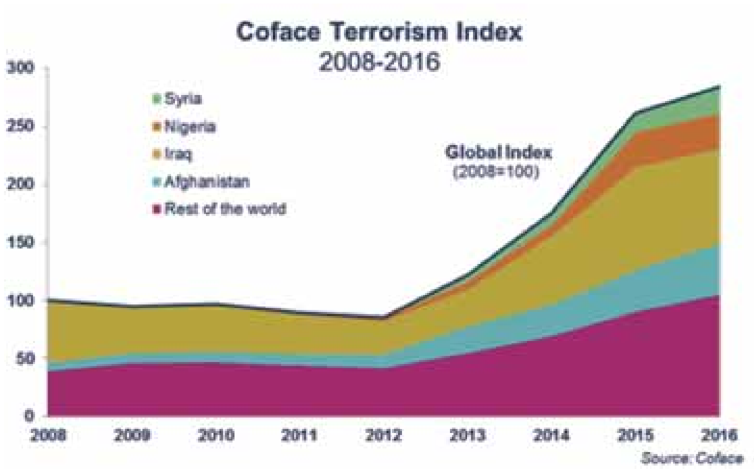
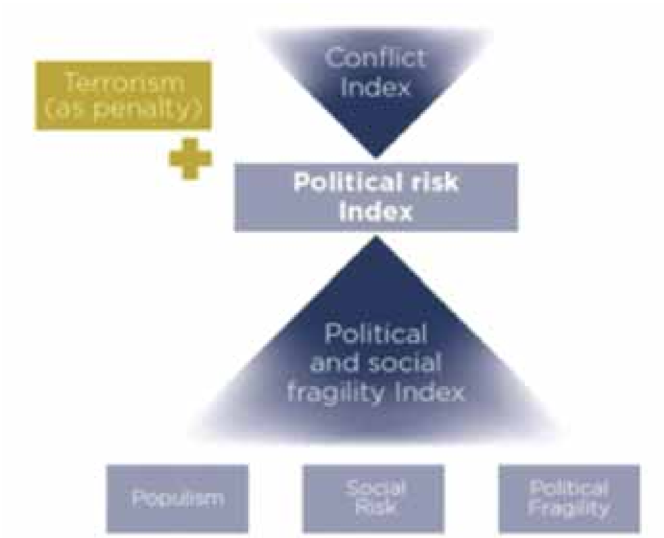


Diagram: Coface Political Risk Index



Notes

1 http://www.coface.com/News-Publications/Publications/The-rise-and-rise-of-political-risks

2 Volkens, Andrea / Lehmann, Pola / Matthieß, Theres / Merz, Nicolas / Regel, Sven / Weßels, Bernhard (2017): The Manifesto Data Collection. Manifesto Project (MRG/CMP/MARPOR). Version 2017a. Berlin: Wissenschaftszentrum Berlin für Sozialforschung (WZB). https://doi.org/10.25522/manifesto.mpds.2017a

3 Conflict index is calculated using database established by the Department of Peace and Conflict Research at Uppsala University (Sweden) under the name of Uppsala Conflict Data Program (UCDP): http://ucdp.uu.se/

4 Ethnic fractionalization is a measure of ethnic diversity, resulting from the work of Roberto Alesina (2003).

A new model for driving Italian SMEs worldwide

Tasked with sustaining Italian export competitiveness worldwide, SACE's new Italian Hub for Export and Internationalization is focused on backing SMEs in new and innovative ways. By Alessandra Ricci, chief underwriting officer, SACE.

Italian policies to support exports and internationalisation are evolving and changing pace. A new phase in SACE history started last year, with a stronger mission assigned to the export credit agency by CDP, the National Promotion Entity which owns the company.

CDP conferred to SACE 76% of the shares of SIMEST, a company supporting Italian companies investing abroad. This created the new Italian Hub for Export and Internationalisation, an organisation with a public mission and private financial management, devoted to sustaining Italian competitiveness in the world.

Targeting SMEs

Small and medium-sized enterprises (SMEs) are the primary targets of the new hub, which goes beyond the role of an export credit company. There are some 136,000 companies that qualify as SMEs in Italy. Of these, 112,000 are small and 24,000 midsize, employing 3.8 million people and generating 12% of national GDP. They represent almost all the entrepreneurial fabric of the country but their propensity to export is below their potential, especially compared to their equivalent peers in Europe.

Exporters with between 10 and 49 employees account for 47% of the corporate world in Germany, 48% in Spain, and 29% in Italy, where only 14,500 out of 75,000 small and midcap companies export over 25% of their sales. This translates into 60,000 SMEs with around €20million-€50 million in sales that could better penetrate the foreign markets, in a more structured and diversified way.

Alessandra Ricci

Three characteristics of Italian SMEs are among the main obstacles to moving forward: lack of scale, limited extension of reference markets, and relatively low research and innovation.

The Italian Export and Internationalisation Hub has two major objectives: to accompany more Italian companies into foreign markets and, more importantly, to promote a more "informed" risk culture and a better-targeted drive for competitiveness in companies that already operate abroad. This should lead to an increase of quality in dimensional growth, market expansion, and innovation.

SACE estimates that better support to small and midcap companies may generate additional €140 billion in Italian exports by 2018 - one-third more than current values. This is an important opportunity for the country, considering the strategic contribution of exports to Italian growth regarding other components of GDP.

Exports withstood the financial crisis in Italy and, unlike domestic demand, have continued to positively contribute to national GDP (+4.5% in average during 2010-2015). This trend is expected to be confirmed in 2017 and exports are likely to outperform GDP, as the former are expected to grow by 3%, with the latter by 0.9%.

A new model for SME support

What are the major features of this new model aimed at involving and supporting more SMEs?

The "hub model" takes into account the importance of SMEs to the Italian economy and the strategic role played by exports. It combines the capacity of intervention of the public sector with the flexibility of a private enterprise. There are several significant implications for Italian SMEs: a range of services beyond the traditional export credit support; a proactive approach vis à vis the client, and a focus on education, with dedicated advisory services and analysis of markets and exports.

SACE's 2016-2020 business plan includes the re-engineering of many products, from export and credit insurance to protection of foreign investments, from financial guarantees to factoring services, and from bonds to equity investments and low-interest loans.

Flexible integrated solutions have been developed for several core industries of "Made in Italy" worldwide, such as the agri-food and wine sectors. SACE provides instruments that aim to sustain the entire product life cycle, from production to sale. It offers protection of inventories and supports financial requirements for the production processes typical of these sectors.

SACE is currently digitialising the products used by SMEs and upgrading the remote contact channels, both on and offline, to boost accessibility. It has also increased its domestic and overseas network, which today has 14 offices in Italy and ten abroad.

Lastly, the theme of education is an important new frontier for the hub.

Italian companies are still under-insured compared to those in other countries, as they often view insurance as a cost rather than an important indicator of competitiveness. The ratio of GDP to volumes insured by companies in Italy is about one-third of other European countries.

Promoting a more evolved "risk culture" means promoting education, but also ensuring that those who develop it are rewarded.

The hub emphasises advisory services aimed at providing companies with managerial support and consulting on growth strategies abroad. It indicates business opportunities in high-potential countries and proposes business-matching meetings, as well as financial and insurance solutions tailored to their needs.

Promoting a more evolved "risk culture" means promoting education, but also ensuring that those who develop it are rewarded. For this reason, the hub will increasingly work with banks and financial institutions so that companies which insure their receivables against the risk of default (thus protecting their revenue) receive a higher credit standing when seeking financing. ■

The "hub model" takes into account the importance of SMEs to the Italian economy and the strategic role played by exports. It combines the capacity of intervention of the public sector with the flexibility of a private enterprise. There are several significant implications for Italian SMEs: a range of services beyond the traditional export credit support; a proactive approach vis à vis the client, and a focus on education, with dedicated advisory services and analysis of markets and exports.

Reaching out to exporting SMEs

For the third consecutive year, EKN, the Swedish export credit agency, reports a record level for the number of small and medium-sized business customers in 2016. Increasing numbers of such companies are taking advantage of business opportunities in emerging markets around the world, with the help of the Swedish Government's export credit guarantees. By Carl-Johan Karlsson, head of the SME business area at EKN.

During 2016, EKN contributed to more SME export transactions. Seventy-nine SMEs became new clients of EKN and guarantee volume also increased. This is the result of an increased sales-driven and customer-focused approach through regional presence, intensified marketing and sales activities as well as collaboration with local bank offices. During the year, EKN employees made more than a thousand visits to companies and banks around the country.

The number of EKN guaranteed SMEs transactions in 2016 increased from 537 to 599. During the year, 271 companies in this segment were EKN clients, compared with 263 the previous year. More and more companies offer their customers credit and insure their risk with EKN or get help with finance, with the bank insuring its risk on the company with EKN.

Variety of industries

SMEs are particularly important for developing Swedish exports. EKN has a specific mandate to promote these companies' exports and the guarantees issued relating to SMEs' export transactions total around €260 million in 2016. This means a contribution to Sweden's GDP of €125 million and around 1,300 jobs. The guaranteed SME companies have 5,507 employees in total. This demonstrates EKN's significance as a complement and catalyst for this corporate segment's exports to more difficult markets. EKN helps many of these companies to take the first step out into the export market.

The SMEs that complete transactions with the assistance of EKN represent many different industries. The largest section, equating to 62% of the guarantee volume, is made up of companies that sell equipment to manufacturing industry, such as electronic components, circuit boards and machinery. After this comes wholesaling, especially in paper and craft paper. Wholesaling represents 19% of the guarantee volume. In third place are companies involved in technical consultancy and the building sector, and companies that are active in design and interiors. Companies that are sub-suppliers to the exporting industry are also EKN customers.

Carl-Johan Karlsson

Priority target group

Sweden is a small, export-dependent country. Nearly 50% of the country's GDP consists of export revenues. Successful Swedish multinational companies such as Ericsson, Scania, Volvo and SAAB have used EKN's guarantees for a long time in order to boost their competitiveness in international markets. However, SMEs utilise the same opportunities to a far too low extent.

The vast majority of Swedish exports go to neighbouring countries in Europe - above all to our closest neighbour Norway, and to Germany and other EU countries. The many years of weak growth in a number of OECD markets have meant a greater need to take advantage of the higher growth in markets further afield, especially in Asia, but also in the Middle East and the Gulf countries, Africa and Latin America.

EKN began a specific drive to reach out to more SMEs already in 2007. A separate business area with particular focus on the target group was created as a first step. The Swedish SME segment is a very diverse target group, and there are several challenges in reaching out to them in regard to export credit guarantees.

SMEs' challenges

In Sweden, approximately 14,000 companies with exports to emerging markets have fewer than 250 employees. Most operate as sole proprietorships and have limited resources and interest in expanding their exports. The segment's exports to emerging markets is limited, as are the development plans for reaching more markets. Many Swedish SMEs are also suppliers to the major exporting companies.

There is a more widespread business culture among Swedish SMEs, compared to many other countries in Europe, not to insure their customer credit. It is more common that Swedish companies demand advance payment. Only 20% of SMEs exporting to emerging markets responded that they offer customers credit, according to a survey EKN carried out in 2015. Of these, 24% reported having used credit insurance, which is a big increase compared to the previous year when 14% answered yes to this question.

Another challenge is the low awareness of EKN among the target group - an awareness of less than 50% in 2016. The perception that government guarantees are only for large companies is also widespread among those who are familiar with EKN.

Long-term focus

After the financial crisis, EKN began a more intensive drive to reach out to more SMEs. A new strategy for a greater SME focus was adopted by management and the Board. Clear results were able to be presented already in 2014. The number of guarantees to SMEs rose to record levels and the number of customers grew steadily. Since then, as mentioned earlier, a new record was set in three consecutive years.

The key focus areas behind the positive development can be summarised in three points; increased regional presence, intensified marketing and product development.

Increased local presence

In the first year of executing the new SME strategy, EKN established local offices in Göteborg and Malmö (the second and third largest cities in Sweden). During 2016, the local presence has been further increased with a new office in Umeå (in northern Sweden) and with more employees in Göteborg, as well as with external finance consultants in five cities throughout Sweden. The consultants have a well-developed network in their regions and work closely with local industry and commercial banks. They extend the reach of EKN's regional presence.

Intensified marketing

Over the past two years, EKN has invested more in advertising and various marketing partnerships to reach out to SMEs. For two years in a row, EKN has been a partner to the nationwide growth company competition, Di Gasell, run by Dagens Industri, the leading Swedish business newspaper. This competition awards the most successful fast-growing SMEs in Sweden. Events around Sweden enable networking with these companies and the opportunity to promote EKN and EKN's offer to the target group. EKN awards an annual prize to the growth company that has been most successful with exports to emerging markets. EKN has also expanded its presence in social media and has customised marketing messages to the target group.

Product adaptation

For many SMEs it is not primarily to secure their receivables that they turn to EKN, but to strengthen their ability to get the bank to provide financing. Banks that issue contract guarantees and lend working capital and investment capital can share the risk in the sub-supplier with EKN. EKN's working capital loan guarantees and investment guarantees are important instruments for SMEs. The guarantees have been developed to better adapt to the needs of the target group, and are now aimed at sub-suppliers too.

When companies insure their receivables with EKN, this can act as security for a bank loan. This is the main reason why SMEs become EKN customers. Companies also need the banks' support with working capital credit and bank guarantees. When EKN shares the bank's risk on the company, it becomes easier for the company to obtain finance from the bank. Around 97% of Sweden's local bank offices are aware of EKN, and collaboration with the banks is vital to enable more SMEs to grow internationally with EKN's assistance. Around 80% of guaranteed transactions for SMEs come via the banks.

Firmly anchored

The SME focus is firmly anchored in EKN's Board and management and this has been crucial to the success of the SME initiative. But even the principal - the Swedish Government - has explicitly given EKN the task of raising awareness among SMEs about how guarantees can strengthen export capacity as part of the Government's export strategy.

A couple of years ago, in 2015, the Swedish Government adopted a new export strategy with the aim of increasing Swedish exports and encouraging more companies to sell to emerging markets. It was stated that SMEs need to increase exports, and a number of priority export markets among the emerging countries were defined. Furthermore, the export strategy established that the Swedish governmental export promotion organisations should improve their cooperation and facilitate contact channels for companies.

Asia is an attractive export market

In order to increase knowledge about SMEs need for support from EKN, EKN has produced a report for a number of years on SMEs exports to emerging markets. The reports have provided clear information that the number of companies exporting to emerging markets in the SME segment is growing year by year. The value of exports to emerging markets from Swedish SMEs is also increasing. The number of SMEs exporting to emerging markets reached record levels for three years in a row. At the same time, exports to emerging markets account for only 13% of the total exports of SMEs, according to the latest survey conducted in 2015.

Asia is clearly the hottest growth market for Swedish SMEs. Asian markets account for nearly half of SMEs' exports to emerging markets. It is also there that exports have grown most strongly in the past five years - the volume has increased 65% since 2005. In 2015, exports grew by 12%, and China is the growth market that most companies are attracted by. It is a positive that SMEs are focusing on Asia, given the potential of these markets.

Focus going forward

Because of the large proportion of guarantee volume coming from banks, EKN is now working to further develop its relationship with local bank branches around the country, to increase their knowledge about how EKN can enhance the bank's ability to finance small enterprises' export business.

The challenges ahead include raising awareness among SMEs, which, despite great efforts, is moving slowly. This requires a continued high level of activity in terms of both extensive and targeted marketing. The SMEs also play a leading role for greater flexibility and efficiency in EKN's internal processes and product development. The demand for strong commercial expertise in a governmental structure increases for EKN's employees.

Sweden is a country with a high level of IT maturity and is at the forefront in the utilisation of the opportunities of web-based business models among entrepreneurs who take advantage of the opportunities that arise in a digital and connected world. These companies are 'born global'. The focus is not on one market at a time, but rather on ten or twenty. Exports are also becoming more service-based, and global value chains are becoming more complex. This requires flexibility and agility for the relevance of export support.

Only 20% of SMEs exporting to emerging markets responded that they offer customers credit, according to a survey EKN carried out in 2015. Of these, 24% reported having used credit insurance, which is a big increase compared to the previous year when 14% answered yes to this question.

