Written Evidence from GKB Ventures Ltd (UEF0001)

GKB Ventures LTD

Response To:

UK Parliament – International Trade Committee - Enquiry into UK Export Finance

Executive Summary 20th August 2020

The UK Government needs to recognize that other Governments will pursue national interest more overtly when it comes to exports. As such, the UK will need to be similarly active if it wants to achieve its export goals. In order to ensure that UK exporters are not disadvantaged and that they can compete globally we make 4 suggestions.

1. Create a culture within UKEF of first mover advantage
2. Allow all contracts that request Direct Lending, ie. at the OECD Commercial Interest Reference Rates (CIRR), to have the full 85% export credit loan funded at the prevailing CIRR
3. Create a Concessional Lending Product now
4. As a temporary agreement (whilst the markets are in flux as a result of the Covid-19 pandemic) provide support from 85% of the contract value to 100% of the contract value for overseas buyers of UK equipment. With perhaps limiting such support to developing markets and for SMEs & Midcaps exporters.

Our view is influenced by decades of international export credit experience and with dealing with the major ECAs, banks and buyers right across the globe. This may provide a somewhat different and less "just UK" perspective on markets and exports to others.

If you would like to delve into the detail of our submission further, please do not hesitate to get in contact.

Background

UKEF is vital

1. UKEF has a high international reputation and is seen as a flexible and strong export credit agency. UKEF's continued support is vital to UK exporters. More so today than in its 100-year history. Covid-19, Brexit and a USA/China trade war will, inevitably, negatively impact UK exporters as they seek to secure new order overseas. Global competition is intense and intensifying.

Trade Finance Gap in the UK Exists

2. The UK is fortunate in being a global center for banking and insurance. However, given the credit uncertainties of world markets and the ongoing retrenchment of capacity there is a trade finance gap. The UK banking and insurance market does not have the capacity to support UK exporters and the gap needs to be filled by UKEF.

Increased global competition

3. ECA's across the globe actively compete to support their domestic exporters, many often providing support outside of the OECD guidelines. The competition is not just to provide liquidity to their domestic exporters (which UKEF have been providing) but also in terms of providing liquidity to buyers so that they "Buy from the UK".

Financing is a determining factor to successful exports

4. Greater global competition, increased transparency, great accountability are all factors that buyers will take into consideration before deciding on where to purchase. The net present value cost of financing between competing bids is an increasing factor. Buyer, especially governments in the developing markets, are acutely aware that financing costs associated with projects impacts affordability. The longer and cheaper the export credit the more attractive your exporters will be.

Introduction to GKB Ventures

5. GKB Ventures is an award-winning independent boutique consultancy firm, based in the UK advising clients on the optimal ECA financing route for large cross border transactions. With over US$4.0bn of transactions under mandate with a specific focus on projects in Africa.

- Collectively, within GKB Ventures our experience covers:-
- 50+ years international banking experience covering all the major ECAs – acting as both global and regional heads for major investment banks
- 6 years Chairing the British Bankers Association Export Finance & Trade Committee
- Commissioner on the UK "Cole Commission on Exports" set up to assist UK Government to define future strategy for UK Exports (published June 2015)
- Chair of the Financial Services Committee at the Business Council for Africa and Trade & Export Finance Ambassador for (SACC) South African Chamber of Commerce
- Regular public speaker on international trade and ECA finance. Lead judge for the UK National Export Excellence Awards and, on an ongoing basis, acting as an independent sounding board to a number of global ECAs on the current "state of the ECA market".

Motivation for submitting

6. Our motivation is business and wishing to see greater international stability through trade. As a UK company we are keen to see the wider UK economy grow through exports and for UKEF to become the premier ECA.

7. Assisting international trade and providing advisory services on ECA finance is our area of specialization. This is GKB Ventures. Approximately half of our turnover is an export of ECA advisory

services, to overseas clients (predominately buyers/project sponsors based in Africa, Middle East and Asia/Australasia) and the remainder to UK exporting clients (mainly SME's and UK project companies) assisting them grow their business through exports. The international "buyer" side of our business GKB will deal with all the main global ECAs including UKEF. The UK exporting "supplier" side of our business is predominately advisory services dealing with UKEF.

