L.5.2 RFD 238

Board of Governors of the Federal Reserve System

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

June 15, 1954

Export Credit Insurance and Export Financing Outside Normal Banking Channels in Foreign Countries — 10 pages

Stephen H. Axilrod

NOT FOR PUBLICATION

This Review is intended primarily for internal circulation and should in no case be cited or quoted. It consists of personal and informal contributions by the author, which in many cases represent tentative analyses of the subject considered.

Export Credit Insurance and Export Financing Outside Normal Banking Channels in Foreign Countries

June 15, 1954
Stephen H. Axilrod

Many countries of the world have export credit insurance programs, and many also have special governmental or quasi-governmental institutions to provide credits directly to exporters. (Special facilities to finance imports have apparently caused little concern abroad.) The credit insurance programs, whereby the exporter for a relatively small premium can cover some large percentage of his credit sales abroad against a wide variety of risks, usually aid the exporter in obtaining credit through normal banking channels. The special export financing arrangements are often used to provide the exporter with medium-term export credit, which he may not be able to obtain, sometimes even with insurance, from the banks or the private capital market because the maturity is too long and/or too large sums are involved.

The available information on these types of facilities is quite sparse. Further, with the increased competition among sellers in international markets, arrangements are continuously being changed. Therefore, one can neither obtain detailed enough information about the statutory provisions of the various institutions -- and even less adequate information on the actual operations of these institutions -- nor can one be sure that the information at hand reflects the present situation. This paper, which attempts to summarize the available information on a number of European countries and Japan, should be read with these reservations in mind.

The United Kingdom's export credit insurance scheme will be discussed first: information about it is relatively accessible; it was put into effect early and has served as a model for other such plans; and it is a moderately important factor in Britain's foreign trade. Insurance plans in other countries will be given briefer treatment since less information is available about them, many of them contain provisions similar to those in the United Kingdom, and most are relatively unimportant when one compares insured exports with total exports. Canada's export credit insurance program will not be discussed as it is a replica of the British plan; less than one per cent of Canadian exports to all countries except the United States were insured in 1953.

The insurance or guarantee institutions of many of these countries -- including the United Kingdom, Canada, France, Germany, the Netherlands, and the Scandinavian countries -- belong to the Union d'Assurances pour le Contrôle des Crédits Internationaux (Bern Union), a non-political organization founded in 1934. Representatives of the various export credit insurance institutions attend regular meetings where common policies and problems are discussed. It is thought that the exchange of information, in addition to being of general interest and benefit, may lessen tendencies toward the unilateral use of types of guarantees (primarily against longer-term credits) that are likely to lead to unwise international credit competition.

There are a variety of special export financing facilities and they will be discussed on a country-by-country basis concurrently with the analysis of credit insurance programs. The discussion of the United Kingdom, which follows, will deal solely with credit insurance since there are no export financing institutions there of a type which need be of concern for purposes of this paper.

United Kingdom

Export credit insurance in the United Kingdom is administered by the Export Credits Guarantee Department (ECGD), a governmental institution established in 1919. Its policies are set in consultation with the Export Guarantees Advisory Council -- a group made up of representatives from banking, industry and labor -- the Treasury, and other interested governmental agencies.

The Department considers two broad classes of guarantees: (1) those covering transactions where the risk can be regarded as commercially insurable-- this may be termed the regular program -- and (2) special guarantees in cases where the interests of the United Kingdom indicate that trade is desirable but where the transaction involves risks that could not otherwise be considered insurable. The ECGD consults with the Advisory Council and the Treasury in regard to the many considerations which go into determining the premium rate, eligible markets, and allowable terms of payment on transactions under the regular program. (With respect to terms of payment, it should be noted that the Foreign Exchange Control Commission, chaired by the Treasury with the participation of the Bank of England, supervises sales to non-Sterling Area countries on credit terms over six months.) Special guarantees, on the other hand, usually arise from requests by other government departments which have an interest in stimulating trade with particular areas. The Department may have outstanding up to £750 million ($2.1 billion) in commercial-type guarantees and £150 million ($420 million) in special guarantees.

Insurable risks -- What may be roughly termed political, commercial, and transfer risks that are outside the control of either buyer or seller are insured under the regular program. In addition, certain special risks entailed in establishing dollar area markets are insured under the program of special guarantees; rather than "insured", a better word in this instance would perhaps be "shared".