Swedish SME's exports to emerging markets, as previously described, are multi-faceted. For example, EKN's customers include companies selling ice hockey equipment to Russia, forestry machines to the Philippines, pilot boats to the United Arab Emirates and blood analysis systems to African countries south of the Sahara.

However, there is potential for more companies to achieve success with exports and growth in new markets, and EKN continues to further extend the focus on reaching out to SMEs. ■

Taking SME support to the next level

Katja Keitaanniemi, executive vice president responsible for SMEs at Finland's Finnvera, explains what special measures the group takes to look after smaller businesses.

Ensuring that profitable projects do not fail due to lack of financing, is an important part of Finnvera's mandate as a state-backed risk financier. Small and medium-sized enterprises (SMEs) have become an important part of our export credit agency (ECA) mandates. We all like to (repeatedly) state this in our strategies and in our communications, both internally and externally. Certainly, many ECAs have streamlined their products and processes to better serve their SME clients.

Finnvera too has 'upgraded' its products targeting SMEs or small transactions in general. The group recently launched 'Export Receivables Guarantee' aimed at the exporter and 'Receivables Purchase Guarantee' aimed at banks financing export invoices. Finnvera has also introduced a 'Bill of Exchange Guarantee' for markets where bills of exchange work well as a simple way of documenting an export credit. In the trade credit business, these new modified credit insurances and buyer credit guarantees serve the short-term credit insurance with relatively small amounts. However, there has been some discussion about longer credit terms and about the possibility to offer direct cross-border export credits for small transactions – a business area where banks seem to have lost interest due to ever-increasing transaction costs resulting from tightening regulation.

Katja Keitaanniemi

Many ECAs have in recent years successfully introduced products such as Working Capital Guarantee. From our perspective this seems curious as Finnvera has been combining domestic SME financing and an export credit agency from the beginning and has always had Working Capital Guarantee in its product portfolio. Providing credit enhancement for the working capital needs of SMEs, has been bread and butter in our business model since the 1960s.

When working with SMEs, one must use simplified policies and procedures. Most ECAs have by now introduced SME-friendly approaches to process applications quickly and efficiently and to offer products with a minimal amount of 'fine print'.

But what else can be done for SMEs apart from improving products and processes? In its risk policy, Finnvera has introduced increased flexibility, a more aggressive approach to taking risk in SME exporters' small transactions compared to larger exporters' transactions. This may be shown, for example, in accepting a lower level of information required on the buyer. We have experienced a tendency where SMEs often

When working with SMEs, one must use simplified policies and procedures. Most ECAs have by now introduced SME-friendly approaches to process applications quickly and efficiently and to offer products with a minimal amount of 'fine print'.

sell or export to other SMEs – and the buyer credit information tends to be insufficient or very scarce. In such cases, Finnvera can be more flexible. The experience so far is encouraging. If loss ratios turned out to be higher, one could argue that the impact of these transactions for SMEs is very high and the SME-related buyer credit portfolio is only a small fraction of Finnvera's overall portfolio.

Focusing merely on products is clearly not enough - and may even be a bit old-fashioned. SMEs may not know which products they need or want. And client managers in commercial banks working with growth oriented SMEs and mid-caps may have gaps in their knowledge of financing instruments used in foreign trade. To bridge these gaps Finnvera has been organising training programmes both for growth oriented companies and their bankers. It is now considering the next step: offering trade finance-related consulting services for SMEs.

As a domestic SME financier, Finnvera offers a product palette that covers loans and guarantees from investments and working capital to financing changes of company ownership, environmental guarantees, start-up -guarantees, internationalisation guarantees, etc. Until recently the products on offer also included early stage Venture Capital 'Seed Financing' for innovative growth-oriented SMEs. The special focus is to offer a palette that covers financing needs from the start to internationalisation. And for the customer, it does not really matter which product is being used: they just need financing or risk cover.

Finnvera focuses specifically on SMEs aiming at growth and internationalisation. Our target clients are growing and globalising enterprises - or 'global' companies. The special unit that covers this market segment offers both domestic financing needs and export credit products. It is absolutely essential that our client relationship and credit managers can offer solutions on a larger scale of financing needs so that domestic SME financing and export credit guarantees as operational functions do not work in silos.

This of course requires some expertise from the personnel as they need to master a wider range of products. These particular client managers focusing on growth-oriented and export-oriented customers are very experienced and have worked on both the domestic and the export finance side of business. The same specialisation is needed on the credit manager side as Finnvera has separated its credit function from its client function. Finnvera has some 1,000 clients in this customer segment taken care of by around 20 highly skilled customer relationship managers, and the yearly offering reaches to several hundreds of millions of euros.

Combining domestic financing solutions with export credit agency offerings is not all: Finnvera is part of 'Team Finland', which gathers various official actors together to find synergies when serving customers. Team Finland members include other important state-backed agencies or entities promoting innovation and growth such as TEKES (organisation for financing research, development and innovation), Finpro (Finland's export promotion agency helping SMEs to export), and TESI (equity / venture capital provider). These groups share the same premises in the same office building. In total, 600 experts from four separate organisations now share a modern open plan, multi-space office focusing on their joint customer base of growth and export-oriented companies.

In its risk policy, Finnvera has introduced increased flexibility, a more aggressive approach to taking risk in SME exporters' small transactions compared to larger exporters' transactions.

We are quite sure that the next megatrend in public SME financing will be in external focusing and cooperation, not any more in internal concentration: how to combine forces with your colleague organisations to serve SMEs better. This requires a new attitude, but Finnvera is determined to remain in the frontline in finding new and better ways to support SMEs. In the end, it is results that matter: we need more 'global' companies! ■

Building and operating an MSME export credit insurance facility in Brazil

ABGF has been working on MSME full-range insurance cover aimed at facilitating prospecting and exports to new buyers abroad. Marcelo Franco, CEO at ABGF, explains the new offering and how it was developed. Co-author Pedro Carriço, ABGF's credit underwriting & international relations executive manager.

In 2015, Agência Brasileira Gestora de Fundos Garantidores e Garantias (ABGF), acting as an export credit insurance agency, deployed a micro, small and medium enterprises (MSME) export credit insurance official support scheme together with the Guardian Authority*. The instrument was developed over two years and required extensive research and deep discussions between the Brazilian authorities and exporters from different sectors and regions to capture the essence of business trends and demand.

The history of MSME export credit insurance support is short, dating back to 2013 when ABGF was requested to provide findings on market gaps in the segment and to assess the real need for such a tool. Brazilian exports have been extremely concentrated in the hands of 500 enterprises, which are responsible for 80% of the country's total exports. The remaining 20% comes from 23,000 enterprises with annual overseas sales worth up to $5 million. Nevertheless, only a small fraction of Brazil's MSMEs are active exporters because of a guarantees market gap. Whereas in developing economies MSME exports represent on average 10% of total exports, Brazilian MSMEs account for no more than 2.5% of the country's exports.

Product research

In our research, we quickly realised that MSMEs' inability to provide the guarantees traditionally requested by commercial banks marginalised an enormous number of enterprises from the financing system. This unconducive environment needed to be corrected if MSMEs were to venture into overseas markets and increase their share of total exports. Official support in the form of export credit insurance seemed to be the right tool to fill the gap as banks were reluctant to engage in such MSME deals given that they systematically do not pay off. On the other hand, many MSMEs were seeking export cover on their own via self-insurance.

Marcelo Franco

The desired solution to MSMEs' expectations would have to be simple, scalable and far-reaching from the point of view of the enterprises, the banks and the Guardian Authority. At the same time, it was imperative that any proposed scheme should have the lowest possible administrative cost to take into account the budget constraints and ABGF's "more with less" public policy approach.

Another key design issue was how to build a platform on which all players could interact securely, from the initial application to the issuance of the policy. Moreover, the market dynamics called for a tool that expedited the process of application, risk assessment, pricing and policy issuance as fast as possible. Adjustments were required after exhaustive testing and the first demo version outcomes, but gradually ABGF and the Guardian Authority have found the right path.

As a result, the product involves a fast-track decision process, free of paperwork. The applicant goes online and applies for cover by simply stating country, sector, name and the buyer's characteristics, as well as requesting a credit limit for the export. ABGF assesses the exporter risk (pre-shipment cover) and/or the buyer (post-shipment cover) risk, flagging the credit limit available and a premium corresponding to the risk score. This whole process takes an average of five working days if there is enough information on the buyer's data and risk profile. ABGF estimates that end-to-end processing should take approximately 10 days.

MSME feedback good

The feedback from MSMEs that are in contact with ABGF experts is highly positive and gives us fresh input to keep improving. So far, the MSME team has processed 338 transactions from 130 unique exporters in 22 different countries, generating exposure of approximately $13 million. As of yet, there have been no claims filed.

Although ABGF was pushed to launch with a post-shipment only cover, the current product is now closely aligned with initial market requests for a complete MSME tool encompassing pre- and post-shipment cover. Eligible enterprises must make no more than $3 million of total export sales yearly and have total turnover of up to $30 million. Roughly speaking, in this example, 10% of the total turnover can be insured by the current facility.

Behind the scenes, ABGF had a lot of paperwork to do in parallel with the product, such as step-by-step online system instructions and the export credit insurance general and particular conditions, as well as the actuarial and technical paper for pricing and risk assessment mapped to the correct rating. We are very proud of the product rolled out, which we believe meets the needs of both exporters and banks.

We realised however that gathering together even the above-mentioned 23,000 MSMEs already registered in officially compiled data and educating them about export credit insurance and the technicalities of this industry would be a big challenge.

In addition, an online presence would not be enough to reach the rest of the addressable market of non-exporter MSMEs. A toolkit, workshops and webinars have a role to play in reaching out to these firms, but there is still an important hurdle to overcome in the management style and mind-set of MSMEs to help them access a combination of insurance and financing via an online tool.

Education and export cover

Our current priority is education on export-related insurance and how to apply for cover for overseas sales. But for those still outside the export business, ABGF has been looking at partnering with official banks and private export representatives, campaigning for more public information on export facilities.

Export and credit insurance promotion is inherent to ABGF's mandate and should be a constant focus of our activities, but we have been very careful to avoid undercutting or interfering with the market. Official support should come into play where there is a market gap or failure. Although a period of poor performance might open up space for public support, we stick to the philosophy of not competing with private insurers.

Since pre-shipment should be an incentive for export production, ABGF launched a product that combines a full working capital insurance facility with export credit risk cover. Doubtless there is a market gap in MSME working capital cover. Commercial banks are not willing to provide such a credit line without appropriate protection, basically relying on their credit scoring systems and/or recourse against MSME's balance sheet. In most cases, banks are unable to finance MSMEs without regular guarantees. ABGF has been studying this market and concluded that the most efficient cover would be a pre- and/or post-shipment product. Of course, MSMEs served under the official support are expected to produce and sell abroad.

To that end, ABGF has also been preparing a stand-alone pre-shipment cover, which should be launched in the current year since the Guardian Authority has already revised and authorised the product.. The main task for ABGF is to educate MSMEs and promote the official cover around the country, much as it did previously with the post-shipment product.

Furthermore, ABGF has also been looking at prospecting cover for MSMEs that are keen on exploring to overseas markets but do not have enough resources to look for business opportunities abroad. This should be challenging for MSMEs, and ABGF understands that a complete service for these enterprises should include prospecting as well as pre- and post-shipment cover.

In short, the ABGF team has been working on an MSME full-range insurance cover aimed at facilitating prospecting and exports to new buyers abroad. We are convinced that MSME export success depends on the facilities provided as well as on the enterprises' production ability and willingness to export. ■

*Guardian Authority is the Secretary for International Affairs (SAIN) of the Ministry of Finance as a policy maker which is responsible for the certificate of guarantee and for hiring ABGF, as fully state-owned enterprise, to run the export credit guarantee business.

The importance of credit insurance for national SMEs

By COSEC

COSEC's board of directors lead an important rhetoric for the relationship between credit insurers and SMEs, focusing on the opportunities won and lost in Portugal, and the introduction of a new tool.

The financial crisis of 2008 was detrimental to the Portuguese economy and led the Portuguese companies to better assess the relationship with their customers and the risks that may arise from launching new business abroad. The approach of Portuguese companies to a risk mitigation tool, reflects the advantages of credit insurance, namely protection against financial losses (customer debts) and the safe management of their financial needs.

In an increasingly competitive market, it is of paramount importance to create favourable conditions for the development of SME business, with solutions tailored according to their needs. Portugal is a country that has several opportunities, support and incentives that stand out for the quality and accuracy of analysis, so that it is ensured that the investment made will bring real returns both to the exporting companies, or to the ones that intend to develop their internationalisation, as well as to the supporting entities (state, banking, insurance companies).

During this period, COSEC has made intensive efforts to better support SMEs and to spark their interest by launching the new export credit insurance solutions into the market. Credit insurance is a fundamental tool to avoid possible defaults, both in cases where trade is carried out domestically, and in transactions involving the export of its products or services to market and non-marketable risk countries.

Not surprisingly, a study on SMEs conducted at European level by our shareholder Euler Hermes, concluded that most companies using credit insurance export on average to twice as many countries as those without such insurance. These companies are increasingly aware of the need to protect commercial credit risk and also political risk, when exporting to non-marketable risk countries, where the commercial and political risks are significantly higher than those encountered in marketable risk countries.

Considering the challenges that the Portuguese SMEs are facing in the credit risk management, and taking into account the specificity of the SMEs market, COSEC offers, together with the banking sector, simplified and standard solutions that support companies in the management and control of credits in the internal and external markets.

Although nowadays most banks offer short and mid-term financing, tailored to the needs of each SME, the truth is that access to finance remains one of the major challenges for these companies. The role of banks is very important, since through the diversity of their distribution network, they not only promote, but also facilitate companies' access to these types of solutions. In our experience, the complementarity of banking with credit insurance is very relevant for SMEs. COSEC's credit insurance has allowed many SMEs the access to bank financing. Through the endorsement of the export credit policies, banks are more willing to support export transactions for SMEs. This type of solution is not only highly valued by the companies, but also contributes to the enlargement of the market: for instance, COSEC has grown, in the past years, 25% in the number of new clients. ■

COSEC
AO SEU LADO EM TODO O LADO

Time to stand up and be counted

The volume of private insurance market credit risk mitigation is growing – but does the industry do enough to voice its activities and concerns to regulators? By Peter Sprent, head of global financial risk at Liberty Specialty Markets and Audrey Zuck, director, A2Z Risk Services Ltd.

Over the last 20 years, the private sector insurance market covering non-payment risk has gone through a transformation in both scale and capability that has not been fully recognised other than by users and providers of this credit risk mitigation tool.

Not only has the private market grown exponentially in terms of numbers of participants and per risk capacity, it has also confidently withstood the global financial crisis and weathered the recent commodity downturn, supporting clients paying billions of dollars of claims in the process. Berne Union numbers show the significant amount of credit insurance coverage provided by private sector members in 2016, although it is worth noting that most private sector insurers are not members of the Berne Union.

More banks using private insurers

Banks have been active users of non-payment coverage from the private market for over 20 years but this has increased substantially since the global financial crisis. A large majority of participants in the International Chamber of Commerce (ICC) Trade Register report for 2016 are clients of the private market, although only export credit agency (ECA) support of trade transactions is acknowledged in the report. In addition, banks active in the financing of trade receivables benefit from billions of dollars of coverage provided by whole turnover insurance policies. At the long-term end of the financing spectrum, eight out of the 10 most active project finance banks are core clients of the private market.

Traditionally, banks have used non-payment insurance to manage counterparty limits and credit risk when considering new transactions. Since its acknowledgement by the Basel Committee,[1] many banks have also been able to deploy this product for capital relief. More recently, private insurers have been partnering with banks to help manage portfolios of exposures already on the books of the bank. For example, Risk.net's Risk Awards 2017 named BNP Paribas Credit Portfolio Manager of the Year for its innovative approach, which included the sharing of existing facilities with the private market, with the specific aim of obtaining capital savings while avoiding some of the downsides of traditional credit portfolio management tools such as credit default swaps.


Peter Sprent

In this period of growth, underwriters have concentrated on developing their products and building their teams, platforms, pricing models and client and broker relationships. Engagement with a wider audience of stakeholders has taken a back seat.