Responses to Key Points

Operation

8. **UKEF's product offering** is fairly comprehensive and are attractive against the private sector. It needs to be. UKEF is not competing with the private sector but with other global ECAs. UKEF's capacity to offer all of its products all of the time is hampered. Direct Lending is a great example. UKEF lacks a concessional finance solution is a problem and occasionally, country limits can also be problematic.

9. **UKEFs processes** whilst robust and thorough are far too long and cumbersome. Especially for those companies who are uninitiated to UKEF processes. No performance measurements exist for turnaround times within UKEF. Whilst centers of excellence exist in UKEF it is not uniform. Response times can run into months even for a preliminary Expression of interest ("EOI").

10. **UKEF support to sectors**, projects and export destinations are in line with the OECD Consensus guidelines. However, these rules have anomalies. For example, defense projects have no restrictions, and with UKEF it is allocated its own Direct Lending allocation. Whereas projects that fit into climate or social economic projects (say for example hospitals) do not have the same level of flexibility. UKEF, to be fair, do try to be flexible, wherever possible, but run up against hard limits imposed by HMT.

11. **UKEF's performance targets** from the perspective of risk protection, compliance, AML / KYC / ESIA and adherence to the OECD rules they are considered fair. They have a strong culture of due diligence and making sure that the underlying project meet with all regulatory and environmental requirements both in the UK and in the buying country.

Engagement

12. **Strong engagement** with different stakeholders including the SME community. This is a challenge for all ECAs and UKEF does well both in its product delivery and in terms of marketing to new exporters and buyers.

13. **Engagement with DiT is developing well.** One of the main recommendations of the Cole Commission on Exports was the need of a "reformed customer focused UKEF and DiT - working as one to champion UK exports". Great strides have been made and the two work well together especially in the overseas markets.

14. **Drawing on external expertise and knowledge – is a particular strength of UKEF.** As a former Chair of the British Bankers Association Export Finance & Trade Committee I can testify that UKEF always consulted and collaborated with the banking community on the developed of new products. A good and current example of this is the development of the revised Supplier Credit scheme.

What could UKEF learn from other successful ECAs?

How can UKEF continue to support economic recovery post COVID-19?

4 Suggestions

15. **Create a culture within UKEF of first mover advantage.** Other ECAs realize that whoever responds 1st to a buyer's preliminary enquiry has the upper hand. In a highly competitive market, a buying entity looks at the speed of response as an indication as to how eager that particular ECA is in providing support. UKEF are often behind the curve. There doesn't seem to be a specific KPI on turnaround times. Especially for an Expression of Interest ("EOI") where waiting two or three months from UKEF for an EOI is not uncommon.

16. **Allow all contracts that request Direct Lending, ie. at the OECD Commercial Interest Reference Rates (CIRR), to have the full 85% export credit loan funded at the prevailing CIRR.** Other ECAs use the ability to provide support at the OECD CIRR as a major competitive advantage. UKEF is limited due to constraints issued to them by HMT and as such UK exporters lose out.

    These CIRR's are the internationally agreed Minimum Rates that other ECAs can provide funding to support their exporters. These rates are at an all-time low and are the most competitive fixed rate funding in today's market. Especially as bank funding has risen. See link for latest rates.

    http://www.oecd.org/trade/topics/export-credits/documents/cirrs.pdf

    Our competitors based in countries like France, Germany, Italy, Sweden and the USA all have programs enabling their exporters to have ECA cover at the OECD CIRR. Funding at these rates enables projects to be affordable and sustainable on a long-term basis. This is key especially for Buyers in low to middle income markets who are often requesting CIRR rates. This is not new to, or unknown by, UKEF where many countries (particularly in Africa) are classified as "Sustainable Lending Criteria Markets". The OECD CIRR helps to make such funding sustainable in these jurisdictions.

Whilst it is acknowledged that the UKEF guarantee can be used to support a wide range of sources of funding (including fixed rate funding, pension funds, debt capital markets and even, occasionally, Shari'ah compliant financing structures) none come close to matching the terms of the OECD CIRR.

