

International Trade Committee inquiry into UK Export Finance

UK Finance submission

7 October 2020

Introduction and summary

UK Finance is the collective voice for the banking and finance sector. Representing more than 250 firms, we act to enhance competitiveness, support customers and facilitate innovation.

1. We welcome the opportunity to provide evidence to the International Trade Committee's inquiry into UK Export Finance's (UKEF) operations and its engagement with stakeholders. Our observations and recommendations can be summarised as follows.
 - a. **UKEFs product set is comprehensive by international standards and among the best in the world.** However, it should consider developing the capacity to cover foreign-exchange (FX) risk in the tender-to-contract (TTC) phase, provide conventional revolving-credit facilities and extend concessional lending as an addition to its existing products in developing countries. It should also extend the use of the OECD Commercial Interest Reference Rates (CIRRs) to its Buyer Credit Facility (BCF) and Export Working Capital Scheme (EWCS).
 - b. **Procedural speed is UKEF's most important operational challenge, especially as it focuses on supporting small SME-backed transactions.** It should consistently review the clarity and simplicity of its application processes and seek to reduce some of the duplication in application protocols between UKEF and the regulated banks it supports.
 - c. **UKEF's biggest strategic challenge—and one it shares with all export-credit agencies (ECAs)—is evolving a sophisticated service for smaller SME exporters and transactions.** It should continue to invest heavily in the success of the General Export Facility (GEF) and Export Development Guarantee (EDG) products and in a broad approach that sees SME opportunity in export credit as a question of success as both headline exporters and parts of the supply chains of larger beneficiaries of export credit.
 - d. **UKEF always needs to strike a balance between supporting the UK exporter cohort as they source market opportunity and actively aiming to shape the UK export mix.** UKEF needs to focus on markets where UK exporters have the capacity and willingness to sell. Evolving the focus of UKEF geographically and thematically into key areas such as clean-energy development (and away from hydrocarbons) is necessary and important but should be done in open dialogue with banks and exporters.

- e. **The EDG's focus on exporters as well as exports is important.** The EDG has taken the valuable step of conceiving UKEF's work as supporting the developing capabilities of high-potential exporters alongside individual export transactions. This is an evolution of focus that has real potential.
- f. **UKEF's role in supporting exports needs to be seen as a distinct component of UK trade policy but well integrated into wider UK government policy.** The Department for International Trade (DIT), the Foreign, Commonwealth and Development Office (FCDO), the Home Office and the Department for Business, Energy and Industrial Strategy (BEIS) are all important partners in delivering on the UKEF mandate.

Detail

2. UKEF is among the world's most effective ECAs. It is an invaluable partner for UK-based banks and insurers seeking to support UK-based exporters in ensuring that no viable UK export fails for lack of finance or insurance. The recommendations that follow for its improvement are offered in a constructive and collaborative spirit and in full recognition of the many positive ways in which UKEF has developed its capabilities over the last decade.¹ Over the years ahead, the role of UKEF will only become more important as the UK continues to support both large and small exporters, deepen and diversify its trading relationships and manage the impacts of covid-19 and its aftermath on the availability of trade credit and linked insurance.

The UKEF product set

3. The product set offered by UKEF is broadly in line with, and in many cases superior to, the products provided by other ECAs. UKEF is both pragmatic and active in seeking to adapt to market needs and expectations and to focus on areas where there is clear complementarity with private-sector supply. It has expanded materially over the last decade to include direct lending, bond support and working-capital support in various forms. The launch of the Line of Credit, EDG and GEF service over the last two years has exemplified this.
4. However, there is a range of areas where UKEF should consider expanding or refining its product coverage further. These could include:
 - a. **FX risk cover.** UKEF cannot currently provide TTC risk insurance against exchange-rate fluctuations. This can be important for firms bidding in foreign currencies that find exchange rates moving against them in the period from a tender to formal contracting,
 - b. **a revolving-credit facility.** UKEF has no product that functions in the way that a conventional revolving-credit facility does in corporate finance, providing a line of credit for a borrower against cashflow needs. A variation of UKEF's existing BCF and EWCS products targeted at buyers could fill a useful gap here,

¹ The British Exporters Association's (BExA) 10th Annual Benchmarking catalogues the many ways in which the quality of the UKEF offering has improved since 2010. See <https://bexa.co.uk/common/Uploaded%20files/BExA%20benchmarking%202019%20v2%20print%20-%20Final.pdf>.