Raising private insurer profile with regulators

Recent changes announced or contemplated by bank regulators – the 'Basel IV' consultation on changes to the internal ratings based models, and the European Commission's amendments to the Capital Requirements Directive (CRD 4) and Capital Requirement Regulation (CRR) – have highlighted the need for the private market to take a more proactive role in ensuring that its voice is heard as regulators continue to revise the capital framework for banks.

While there is significantly more to be done to recognise the role the private market plays in supporting international trade and investment, many private insurers have increased their profiles in finance industry associations and other international institutions.

Private market membership in the Berne Union is growing, as is participation in the International Association for Credit Portfolio Managers (IACPM) and in the International Trade and Forfaiting Association (ITFA), which formed an insurance committee to address its members' interest in the product. In its submission to Basel IV, ITFA noted that "insurance, although a conditional product, has responded consistently in paying claims to banks under non-payment policies, justifying banks' treatment of insurance policies as guarantees."[2]

Private and ECA – are they eqivalent?

The private market product is equivalent to ECA coverage in as much as:

- Performance is uncorrelated to underlying risk
- There is a direct claim against the insurers, which are located in strong and stable jurisdictions
- Coverage is provided by highly rated entities (generally minimum A- financial strength rating from Standard & Poor's or equivalent rating agency)
- Insurers conduct their own credit analysis before a risk is selected to be covered, providing independent validation of the counterparty risk.

The ICC's 2016 Trade Register noted that medium- and long-term trade finance is low risk largely because transactions are covered by investment-grade ECAs sponsored by high-income OECD governments which have never defaulted on a valid claim[3]. The private market also has an excellent track record of paying out valid claims, but information is patchy at best. While brokers have been providing their claims data as proof[4], there is a growing need for more detailed and comprehensive data to support the wider adoption of the product by banks and help convince regulators and government bodies that the product is a strong credit risk mitigation option.

In addition to strong claims performance, the private market has other unique benefits:

- Multi-line insurers' other lines of business are highly uncorrelated with credit default coverage
- The prudential regulatory regimes in the main jurisdictions impose substantial capital requirements on private insurers, designed to ensure that private insurers always maintain sufficient capital to fulfil their payment obligations to policyholders. In the rare event of an insurance company insolvency, applicable law and regulation in most jurisdictions would ensure that, as policyholder, the bank stands in a privileged position ahead of regular creditors
- As witnessed by the BNPP example mentioned above, private insurance is flexible in application, with the ability to commit quickly to coverage once risk analysis has been satisfactorily completed.

Looking specifically at the proposed amendments to the CRD4 and CRR, while the rationale for excusing loans insured by ECAs from the leverage ratio is consistent with the risk weighting of zero for banks' exposure to their own governments in local currency, we believe that the focus solely on ECAs' provision of credit risk protection is a missed opportunity.

The private market is an important partner for banks, and private insurers are an increasing presence in international institutions supporting the financing of the global economy. However, the private market has yet to pull together coherent and consistent data to demonstrate to regulators and other interested parties the performance of the private insurance product that warrants more explicit recognition of its merit as a credit risk mitigant. With the help of banks, industry groups, and private insurers willing to provide more comprehensive premium and claims data, we believe we can prove that the size, scale, professionalism and other benefits of the private insurance market justify greater recognition. ■

Notes

1 Basel Committee on Banking Supervision: QIS3, FAQ E: Credit Risk Mitigation, FAQ6

2 Letter to the Basel Committee on Banking Supervision dated 24 June, 2016

3 2016 ICC Trade Register report, pp 51 and 73

4 For example, BPL Global, a specialist trade credit risk broker, notes that over the last 30 years and in respect of claims for exporters, traders and banks, overall 95.5% of their claims for non-payment were settled in full; 3% were settled amicably but not for the full amount because of operational issues with respect to the underlying transaction; and only 1.5% were denied either for breach of policy condition or because the client could not produce evidence to support the claim.

The global opportunities for insurers prepared to embrace change

The credit insurance industry needs to break into new geographic markets and adopt new technology to keep pace with changing regulation and stay cost competitive. By Jérôme Pezé, CEO and founder, Tinubu Square.

The international credit insurance industry has proven itself to be very resilient and highly credible, particularly through the recent economic downturn. However, there are vital geographies and market segments that are simply untapped from a credit insurance perspective. And to realise the huge opportunities they present, the industry must re-evaluate its proposition to customers.

The industry also needs to adjust to a new ecosystem and look at how it could improve operations and take advantage of an overhaul of its services. For an industry that has been successfully operating for over a century, this will mean embracing change and pushing at established conventions – but the rewards will be worth it.

Many of the processes and product-types that characterised the early days of the industry are still in use, and while it could be argued that these have held insurance companies and their customers in good stead for a long time, they are now ripe for change. What we want to see is an expansion of this established model. Worldwide premiums have been increasing since 2003, but mainly outside the core European markets, and the industry has a great opportunity for further growth if it is outward looking and bold.

The long-standing influence of a handful of European insurers has brought benefits. Critical mass has kept costs down, the market has diversified within controllable limits and multi-country services have been developed. Risk control has been supported by a large base of European buyers.

What about the rest of the world? There are both challenges and opportunities, and there are many territories that offer highly advantageous opportunities for market penetration. Growth of credit insurance in the US, for example, has been restricted by an open business culture, acceptable bankruptcy legislation, a perceived high cost, and very limited export flow from mid-sized American companies, particularly to markets other than Canada, Mexico and a few European countries. Additionally, credit insurance never managed to integrate effectively with the finance industry, notably to provide joint receivable financing solutions to SMEs.

Jérôme Pezé

What businesses in that area are missing is the massive emergence of global trade prospects with burgeoning markets in the Far East, Latin America, India and other parts of Asia and Africa. Exporters must be eyeing these markets and looking for ways to maximise opportunities while still mitigating their risk. Emerging markets too – Asia-Pacific alone saw trade expand by 25% to 33% in the 10 years from 2003 to 2013 – have even more options for the credit insurance sector.

Embracing technology

One barrier for the industry is its often entrenched processes, which need to be improved. Digitisation is having its effect on product delivery processes, distribution, supply chain integration, the emergence of alternative payment and settlement solutions and data analytics. Meanwhile, while Solvency Capital Requirements are boosting credit insurance, they also demand more efficient attention to detail and improved governance and controls.

Insurance companies are finding themselves to be part of an extended and more rigorous ecosystem and it's not always clear that they understand the position they occupy or – even more importantly – the advantageous position they should be aiming for. This is a challenge that must be faced. While they have met the demands of their traditional core markets including brokers, insureds and reinsurers, and even the needs of extended enterprise, including trade associations, banks, regulators and investors, what they now have to do is face the challenges of disruptive technologies and innovations that will have an impact on their business. This includes new payment and settlement solutions, changes in the supply chain and technology developments.

One topic that is causing ripples throughout the industry is blockchain technology, with one of the main concerns being the databases that store details on buyers. These are no longer the sole domain of the credit insurers, and as new entrants come into the market, offering more economical access to buyer information, insurers will have to compete on a new stage. This is a challenge that will require fresh strategies and specialised services to keep existing clients engaged and attract prospects, and is particularly pressing in terms of meeting the individual needs of clients in different geographical territories and industries.

If credit insurers don't want to fall behind they will need to be more effective, not just in the way that they choose to communicate but in the speed with which they deliver information. It has to be in real-time so that the credit limits of buyers are up-to-the-minute and any area of risk can be assessed accurately.

Technology is crucial to this. Not only does it enable the insurer to make informed decisions based on accurate information, it also speeds up the process, avoiding a frustrating wait for clients. The same applies to payments, which may continue for some time to be transferred in the traditional way but which will inevitably start to use blockchain technology in the years to come.

Blockchain is part of the ecosystem that the insurance industry is now operating in. Critical mass is no longer the key competitive advantage as work-around solutions have emerged, but flexibility and the benefits of innovation are becoming paramount. The sooner that the market starts to work with technology providers, the sooner digital and operational transformation can take place. With the right checks and balances in place, insurers should not be afraid to embrace technology progress.

In fact, many insurance companies are already overhauling and updating the services they offer to customers. A few have embarked on the digital transformation of their organisations. Such moves have required vision, a methodical approach, commitment and consistency. But it positions such players in the forefront to take the benefit of the opportunity offered to the credit insurance industry as well as to fulfil their mission to the business community.

Best practice – rules and provision

Provision of best practice enhances processes and good governance for mid-sized and smaller companies and is reaping dividends in the form of support from reinsurers. Instead of maintaining their focus on traditional products, insurers should be keen to build tailor-made solutions and adopt a multi-niche, customer-centric strategy to boost growth.

There are 'golden rules' that insurance companies really should abide by and which they will be aware of. They include: Identifying that they are capable of operating effectively within the market; that they can oversee local relationships and partnerships with a good cultural understanding; that they can accordingly empower their partner with know-how transfer; that their products and services are competitive; and that they have access to local up-to-date intelligence. With these in place, it is then much easier to diversify geographically and across different market sectors with unfamiliar economic cycles.

With emerging markets growing in prominence and accessibility, competitive insurers can use their unique expertise and knowledge, supplemented by local partnership help, to build culturally and economically appropriate solutions. In reality, any geography is accessible if you have the strength and business intelligence to tackle it confidently. There is a trend for companies to offer expertise in multiple niche areas, and diversification helps to spread risk, as long as the insurer is able to support each of those areas within the golden rules.

Now is the time to cast off the cloak of convention and look around for partners that can help make inroads into new markets. It's the time to embrace technology that delivers more accurate intelligence, and it's the time to start honing convincing arguments about why credit insurance is needed in these vast emerging geographies. The opportunities for market penetration are too rich to ignore. ■

Surety market developments - from local market players to ongoing globalisation

Rob Nijhout, executive director - International Credit Insurance & Surety Association (ICISA) – on how surety members are seeing nowadays an increasing number of international companies operating cross border

Bonds and guarantees are normally required under the terms of a construction or engineering contract, or in accordance with mandatory legal requirements, to secure the obligations of the principal debtor against the beneficiary. They guarantee the performance of a variety of obligations, from construction or service contracts, to licensing and to commercial undertakings. Almost any sale, service or compliance agreement can be secured by a surety bond. Most OECD countries have their own legislation under which bonds can be required. The bonding industry was, therefore, traditionally country specific and not cross border.

Bonding market – current & outlook

The most recent ICISA survey among surety members reported a strong overall decrease in claims over 2016, with an increase in written premium and in insured exposure. But results vary per company and depend partly on the state of recovery of leading sectors, such as construction and transport, which can differ per country. With a premium increase of 13.7%, an insured exposure increase by 5.4% and a decrease in claims by -15.4% over 2016, the market has in most countries improved.

"One major trend in the current surety market is for sure the ongoing globalisation," Nijhout reports. "It means that large and smaller underwriters are crossing borders and expanding into other countries. They do this through acquisitions or by establishing new operators, this leads to more players and consequently to increasing competition in most regions." He notes, however, that "often enough this rise in players is not accompanied by an equal growth in the overall market premium".

Rob Nijhout

A second trend - which is a consequence of the first, is a more sensible competition level in the different markets. "These competition levels are not only seen in lower prices, but also in looser policy wordings," he says. This is a problem "as more and more obligations apart from the pure performance risk are passed on to sureties".

ICISA surety members commented that the industry now faced a challenging task because of these developments, Nijhout notes. "This leads to a big challenge for the surety industry to find growth in this environment." Nijhout observes that this is done very successfully in some areas by entering new segments or developing new products. "Cooperation with banks is increasing; however, banks remain the main competitor of sureties."

But there are also regional or country specific challenges to overcome before surety can become a household financial product. "There are still a lot of large regions, for example East Asia, Middle East, Africa and Eastern Europe, where the surety product is underdeveloped. This means a lot of potential for this line of business and a great task for an organisation such as ICISA in promoting the benefits of the product. At the same time governments need to be lobbied to create the right environment and level playing field for sureties to develop", Nijhout explains. "A lack of surety legislation is, in most of the underdeveloped surety countries, the key reason the product cannot mature. Overall, the surety market continues to offer large capacities and excellent security and is very well positioned to take up competition with banks. The more we are able to share this message with lawmakers and beneficiaries, the more surety will penetrate the markets."

Surety data

"Global surety premium is estimated to be around EUR 9 billion", Nijhout says. "Members of ICISA account for around EUR 5 billion in premium income with a loss ratio of 16.3% in 2016. Insured exposure grows year on year and, in 2016, this was reported at EUR 460 billion."

Among the largest surety markets are the US, Korea and Italy, while the Chinese market is growing rapidly. "Surety members of ICISA are active on all continents. Asia and Africa are particular growth markets, although supporting legislation and regulation is still lacking in many countries. Similarly, a lack of adequate insolvency legislation in some countries in the Middle East and North Africa region holds back the growth of surety in certain countries." Nijhout predicts a positive outlook for surety bonds. "With an improved economic outlook and a focus on infrastructure in leading economies, the demand for surety bonds is expected to increase. Ample capacity and risk appetite add to this," he says.

Surety and banks

Surety bonds and bank guarantees are often seen as similar products, with competition between the two product lines as a result. Nijhout notes that "this is a generalisation and does not apply to every country. Bank guarantees and surety bonds also differ in wording and conditions of cover. Surety bonds are typically conditional while bank guarantees are normally on demand".

Differences between surety bonds are country specific. "In the US, for instance, surety bonds are required by law for government funded projects. In Europe the market is often divided between banks and sureties. A determining factor in this distinction is the amount covered by a surety bond, where in the US 100% bonds are common, while in Europe this percentage is much lower, depending on the country involved."

Legislation and regulation also play a part, as does the bank's appetite for bank guarantees, Nijhout explains. "In some countries banks have pulled back from this market, while in other countries they continue to compete with sureties."

What kind of surety bonds does a surety insurance company issue

The secured contractual obligation can have many forms, for example, constructing a building or being compliant to legislative regulations. Nijhout likes to give two examples of surety bond contracts: "The first one is the failure of a contractor (principal) to complete a contract in accordance with its terms and specifications. But also the failure of an enterprise to pay taxes or customs duties to a government or department (beneficiary) can be a situation covered by a surety bond." Nijhout says the most common types of surety bonds can be categorised in seven types. "There are customs, tax and/or similar bonds, bonds concerning concessions and licenses, judicial bonds, bonds concerning purchases of goods and/or services, bonds concerning leases, bonds concerning construction and/or supply contracts and, last but not least, financial bonds. But this list is not complete, there are many types of other bonds as well."

Nijhout concludes by reiterating how the bonding industry is now developing is a very positive way. "In most OECD countries the product is now seen as a valuable alternative for insuring large infrastructural projects and a solid alternative for bank guarantees. The development of multi-country players will probably speed up the developments in countries where the surety industry is not yet a household product and surety bond legislation needs to be improved. But I dare to predict that the ongoing process in the industry will continue over the next five to ten years. The industry will continue growing from local market players to more global players." ■

The most recent ICISA survey among surety members reported a strong overall decrease in claims over 2016, with an increase in written premium and in insured exposure.

The new landscape of sovereign debt restructuring

By Paola Valerio, head of international relations at SACE (Cassa depositi e prestiti Group).

For more than sixty years, the Paris Club has been engaged in the coordination of sovereign creditors' recovery activities granting considerable debt treatments towards more than 90 countries, for an aggregate amount of debt equal to $583 billion. Export credit agencies (ECAs) have always played a significant role in such restructurings, since a substantial portion of claims held by the 22 Paris Club creditor states refers to credits owned by their respective ECAs.

Along with the standard rescheduling agreements, additional major actions have been implemented to allow relief in the long-term period and to restore debt sustainability of highly indebted countries. One of the most relevant examples is represented by the so-called HIPC Initiative[1], jointly launched by the World Bank and the International Monetary Fund back in 1996.

