

## **GOVERNMENT RESPONSE**

### **Productivity Commission Review Australia's Export Credit Arrangements**

#### **The Export Finance and Insurance Corporation's mandate and scope of operations**

The Government considers that the Export Finance and Insurance Corporation (EFIC) plays an important role in facilitating exports and it has performed this role very well, but that some adjustment of its mandate and powers is necessary in light of the changing international environment and resulting challenges to the Australian economy and exporters. The Government is committed to assisting exporters, particularly small and medium-sized enterprises (SMEs), overcome the financial barriers they may confront when seeking to engage in the international economy. To help achieve this objective the EFIC mandate will be refocused towards addressing credit market failures (particularly failures relating to inadequate information) that may impede Australian exporters. In particular, EFIC's operations on the Commercial Account will be focused on:

- SMEs with annual turnover of less than \$100 million or fewer than 100 FTE employees; and
- non-SMEs undertaking transactions in emerging and frontier markets (where information-related market failures are most likely to affect larger exporters).

The *Export Finance and Insurance Corporation Act 1991* (the Act) will be amended to better align EFIC's operations with the revised policy mandate, including to:

- specify that EFIC is to facilitate and encourage Australian export trade (including through global value chains) by addressing information-related market failures that may impede commercially viable export transactions; and
  - to do this through the provision on the Commercial Account of insurance and financial services and products to persons involved directly or, in some cases indirectly, in such trade;
- specify that EFIC's operations on the Commercial Account should be focused on, but not limited to, supporting export-focused SMEs, particularly SMEs seeking to engage in global value chains;
- tighten the definition of 'Australian export trade' to cover transactions resulting in an increase in exports from Australia, access to new markets for Australian exports or dividend flows from overseas or other benefit as specified in regulation;
- remove Australian Public Service personnel (the DFAT Secretary) from the EFIC Board;
- ensure that the provision of tender guarantees and performance bonds by EFIC for contracts associated with an export contract or eligible export transaction require the contract to be an integral part of such a transaction or contract;
- require the Trade Minister to prescribe through regulation the detailed scope of EFIC's operations, including:

- the definition of an SME (annual turnover of less than \$100 million or fewer than 100 FTE employees); and
- a new market failure test.

The market failure test will replace assessments based on the ‘market gap’. The test would specify that EFIC support for exporters (on the basis of export contracts, eligible export transactions or Australian export trade) should be based on evidence of:

- inadequate information about the credit risk and standing of an Australian exporter (or SMEs ‘integral’ to the domestic supply chain for export-focused projects), foreign buyer or the foreign buyer’s bank, which has resulted in private financial providers employing rigid generalised rules and not forming an assessment on the merits of the transaction;
- inadequate information about the value of some tradeable capital goods or the existence of liquid secondary markets for these goods, which has resulted in private sector financial providers refusing to provide services for transactions involving such goods; or
- inadequate information about the risk associated with emerging and frontier country export markets or emerging and frontier country outward investment destinations, which has resulted in private sector financial providers refusing to provide products or services for transactions in those markets.

EFIC may continue to provide the financial products currently prescribed in the Act (which are linked to the eligibility criteria in the Act). The provision of loans and insurance by EFIC may continue to be appropriate in some circumstances where the provision of a guarantee is not sufficient to attract the private sector to support the transaction, particularly where long tenors are involved.

The Trade Minister’s Statement of Expectations (SOE) of EFIC, which will be issued annually, will outline EFIC’s revised policy mandate. Additional changes will be made to the SOE to ensure that EFIC’s operations align with the revised policy mandate, including:

- specifying that the EFIC Board must outline to the Trade Minister through quarterly progress reports evidence of information-related market failure as the basis for EFIC’s support for particular transactions (with more detailed analysis for non-SME transactions);
- outlining the Trade Minister’s expectations about the nature of contracts that are an integral part of the domestic supply chain for export-focused projects and thereby eligible for EFIC support;
- requiring non-SMEs involved in domestic export-focused projects to have an Australian Industry Participation Plan (AIPP) in place to be eligible for EFIC assistance;
- outlining the Trade Minister’s expectation that a limit of three facilities per client should normally apply to EFIC’s future operations on the Commercial Account and that where EFIC exceeds the limit some justification should be provided to the Board and Trade Minister (through the quarterly reports);

- noting that the Trade Minister expects the use of a market failure test to result in a reduced level of EFIC support for non-SMEs involved in domestic export-focused projects, but continued support for non-SMEs exporting to, and investing in, emerging and frontier markets; and
- noting that EFIC's support should not be based on temporary imbalances in the demand for, and supply of, capital where balance is typically restored in the short run through changes in the market price or on meeting the credit preferences of a firm's owners.