The specific risks insured under the regular program are: (1) buyer insolvency; (2) failure of buyer to pay for delivered goods within one year of due date; (3) inability to transfer sterling to the United Kingdom from the buyer's country; (4) war or other hostilities involving the buyer's country; (5) irrecoverable extra delivery charges caused by diversion of voyage; (6) cancellation of export license or imposition of restrictions on goods previously not subject to license; and (7) any other cause of loss outside the United Kingdom and beyond the control of the exporter or buyer. It may be well to mention, also, certain risks the Department does not cover: (1) losses from events within the United Kingdom; (2) refusal of buyer to accept delivery of goods previously ordered; (3) exchange fluctuations; (4) marine risks normally insurable through other groups; and (5) generally, losses that occur from causes within the control of the exporter or buyer.

Policies and premiums under the regular program -- Policies are issued to the exporter on his application. (There is presently, however, a governmental proposal which would permit the ECGD to enter into direct insurance contracts with the banks providing finance to the exporter.) The exporter may take out either a Contracts or Shipments policy covering short or medium-term transactions. The Contracts policy covers the exporter from the time he books the order until he receives payment in the contract currency; thus, certain pre-shipment risks would be covered, such as the possibility that the exporter may be unable to ship the goods to the original purchaser because of the occurrence of some event specified in the policy and, therefore, may have to sell at some loss to another buyer. The Shipments policy covers the exporter only from time of shipment.

Short-term policies, normally involving credits up to 180 days on consumer goods and raw materials shipments, are comprehensive in the sense that all insurable risks are covered as well as, to a large extent, the exporter's whole turnover for a twelve-month period. The exporter may exclude certain markets from insurance cover, but he may not exclude certain buyers within particular markets. The ECGD, however, apparently discourages selection of risks by the exporter since it prefers to base short-term policies on the principle of averaging a broad range of risks. Medium-term policies, on the other hand, usually cover the export of capital goods on extended terms of payment and are normally written to cover a single transaction with a particular buyer.

The premium rate varies in accord with the estimated creditworthiness of importing country and buyer, the terms of payment, and the type of commodity exported. On short-term policies, the rate might vary from as low as one-fifth of one per cent for the export of raw materials on a cash against documents basis to a reliable buyer in a country whose economic situation gives every indication that foreign exchange will be made available, to perhaps two per cent on the export of luxury goods against six-month paper when the reliability of the buyer may be in some question. The average premium on a short-term policy containing well-mixed risks has been less than one per cent. On medium-term transactions the premium may be anywhere in the range from one-half of one per cent to two or three per cent.

The ECGD will not cover the exporter for the whole value of his shipment; rather, the extent of the indemnity will vary with the nature of the risk. If loss is due to the buyer's insolvency or failure to pay for delivered goods within twelve months of the due date, the Department may cover up to 85 per cent of the loss; no more than 90 per cent of losses attributable to other causes will be covered. In addition to this limitation on the extent to which losses are covered, all short-term policies have a clause which limits the amount of credit that may be outstanding at any one time on a particular borrower.

Special guarantees -- Special guarantees are now largely related to the extraordinary export risks of breaking into dollar markets. There are several types of guarantees in use, some of which have been adopted by continental European countries. In brief, the ECGD will guarantee up to 50 per cent of the cost of market surveys, product tests, advertising, and other promotional expenses in dollar markets; the exporter will be indemnified if preliminary surveys indicate there is no worthwhile potential market or if the exporter's future return from sales does not reach some agreed upon level. In addition, the ECGD will guarantee the exporter against 50 per cent of the risk involved in carrying stocks in this country and Canada.

There is also a so-called Joint Venture policy to encourage dollar exports. For a high premium, relative to that on other policies, the Department will, for a period of four to seven years, share in all risks from manufacture to receipt of payment on the goods. If the project fails, the ECGD will assume an equal share of the loss; if it is successful, the Department will leave the project, all profits being retained by the exporter.

Relation to export financing -- About 15 per cent of the United Kingdom's total exports have recently come under guarantee; close to 80 per cent of the guaranteed exports are consumer goods or raw materials sold on short-term credit up to 180 days.

It is not possible to determine what share of insured exports is financed by the exporter himself, by the exporter's bank, or by the importer; there is no special governmental institution that directly finances exports. It is clear, however, that bank participation in the financing arrangements, particularly for medium-term capital exports, may be more readily obtained if the exporter has first secured a guarantee; in the presence of a guarantee the bank may also reduce its interest charge by perhaps one-half per cent below what it otherwise would have been.

Up to the present, the guarantee contract has usually been between the Department and the exporter; obtaining credits would be the exporter's responsibility. A bank, if involved, would provide financing for either the guaranteed portion of the transaction or perhaps for the whole of the transaction. In either case, if payments are not met, the bank has recourse only on the manufacturer, who in turn deals with the Department.