Under this initiative, the international financial community, governments and ECAs have worked together on the same side to ensure that the most indebted poor countries, especially in the African continent, could maintain sustainable debt levels. As a result, various countries benefitted from significant restructuring agreements and cancellation treatments. To date, debt reduction packages under the Initiative have been approved for 36 countries, 30 of which are in Africa, providing $76 billion in debt-service relief[2]. During the period 2005-2016, SACE took part in almost 20 of these multilateral agreements for the implementation of the HIPC Initiative within the Paris Club framework, providing bilaterally 100% debt cancellation. The Initiative is currently coming to an end: nowadays, only few additional countries remain eligible for HIPC assistance.

More generally, strict sustainability

Paola Valerio

requirements imposed on local governments by multilateral institutions have led in the past decade to a lesser recourse to sovereign guarantees for export credit transactions. This tendency has – in turn – translated into a revised role of the Paris Club. Debt cancellation, in fact, currently represents a minor portion of Paris Club activities however in parallel new challenges and topics are raised.

Sovereign debt restructuring is facing significant evolutions which imply considerable challenges and require new solid instruments to promote development and debt sustainability.

The outreach success and best practices

The sovereign debt restructuring landscape these days is facing a significant evolution in terms of participation. New sovereign creditors have joined the international arena, such as South Korea and Brazil[3]. Furthermore, subject to the agreement of permanent members as well as debtor countries, the Club may also invite 'ad hoc members' which can follow the discussion during the monthly 'Tour D'Horizon' and participate in specific negotiating sessions. The scenario would not be complete without mentioning the increasing role of private creditors, which sets new challenges for coordination.

Recent discussions, as the ones that annually take place during the meetings of the Institute of International Finance (IIF) and the Paris Club, which are used to gather official and private creditors, demonstrate that synergy among actors is more crucial than ever. The boundary between officials and private creditors is becoming less and less defined. The widespread issuance of sovereign bonds by emerging countries and their subsequent purchase by both private and sovereign entities are putting the spotlight on the need to reinforce coordination among these two spheres.

Another emerging issue is the enlarged basket of solutions proposed within the Paris Club. Creditors are becoming aware of the necessity to build up and implement sustainable development instruments which should be as resilient as possible. To this purpose, new financing instruments have been developed recently to promote sustainability and avoid future sovereign debt crises, allowing beneficiary countries to react and rebuild their macroeconomic indicators in the medium and long term. Moreover, new sustainable financing schemes have been promoted during these years within the Club with the purpose of encouraging high–return investment projects in debtor countries. By way of example, in February 2015 the Paris Club agreed on an innovative proposal by the authority of Seychelles for financing marine conservation through a debt repayment operation named ‘blue buyback’. Notwithstanding previous experience on pre-payments within the Paris Club, this initiative has been internationally recognised as one of the most successful and best-sustained economic reform programmes conducted with the support of the IMF.[4] The Seychellois pre-payment was partially financed by an NGO while profits would be used in the near future for the development of environmental protective projects.

In a similar spirit in November 2015 a debt restructuring agreement was offered to the Caribbean island of Grenada. For the first time in the history of Paris Club treatments the agreement included the ‘hurricane clause’, a provision which allows vulnerable states to obtain a rapid additional debt relief in case of environmental shocks, which might severely affect their economies.

Finally it is worth mentioning that in the past few years, as a counter-trend, sovereign risk has re-emerged in ECA-backed transactions. Taking into account SACE’s experience, back in the 1990’s sovereign risk represented a substantial portion of the portfolio which sharply declined over the following 10 years. However, increased risk levels in certain emerging markets, also due to the commodity crisis as well as the development of large infrastructure projects (e.g. dams, railways, power plants), have contributed to the resurgence of sovereign debt and sovereign guarantees on public or semi-public buyers. At this stage the involved countries are not requiring recourse to the Paris Club, however this might be the case in the distant future.

Path for new challenges ahead

Further discussions on other contingent instruments are ongoing within the Paris Club forum with the aim of preventing the occurrence of debt distress. The prevailing objective is to avoid vicious circles of indebtedness, whereby economic treatment is postponed to when no other options are available or the debt sustainability is already jeopardised. On the other end, the utilisation of the aforementioned contingent instruments might mitigate the cyclical nature of indebtedness, reinforcing the economic recovery of external debt levels[5].

In this spirit, the Paris Club and its members, with the support of the major financial institutions, are engaged in a strict monitoring of countries’ conduct and economic performance. ECAs play a very important role since they can rely on updated information on payment track record.

Nowadays several emerging countries are facing a critical situation due to external contingences such as, among others, the drop in commodities prices. This holds particularly true for those African countries that structurally depend on the export of commodities. The debt ratio of these countries is now approaching the pre-HIPC levels and this worrying trend of debt re-accumulation might suggest the need for a new debt relief initiative.

All these issues bear considerable challenges. A robust coordination among creditors along with their strong engagement is more important than ever and the implementation of sustainable mechanisms to support emerging countries is, without any doubt, a win-win strategy for all players. ■

Notes

1 Heavily Indebtness Poor Countries.
2 Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative, IMF Factsheet, April 17, 2017.
3 Korea join Paris Club in July 2016 while The Federative Republic of Brazil on November 2016 respectively as 21st and 22nd member of the Club.
4 Paris Club annual report 2015.
5 IMF paper “Too little, Too Late”, 2013.

Leading Mexico's banking transformation

The Government led by President of Mexico Enrique Peña Nieto has driven the transformation and modernisation of the Mexican Government by different reforms, one of them the Financial Reform with special emphasis given to the development banks, particularly Banco Nacional de Comercio Exterior (BANCOMEXT), whose core mandate is to foster international trade and activities linked to export and foreign currency generation.

The undertaken strategy and the International Agreements established with other countries, seeks to continue to promote the expansion of production capacity in companies that export goods and services, with the aim of enhancing Mexico's economic development, taking care of the environment and its capacity to generate employment.

In the last four years, the outstanding credit portfolio balance grew 175.2%, from MXN 80 billion in December 2012 to MXN 219 billion as of June 2017. The credit portfolio growth has been greater than that of the entire group of commercial banks in Mexico, achieving this in a responsible way; for reference, our past due loans rate is 1.1%, meanwhile the credit reserves covers 2.0 times the past due loans and our capital index reached 19% as of June 2017.

BANCOMEXT is a long-term partner of the commercial banks. One of the strengths that the bank has achieved, of the total credit portfolio, 66% is in foreign currency, mainly United States dollars and 34% is in local currency. In addition, BANCOMEXT´s total private credit portfolio is 89% long term (more than 2 years and up to 18 years) of which 88% is longer than 10 years.

BANCOMEXT, as the Export Credit Agency (ECA) of the Mexican Government with solid international relations, maintains a strong interaction with several ECA´s, sharing political and commercial risks on long-term credits given to Mexican companies.

These credits help the expansion and modernisation of plants, as well as the productivity and competitiveness of exporting companies that seek their inclusion in the international markets, a fundamental activity in the development of any nation.

In 2017, BANCOMEXT has been awarded with the recognition of Bank of the Year among Development Banks by the Latin American Financial Institutions for Development Association (ALIDE) and the Deal of the Year by the prestigious financial magazine World Finance for the execution of First Tier 2 transaction executed by a Mexican Development bank.

Iran: sanction-related uncertainty is still hanging in the air

John Blackwell, senior communication and marketing manager at Atradius, explains why Iran still has a long way to go before its economy is fully back in the international arena.

A protracted relaunch into the international arena

When nuclear sanctions on Iran were lifted in January 2016, it was expected to put the country's economy back into the international arena by opening it up to trade, investment flows and economic growth. About 18 months down the line, this has become only partly true.

At an annual rate of 4.6% in 2016 , Iran's economic growth has definitely outperformed its regional peers – and is expected to do so again in 2017. But this rebound is mainly driven by a recovery in oil production and exports to pre-sanction levels because the oil embargo was lifted as part of the nuclear deal.

Moreover, when other oil producers agreed to cut production to support prices in last November's OPEC deal, Iran negotiated exemption and was allowed to regain market share. The return of petrodollars has also sparked non-oil sector activity, according to data of the Iran Statistical Center. This is particularly true in the manufacturing & mining and in the services sectors, such as transportation and storage services.

John Blackwell

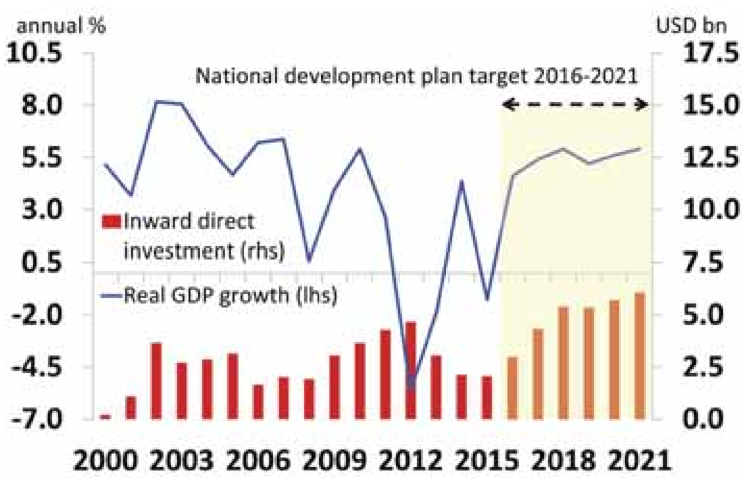
However, the growth acceleration will soon taper off without further impetus as foreign direct investment (FDI) inflow, which is essential to Iran's growth strategy, has not yet taken flight (see chart).

The Iranian government aims for an even higher annual growth rate of 8% in its five-year economic development plan (2016-2021). This optimistic target is based on expectations of receiving around $15 billion of FDI annually. But only a fraction of it has materialised since the nuclear deal.

There are some investment inflows in the pipeline though. An estimated $12 billion in deals has been announced in 2016. Most investment deals so far concentrate on the oil and gas sector. Iran signed a milestone deal of $4.8 billion in July 2017 with a consortium led by Total for the development of the South Pars gas field. This is reasonable as Iran's proven gas and oil reserves rank first and fourth in the world.

Investment is also needed to modernise and diversify Iran's oil-dependent economy and boost the development of the private sector.

Iran growth and FDI prospects



Source: EIU

Reintegration in the global financial system is the main challenge

One of the major obstacles facing potential international investors in Iran is that global banks (including non-US banks) are still reluctant to facilitate investment and trade deals in order to avoid any risk of incurring US fines for breaching remaining non-nuclear sanctions. For instance, because of existing US dollar clearing restrictions, money transfers or the opening of a letter of credit (LC) with Iranian banks in US dollars can only be arranged outside the US banking system. Iran attempts to tackle this hurdle by trading more often in euros. A number of mostly small and medium-sized non-US banks have re-established correspondent relationships with Iran, but major global banks that are better equipped to finance the bigger projects have remained on the sidelines.

Banks' uncertainty over sanctions should be seen in light of the still-high political risk in Iran and in the Middle East in general. Iran's tense relationship with the US must also be taken into account. US President Donald Trump has imposed new, albeit limited, sanctions in response to Iranian ballistic missile tests. Relations cooled further amid the US travel ban imposed on several Arabic countries, including Iran. A modified version of the ban came into effect in July.

But a fully-fledged re-introduction of sanctions by the US would not be effective without the cooperation of Europe, China and Russia. Moreover, the risk that a 'hardliner' would come into power in Iran and escalate the situation has subsided after the re-election of the reform-oriented President Hassan Rouhani in May.

But political tensions remain. Iran's regional rivalry with Saudi Arabia – a US ally – has intensified since the recent diplomatic rift and economic boycott of Qatar, as Saudi Arabia and Iran are at opposite sides of the conflict. Rouhani's position has come under renewed pressure domestically after terrorist attacks in Tehran in June, and polarisation between reformers and hardliners increased. The hardliners retain a lot of power in Iranian society, for example through the Islamic Revolutionary Guards Corps, which are involved with many companies in key strategic sectors in Iran.

The situation is not helped by the fact that Iran's banking sector is generally in bad shape, which makes re-integration into the global financial system even more challenging. The sector is dominated by state-owned banks, whose activities are strongly guided.

The Iranian government continues to exert substantial influence in the background on some partially-privatised banks. These directed lending practices, combined with poor risk management, means the ratio of non-performing loans is high, at around 11%. This is also reflected in government payment arrears, while capital buffers are extremely low (Capital Adequacy ratio of 5.8% in March 2015) and on a downward trend. The IMF says recapitalisation of a number of state-owned banks is therefore urgently needed.

Banks also have trouble obtaining funding because they are dependent on domestic savings, and have to compete with unlicensed financial institutions. This has led to high interest rates, depressing banks' profitability. Iran is still on a 'black list' for money laundering and terrorism financing, which puts off correspondent banks from dealing with the country as it requires additional due diligence.

Iran has at least started to address the various problems in the banking sector. It is working with the Financial Action Task Force to address the deficiencies in its frameworks for anti-money laundering and combating the financing of terrorism. The government also attempts to patch banks' balance sheets by clearing its arrears to the banking sector via

The Iranian government continues to exert substantial influence in the background on some partially-privatized banks. These directed lending practices, combined with poor risk management, means the ratio of non-performing loans is high, at around 11%. This is also reflected in government payment arrears, while capital buffers are extremely low (Capital Adequacy ratio of 5.8% in March 2015) and on a downward trend.

domestic bond issuance. A new comprehensive banking law, which is vital to upgrade Iran's financial supervision and implement reforms, still needs to be finalised. A large scale recapitalisation seems inevitable, but there is no progress to be reported here so far.

Macroeconomic indicators remain favourable

Iran's macroeconomic fundamentals are good. Public finances are healthy with a modest fiscal deficit and a very low public debt level, estimated respectively by EIU at 2.7% and 14.3% of GDP in 2016. The Rouhani administration's prudent fiscal policy means the budget has also become less dependent on oil revenues, for instance due to sales tax increases. Iran plans to replenish its Oil Stabilisation Fund with revenues that occur when the oil price exceeds the budgeted amount of $55 per barrel in order to build a buffer to absorb future budgetary shocks. The current account is expected to remain in surplus, and external debt is almost non-existent (around 2% of GDP). This of course partly reflects Iran's disconnect from the international capital market. Iran also demonstrated excellent payment morale, when it repaid arrears to credit agencies that were built up during the sanction period.

The success of the Rouhani-administration in reforming the economy partly depends on how much it needs to compromise with the hardline opposition at home in light of the increasingly assertive stance of the US and its regional allies.

Iran's international reserve position is strong, at around 21 months of import cover in 2016. Central bank access to the reserve improved when frozen assets were released following the removal of nuclear sanctions. Monetary policy is also prudent with relatively stable inflation (single digit in 2016) and exchange rates. The alignment of the official exchange rate with the parallel free market rate, which has been postponed, is now planned for the beginning of 2018. This would remove economic distortions and put the central bank more in control. It would also make Iran more cost competitive and may encourage FDI inflows because it would likely require a devaluation of the official rate to align it with the market rate. The official exchange rate is currently moderately overvalued by 5–7%, according to the IMF.

Last but not least, Iran's population is large, young and relatively well-educated. This forms a solid base for economic diversification and boosting the private sector economy. But structural reforms are required in order to fully utilise these strengths, for example in the labour market to address job mismatches and increase female participation; and the business environment to cut red tape and address other institutional and market inefficiencies. There is plenty of scope for improvement. The unemployment rate is high, especially among the young (29.1%), while the participation rate is low especially for woman (14.2%). Iran currently ranks poorly on the World Bank Doing Business scale at No. 120.

Iran's outlook has improved, but downside risks are there to stay

To conclude, Iran's economic outlook has improved since sanctions were lifted and growth potential is promising. However, high political risk and the weak banking sector are potential pitfalls for doing business with Iran. These are not likely to be solved in the near-term. The success of the Rouhani-administration in reforming the economy partly depends on how much it needs to compromise with the hardline opposition at home in light of the increasingly assertive stance of the US and its regional allies. It also depends on whether major international banks begin servicing transactions with Iran. Export financing and investment deals are logically more exposed to those risks.

We acknowledge the potential of this sizeable market once it completely opens up to foreign trade but there remain a number of risks in doing business in Iran. Some inconsistencies remain in the desire of the government and other authorities in doing business with Western trade and investment partners. The election of Donald Trump as US President also dampens interest of US companies in working with Iran, also freezing funds and resources of listed persons/entities. It is also still not clear that money can be transferred out of the country directly and legally through banking channels. Consequently we remain very restrictive and off cover on Iran. ■

A Cinderella story

From civil war to Africa's darling in under five years, Côte d'Ivoire poses challenges and opportunities for investors. By George Otieno, CEO, African Trade Insurance Company.