## **EFIC's pricing arrangements**

The pricing of EFIC's products should reflect their full expected economic costs. This is central to EFIC meeting its policy objective of helping commercially viable exporters overcome financial barriers (resulting from information-related market failures) while also encouraging private sector participation.

Given the sensitivity of economic profit (and pricing) to EFIC's methodology for pricing risk, EFIC could benchmark how actual rates of default for its facilities compare to expected losses. This could also help to determine if EFIC is evaluating risk appropriately and meeting its policy objectives. The EFIC Board will give consideration to implementing the Commission's recommendation to review its risk score assessment process.

The objective of competitive neutrality (CN) policy is to ensure that significant government businesses do not have a net competitive advantage over other businesses (or potential competitors) simply by virtue of their government ownership.

Given that EFIC is required to provide assistance to commercially viable exporters (albeit exporters affected by information-related market failures) without CN EFIC's activities may discourage market entry by potential competitors or the provision of more marginal financial products. To ensure that EFIC does not have a commercial advantage over potential providers of export finance and export insurance and that EFIC does not use its government-granted guarantee to borrow excessively, the Government will amend the Act to remove EFIC's current exemption from CN principles. EFIC will be required to pay a tax-equivalent charge and debt neutrality fee.

## **EFIC's governance and risk management**

Sound governance arrangements and procedures are central to the effective management of public sector organisations and can also help to ensure that an agency's public policy goals are achieved efficiently and effectively.

Improved clarification of EFIC's objective (based on a market failure test) would improve EFIC's internal and external governance, and would better enable the Trade Minister to evaluate EFIC's performance. The Government will also implement a number of measures to enhance EFIC's external governance framework, including:

- tabling EFIC's Corporate Plan in the Parliament;

- removing Australian Public Service personnel (the DFAT Secretary) from the EFIC Board; and
- requiring EFIC to provide quarterly reports to the Trade Minister against the Corporate Plan, including categorisation of market failures for each SME export transaction, and more detailed analysis of market failure for each non-SME export transaction.

The Productivity Commission recommends enhancements in EFIC's internal governance arrangements. The Government considers decisions to create or amend internal prudential benchmarks, establish internal audit programs or establish performance management frameworks are the responsibility of the EFIC Board.

The Government undertakes a detailed assessment of the risks and benefits of proposed transactions on the National Interest Account (NIA) and provides clear public explanations of the reasons for providing facilities on the NIA. In addition, information on the performance of the NIA is disclosed in the Department of Foreign Affairs and Trade's Portfolio Budget Statements.

- For example, on 8 December 2009 the then Trade Minister provided a detailed explanation of the Government's reasons for providing a loan on the NIA in support of the Liquefied Natural Gas project in Papua New Guinea.

EFIC currently provides information on the facilities signed during a financial year in its on-line register and Annual Report. This information includes the name of the firm, the facility type, the amount of the facility and the environmental category.

While it may not be appropriate for EFIC to publish detailed information about individual transactions (i.e. price and other terms of provision), the Government proposes EFIC consider the costs and benefits of developing an online calculator (similar to the German and Danish export credit agencies) in the context of EFIC's 'Navigator' initiative. 'Navigator' is an online tool to help exporters understand their export finance options through the various stages of exporting. At each stage, 'Navigator' identifies the financial challenges a company may face.

### **EFIC's capital and treasury operations**

The Treasury and the Department of Finance and Deregulation have commenced a review of the need for, and the scope of, EFIC's treasury function to ensure that the size of treasury operations is commensurate with the size and product offering of the origination business it supports.

The Act will specify that the Trade Minister can direct EFIC to pay a special dividend after seeking the views of the EFIC Board and the agreement of the Minister for Finance and the Treasurer.

### **Environmental and social responsibility**

The Government considers that EFIC's *Policy and Procedure for environmental and social review of transactions* provides a sound framework for ensuring that EFIC

upholds best-practice environmental and social standards in the transactions it supports.

