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The State of the Credit Insurance Market in Emerging Markets

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Proposed Agenda

1. Introduction and Background
2. The Role of Official Export Credit Agencies in Latin America
3. The Role of Multilateral Development Banks in support of Trade Finance and Credit Insurance
4. The State of the Private Sector Credit Insurance Market
5. How the SME Segment in Emerging Markets can get Access to Credit Insurance
6. Conclusion

1: Introduction and Background

Export Credit Agencies (ECAs)

Role: to support and encourage exports and outward investment by insuring international trade and investment transactions and, in some cases, providing finance directly.

- No such thing as a typical ECA.
- Developing countries actively setting up ECAs as an important tool for export development.
  - Effective and apparently low-cost method of carrying out policy objectives
- Major ECA product is export credit insurance.
- Growth of private sector significant, especially in the area of short-term credit.

Berne Union and Latin America

Berne Union

- 52 Berne Union members from 43 countries
  - Majority are official ECAs or have some link to their national government.
  - 2002: US $485 billion dollars insured; total outstanding commitments at year end of US $515 billion.

Latin America

- Four Berne Union members in Latin America and the Caribbean.
  - National Eximbank (Jamaica) – official ECA
  - Bancomext (Mexico) – official ECA
  - CASC (Argentina) - privately-owned credit insurer.
  - SBCE (Brazil) - private company. BNDES-EXIM ("official" Brazilian ECA) not a member, but holds a 12% share in SBCE.
- Banco Latinoamericano de Exportaciones (Bladex).
  - Multinational bank specialized in foreign trade in the region
  - Offers a Country Risk Guarantee

2: The Role of Official Export Credit Agencies in Latin America

Reasons for Establishing an ECA

Good Reasons:

- Protection against Risks:
  - Provide exporters with confidence to export and protection against losses
- Access to Bank Finance:
  - Insurance as collateral for financing
- Access to Information, Expertise, and Training:
  - Information on buyers and countries
- International Cooperation

Best Reason to Establish an ECA:

Meet a need or a market gap so as to act as a catalyst to the private sector.

Bad Reasons:

- Encouraging Exports to Bad Credit Risks:
  - Not in the “business” of foreign aid
- ECAs as Providers of subsidized Working Capital:
  - Providing working capital is a commercial bank function
- ECAs as Providers of Subsidized Medium and Long-term Credit:
  - Beneficiary is the buyer, not the exporter
- ECAs as a Guarantor of Exporters and Banks:
  - Taking risks without sharing in the profits

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Multinational Groups

- **Important development:** Move away from the tradition of having one “national” export credit insurer, private or public, in each country.
- Three large multinational groups providing largely short-term insurance against both commercial and political risks using private market reinsurance.
  - Euler-Hermes
  - Atradius
  - COFACE
- Dominate the market, benefit from economies of scale
- Difficult for small insurers to match speed of service and electronic systems and products.

Major ECA Models and Government Involvement

- Although credit insurance was developed in the private sector, typically government has been involved in some way.
  - Perception of a market gap
  - Desire to protect and promote exports - If support is not provided, then exports will be lost.
- No single or perfect model in an official export credit scheme.
- No such a thing as a typical ECA.
- Vital to design a model in the specific context of the country concerned. Important to keep this model under constant review

Major ECA Models and Government Involvement

Four broad categories:

1. **Private Company Acting as Agent**

- Government has exclusive arrangement with the private company concerned and the company issues policies as agent for the government.
- All risks are taken by the government
- Key decisions taken by government, but open to company recommendations and to company providing initial analysis of risks involved.
- **Examples:**
  - COFACE in France
  - Euler Hermes in Germany
  - Atradius in the Netherlands

Major ECA Models and Government Involvement

2. **Government Department / Facility**

- **Examples:**
  - Export Credit Guarantee Department (United Kingdom)
  - Swiss Export Risk Guarantees (ERG)
- Note: Certain countries offer special export credit facilities via the Central Bank (Barbados) or the Commerce/Industry ministries (Cyprus).

3. **State-Owned Agencies**

- Most common form of delivery for export credit facilities
- Some provide only insurance (e.g. SACE in Italy) while others provide only lending (e.g. Czech Export Bank). Many more combine both insurance and lending under one roof (e.g. EDC in Canada).
- Only in the US and Germany is export and investment support in separate institutions (i.e. US Eximbank and OPIC; Hermes and PWC in Germany).

Major ECA Models and Government Involvement

4. **Government Provider of Reinsurance**

- Growing trend: Governments review extent and nature of involvement in export credit insurance and whether they want to be involved at all.
- Government will not issue facilities for short-term business to exporters and banks but will provide reinsurance (100% or less) to one or more approved insurers (e.g. United Kingdom)

5. **Government Provider of Working Capital Facilities**

- Primary focus (particularly in developing countries) on provision of working capital, offering guarantee facilities to the banks or direct loans to the exporters or financing banks.
- Two types of facilities offered:
  - General financing facilities
  - Specific financing related to an export transaction.