Unprecedented growth

When reading about the tremendous progress of Côte d'Ivoire today, it's hard to believe that this thriving country was embroiled in two civil wars from 2002 to 2011. The country is listed as the fastest growing economy in Africa and, according to the IMF's 2016 Economic Outlook, is the world's second fastest growing economy with average growth rates of 8% in the last three years. Thanks to a spate of business-friendly policies, Côte d'Ivoire has also gained 40 positions in the World Economic Forum's Global Competitiveness Index since the 2012-13 report. The rise is based on improvements in access to electricity, enforcing contracts, and trading across borders.

With such impressive growth and a private sector-focused government, it's not surprising that the country has managed to attract an impressive list of investors, including a recently built $167 million Heineken brewery, and a raft of UK-based investors including Crown Agents, Diageo, GlaxoSmithKline, Globeleq Holdings, PwC, Standard Chartered Bank, Tullow Oil and Unilever, as well as financial multilaterals such as African Development Bank, Africa Re, African Export-Import Bank and Zep-Re.

The country's rags to riches transformation is one of the greatest African success stories of this decade, which began in 2010 when Alassane Ouattara – an economist and former deputy director of the IMF – won the presidential election. He was not able to assume office until 2011 after a brief challenge by the previous leader but, since that day, President Ouattara is widely thought to have shown commitment backed by policies to move the country toward more transparency and private sector-led growth.

Key risks remain

Despite this impressive progress, there are elements that investors and companies need to know before entering the market. Like many countries moving from what the IMF terms a 'frontier market' to 'emerging market' status – which is the ultimate goal of the government as outlined in its 2016-2020 National Development Plan (NDP) – Côte d'Ivoire is undergoing what we can call growing pains. The country is arguably doing many things right, which we will also touch upon, but key risks remain and, in our estimation, require some vigilance:


George Otieno

- The current focus on succession politics which underscores the importance of the upcoming 2020 election;
- Bribery and corruption;
- Deterioration of banking sector indicators;
- Mutiny;
- Terrorism.

Our analysis draws extensively from EXX Africa, a specialist intelligence company defined by its unvarnished and accurate reports that, like ATI, are based on a reliable network of on-the-ground sources.

Succession politics

Perhaps nothing highlights the current political situation more than recent media images depicting masked men with guns. Strikes led by armed mutinous soldiers shut down several of the country's cities in January 2017 and then again just five months later. The soldiers, many former rebels, demanded back pay for their work that included battles in the 2011 civil war that effectively ended the impasse between the current president and former president Gbagbo. The government acquiesced to the first demand but, by May 2017, it dispatched loyal army units to end the mutiny. This decision may have been fuelled by the growing bill of $170 million, which the government was ill prepared to honour with falling cocoa prices, proceeds from which account for a large portion of its budget.

This episode has two aspects worth

noting. First, there is a political element driven by speculation that these mutinies are led by Guillaume Soro, the president of the National Assembly, who led the rebels during the civil war and who has expressed a desire to be the next president. This runs counter to President Ouattara's selection of former prime minister and long-time ally Daniel Kablan Duncan as the vice president in early 2017. It is a newly created position under the revised constitution meant to signal the president's choice for his successor as he is mandated to step-down in 2020.

The second aspect to the theatre of succession politics is that the government's preoccupation with politics may give way to its taking the eye off ongoing implementation of critical reforms. These include recommendations from the World Bank such as reducing the start-up time for a business to 24 hours; lowering processing and transaction times at the Abidjan Port for both exports and imports; setting up credit information bureaus; establishing a commercial court of appeals and creating e-government platforms to simplify a number of operations such as filing and payment of taxes and tariffs.

Bribery and corruption

Corruption is, of course, not specific to Côte d'Ivoire, where it is characterised as entrenched. For instance, corruption still has an impact on judicial decisions, contract awards, customs and tax issues, with bribery reported at every level of the civil service. At a lower level, foreign companies may encounter petty corruption in business transactions – tax officials, for example, may be overenthusiastic in enforcing laws in the hopes of receiving bribes.

The former militia leaders, who helped President Ouattara end the post-election conflict in 2011, are reported to be one of the most visible sources of corruption. A 2013 UN panel of experts cited a military economic network of former leaders, who held powerful military positions in government, participating in smuggling, illegal trade and parallel tax.

Corruption by its very nature is difficult to root out. The government has been trying to make headway in this area with modest measures that include a new anti-corruption force established by the gendarmerie. It has led to a considerable reduction in demands for bribes at police checkpoints on major thoroughfares. The Finance Ministry's inspector-general's office and the country's financial intelligence unit have also been strengthened – but capacity remains an issue. Clearly more needs to be done on this front but the ambitious pace of the government's policy agenda coupled with the endemic nature of corruption means that this is likely to be a slow process.

Banking sector risks

The reported 26 banks in Cote d'Ivoire manage about 80% of the country's financial sector assets, with the rest covered by insurance companies. Ten foreign-owned banks dominate the sector, accounting for 51% of assets, followed by seven subsidiaries of regional banking groups, five locally-owned banks and four public banks, which account for about 10% of the sector's assets – though this is decreasing as the government continues to privatise and restructure public banks.

With a population of 22 million, Côte d'Ivoire is attractive to foreign banks because it is one of the largest economies of the West African economic bloc – ECOWAS. It is West Africa's strongest economy, representing about 40% of the West African Economic and Monetary Union (WEAMU) GDP. Banks reason that establishing a base in the country provides entry to French-speaking West African countries in the WEAMU block that includes Benin, Burkina Faso, Guinea-Bissau, Mali, Niger, Senegal and Togo.

Overall, the sector has seen an increase in bank loans and improved access to banking services. But the country still lags behind neighbours Togo and Senegal because one in eight Ivorians are reluctant to deposit savings in formal financial institutions.

The greatest risk to the banking sector is high exposure to indebtedness to the country's five largest borrowers, representing about one-third of their assets and three-times their capital – which poses an increase in credit risks. These borrowers are reported to be public and private entities in the agro-business and commerce sectors.

In 2015, the stock of bank non-performing loans (NPLs) increased by more than private sector credit – an estimated rise of 75% net of provisions, indicating an increase in bank credit to small-and-medium sized enterprises (SMEs), which have high default rates and arrears from financially weak public companies.

The IMF has encouraged the restructuring of public banks and faster implementation of financial sector reform to resolve some of the challenges stemming from government arrears and falling oil prices.

The ever-present scourge of terrorism

Overall, there is an increased threat of attacks by radical Islamists in West Africa. Côte d'Ivoire shares a border to the north with Mali, a known hub of jihadists in the region, which increases the likelihood of attacks within the country. In March 2016 the country experienced its first significant attack at a popular tourist site in Grand Bassam, 40km east of Abidjan, by six gunmen affiliated with Al-Qaeda in the Islamic Maghreb. France's intelligence services indicate that these types of attacks, targeting tourists in countries such as Côte d'Ivoire and Senegal, outside the previously targeted Sahelian countries, are likely to continue.

In response to a growing extremist presence along its border with southern Mali, Cote d'Ivoire has stepped up security in northern areas and predominantly Muslim neighbourhoods in the commercial capital of Abidjan. The government is also working closely with religious leaders and Muslim organisations, requesting that they notify police of newcomers and suspicious activity. They've also sent reinforcements to their northern border.

Côte d'Ivoire leads the charge in these risk areas

In addition to economic indicators, Côte d'Ivoire is also leading Africa in two risk areas which emphasise the country's commitment to improving the business environment – contract frustration and expropriation.

There is a low risk of contract frustration largely because the peaceful transition to the Ouattara government decreased fears of retaliation against French companies by the previous president, who saw France as the main culprit behind his eventual ouster. Beyond this, Côte d'Ivoire is one of the best countries in sub-Saharan Africa for enforcing contracts – supported by the creation of a specialised commercial court in 2012. The average time to resolve disputes is estimated to be even lower than the OECD average, though the cost is about the same as the continental norm.

New investment, telecoms and mining codes, and the establishment of a business facilitation centre are all meant to reduce disputes caused by issues including allegations of collusion between government officials and companies.

Another risk area showing stellar results is expropriation. While there is a public expropriation law in place, there have not been any cases of government expropriation of private property. In fact, private expropriation as a way to settle contractual or investment disputes has historically been a larger problem – but under Ouattara's presidency these have seen a noticeable drop off.

A country on the move with a progressive strategy for future growth

President Ouattara, much like the current president of the African Development Bank Akinwumi Adesina, sees food production as a major factor in plotting the country's future growth strategy. The rationale goes that a country that can feed itself will be able to feed the world.

To this end, the government is focusing on creating a market in the 300 million West African region, where about 100 million are estimated to be middle-income. The government is investing in processing in-demand commodities such as cocoa, palm oil, rubber and rice to reduce costly imports. The strategy is already paying off, with the government negotiating with Swiss companies interested in making juice to sell in the region. Cemoi, the French chocolate maker, recently opened a factory to make products for eventual export to other West African countries.

As our newest member, we at ATI see great opportunities in Côte d'Ivoire, particularly in the infrastructure (construction, energy and roads) and services (banking) sectors.

As our newest member, we at ATI see great opportunities in Côte d'Ivoire, particularly in the infrastructure (construction, energy and roads) and services (banking) sectors. While there is tremendous momentum, the true test will be the country's ability to transition peacefully through another election cycle. The ability of countries within the ECOWAS region to pull together to avoid widespread political instability – as in the recent cases of The Gambia and Burkina Faso – gives reason to believe in the power of the community to reign in bad behavior in 2020 and beyond. ■

The Mozambique debt crisis – how it is unfolding and potential resolutions

Despite the recent signing of a major ECA-backed project financing – Coral FLNG – the Mozambican government needs to ensure that the path for large investment in mining and LNG projects is cleared. Cooperating with donors in solving the debt crisis remains paramount. By Benoit Fugah, head of the political, economic analysis and research unit at ECIC South Africa.

Most heavily indebted countries in Sub-Saharan Africa (SSA) had taken advantage of the foreign debt relief initiative under World Bank and International Monetary Fund (IMF) programmes by about 2010. Sovereign leaders could reallocate finances into development programmes and the expansion and modernisation of public infrastructure.

This path was also supported by high prices in commodity markets, from which high export earnings and fiscal revenues were generated. The prospects for positive market outlook allowed governments to return to capital markets (specifically the Eurobond) to accelerate their expansionary programmes on the back of expected higher revenues.

But, with sluggish demand in advanced economies and the subsequent fast landing of the Chinese economy, high commodity prices could not be sustained. Most fell by more than 40% in 2015 alone, meaning SSA countries faced lower export and fiscal revenues. The unpredictability of when the upturn would come again led to (i) the reviewing of budgets; (ii) the reassessment of government programmes and development priorities; (iii) severe pressure on the exchange rates and currency reserves; (iv) restructuring of debt obligations; and (v) delays/cancellation of investment projects.

Mozambique is not an exception to this cycle. The country benefited immensely from the World Bank/IMF debt relief initiative after reaching the Completion Point in 2001. From there it returned to the capital markets as a means to raise funds for national programmes.

Unfortunately, Mozambique was shortly afterwards plunged once again into a fresher indebtedness cycle. Some of the debts were not accounted for in public debt records. A forensic audit query, aimed at allowing for accountability and transparency on acquiring new debts going forward, has since begun.


Benoit Fugah

How the current administration handles the matter could either drive away or raise the cost of the awaited foreign investments. The revelation of hidden debts of such magnitude has caused uncertainties to the extent that investors and all fund donors have adopted a wait-and-see approach as they try to comprehend the level of risks and ramifications.

Eurobonds – a new gateway

Some African countries' eligibility to raise money by issuing Eurobonds was enhanced by higher commodity prices, sound economic policies, and improved governance. It became a trend to sell Eurobonds in Africa as an alternative to getting money at historically low interest rates to finance infrastructure unsecured, i.e. without conditions attached to the funding.

The increase in sovereign bond issues for SSA surged after the global financial crisis of 2007/8, with strong levels of issuances from 2013 to 2015. The drivers included the slump in the global economy which ignited a strong appetite among investors for higher yielding debt outside the traditional markets in the advanced economies. Most bond issuances were largely oversubscribed, a testimony of investors' appetite for risk in the frontier markets.

This new round of indebtedness now poses acute challenges in the face of economic headwinds due to stagnant commodity prices, poor fiscal revenue collection, lack of transparency, and shortage in hard currency reserves. What was thought to be a new funding option has turned into a financial burden. Interest payable on issued bonds continues to increase as investors demand higher returns for perceived risks. This has resulted in a number of African countries appealing to the IMF for help in restructuring their public debts.

From old to new debt concerns

Mozambique was heavily indebted up until the early 2000s, as reflected in the chart below. Repeated reschedulings and write-offs by various bilateral creditors preceded complex negotiations. The talks eventually resulted in the World Bank and IMF declaring in April 1998 that Mozambique was eligible for debt relief under the Heavily Indebted Poor Countries (HIPC) initiative. The country reached a Decision Point in April 2000, and the Completion Point of the HIPC initiative in September 2001 – a feat which allowed it to receive $3.2 billion debt relief in nominal terms.

As a result, foreign debt fell from about $6.6 billion in 1998 to $3.4 billion in 2001. Total debt stock at this stage was brought to a sustainable level. However, debt has grown because of the need for more investment in infrastructure and economic development programmes.

Constraints in broadening the government's income base to finance the ambitious programmes left only one option of raising non-concessional borrowing in an environment of lower donor aid flows. The government expanded in these new sources of funding, ignoring the reading of global economic challenges.

The public debt peaked in 2013 and 2014 based on an assumption that Mozambique would quickly become a global gas exporter. But the slump in commodity prices seems to have delayed the finalisation of the gas projects.

Mozambique issued a state guaranteed Eurobond of $850 million in 2013. However, the government acknowledged that the previous administration had incurred further $1.4 billion Eurobond debt around the same time. This resulted in the total debt to GDP (domestic and external) being about 84.8% in 2015.

A parliamentary commission in December 2016 found that the government guarantee to repay the undisclosed loans was illegal, particularly because the loans were not approved by its parliament. The IMF then issued strong views on remedial steps that needed to be taken to improve the issue of undisclosed debt. The IMF, as part of that effort, and in agreement with the government of Mozambique, initiated an audit on the three companies that received the bulk of the previously undisclosed debt. The contract for this independent audit was signed in November 2016 in consultation with the IMF. It was expected that Kroll's audit report would be completed by 28 April 2017. The outcome of the audit is still pending, and will be the basis for discussions over a potentially new IMF-supported programme.

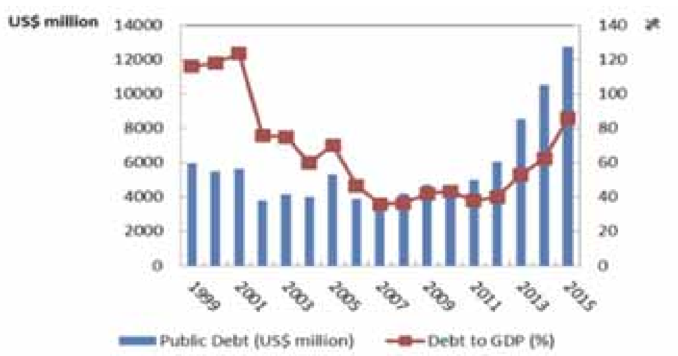
The audit query is to investigate the $2 billion debt made in favour of the three companies, Proindicus, EMATUM and Mozambique Asset Management (MAM).

- $850 million loan to the EMATUM company for a tuna fishing fleet
- Proindicus ($622 million) to provide maritime security, particularly for offshore gas operations
- MAM ($535 million) to set up maritime repair and maintenance in 2013.

Noteworthy, Credit Suisse AG's London unit, arranged the Proindicus loan. Palomar Capital Advisors Ltd, based in Zurich, and Russia's VTB Capital Plc, arranged the MAM debt. London-based Clifford Chance LLP and Maputo-based Couto, Graca e Associados, Lda, were the legal advisers to the arrangers for both loans.