EFIC already discloses its prospective involvement in a transaction associated with a project that has potentially significant adverse environmental or social impacts (a category A project) when the transaction is of a minimum size (SDR 10 million) and duration (minimum two years) and the project is located outside Australia. That approach is consistent with EFIC's international obligations and guidelines.

EFIC does not disclose its potential involvement in transactions associated with non-projects and bonds, an approach consistent with its international obligations and the practices of OECD export credit agencies. EFIC's risk management approach for non-projects and bonds is to undertake an environmental and social risk evaluation and, where necessary, benchmark the transaction using the International Finance Corporation Performance Standards. EFIC will decline transactions if it determines that the environmental and/or social impacts do not satisfy relevant benchmarks.

EFIC makes public its support to projects located in Australia after a transaction is signed. EFIC does not disclose its potential involvement in transactions associated with a category A project in Australia as such projects are subject to the approval requirements of the relevant State or Territory government and, where required, the Commonwealth Government. Commonwealth and State and Territory assessment processes already provide for extensive public consultation on domestic projects with environmental consequences.

EFIC incorporates Australia's international obligations and guidelines into its commercial decision-making framework. It examines human rights issues as part of its due diligence process. EFIC is informed in this regard by the World Bank's International Finance Corporation Performance Standards, the Organisation for Economic Co-operation and Development (OECD) Guidelines on Multinational Enterprises, the United Nations Guiding Principles for Business and Human Rights, the Equator Principles and the OECD Common Approaches.

### **Limited expansion of EFIC's guarantee powers**

In addition to its response to the Productivity Commission's recommendations, the Government has also decided to provide EFIC with a limited expansion of its powers to provide EFIC with greater flexibility to support Australian SMEs participating in global value chains. The manufacturing taskforce and the Asian Century White Paper both emphasised the growing importance of global value chains.

EFIC is currently constrained in its ability to assist SMEs in global value chains, which can result in sub-optimal financing structures.

The Government has decided to broaden EFIC's guarantee powers to enable it to provide effective assistance to subsidiaries of Australian-based SMEs that are incorporated in a foreign country, where:

- . the subsidiary is majority owned by an SME based in Australia;

- . the SME can demonstrate the guarantee will support ‘Australian export trade’ (as defined in the Act);
- . the SME meets the definition prescribed by the Minister in regulation (annual turnover of less than \$100 million or fewer than 100 FTE employees);and
- . the SME certifies that there would be no net reduction in the number of its employees in Australia during the term of EFIC’s guarantee facility as a result of it undertaking the activity for which it seeks EFIC’s support.

<b>PC Recommendation</b>	<b>Government response</b>
<p><b>Recommendation 5.1</b></p> <p>The Minister should amend the Statement of Expectations to require EFIC to define a small and medium-sized enterprise as an entity, including any related entities, with fewer than 100 full-time equivalent employees or annual turnover of less than \$50 million.</p>	<p><b>Agreed in part</b></p>
<p><b>Recommendation 6.1</b></p> <p>The Minister should amend the Statement of Expectations to require EFIC to commission an independent review of the process it follows to allocate an EFIC risk score (ERS) to a facility. This review should include a comparison of the ERS of each facility at signing and at maturity to examine any changes over time. Evaluating the forecasting accuracy of expected losses compared to actual losses will help ensure that EFIC prices risk appropriately. EFIC should report the results of this review to the Minister.</p>	<p><b>Noted</b></p>
<p><b>Recommendation 6.2</b></p> <p>The Australian Government should amend the <i>Export Finance and Insurance Corporation Act 1991</i> (the Act) to ensure EFIC's activity on the Commercial Account complies with competitive neutrality arrangements. This will require EFIC to pay a tax-equivalent charge and a debt neutrality fee.</p> <p>The Minister should amend the Statement of Expectations to:</p> <ul style="list-style-type: none"> <li>· Require the pricing of EFIC's Commercial Account facilities to reflect the expected full economic cost of provision, including the opportunity cost of capital, taxes paid by private sector participants and the benefit that EFIC obtains from the government guarantee.</li> <li>· Set an appropriately benchmarked rate of return on equity following consultation with the Treasurer and the Minister for Finance.</li> <li>· Require EFIC to identify in its annual report and corporate plan that part of its revenue that relates to not having to pay a tax-equivalent charge and debt neutrality fee, until the Act is amended to apply competitive neutrality</li> </ul>	<p><b>Agreed in part</b></p>