The UKEF Direct Lending Facility is the only mechanism by which UK exporters can gain access to these minimum rates. But the limits allocated to UKEF by HMT is not sufficient to cover all requests made to UKEF. All contracts that request Direct Lending (ie. the OECD CIRR) should have the ability to have the full 85% export credit loan funded at the prevailing OECD CIRR. Post COVID-19 affordability of new projects will be a key determining factor and we need to compete using the Minimum Rates allowed under the OECD rules.

17. **Create a Concessional Lending product now.** Other ECAs recognize that many buying countries who are under an IMF / World Bank program may only borrow if the terms are deemed concessional by the IMF. See grant calculator: -

https://www.imf.org/external/np/pdr/conc/calculator/

Other ECAs combine their support with their developmental agency who provide grants to make the overall ECA financing concessional. Thus, creating solutions for Sovereign buyers where the debt needs to be concessional.

Even though UKEF has the credit risk appetite to cover such markets it does not, currently, have such a programme nor solution to provide concessional finance. As a result, UK exporters are excluded and have no means to compete for huge opportunities across the globe. UKEF and DFID (Department for International Development) should combine and target resources. Especially for social infrastructure projects in concessional markets. This would put UK exporters on par with other exporters.

Furthermore, for markets which meet UKEF's "sustainable lending criteria" DFID's approval to support needs to be undertaken upfront at an EOI stage. The current practice of DFID's approval towards the later stage of the project development hinders UK exporters competitiveness and creates uncertainty as to whether they have support or not.

18. **Provide support from 85% of the contract value to 100% of the contract value for overseas buyers of UK equipment.**

UKEF, like other major ECAs have been quick to respond to Covid-19 with additional liquidity solutions for their domestic exporters. The various programmes undertaken by UKEF and, UK Government as a whole, has been very successful. However, at a buyer end Covid-19 will impact demand side and UKEF need to start addressing how they can assist "Buyers Buy" and buy from the UK. Other ECAs already have solutions supporting their exporters with various schemes some of whom are outside of the OECD arrangements.

Banks have significant difficulty in pricing the commercial 15% portion of export orders due to the volatility of the market pricing associated with Covid-19.

An ability of UKEF to cover both the 85% and 15% would give UK exporters a huge boost to secure new export order. This we advocate could be done on the following parameters.

- Making this a temporary agreement whilst the markets are in flux as a result of the Covid-19 pandemic
- Limit such support to developing markets, for SMEs & Midcaps and until the current crisis is over and the markets stabilize
- Only support 100% where the total risk appetite of UKEF allows
- Undertake on a dual tranche basis with the 15% on terms shorter than the 85% facility

Even before COVID-19 100% finance was being flagged as a growing requirement. In November 2019 Business at OECD, The European Banking Federation and the International Chamber of Commerce issued a paper :- http://biac.org/wp-content/uploads/2019/11/Final-version-Joint-business-position-on-Future-of- OECD-Arrangement3.pdf laying out their vision for the future of the OECD arrangement on officially supported export credits. This paper argued for (amongst other things) the ability of the ECAs to cover both the 85% and the 15% down-payment. Their main premise was that the global landscape has changed, including that of regulation, requiring markets such as sub-Saharan Africa to have ECAs covering both the 85% and 15% tranches.

The paper highlighted: -

"However, we would like to highlight that in some markets, such as sub-Saharan Africa, it can be difficult to source funding for 15% of the contract value, particularly for large government contracts. The consequence is often delays or, ultimately, no export, as public sector contracts tend to be subject to the political cycle, with the result that the much- needed infrastructure is not built, or it is sourced from non-OECD countries, with a negative Sustainable Growth agenda impact.

ECAs should have more flexibility to support the financing of the down payment, for example by reinsuring themselves through the commercial market. An alternative approach is a two-tranche solution, a shorter term for the down payment, with a longer term for the balance. ECAs could still reinsure with the private sector, if available, to manage risk exposure. Further investigation in this regard is welcome".

August 2020