Recently, the U.K. Government has suggested a change in the usual ECGD procedure; it is proposed that the Department undertake direct insurance contracts with the banks that may be providing credit. This type of contract would be particularly helpful to the exporter of heavy capital equipment on relatively long terms who wishes to keep such transactions apart from his normal credit transactions. Since the bank would have recourse directly on the ECGD to the extent of the guarantee, the granting of long-term credit by the exporter would in this case presumably not seriously affect his normal borrowing powers. It has been suggested that the maximum coverage under this sort of arrangement may be 85 per cent, in contrast with a maximum of 90 per cent when the exporter is guaranteed directly.

Some problems in effectuating this proposal may arise from the fact that policies, as conceived to date, may not cover a broad enough range of risks to suit the banks. For example, the policy does not cover the possibility of non-payment when the buyer rejects the goods. This problem may be taken care of in a number of ways, perhaps involving some modification of policies.

The extent to which securities or promissory notes held by banks and guaranteed directly by the ECGD would be saleable to institutional investors is not known.

Germany

Both export credit insurance and direct export financing outside normal banking channels are available in Germany. Export credit insurance is provided by the Hermes Kredit Verischerungs AG, which covers risks involved in exporting to private foreign buyers, and the Revisions und Treuhand AG, which covers risks in dealing with state agencies or foreign public corporations. For all practical purposes, both of these corporations may be considered governmental institutions; though privately owned, they are reinsured one hundred per cent by the state and are subject to government direction. Practically all insurance is underwritten by Hermes and only its policies, to the extent information is available, will be discussed.

Direct export financing outside normal banking channels can be obtained from the Deutsche Ausfuhrkredit AG (AFAG), an institution set up in 1952 by a consortium of thirty banks. Export credits were previously made available through the Reconstruction Loan Corporation, whose line of credit with the Bank Deutscher Laender, the Central Bank, was transferred to the AFAG.

Export credit insurance -- Roughly the same sorts of risks that are covered under the United Kingdom's export credit insurance plan may also be covered under the German plan; there are, however, no special dollar drive facilities provided by Hermes so far as is known. As in the United Kingdom, perhaps 75-80 per cent of insured exports have been on credit terms up to six months; at least this has been true until recently, when there has apparently been some lengthening of credit terms and, assumedly, increased insurance of longer-term exports.

A single invoice policy, even in the case of short-term transactions, is apparently more widely used than in the United Kingdom, where, as has been mentioned, a comprehensive policy covering an exporter's shipments to a variety of markets is the usual type of short-term policy. The premium rate varies between one-half of one per cent and two per cent on short-term transactions; the average rate seems to be close to the top of the range. Rates on long-term transactions are not known.

The exporter carries at least 15 per cent of the political risk himself and this may go as high as 40 per cent; in the case of commercial loss, the exporter carries anywhere from 25 per cent to 50 per cent. Although the actual average coverage in the United Kingdom and Germany is not known, it would appear that the German exporter bears a somewhat larger share of the risk. This would probably have some effect on the extent to which the exporter might obtain bank credits.

There may be DM4,000 million (about $950 million) of outstanding guarantees in Germany. It is estimated that government guarantees are sought on over 20 per cent of export transactions.

Export finance facilities -- The AFAG will finance only amounts insured by Hermes. The exporter, after obtaining a guarantee, applies to a consortium bank for a loan. The Bank decides whether to grant the full amount of the loan itself, whether to submit it to the AFAG, or whether to reject it. If submitted to the AFAG and approved, the consortium bank must carry one-quarter of the loan itself. It is probable that the AFAG is called upon mostly in the case of fairly large medium-term credits.

The AFAG has two lines of credit available to finance its operations: (1) each participating bank contributes a certain percentage of its deposits, the total amount reaching DM 235 million ($56 million); (2) the Central Bank will rediscount up to DM 600 million ($143 million) of credits granted.

Credits under these two lines of credit are provided for periods from one to five years; in exceptional circumstances, longer-term credits may be arranged. The rate of interest varies with the line of credit used. If the rediscount facilities of the Central Bank are used, the rate to the borrower is one and a half per cent above the Bank rate; the Bank rate has recently been reduced from 3-1/2 to 3 per cent. The consortium's line of credit is somewhat more expensive; that rate was reported at 7 per cent when the rate to the borrower through the use of rediscount facilities was 5 per cent.

As of the end of 1953, after two years of business, the AFAG had paid out DM 455 million ($105 million), facilitating export sales of considerably larger volume. German exports during 1953 amounted to DM 18.4 billion ($4.4 billion) and were somewhat smaller in 1952.

France

Export credit insurance arrangements as well as export finance facilities in France involve joint state and private participation. With regard to insurance, the State bears practically all the risk, however. The extent to which the insurance and finance facilities are used is not known. There are indications that the insurance is less extensively used than in the United Kingdom or Germany.