arrangements.	
<p><b>Recommendation 7.1</b></p> <p>The Minister should remove the 'market gap' mandate from the Statement of Expectations as it lacks rigour and does not ensure that EFIC's activities generate a net benefit to the economy.</p>	<b>Agreed</b>
<p><b>Recommendation 8.1</b></p> <p>EFIC should revise its risk management policies to include a limit on exposures to particular industries.</p>	<b>Noted</b>
<p><b>Recommendation 8.2</b></p> <p>The Treasury and the Department of Finance and Deregulation should regularly review the need for, and the scope of, EFIC's treasury function to ensure that the size of treasury operations is commensurate with the size and product offering of the origination business it supports.</p> <p>The first review of this type should include an assessment of EFIC's capital requirements and dividend policy, and be completed by June 2013.</p>	<b>Agreed in part</b>
<p><b>Recommendation 8.3</b></p> <p>The Act should be amended to allow the Minister to direct the Board of EFIC to return capital to the Australian Government when the Minister determines that EFIC has surplus capital, after seeking the views of the Treasurer and the Minister for Finance.</p>	<b>Agreed</b>
<p><b>Recommendation 9.1</b></p> <p>Consistent with the findings of the Uhrig Review, the Australian Government should amend the Act to exclude Australian Public Service personnel from the EFIC Board. Where the EFIC Board considers departmental advice beneficial, officials from the Department of Foreign Affairs and Trade should be invited to present to board meetings for the relevant agenda items and to answer questions relating to those items.</p>	<b>Agreed</b>
<p><b>Recommendation 9.2</b></p> <p>The Minister should amend the Statement of Expectations to require EFIC to include in its regular internal audit program an assessment of its</p>	<b>Noted</b>



<p>compliance with the operational restrictions, as set out in the Statement of Expectations, any relevant directions from the Minister, and Part 4 of the Act. Board papers should be sufficiently robust to ensure that they can be used in EFIC's internal audit program to confirm that EFIC is complying with its mandate.</p>	
<p><b>Recommendation 9.3</b></p> <p>The Minister should table EFIC's corporate plan in Parliament and, in due course, the Act should be amended to require this.</p> <p>EFIC should provide quarterly progress reports to the Minister against its corporate plan, including information about facilities on the Commercial Account executed during that quarter.</p>	<p><b>Agreed</b></p>
<p><b>Recommendation 9.4</b></p> <p>The Minister should amend the Statement of Expectations to require the EFIC Board to establish a performance management framework, based on a more clearly defined and rigorous objective under the Act, directed at market failures affecting small and medium-sized enterprises. The framework should be developed in consultation with other Australian Government agencies, and use relevant performance benchmarks and indicators for EFIC's business units, including treasury operations.</p> <p>EFIC should report its performance against this framework in its annual report and corporate plan.</p>	<p><b>Noted</b></p>
<p><b>Recommendation 9.5</b></p> <p>Proposed facilities with national interest objectives should only be considered in the context of the National Interest Account.</p> <p>The Australian Government's assessment of National Interest Account facilities should include analysis of whether the proposal is the most cost-effective way of achieving intended outcomes.</p> <p>The Australian Government should clearly and publicly articulate the justification for a National Interest Account facility after it has been approved by the Minister.</p> <p>Information on the performance of National Interest Account facilities should be collated and publicly</p>	<p><b>Agreed in part</b></p>

<p>reported by the Australian Government.</p>	
<p><b>Recommendation 9.6</b></p> <p>The Minister should amend the Statement of Expectations to require EFIC to publicly disclose its prospective involvement in any facility with potentially significant environmental or social impacts. This includes all category A projects, and 'non-projects' and bonds where it has been determined that there is potential for significant environmental and social impacts.</p> <p>Information relating to the environmental and social classification of projects and the reasons for their approval should be predictable and disclosed in the annual report and on EFIC's website. This information should include assessment benchmarking and processes, conditions of approval and consequences for non-compliance. Information that is relevant to EFIC's assessment of environmental and social impacts should be made public.</p> <p>EFIC should make public its involvement in supporting projects that are subject to environmental assessment in Australia.</p>	<p><b>Agreed in part</b></p>
<p><b>Recommendation 9.7</b></p> <p>The Minister, by way of a direction under the Act, should articulate which international obligations, including human rights obligations, EFIC is required to comply with.</p> <p>EFIC's compliance with those obligations should be included in its internal audit program with outcomes publicly reported, including in EFIC's annual report.</p>	<p><b>Noted</b></p>
<p><b>Recommendation 9.8</b></p> <p>The Australian Government should remove EFIC's special exemption in relation to matters done under Parts 4 and 5 of the Act from the Freedom of Information Act 1982 (while retaining protection for Cabinet and commercial-in-confidence material).</p>	<p><b>Noted</b></p>
<p><b>Recommendation 10.1</b></p> <p>a) As soon as possible, the Minister should direct EFIC to cease providing financial services for transactions that are not based on an export contract as defined in</p>	<p><b>Agreed in part</b></p> <p><b>Not agreed</b></p>