These new loans make up about 20% of a

Mozambique debt to GDP



Source: Based on IMF and World Bank data foreign debt burden which is currently estimated at approximately $10 billion.

Status and management of Mozambican debt

Mozambique's government failed to make coupon payments on a sovereign Eurobond in May 2016, and January and March 2017 because of a deteriorating economic and fiscal situation.

Ratings agencies reacted by downgrading the country's long-term foreign currency rating to "restricted default". Mozambique's debt has therefore become unsustainable. The country is now experiencing debt distress with rescheduling of instalments or repayments due to lack of funds. The recent decision by the WB and IMF and G-14 donor aid partners to suspend all balance of payments and budget assistance crippled the interbank market. US dollar supply ran dry, causing persistent depreciation of local currency.

The high degree of uncertainty over the future of negotiations between the government and bondholders means the country will continue to struggle with low economic growth. Access to credit markets will remain closed, while any deal with the IMF will likely have to wait until some kind of arrangement has been made with bondholders.

This scenario is costly to GDP growth, which is expected to reach just 3.4% this year – the worst performance in more than a decade. A lack of credit will constrain the government's fiscal position, forcing cuts that could well exacerbate already elevated levels of political risk. However, this outlook is unlikely to deter progress in the development of the country's substantial gas fields by ENI and Anadarko, the economy's one bright spot. The government's minimal role in the project has meant that progress has not been affected by the significant levels of political risk.

The authorities have revamped efforts to enhance public management, removing from the pipeline of priority investment all the projects that have not been subject to a feasibility study and evaluation. All projects exceeding $50 million are subject to a mandatory technical assessment and approval by the Investment Evaluation Committee prior to inclusion on the budget.

In an attempt to control foreign currency, the Central Bank has reverted to a form of moral persuasion where it issues instructions on currency trading.

The way forward

The Mozambican government needs to ensure that the path for large investment in mining and LNG projects is cleared. Accordingly, cooperating with the donors in solving the debt crisis remains a paramount parameter. In this process, Kroll's findings will dictate the direction of the decision-making by IMF, G-14 and bondholders. Meanwhile, the country is currently in default and there are no visible signs of alternatives.

Pursuing former ministers with the intention of prosecuting them is likely to cause discord in the ranks of the Frelimo ruling party, which could spill over into political instability in the run-up to the 2018 and 2019 elections.

Even if the government had to go down legal avenues, it might lose the case and see some of the assets being attached in foreign jurisdictions. Nonetheless, responsibility of debt default would be shared between the banks, the advisers and the Mozambican government. It is also possible to pursue a different route to maintain good relations with capital market players through negotiations. The government can admit the responsibility of the debt and negotiate the restructuring via one financial facility (regrouping all debts), with new terms and longer tenor. This option is likely to be the most preferable if the government wants to see the continuation of IMF support and FDIs inflows. ■

"What was thought to be a new funding option has turned into a financial burden. Interest payable on issued bonds continues to increase as investors demand higher returns for perceived risks. This has resulted in a number of African countries appealing to the IMF for help in restructuring their public debts."

Notes

www.imf.org/en/countries/resrep/moz

http://data.worldbank.org/topic/external-debt?locations=MZ

Rhula Intelligence solutions, weekly media review No. 167: 10-17 February, www.rhula.net

www.reuters.com/article/us-mozambique-politics-idUSKBN1330KV

http://www.reuters.com/article/us-mozambique-debt-idUSKBN15C0QD

TXF

WORLD TOUR 2017/2018
EXPORT & PROJECT FINANCE

PLUS TXF TRAINING:

SUPPLY CHAIN FINANCE

MIAMI | FEBRUARY 2018

FOR SPONSORSHIP ENQUIRIES PLEASE CONTACT DOMINIK.KLOIBER@TXFMEDIA.COM
TO BOOK YOUR PLACE AT A 2017/2018 EVENT, EMAIL MARKETING@TXFMEDIA.COM
OR CALL +44(0)20 3735 5183

WWW.TXFNEWS.COM/EVENTS

Argentina: opportunities for business and cooperation next door

Since the rise of China, Argentina has been demoted to Brazil's second largest commodities trading partner, but this has not stopped Argentina finding new opportunities for business. ABGF's executive manager, Pedro Carrico, discusses the new avenues pursued by Argentina, as well as how political transitions have impacted on the ECA.

Argentina is historically one of Brazil's most important trading partners. Along with Uruguay and Paraguay, the two countries share the economic and agricultural heartland that surrounds the extensive Paraná-Paraguay river basin. There is intense trade in the border areas and a high level of economic integration, especially between the southern region of Brazil – where much of Brazilian manufacturing is located, and Argentine industrial centres. Supply chains for some key sectors, such as the automotive industry, are spread across either side of the border of the two neighbours.

The rise of China as a market for Brazilian commodities demoted Argentina from the rank of second most important destination and 10% export share 20 years ago to a more modest, yet still highly relevant, position today. Despite this diversification of trade partners and a recent precipitous decline in bilateral trade between the Mercosur partners brought on by economic slowdown in the region and tit-for-tat trade restrictions, Argentina was still the third largest export destination for Brazil in 2016, representing 7% of total exports (one fifth of Argentine imports). As for Argentine exports, the large northern adjoining market has remained in first place (six percent of total goods imported by Brazil) but its share of total shipments has fallen from 28% to 18% in the same period.

The Brazilian export credit insurance system saw a similar evolution of its portfolio exposure to Argentina risk. After a rapid increase sustained by the recovery that heated up demand in post-Currency Board Argentina after 2002, the Brazilian ECA had reached between 25% and 30% of its total commitments in the country by 2012. From that point on, the share of exposure to Argentina began declining yearly until 2016 as the commitments to other countries continued to grow, but new transactions involving Argentina were few and far between.

Pedro Carriço

Both demand from exporters for cover and ECA appetite for Argentina risk gradually declined. On the one hand, the Brazilian system still had fresh memories of the commercial claims paid a little over a decade earlier as a result of the currency devaluation crisis. Not only was that event the first default experienced by a still young ECA scheme, but the recovery process, which had yet to be concluded for a number of claims, was a daily reminder of potential negative results. Furthermore, a feeling of déjà-vu hovered in the minds of the people who had lived through the Argentine crisis. From 2012 on, once again the peso was artificially maintained over-valued, hard currency was rationed by the authorities and a thriving black market for US dollars gave a real time reading of the pressures mounting in the system. The outcome seemed to be an inevitable repeat of what had come before.

Although not formally off cover, economic and financial conditions on the ground in Argentina prompted the ECA to request sovereign guarantees whenever appropriate along with explicit government support for projects, as well as to turn down private risk as long as hard currency availability remained on a downtrend. Nevertheless, the Argentine government's ability to extend sovereign guarantees, even for public works projects, weakened as the government encountered fiscal difficulties and Congress focused on the coming elections. As a result, fewer and fewer projects moved forward.

If the system was reluctant to assume more risk, demand from exporters was similarly subdued. Applications for medium and long term cover in Argentina in the previous decade had been concentrated mainly in public works led by large engineering and construction firms that mobilised suppliers back home to provide a substantial share of equipment and machinery used in the projects. As the second Christina de Kirchner administration drew to a close, decision making came to a halt due to generalised uncertainty over policy direction in the next government. A list of approved projects with promise of cover never broke ground during this period and remained stuck in the pipeline after the Mauricio Macri administration was inaugurated. In addition, the financing for these transactions was called into question when the recession in Brazil brought about spending cuts and dried up credit in the system. Financing difficulties were compounded by the involvement of some of the engineering firms in corruption investigations that all but shut them out of the credit markets. On top of all this, broad bilateral trade negotiations encompassing supply chains, non-tariff trade barriers, Mercosur relations, and trade/export financing were frozen during the political transitions in Argentina and Brazil. Had these talks advanced, there was hope that a framework agreement on the project pipeline would have been part of the package.

Gradual political and economic stabilisation allowed for the disagreements between the two countries to begin slowly being resolved with the new governments in place. A concurrence of economic management approaches to include more market-friendly policies helped to prod negotiations forward. In the meantime, the backdrop was evolving favourably: the resolution of the long-lasting battle with hold-out creditors and renewed market confidence in the direction of economic policy taken by President Macri's team reopened international credit access to Argentina. External liquidity fears subsided and investors were able to focus once again on the country's enormous potential in various sectors, from energy and logistics to manufacturing and services.

On the domestic front, after the longest recession in a century, Brazilian credit markets have shown signs of normalising again, with the Central Bank reducing policy rates and loan quality deterioration ceasing. Financing availability for medium/long term exports has returned, although at a lower level than previously seen and with a plethora of compliance requirements. As a result of improved conditions in both countries, new opportunities for export contracts started to emerge in earnest in 2017. There has been a significant shift in demand for cover: engineering and construction firms have yet to submit new applications while capital goods manufacturers have returned from their long absence. According to market news, it seems that although competition from other exporters has increased, Argentina simply has not been concluding public works transactions lately. In other words, Brazilian engineering firms are not necessarily missing out on export opportunities to Argentina because of internal and domestic issues. Proof of this may lie in the fact that the Macri government apparently has yet to revise the list of priority infrastructure projects in Argentina.

Having said this, there is no doubt that competition has intensified with the normalisation of Argentina's financial relations with the rest of the world. Fortunately, it is often the case that even when transactions are closed by firms from third countries, part of the production of goods sold to Argentina has a good chance of occurring in Brazil, given the manufacturing presence maintained in the country by a large number of multinational firms. Furthermore, increased competition also has an effect on the ability of exporters and lenders/insurers to extract additional guarantees from their buyers. The new government, naturally reticent to offer sovereign guarantees due to its laissez-faire approach, has been able to resist calls for such commitments. As a result, more creative solutions need to be developed, proposed and negotiated within the context of transactions, bringing together parties that may be unfamiliar to each other in more complex structures involving a larger number of players and steps. As necessity is the mother of invention, the future seems to be bright for cooperation and risk sharing opportunities between the Brazilian ECA and other export credit insurance industry players. ■

Introducing the BECI Local Contractors Programme

BECI has historically provided construction guarantees to the top end of the market. Now, to address the growing needs of local contractors, BECI has introduced the Local Contractors Programme. By Bonani Dube, marketing manager, BECI.

The Local Contractors Programme is designed for local citizen-owned contractors that are emerging and still in need of guidance into the next stages of business growth. BECI realised that smaller contractors face a number of challenges, all of which need to be addressed: Weak or non-existent construction technical education background among the smaller contractors; lack of understanding of contracts and the application of clauses; and how to boost project and business management skills.

Smaller contractors can also face the hurdles of weak construction management, waste management, and quality management skills; as well as a lack of financial acumen compared with larger contractors.

Insufficient capital, a weak balance sheet and a lack of sufficient assets to provide as collateral can also hold local contractors back. And understanding of pricing structures and quality standards was also found to be limited, with poor credit arrangements with suppliers another common problem.

The solution to challenges

BECI has developed sufficient skills in the underwriting and technical expertise of bonds over time and has adapted those skills to creating a unique underwriting criteria for smaller contractors, thus developing a product that best suits them. It provides a contractor's guarantee, encompassing both the support and monitoring of the small contractors. BECI underwrites each contractor individually and provides the employer with a guarantee. The financial burden on small contractors is reduced by a lower level of collateral being required, and risk is mitigated by co-signing with the contractor.

When working with local contractors BECI negotiates good credit terms from its policy holders for materials needed, and can help the emerging contractor gain skills through monitoring and mentoring. We will also assist the contractor with a full detailed construction programme.

Bonani Dube

The cost structure

The Guarantee costs structure comprises the following:

- Premium
- Monitoring fees
- Administration fees.

The fees vary between 2.5% and 4.5% of the guarantee depending on the risk profile and resources required to support the contractor.

Project management services to BECI

BECI worked with a project management firm to help identify any areas where smaller contractors could improve. The firm would in turn provide the following services to both BECI and the local contractors: Project management services, risk management facilities, cost control, construction programming contract administration, and quality control.

There are a number of other advantages to getting a project management firm involved. It will monitor the project and give BECI updates, as well as be responsible for dealing with compliance issues. Furthermore, the firm attends to site meetings and signs off all the payment certificates. We find the consulting firm to be a real boost to the smooth running of the product. ■

A new approach to mitigating offtaker risk in African power

Africa's continued growth hinges on improvements to the energy infrastructure and innovations in power sector financing are vital to reducing Africa's $40 billion energy sector funding gap. By John Lentaigne, chief underwriting officer, ATI.

African economic growth continues to outpace most other regions in the world. International Monetary Fund (IMF) projections estimate that seven of the ten fastest growing economies in the world in 2017 will be in Africa. This growth is expected to continue into the next decade, with increased foreign direct investment and improved regulatory and fiscal management. Future growth, however, is predicated on improvements in infrastructure. Improvements to public services such as power, transportation and water can increase trade, provide employment and promote access to better services such as healthcare - all of which compound to increase the attractiveness of the region to investors.

Within infrastructure, the energy deficit remains perhaps the most critical challenge in sub-Saharan Africa. Daily per capita electricity use in the region is estimated to be 124 kilowatt-hours, or the equivalent of using a 100-watt bulb for three hours. This represents one-tenth of per capita usage in other developing regions around the world. Limited access, rolling blackouts and increasing costs also act as a disincentive to investment by corporates which face an average of nearly 60 days of power outages each year. Added to this is an estimated $40 billion funding gap in terms of available capital vs demand. African countries realise the urgent need to invest in the energy sector, but they cannot finance the investments required solely through the public sector. They are also hampered by an inability to make energy sector projects appealing to private investors.

Most infrastructure investments in the region are currently financed by governments (the public sector), the private sector and other countries - such as China. External official development assistance (ODA) represents a fraction of the total financing – well under 10%. Multilateral and bilateral organisations, as well as development finance institutions (DFIs) such as the World Bank's Multilateral Investment Guarantee Agency (MIGA), the African Trade Insurance Agency (ATI), the African Development Bank and other similar institutions, are also important partners in bridging the financing gap by reducing risk so as to encourage private sector investors.


John Lentaigne

DFIs typically bring to power projects significant experience, a commitment to encourage sustainable development, improved transparency, risk mitigation and improved returns on investments (or certainty of return). They provide options such as direct loans, credit enhancements and first-loss funds. Export credit agencies (ECAs) also provide similar products such as guarantees and insurance. Figure one lists the financing tools offered by DFIs for infrastructure investments in developing economies.