- c. **wider use of CIRRs for buyer credit.** While UKEF uses the competitive OECD CIRRs for its smaller Direct Lending Facility (DLF), it could usefully extend this practice to the larger BCF and Export Refinancing Facility,
- d. **developing support for discounting of deferred-payment line-of-credit facilities.** This would help banks provide valuable payment insurance for smaller exporters that can struggle with deferred-buyer payment schedules, and
- e. **untied concessional lending.** UKEF does not provide concessional loans to developing-country sovereigns intended to support projects that ultimately support UK exports of goods or services. There is potential scope to introduce such a product as a way of integrating the work of UKEF and the FCDO. Comparator governments in the United States, Germany, France and Japan make materially greater use of both tied and untied concessional lending as a support for national investment and supply chains.²

UKEF's processes

5. The primary challenge for firms engaging with UKEF is expeditious processing; customers need faster turnaround times on transaction supports than is currently the norm. Efficiency is always important in export-credit provision, where a UK exporter may be competing against suppliers from other jurisdictions backed by their own ECAs. It is especially important for smaller contracts where agreements can be concluded in weeks or even days. For this reason, improving the speed with which applications for support can be developed and processed is an important priority. This is the area where the UK has perhaps the most to learn from ECAs in some of its comparators and where UKEF has acknowledged a need for continuous improvement and a more commercial approach.
6. In this respect, UKEF should consider:
 - a. **consistently reviewing the wording and complexity of its product descriptions.** It is especially important to do this against the capabilities of smaller firms seeking key products such as export insurance. Avoiding opaque language and using case studies to demonstrate the practical features of different products could help users better navigate the options available. Clear checklists for application processes could also be provided consistently, and UKEF should consider improved ways to allow customers to track the progress of proposals, and
 - b. addressing both the **duplication of risk-assessment functions** between itself and partner banks/insurers and the extent to which it could be outsourcing processes to relieve pressure on internal teams. Given the regulatory obligations of banks partnering with UKEF, there is often no need for UKEF itself to fully replicate the risk-management protocols that they employ in assessing applications. **Outsourcing some underwriting assessment** in the manner of other ECAs could also support streamlining internal timeframes. Protocols should also be **calibrated for different transaction sizes and risk profiles** more clearly than they currently are, and tighter reviewing-time targets should be adopted. None of these measures

² See BExA, p. 13.

needs compromise the rigour of the UKEF diligence process or the basis of its guarantee.

UKEF's lending focus and risk appetite

7. UKEF is widely seen to take an agnostic approach to sectors, which is appropriate for its role in supporting UK exporters where they are able to source opportunity. Its risk appetite is appropriate for the forms of contract generally underwritten by an ECA. A good basic measure of both of these is that none of our members records having turned away business in the last five years because of the unavailability of UKEF support.
8. It is also welcome that UKEF has developed a practical view of UK content requirements that strikes a balance between ensuring clear UK benefits from taxpayer guarantees and recognising the realities of international trade and investment. The changes to this framework in 2019 were pragmatic and useful. The national content threshold is calibrated to encourage investors to use the UK as a base for production for export in ways that they might otherwise not or to recognise the clear value to UK supply chains of linked investments abroad.³ A stricter view of UK content would arguably have seen some of these investments and the jobs they bring lost to the UK.
9. There is an important balance to strike in seeing UKEF as a reactive follower of demand generated by UK exporters and using the export-credit system to favour or encourage certain export sectors and markets. For example, UKEF's recent strengthening of capacity in Latin America arguably is not matched—at least not yet—by UK exporter interest or focus. UKEF faces a similar challenge in setting targets for lending against clean energy or climate-mitigation activity and potentially beginning to wind back support for hydrocarbon technologies. This is a necessary and important shift in UK priorities, but it is vital that such targets or parameters are set and evolve in dialogue with banks and exporters.
10. UKEF's focus should be a hard-headed one based on genuine UK strengths and UK employment. That said, UKEF should continually review the scope to support cutting-edge UK exports in both goods and services by targeting marketing at innovative UK sectors and considering ways in which the export-credit system could support advanced-services exports such as intellectual-property licensing.
11. UKEF's recent focus on the UK SME supply chain (see below) reflects an important shift in thinking about the UK's exporters to take in activity that supports the ultimate exporter. A further iteration of this kind of thinking would see UKEF focus on developing the UK's export *capabilities* as well as individual export transactions—on exporters as well as exports. The EDG takes a valuable step in this direction in its support for developing firms' defined export capabilities untied to a specific transaction. For an exporter, support on a transaction-by-transaction basis inevitably cannot provide the level of comfort and planning stability that general lines of credit can. This is a model that merits further consideration both in the form of general credit support and in areas such as supporting equity investment in major export capabilities.