<p>section 3 of the Act. This includes resource projects located in Australia, and related infrastructure, and suppliers of goods and services to those projects.</p> <p>b) The Australian Government should not broaden the eligibility criteria under Part 4 of the Act. Specifically, the Act should not be amended to allow EFIC to enter into loans for the export of non-capital goods.</p>	<p><b>Agreed</b></p>
<p><b>Recommendation 10.2</b></p> <p>Until it is next reviewed by an independent body, EFIC’s role on the Commercial Account should be limited to demonstrating to the private sector that providing export finance to newly exporting small and medium-sized enterprises (SMEs) can be commercially viable. This demonstration role should be articulated in the Minister’s Statement of Expectations.</p> <p>EFIC should demonstrate that the provision of financial services to newly exporting SMEs can be done on the same basis as the private sector – with price covering the expected full economic cost of provision.</p>	<p><b>Agreed in part</b></p>
<p><b>Recommendation 10.3</b></p> <p>In respect of the Commercial Account, the Australian Government should make amendments to the Act to:</p> <p>(a) Reorient EFIC’s objective to addressing information-related market failures in financial markets affecting newly exporting small and medium-sized enterprises (SMEs) seeking access to export finance</p> <p>(b) Specify that EFIC is to demonstrate to the private sector that providing export finance to newly exporting SMEs can be commercially viable</p> <p>(c) Clarify that assistance is only to be provided in respect of export contracts as currently defined in the Act</p> <p>(d) Remove references to EFIC providing support to persons indirectly involved in Australian export trade</p> <p>(e) Limit the financial products offered by EFIC to guarantees and bonds falling within the definition of ‘guarantee’ under section 3 of the Act</p> <p>(f) Allow for the product range to include the provision of reinsurance cover for sovereign and country risk</p>	<p><b>Agreed in part</b></p> <p><b>Agreed in part</b></p> <p><b>Noted</b></p> <p><b>Not agreed</b></p> <p><b>Not agreed</b></p> <p><b>Not agreed</b></p> <p><b>Noted</b></p>

<p>insurance provided by the private sector in times of disruption in particular markets, subject to ministerial direction</p>	
<p><b>Recommendation 10.4</b></p> <p>A limit of three facilities per client should normally apply to EFIC's future operations on the Commercial Account. Proposals to exceed this limit should be subject to at least one of the two conditions below:</p> <ul style="list-style-type: none"> <li>. the export transaction is in an emerging export market or</li> <li>. the facility has been explicitly approved by the EFIC Board (and not by a delegate), is notified to the Minister and is included in EFIC's internal audit program and independent review of EFIC's operations.</li> </ul> <p>The limit of three facilities should not apply to political risk reinsurance facilities provided pursuant to the direction by the Minister.</p>	<p><b>Agreed in part</b></p>
<p><b>Recommendation 10.5</b></p> <p>EFIC should publish information on the facilities it approves on the Commercial Account within a month of execution, including the name of the firm, price and other terms of provision.</p>	<p><b>Agreed in part</b></p>
<p><b>Recommendation 10.6</b></p> <p>Where possible, the Minister should give effect to the proposed changes to EFIC's operations through a ministerial direction or a revised Statement of Expectations, until such time as the Act can be amended.</p>	<p><b>Agreed in part</b></p>

**Recommendation 10.7**

EFIC's performance against the more clearly defined and rigorous objective should be independently reviewed three years after a revised Statement of Expectations is issued by the Minister or the amendments to the Act have been passed by Parliament, whichever occurs first.

This independent review should consider whether the rationale for government intervention remains valid, and whether the provision of financial services through EFIC is the most effective and efficient way of addressing any failures in financial markets that are impeding otherwise commercially viable export transactions. This review should also include examination of alternative arrangements for post-approval administration of the National Interest Account.

**Agreed in part**