Challenges to using project financing in Africa's energy sector

Traditional funding sources such as project finance from commercial banks are increasingly a challenge in the region due to Basel III requirements and the sub-investment grade ratings of most African countries. In

Figure 1

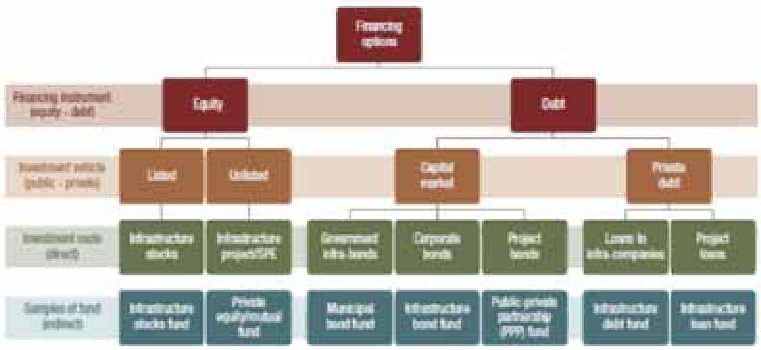
TABLE 1 | DFI Financing Tools

Mechanism	Direct public financing or guarantee?	Debt or equity?	Risk level	Mitigates which risks?
Political risk insurance	Guarantee	Mix	Medium	Currency inconvertibility, expropriation, regulatory, political violence
Credit enhancements	Guarantee	Debt	Medium	Commercial/default risks
Full credit wrap	Guarantee	Debt	High	Credit (covers entire debt load of project)
Sovereign guarantees	Guarantee	Mix	High	Contractual, failure to pay (provided by host government)
Partial risk guarantees	Guarantee	Debt	High	Political, sovereign, contractual (provided by DFIs regarding host governments)
Direct debt financing	Direct financing	Debt	Medium	Perceived credit and political risks by commercial banks
Forex liquidity facility	Direct financing	Debt	Low	Liquidity
Portfolio guarantees/first loss	Direct financing	Equity	High	Credit, political

Source: Adapted from the Institutional investment in infrastructure in Emerging Markets and Developing Economies, March 2014

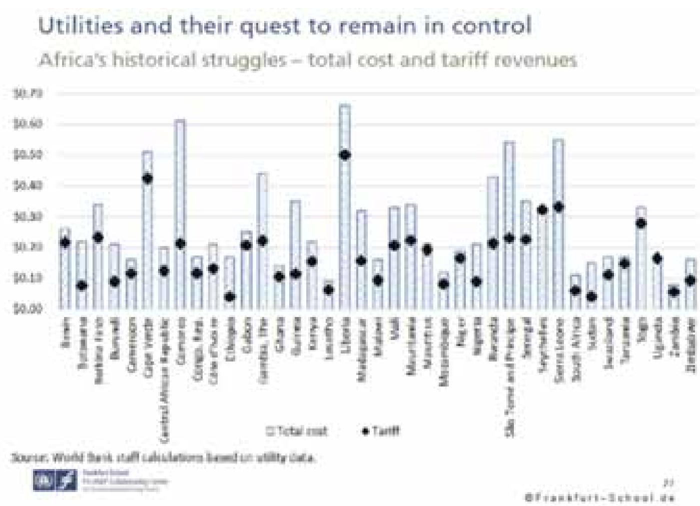
Figure 2

Infrastructure financing options



Source: Institutional investment in infrastructure in Emerging Markets and Developing Economies, March 2014.

Figure 3



Information and stats are drawn from a May 2016 Report by the Milken Institute on "Innovative Financing Models for Energy Infrastructure in Africa"

addition, the turn-around time to execute a deal in Africa can take between 30 and 72 months compared to the average of 12 months in Asia and Latin America.

There are several important factors restricting the use of project financing more broadly for energy projects in Africa. Long tenures, the complexity of coordinating between multiple public and private sector partners, credit and sovereign risks, and a lack of sound regulatory frameworks in many countries are all inhibitors.

Power projects themselves are typically financed through a mix of equity investors and debt providers according to risk appetite. Projects financed in this manner normally include an equity investment from a private equity firm or investors, with an insurance wrap from a DFI and a pledged debt from a bank. Figure two outlines project financing options that are usually available for infrastructure projects, some of which are simply not available in African capital markets.

Successful project financing relies on the prediction of future cash flows. The greater this is, the easier a project is to finance. Cash flow in the energy sector depends on the amount of power generated by the independent power producer (IPP), and then sold to a state-owned utility – known as the offtaker. To determine projected cash flows, developers and sponsors create a power purchase agreement (PPA). Essentially, this provides the terms and conditions that guides the sale of the energy into the national grid or other power source.

Frequently, the biggest single obstacle to financing in this dynamic is the perceived (and often actual) poor financial state of the main sovereign offtakers. They are often caught between political realities (such as the need to keep down the cost of power for the general population) and the actual cost of the power being produced. The offtakers' biggest arrears tend to be to other state-owned enterprises (SOEs), while they may also be obliged to sell at a tariff that is below their actual cost of production.

This situation leads to a deteriorating dynamic where higher quality, more reputable IPPs are reluctant to bid for tenders, leaving governments with higher cost power from less reliable IPPs. Without adequate risk mitigation instruments on the national offtaker, the cost of power will increase even further given the increased debt and equity hurdles that investors will demand in order to participate. The result is often reflected in a higher rate of defaults on such high cost or marginal PPAs over time, leading to international arbitrations and law suits. This is generally a vicious cycle that will further deter future investors.

Figure three outlines the historical mismatch in Africa between the total cost of energy production and tariff revenues.

With these well documented challenges, much needed innovations are being developed and, in some cases, successfully implemented as a means of addressing the energy sector financing gap.

Existing innovations from investors

The Milken Institute, an economic think tank, hosted investors in a forum designed to offer new financing options for Africa's energy sector. Broadly, it was felt that Africa could address the funding gap while appealing to a wider variety of investors by tackling credit/sovereign risk, improving deal implementation and time to completion, and mitigating financial risk through an increased variety of product offerings.

Some of the solutions outlined included alternatives to current risk mitigation tools such as sovereign guarantees, which were perceived by investors as untrustworthy. A put/call option to the sovereign was listed as a viable alternative. These effectively function as a guaranteed sale of the power plant to the government at a specified price if the offtaker doesn't pay as scheduled. They are structured as such to have no effect on the sovereign balance sheet. The "Sponsor" rating model was another option cited. It basically substitutes a better-rated "sponsor" for the sovereign to issue debt that would then be repaid through a loan to the government. The World Bank utilises this model by issuing bond offerings to fund infrastructure projects while the government repays the bank to cover the bond.

Other options outside the area of sovereign risk include developing more effective and uniform rating systems. They could assess projects across the entire energy spectrum and across countries and regions in Africa. Investors could then quickly assess projects and expedite their due diligence and decision making process. Participants also suggested the development of structured portfolio options that would allow investors to participate in different tranches of an investment portfolio, such as junior, mezzanine and senior debt as well as equity and first-loss junior positions. This model, implemented by the African Development Bank, ensures greater risk sharing, which helps attract more investors.

Fixed-income products such as infrastructure project bonds (with debt that is typically covered by government-issued or corporate offerings with an insurance wrap provided by multilaterals) and covered bonds (securities that are backed by a pool of loans, which stay on the credit issuer's balance sheet) are also being used more frequently in Africa. They offer a double recourse to the issuer and the pool of loans – the diversification of the pool can help mitigate the impact of project default.

A new innovation by KfW and ATI

There are insurance products available to mitigate offtaker risks, principally arbitration award default insurance. This responds after the IPP has taken the defaulting sovereign to international arbitration and obtained a judgment that is subsequently not honoured. The downside to this option is that it is timely and expensive. Smaller IPPs may well also be insolvent by the time a judgment is reached. But obtaining a cleaner 'protracted default' insurance (that responds, for instance, after six months of default by the offtaker) is frequently a challenge given the poor financial health of many sovereign offtakers.

"There are insurance products available to mitigate offtaker risks, principally arbitration award default insurance. This responds after the IPP has taken the defaulting sovereign to international arbitration and obtained a judgment that is subsequently not honoured. The downside to this option is that it is timely and expensive."

Because of the perceived high risk of offtaker default, we (the African Trade Insurance Agency - ATI) in partnership with Germany's KfW, in June 2017 launched a new instrument, the Regional Liquidity Support Facility (RLSF). It is designed to tackle the offtaker liquidity risk for renewable energy IPPs. Usually, such IPPs – especially when project financed - rely on the predictable and regular cash flow of the PPA for debt service and repayment. Off-taker payment delays therefore constitute a real threat to the IPP and project lenders.

To mitigate, lenders to project-financed IPPs insist on letters of credit (L/Cs) being put in place in order to provide a buffer for a certain period of time – usually three to six months of the IPP's revenues – for which respective collateral needs to be put in place. However, utilities struggle to - or are not willing to - provide such (cash) collateral. If the liquidity cannot be found, for example by the sovereign or by the IPP itself, this can create an un-bankable project. The project economics can also be severely impacted.

For that reason, the main objective of the RLSF is to provide a bridging mechanism in order to help lenders in markets that have a limited track record with IPPs, and little to no transparency on the payment record of the utility. The business practice as described above is currently rather inefficient and prevents many IPPs from reaching financial close.

The RLSF offers the required collateral for project lenders, rather than the utilities or host governments being required to do so (for example by drawing on existing financing structured instruments in the market as much as possible). It does not aim to be a substitute for the role of L/C bank(s), but rather to replace the existing cash collateral requirements made under such L/Cs.

The proposed liquidity support facility is considered a crucial piece of the overall enabling environment attracting private investments. Offering liquidity support mitigates challenges which cannot be addressed by the IPPs directly, but are imposed on them by lenders. The RLSF is complementarity to other risk mitigation instruments, therefore it will further assist IPPs in attracting suitable financing and ultimately create bankable projects.

"Because of the perceived high risk of offtaker default, we (the African Trade Insurance Agency – ATI) in partnership with Germany's KfW, in June 2017 launched a new instrument, the Regional Liquidity Support Facility (RLSF). It is designed to tackle the offtaker liquidity risk for renewable energy IPPs."

We see this direction - utilising public and private partnerships to provide regional solutions - as a blueprint for innovation in the energy sector space within Africa. ATI expects to unveil another energy sector solution within the next year which also features another partnership with a well-respected international financier.

For Africa to move beyond the current deficit it seems clear that it must focus on options that boost the appeal to investors. At the same time, governments must continue to implement financial sector reforms. As a start, investors can be encouraged by some of the innovations already taking place in this sector. I also predict that, over time, as more and more equity investors and commercial banks establish solid track records in this sector, this in turn will pave the way for others to follow and costs to continue to fall. ■

"Frequently, the biggest single obstacle to financing in this dynamic is the perceived (and often actual) poor financial state of the main sovereign offtakers. They are often caught between political realities (such as the need to keep down the cost of power for the general population) and the actual cost of the power being produced. The offtakers' biggest arrears tend to be to other state-owned enterprises (SOEs), while they may also be obliged to sell at a tariff that is below their actual cost of production."

Oil price developments and prospects

As the world's most internationally traded commodity, it is no wonder a dramatic drop in price has sparked concern. Dr Rouben Indjikian, Webster University, Geneva, takes us through what to pay attention to, as well as taking a reflective view of what we can learn from past decisions.

After dramatically halving oil prices to around $50 per barrel during the last three years, crude oil continues to be the biggest internationally traded commodity. Crude and oil products produced from it still represent the most important part of global energy, despite the decline seen in its share from the 1970s to become one third of the current world energy consumption. It is paramount that we continue to observe and understand the dynamics of crude oil and the products within the market.

The evolution of oil markets and price regimes were among the most exiting parts of the economic history of last century, reflecting changes in the roles of its main actors and arrangements. The golden age of post-war capitalism was characterised by stable key prices of oil and the dollar (linked to gold). However, in the 1970s, that stability ceased to exist. Low oil prices had been defended for so long by cartels of the international oil companies; the 'Seven Sisters'. An increase in pricing has also been pushed by developing oil-exporting countries-members of OPEC in 1970s. The abandonment of supply management policies by OPEC (principally Saudi Arabia), brought about two dramatic declines of prices starting in 1986 and 2014, followed by prolonged periods of low prices. At the same time, the price increase during the last decade were mainly explained by growing demand from China, coining the term 'super cycle', i.e. the ever increasing prices of commodities.

Rouben Indjikian

Since the 1980s price regimes started to be increasingly determined by future markets, based on the so-called main benchmarks, Brent and West Texas Intermediate (WTI). The price of more than 100 sorts of crude oil were based on quality differentials around main benchmarks. The change in oil price regimes, which has been dominated by suppliers and prices determined by future markets, were also dictated by the need to give market response to price instability and fluctuations. However, the digitally advanced futures markets permitted to stabilise, through hedging expected prices on an individually transacted level, but could not manage to tame overall instability and volatility of market prices. Also, accumulation of strategic and commercial stocks in main importing countries, while making domestic supply of oil products more secure, were not flexible or large enough to seriously contribute to the stabilisation of prices.

When prices increase, producers will also need to consider new investment decisions, while projects in turn will need a few years for realisation. Whether new streams of oil will enter the market with high prices or at least in contango is a big question.

Supply and demand instability

Fundamentally, the slow response of supply and demand in the short term, was continuing to be the main reason of price instability and volatility. However, major spikes and falls in prices during the last five decades also reflected the policy changes in the OPEC price and supply management initiatives. The build-up of stocks partly softened these effects as stock drawdowns and replenishments were moving against the increase and decline in prices. The excess of tax imposed on oil products such as gasoil and diesel in importing countries, and export tax on crude oil in exporting countries, also influenced supply and demand. Tax mechanisms, international trading practices, domestic economic policies are among the factors altering crude prices.

The elasticity of low prices for crude oil supply and demand is also an important factor. It explains why prices after increase or fall do not adjust quickly to the market level. For example, consumers do not react to increased petrol prices by the similar decrease in consumption, if at all. Yet crude oil producers continue to sell supply in spite of a fall in prices. Massive cuts in investment, especially new projects, took place with a time lag due to price declines after 2014.

When prices increase, producers will also need to consider new investment decisions, while projects in turn will need a few years for realisation. Whether new streams of oil will enter the market with high prices or at least in contango is a big question. Short-term elasticity of supply is very low and can increase only if there are under-used productive capacities. The developments in crude oil markets reflect the geography of production and the main players, as well as the state of economic cycles and geopolitical events.

The impact of shale oil and gas

The question today is what main forces are determining current prices – which have been relatively stable since last year. Shale oil and gas, along with the emergence of the US as one of three biggest oil producers, with a relative decrease of its crude oil imports, will make OPEC supply management policies less effective. It depends on OPEC and non-OPEC oil exporting countries cooperating and how future markets develop. For instance, the expected demand for oil products and the supply of crude oil, given the energy policies, climate change restrictions, technological innovations and cuts in investments in current and perspective oil fields.

Hosts of organisations and experts are following price developments on a daily basis. Prices are still gravitating around $50 in the main commodity exchanges which determine the current spot and future prices. Market participants are actually hesitating between a quite flat contango (expectation of increasing prices in future) and backwardation (the contrary expectation). In spite of the conflicts and political risk in the Middle East and Venezuela, market participants consider supplies and stock enough that they do not need to react to events, which historically were considered as important game changers. Specialised press follows and tries to explain the small fluctuations in price and changes in differentials between Brent and WTI spot and futures pricing. Thus, there was around a 3% increase in the price of Brent crude on August 19, 2017, subsequently characterised as a 'jump' in price by the media.

Let us look at the long and short-term determinants of the current relative stability of oil prices at around $50 per barrel. The spread between future prices of September 2017 and say April 2018, will become much lower compared to the August 2016 price expectations for September 2016 to April 2017. The dramatically lowered spread suggest that markets do not expect much change in the supply and demand balance.

The supply and demand balance in the mid-term has the potential to differ and could create conditions for price increases due to the growth of the world economy, especially emerging economies such as India, Indonesia and others. It is also relevant to note that China continues to import crude oil, with a

The short-term prospects and market expectations suggest very small changes in pricing, albeit volatility around existing price levels may persist. The mid-term prospects could suggest a potential for considerable price increases.

view to increase its stocks in an environment of relatively low prices. In spite of the country's efforts to develop electric cars, an increasing middle class in those countries will use more hybrid models with lower petrol/diesel consumption rates, still increasing demand for those products in absolute terms.

The progression of infrastructure to produce electric cars needs investment, while hybrid cars will continue using existing petrol stations. In this sense, expectations of investors for electric cars could be proved excessive, at least in a mid-term. Also in spite of climate change commitments of most countries, the inertia in structural change towards gas and renewables, as well as the pace of energy consumption will probably not permit governments to meet the Paris climate accord commitments – as a result of policy measures. So an increase in demand without enough increase in supply, due to the explained time lags, may bring about considerable increase in crude oil pricing. This is the most probable scenario, considering that technological breakthrough and drastic policy measures will affect the sector in the next two to three years.

For the long term, the big unknown is the pace of technological innovation and, more importantly, its diffusion. Apart from electric cars, innovations such as the Internet of things (IoT) may permit to better management of energy consumption and waste avoidance. Better construction materials used in residential areas and industrial complexes can also contribute to energy conservation. Good news may in addition come from technologies capturing Co2 and other emissions, while producing crude oil and oil products and consuming the latter. Technology solutions could seriously limit the level of Co2 emissions, protecting the environment.