3: The Role of Multilateral Development Banks in support of Trade Finance and Credit Insurance

MDBs and ECAs

- Strong relationship between international trade and economic growth.
  - Growth more rapidly over a sustained period.
  - Larger reductions in poverty.
- MDBs active in developing programs to assist in national and regional trade development and facilitation efforts.
- Logic in greater co-operation between MDBs and ECAs
  - Government backed entities; similar focus in emerging markets.
- MDBs not intended to be providers of credit insurance or to compete with ECAs.

MDBs and ECAs (cont'd)

- **Areas in which MDBs could take an interest:**
  - Developing an effective export credit insurance scheme within a country concerned so as to develop and increase profitable exports
  - Improving/increasing credit facilities for trade for <u>imports</u> into a country
  - Increasing working capital available to exporters into countries
  - Helping new or small exporters
  - Improving the performance and increasing the involvement of local banks in trade finance, both import and export

- **Main approaches taken by MDBs in these areas:**
  - Technical assistance to a national or regional scheme in borrowing countries either for the establishment of a facility or institution, or the further development of an existing facility or institution;
  - Direct support to an export credit agency, e.g. to on-lend to exporters for pre-shipment working capital; and
  - Counter guarantees or confirmation of letters of credit opened by local banks.

Making Trade Finance a Priority

- **Are MDBs equipped to play a pivotal role in maintaining trade credit in times of economic crisis?**

EBRD Trade Facilitation Program

- Provides guarantees to international confirming banks on L/Cs and other trade-related instruments issued by selected financial institutions.
- Provides pre-export financing facilities through local financial institutions.
- Program is pioneering as it:
  - Recognizes the importance of trade finance in development
  - Seeks to support this crucial sector through the basic schemes described.
- Development of in-house knowledge an important first step

IDB International Trade Finance Reactivation Program

- Provides loans and guarantees in support of the private sector
- Recent development: $400 million Regional Trade Finance Facilitation Program

ADB Trade Finance Program

- Modeled after EBRD's program

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4: The State of the Private Sector Credit Insurance Market

Private Sector Credit Insurance

- In the context of the short-term business, private sector participation has accelerated dramatically.
- Export Credit Insurers crucially need business of large exporters to generate income to pay for substantial infrastructure. The necessary infrastructure cannot be financed from premium income of SME’s alone.
- The large groups have developed partly by acquisitions and partly by setting up branch offices.
- “Toe in the water" approach - representative offices which concentrate on obtaining buyer information; helping with claim/recovery problems.
- Big insurers have continued to develop emerging market opportunities and have pursued separate strategies, each with their own “specialist strength”.
- Latin America market: COFACE currently has a direct presence in 10 countries, Atradius in 3 countries, and Euler Hermes in 2 countries.

5: How the SME Segment in Emerging Markets can get Access to Credit Insurance

What do to about Small Exporters?

- Needs of small exporters are different from those of larger exporters
  - This does not mean that insurers should apply different underwriting standards
- Credit Insurance facilities designed for SME's are costly to operate, largely because of "diseconomies of scale".
  - High administrative costs, lower premium <u>income</u> per contract
  - Dangerous to design and operate SME facilities on a below cost and so "money-losing" basis.

- Lack of experience and expertise in international trade and finance.
- SME's will normally find traditional ECA products difficult to understand and complicated and expensive to operate.
- Need simplicity of concept, approach and documentation; need clear and easy administrative procedures.

What do to about Small Exporters?

- SME’s are used to paying higher prices for their inputs than large companies do. Why should Credit Insurance be any different?
- Misleading for Governments to assume that private insurers will not want SME's as customers and will not offer special facilities for them.
- If SME facilities treated as inevitable money-losers, facilities will always be vulnerable to change, reduction or withdrawal.
  - SME’s will normally get what they pay for.
- SME’s will get better products and service if they meet the full costs of the provision of these.
  - Recognizing the particular needs of SME’s; do not offer low or subsidized prices or premium rates.

SME Solutions

- Policy documents can be made shorter and written in plain language.
- Streamlined administration
- Special facilities designed but issued to or via other, specialized institutions, which would then act as "policy managers" for SME’s.
- "Wholesale" policies
- Help and advisory facilities
- Provide training either directly to SME’s or to brokers
- Train banks and brokers on the export insurance needs of smaller exporters and on the facilities that Export Credit Insurers provide
- Facilities that associate Credit Insurance and working capital.
- Work with factors and forfaiters to develop special facilities for SME's.
- Co-operate more closely with national and local chambers of commerce, which in turn could act for or with or on behalf of SME’s in various ways.

6: Conclusion

Conclusion

- Private sector could take over all of this business; role of government should be reduced to that of a contingent re-insurer.

Latin America:

- Emerging markets remain relatively untapped.
- Competition for credit insurers entering Latin America:
  - Self-insure
  - Letters of credit (L/Cs), forfaiting and factoring
- Entrance of Multilateral Development Banks into the field.
- Optimism in the emerging markets.

Thank You

Questions?