³ See UKEF's annual report and accounts 2019-20 at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/895102/ukef-annual-report-and-accounts-2019-to-2020.pdf for the case study of Solarcentury, which received support from UKEF in 2019 for major investments in Spain that will draw materially on UK supply.

Supporting UK SMEs

12. The most complex challenge for UKEF over the decade ahead is likely to be developing a truly effective mechanism for supporting UK SMEs and smaller transactions. This is new territory for many ECAs and requires different approaches to the large volumes, long lead times, sophisticated counterparties and generally capital-goods-focused transactions of the mid- and long-term market.
13. The UK's success in bringing SMEs into the export-credit system is only a partial one. Absolute numbers of firms served remain low, and the SME/non-SME mix in UKEF volumes is far lower than comparator ECAs in Germany, Australia and Korea.⁴ However, UKEF has made useful steps in establishing its small-transactions team, developing products that actively move down the credit curve. The GEF and the EDG are both potentially highly valuable services for UK SME exporters in the years ahead. It will also be important to continue to maintain sufficient headroom in the DLF to enable support for SME exporters to be ramped up through the recovery from covid-19. Furthermore, we would recommend further consideration of support for activities such as discounting of deferred-payment letters of credit, which can be of material value for smaller exporters.
14. Building an export-credit system that works for SMEs requires careful consideration of how best to support the shorter transaction timeframes of smaller contracts, including by considering how basic protocols can be calibrated to streamline approvals in ways that reflect the reduced risks of smaller transactions. As noted above, it also requires ECAs to be strongly committed to clear and effective communication and engagement with prospective clients.
15. It is also important to remain pragmatic and realistic about the capabilities of SMEs as potential exporters, especially in higher-risk markets. It is a basic reality that the UK has a number of key export strengths in large contract sectors such as petrochemicals, aerospace, defence and energy, which have been, and will necessarily remain, a pillar of its export-finance activity. For this reason, it is welcome that UKEF has recently taken a broad view of the challenge of bringing UK SMEs into the export economy that has focused on their role in UK supply chains as well as lead exporters. This has seen it actively and successfully develop its capability to convene large exporters and UK SMEs with the potential to operate in their supply chains.
16. Active and effective marketing is integral to the challenge of bringing SMEs into the export-credit system both as borrowers and as supply-chain participants. UKEF has a deserved reputation for effective supplier fairs and technical and educational outreach in which it should continue to invest. It should also continue to develop its capacity to run virtual trade shows and other online events.

Aligning export-credit policy with other government activity

17. It is important that the work of UKEF reinforces, and is reinforced by, the policies and actions of other parts of the government. However, it is also important to recognise that export credit is a specialist discipline distinct from general export promotion and its geographic focus will generally be on riskier and less marketable jurisdictions different

⁴ While more than 77 per cent of UKEF facilities in 2019 were provided to SMEs, the share of SME support in total volumes remains less than 5 per cent (UKEF annual report and accounts 2019-20).

from areas such as free-trade-agreement negotiations.⁵ It is complementary to both. DIT, BEIS and UKEF need to work closely together in developing a joint strategy that combines their different strengths in convening the UK exporter base and its supply chain and engagement with export markets.

18. UKEFs relationship with the FCDO is clearly key. UK diplomatic representation abroad can be key to identifying and cultivating opportunities for exports, including for sovereign contracts. If the UK were to consider moving into targeted concessional lending, this should be closely integrated with the development work of the FCDO. Posts can also be important in working with the Home Office to ensure that beneficiaries of UK export credit can secure the necessary visas to travel to the UK in the course of completing an export transaction.
19. We strongly support the use of debt-sustainability assessments in relevant lending to sovereigns subject to sustainable-lending criteria. However, it is important that such assessments be fully integrated in parallel into UKEF's work and not conducted once that work is complete, which can produce problematic delays. We believe the best model would be for UKEF itself to integrate these assessments formally into its country strategies so as to streamline any approvals.

⁵ The top-10 destinations of supported exports for UKEF in 2019-20 were the United Arab Emirates, Oman, Bahrain, Taiwan, Zambia, Ghana, Israel, Angola, Brazil and Malaysia (UKEF annual report and accounts 2019-20).