To conclude, the short term prospects and market expectations suggest very small changes in pricing, albeit volatility around existing price levels may persist. The mid-term prospects could suggest a potential for considerable price increases. At the same time, it is difficult to predict prices in the long-term due to the pace of technological changes and dynamics of the world economy. Looking at the last decade, the global crash of 2008 reflects how the governance of global monetary policy and financial arrangements still cannot predict and tame future boom and bust cycles. ■

Risk aversion, financing and real services

Risk will always be there, and it is how that risk is covered which will keep the conversation moving. Professor Andreas Klasen, Offenburg University, and Dr Simone Krummaker, University of Westminster, discuss the how risk and financing will move forward with one another, as well as challenges along the way, looking at results from the Global CEO Survey and other sources.

The global economy would not exist but for a complex series of institutions and rules, which governments, international organisations, and private bodies have created over the previous decades of globalisation. Since the 1950s, many multilateral organisations have adopted a rule-based approach that have given states increasing confidence to liberalise their economies and reduce tariffs, quotas, and other barriers to trade. As a result, the expansion of international business activities through a multilateral trading system provided a major pillar for growth enjoyed by many countries in the last century.

However, firms are exposed to several dimensions of risk when they export their products and services or set up foreign manufacturing operations: Political risk, commercial risk, currency exposure as well as cross-cultural risk. In addition, international trade is embedded in a well-developed and functioning financial environment. Financing is crucial for trading partners in order to bridge the time lag between export order and payment for goods and services produced. Scholars strongly support the argument that companies need adequate provision for their export transactions. Factors such as export transaction volume and credit period can considerably increase costs of financing.

As a consequence, firms require cover from private credit insurers and government export credit agencies (ECAs) for political and commercial risks linked to export transactions. ECAs are also important to mitigate negative trade effects of financial constraints due to market failures.

Andreas Klasen

Simone Krummaker

Main objectives and research gap

The Global CEO Survey was launched in 2015 by researchers from Offenburg University, the University of Westminster and the London School of Economics and Political Science (LSE) to better understand what factors influence exporters' demand for credit insurance. Although some scholars discussed aspects of corporate insurance demand with regard to exporters, there is limited research concerning the demand for export credit insurance associated with firm-specific factors.

The study follows an explorative qualitative approach and an explanative quantitative approach, both informing each other. Data was collected via surveys with qualitative and quantitative questions, open-ended interviews, as well as publicly available documents including annual reports. Multiple rounds of qualitative data collection via interviews ran simultaneously with the collection of data via questionnaires. This research was conducted with CEOs, COOs and managing directors from 35 export credit and political risk insurers in both public and private forms. In addition, more than 100 interviewees from governments, exporters, project sponsors, buyers, as well as commercial banks and development banks participated. The selection was driven by the aim to include a variety of participants from different regions in order to cover organisations from different cultural and national backgrounds. Full research results will be published by the end of this year.

Risk aversion

The risk management function of credit insurance is a significant factor for exporters' insurance demand. This applies for both private credit insurers and government agencies. As discussed by Mayers and Smith (1982) the structure of ownership affects the firm's risk aversion and consequently their demand of insurance. Focusing on publicly listed corporations, theory assumes that their shareholders and investors are holding a well-diversified portfolio, thus are neutral with regard to firm-specific risks. In contrast the insurance purchasing behaviour of single owners of sole proprietorships can be explained with their individual risk aversion. Because rather small companies have only a limited number of shareholders, firm size has been connected to risk aversion. Size leads to a relatively smaller diversification regarding the equity structure and can also lead to a risk-averse attitude of an exporter.

In our research, nearly all interviewees mentioned that small and medium-sized companies have a higher need than large corporations to cover risks associated with international trade via insurance agreements. According to the empirical data, the size of the exporter drives demand for cover through three main motives: The transaction cost of risk management, knowledge about foreign buyers and markets, and business diversification. Interviewees also mentioned that larger firms have more weight in negotiating the terms of credit insurance facilities.

Transaction cost of risk management is most relevant because the effort of building up a fully-fledged risk management function as well as the related knowledge is not increasing proportional to firm size. Larger

Larger exporters not only have more professional risk management functions but also more knowledge about markets for risk and insurance products available.

exporters not only have more professional risk management functions but also more knowledge about markets for risk and insurance products available. Once a growing firm has installed such a risk function, benefits are that more resources are available to manage risks efficiently. In addition, most interviewees mentioned that risk aversion is a key driver due to a rise of geopolitical risk, and SMEs' lack of knowledge about buyers and markets. The evidence indicates that there is a strong relationship between small firms' demand for coverage against those risks and the perceived or actual risks. Private credit insurance as well as ECA cover can alleviate some of these issues.

Financing function

Financing of the specific trade transaction is a key determinant for companies to purchase government export credit insurance. Liquidity for transactions is a relevant factor of risk and financial management including, for instance, hedging. Purchasing insurance can be necessary to safeguard liquidity for transactions, and insurance enables companies to realise financial advantages such as more consistent cash flows. This

In our research, nearly all interviewees mentioned that small and medium-sized companies have a higher need than large corporations to cover risks associated with international trade via insurance agreements.

especially applies in the export credit insurance context. It is of vital importance for the company to structure financially sound export transactions in order to safeguard cash flows. In addition, firm-level evidence indicates that exporters cut back exports more than other companies if financial institutions are not able to provide adequate credit facilities.

Insurance increases the opportunities for exporters to receive financing from commercial banks and mobilises additional funds otherwise not being available. Thus, the bank which finances the transaction plays a decisive role in the demand for coverage against these risks. The role of the financial intermediaries is also emphasised in the topic of financing for SMEs. Several statements in the interviews describe that external financing for SMEs is more difficult than for larger companies, which often have long and active relationships with several banks. In addition, there is often no sufficient offering from commercial banks for 'small ticket' transactions below €5 million due to limited risk appetite and competition. Tight financing conditions also become apparent both for very large transactions, as well as projects with longer maturities and in risky markets.

Although interviewees mention that financing is one of the most important functions of credit insurance, there are also other findings leading to potentially opposing trends: less traditional international players are now active in export finance in general. Many commercial banks' activities are volatile, and trade and export finance bank strategies change quite often. Global financial institutions have shown less appetite, and a large number of correspondent banking relationships have disappeared. This is related, in particular, to the changing regulatory environment including Basel III (some say Basel IV) implications and AML/KYC requirements. As a consequence, direct lending (i.e., funding directly provided by government export credit agencies) becomes much more important now. Several ECAs enhanced their financing programmes, introduced specific direct loan programmes for transactions up to €5 million for medium-term projects, or work on a more competitive direct lending offering for SMEs.

Insurance services

Several studies mention insurance services as an additional argument for corporate insurance demand. Private credit insurers are able to provide efficient services for the administration and processing of claims as well as the prevention of losses due to, for instance, economies of scale. Government export credit agencies also have a specific knowledge and are well versed in risk analysis. This includes the assessment of country risks and foreign buyers' financial ratios. Providing real services for their customers, insurers have a comparative advantage concerning the development as well as the application of risk management, and have mechanisms to control adverse outcomes.

Some European ECAs have been pioneers in offering advisory services to exporters. They provide managerial and advisory support for the definition and implementation of market-specific international growth strategies.

Some European ECAs have been pioneers in offering advisory services to exporters. They provide managerial and advisory support for the definition and implementation of market-specific international growth strategies. Insurers also support exporters in identifying business opportunities in countries with sales potential, proposing financial and insurance solutions. In collaboration with universities and industry associations, some ECAs developed training initiatives and seminars dedicated to exporters. These workshops and training sessions allow participants to acquire strategic and operational skills needed for successful internationalisation.

Other factors

In addition to risk aversion, financing and real services, demand for credit insurance is associated with agency conflicts. These agency conflicts between shareholders and outside creditors are caused by a non-linearity of rights or claims for payment. This is because risk positions with regard to expenses and income are shifted between shareholders and outside creditors. Export credit insurance is able to solve the underinvestment and the asset substitution problems.

Agency conflicts can also arise from

A driver for demand of government export credit insurance is the integration of ECA offerings into a concise national strategic framework to leverage impact.

different interests of shareholders and managers. Shareholders of large exporters intend to have a risk neutral behaviour due to the diversification of their portfolio whereas managers are risk-averse and tend to operate self-interested at the cost of shareholders. Furthermore, there is a different time horizon between the managers' working life and the indefinite life of a corporation. Theory suggests that managers will therefore try to maximise expected revenues in a specific financial period and will neglect the companies' long-term perspective to increase the firm value. Buying export credit insurance is a result of the managers' risk aversion and their behaviour to reduce or transfer risk.

Interviews reveal that many exporters are concerned about the impact of the risks of international trade on the firm's balance sheet. The key reason here is to avoid earnings volatility, as this is in general considered to be a feature of risky firms. This motive is closely connected with the factors of signalling to stakeholders. Insurance is assumed to be a means of signalling risk of the company to markets and stakeholders, as companies with insurance contracts will have a lower earnings volatility due to insurable unsystematic risk.

Government credit insurance in the 'Strategic Econsystem'

A driver for demand of government export credit insurance is the integration of ECA offerings into a concise national strategic framework to leverage impact. Governments provide opportunities for technological transformation and sustainable economic development through the establishment of coherent policy goals and innovation systems. An innovation policy mix includes, for example, the provision of an appropriate infrastructure, networks of publicly-financed research institutes and universities, as well as government financing instruments such as conditionally repayable loans. Effectively managing the interaction of government entities involved in innovation, trade promotion and export credit support is key to crafting sustainable and responsive economies.

This supportive economic environment, the coherent interplay in a 'Strategic Econsystem', is capable of adapting to the demand of exporters. Interviewees mention that it is crucial that innovation funds, trade promotion agencies, export credit agencies and investment promotion organisations work closely together. Innovative and integrated government financing instruments meet exporters' demand and have the potential to substantially support the competitiveness of companies in the global economy.

Conclusion

Results show concepts emerging from the data which enrich the current theoretical landscape on firms' demand for export credit insurance. There is empirical evidence that risk management, financing and real services are key drivers for export credit insurance demand. In addition, motives include signalling effects. It is important to mention that the context of risk management and financing for SMEs differs significantly from those in larger or even multinational companies, in particular with regard to restriction on access to finance and limitations on the sophistication of risk management and knowledge. The role of financing institutions is crucial, and regulatory issues have to be addressed in an appropriate manner. However, regulatory effects have a negative impact on export credit insurance demand as well leading to deflexion of demand towards direct lending from government agencies. A further important finding of this research is that governments following the approach of a coherent 'strategic econystem' seem to have a competitive advantage meeting exporters' demand for credit insurance. ■

4

Directory

Berne Union Members

The Berne Union has 82 member companies from around the world, including 3 observers. The membership is diverse – member organisations may be private or state linked, small or large. They represent all aspects of the export credit and investment insurance industry worldwide.

As of October 2017, the Berne Union's 82 members include:

69 ECAs, 9 private insurers and 4 multilateral institutions.

The Berne Union member directory has moved online – this allows us to ensure that member information and contact details are always current and accessible. For contacts and more detailed information about each member please visit:

https://www.berneunion.org/Members

ABGF Brazil
Agência Brasileira Gestora de Fundos Garantidores e Garantias S.A.

AIG United States of America
American International Group, Inc.

ALTUM Latvia
Development Finance Institution Altum

AOFI Serbia
Serbian Export Credit and Insurance Agency

ASEI Indonesia
Asuransi Asei Indonesia (Asuransi Asei)

ASHRA Israel
Israel Export Insurance Corp Ltd

ATI Multilateral
African Trade Insurance Agency

ATRADIUS The Netherlands
Atradius NV / DSB

BAEZ Bulgaria
Bulgarian Export Insurance Agency

BANCOMEXT Mexico
Banco Nacional de Comercio Exterior S.N.C.

BECI Botswana
Export Credit and Guarantee Company

BPRFRANCE France
Bpifrance Assurance Export

CESCE Spain
Compania Espanola de Seguros de Credito a la Exportacion

CHUBB Switzerland
Chubb Insurance Company

COFACE France
Compagnie Française d'Assurance pour le Commerce Exterieur

COSEC Portugal
Companhia de Seguro de Créditos, S.A.

CREDENDO GROUP Belgium

DHAMAN Multilateral
The Arab Investment & Export Credit Guarantee Corporation

CREDIT OMAN Oman
Export Credit Guarantee Agency of Oman

ECGC India
Export Credit Guarantee Corporation of India Ltd

ECGE Egypt
Export Credit Guarantee Company of Egypt

ECIC SA South Africa
Export Credit Insurance Corporation of South Africa Ltd

ECICS Singapore
ECICS Limited

ECIE United Arab Emirates
Export Credit Insurance Co. of the Emirates

ECIO Greece
Export Credit Insurance Organization

EDC Canada
Export Development Canada

EFIC Australia
The Export Finance and Insurance Corporation

EGAP Czech Republic
Export Guarantee & Insurance Corporation

EGFI Iran
Export Guarantee Fund of Iran

EH GERMANY Germany
Euler Hermes Aktiengesellschaft

EIAA Armenia
Export Insurance Agency of Armenia

EKF Denmark
Eksport Kredit Fonde

EKN Sweden
Exportkreditnämnden

EXIAR Russia
Export Insurance Agency of Russia

EXIM HUNGARY Hungary
Hungarian Export-Import Bank Plc.

EXIM J Jamaica
National Export-Import Bank of Jamaica Limited

EXIM R Romania
Eximbank of Romania

EXIMBANKA SR Slovak Republic
Export-Import Bank of the Slovak Republic

EXIMGARANT Belarus
Eximgarant of Belarus

FCIA United States of America
FCIA Management Company, Inc

FINNVERA Finland
Finnvera Plc

GIEK Norway
Garanti-Instituttet for Eksportkreditt

HBOR Croatia
Croatian Bank for Reconstruction & Development

HKEC Hong Kong
Hong Kong Export Credit Insurance Corporation

ICIEC Multilateral
Islamic Corp for the Insurance of Investment & Export Credit

JLGC Jordan
Jordan Loan Guarantee Corporation

KAZAKHEXPORT Kazakhstan
Kazakh Export Credit Insurance Corporation

KREDEX Estonia
KredEx Credit Insurance Ltd.

KSURE Korea
Korea Trade Insurance Corporation

KUKE Poland
Export Credit Insurance Corporation Joint Stock Company

LCI Lebanon
Lebanese Credit Insurer

LIBERTY United Kingdom
Liberty Mutual Insurance Europe Limited

LPEI Indonesia
Indonesia Eximbank

MBDP Macedonia
Macedonian Bank for Development Promotion

MEXIM Malaysia
Export-Import Bank of Malaysia Berhad

MIGA Multilateral
Multilateral Investment Guarantee Agency

NAIFE Sudan
National Agency for Insurance & Finance of Exports of Sudan

NEXI Japan
Nippon Export and Investment Insurance

NZECO New Zealand
The New Zealand Export Credit Office

ODL Luxembourg
Luxembourg Export Credit Agency

OeKB Austria
Oesterreichische Kontrollbank Aktiengesellschaft

OPIC United States of America
Overseas Private Investment Corporation

PICC China
People's Insurance Company of China

PwC Germany
PricewaterhouseCoopers AG

QDB Qatar
Qatar Development Bank

SACE Italy
Servizi Assicurativi e Finanziari

SEP Saudi Arabia
Saudi Export Program

SERV Switzerland
Swiss Export Risk Insurance

SID Slovenia
SID Inc, Ljubljana

SINOSURE China
China Export & Credit Insurance Corporation

SLECIC Sri Lanka
Sri Lanka Export Credit Insurance Corporation

SONAC Senegal
Société Nationale d'Assurances du Crédit et du Cautionnement

SOVEREIGN Bermuda
Sovereign Risk Insurance Ltd

TEBC Chinese Taipei
Taipei Export-Import Bank of China

THAI EXIMBANK Thailand
Export-Import Bank of Thailand

TURK EXIMBANK Turkey
Export Credit Bank of Turkey

UK EXPORT FINANCE United Kingdom
Export Credits Gurantee Department

UKREXIMBANK Ukraine
Joint Stock Company the State Export-Import Bank of Ukraine

US EXIMBANK United States of America
Export-Import Bank of the United States

UZBEKINVEST Uzbekistan
Uzbekinvest National Export-Import Insurance Company

XL CATLIN United Kingdom
XL Insurance Company SE

ZURICH United States of America
Zurich Surety, Credit & Political Risk

berneunion

YEARBOOK
2017