Export credit insurance -- Export credit insurance is administered by the Compagnie Francaise d'Assurance pour le Commerce Extérieur (CFACE). Its capital has been provided by various nationalized credit institutions and several private insurance companies; most of the stock is held by the nationalized credit institutions. Insurance proposals are submitted directly to the CFACE presumably by the exporter. The CFACE is guided by rulings of the Commission des Garanties et du Crédit au Commerce Extérieur, which is made up of interested government agencies. The Commission determines what sort of proposals must be submitted to it for individual approval and lays down conditions under which credits may be granted directly by the CFACE.

Broader categories of risks may be insured under the French plan than under the English or German arrangements. In addition to risks insurable in the United Kingdom (including special guarantees for dollar exports), France provides cover for losses because of catastrophes (earthquakes, floods, etc.) and adverse movements in the exchange rate. In addition, insurance of a quoted price on dollar exports is provided directly by the State; the

Government assumes any loss from increased costs because of wage and raw material rises, the imposition of additional taxes, and certain other cost increases during the six to nine month period for which the price may be guaranteed.

The CFACE insures on its own account the usual commercial risks of insolvency and failure to pay and insures other risks (except the price guarantee) with reinsurance by the State. The exporter carries 20 per cent of the non-commercial risks, while, depending on the degree of riskness, he may carry anywhere from 20 to 35 per cent of the usual trade risks.

The exporter is required to take out a comprehensive policy covering all, or a large proportion of his exports to various markets. A policy covering all risks except insolvency may be taken out, in which case the premium may lie between .8 per cent and 4 per cent, according to reports; when the risk of loss through the buyer's insolvency is also covered the premium apparently ranges between 2 per cent and 8 per cent.

Export finance facilities -- The Banque Francaise du Commerce Extérieure (BFCE) and the Compagne Intercontinentale d'Etudes et de Réalizations (CITER) are important semi-public financial institutions which help exporters secure financing. The major stockholders of the BFCE are governmental financial institutions; its top officers are appointed by the Government, and its board is composed of businessmen, financiers, and traders. It helps exporters secure financing by placing its signature on the required guarantees, thereby, according to reports, permitting the exporter to draw immediately on the Banque de France. The BFCE agrees to collect on the foreign credit. Its charge for this service has recently been reported at 5.3 per cent; the interest rate on medium-term export credits in France often falls between 5.25 per cent and 6.4 per cent.

The CITER was formed in 1950, its capital contributed in part by the BFCE and the remainder by the Banque de Paris et des Pays-Bas, the largest private "banque d'affaires". It has been reported that the CITER was created to facilitate dollar exports which are financed jointly by the participating banks. The details of these transactions are not known. The Compagnie also helps manufacturers make market surveys and makes some loans to manufacturers who are interested in production for export.

Low Countries

The exporter in the Netherlands and Belgium may secure export credit insurance and also has access to export credits through institutions especially established for those purposes by the Government or on the initiative of the Government. Export credit insurance in the Netherlands is handled by the Nederlandsche Crediet Verzekering Maatschappij NV (Netherlands Credit Insurance Co., Ltd.), a private company supervised by the Government; all risks, except some part of insolvency losses, are re-insured with the Government. Credit insurance in Belgium is administered by the Office National du Ducroire (OND), a governmental institution, while insolvency risks may be insured with a private insurance company, the Compagnie Belge d'Assurance Crédit; the Compagnie, however, may re-insure with the Government. Export credits in both countries may be secured from quasi-governmental institutions.

Export credit insurance -- The types of risks which may be insured are roughly similar in both countries; coverage corresponds to risks insurable in the United Kingdom, including special dollar export guarantees, as well as insurance against natural catastrophes as in France. No information on premium rates is available for the Netherlands, while premiums in Belgium seem to vary from 0.3 per cent to 1.25 per cent on short-term transactions to a range of 3 to 5 per cent on longer-term credits. Depending on the type of transactions and cause of the loss, the insured's own risk apparently varies between 5 and 25 per cent in the Netherlands. Maximum coverage by the state in Belgium seems to be 85 per cent. Only about two per cent (or less) of Netherlands exports usually come under guarantee, and there is no reason to believe that the proportion is any larger in Belgium.

There is an interesting provision of the Netherlands plan in cases where an exporter's total sales for a given period are insured. The exporter bears the entire initial loss up to an agreed amount; this would presumably correspond to some normal business loss, which may be allowed for in the price. Only after the initial loss does the insurer assume a liability based on an agreed percentage of the remaining risk.

Export finance facilities -- In the Netherlands, as in other countries, long-term financing of exports is not considered part of the normal activities of commercial banks, excluding so-called ship mortgage banks. As a result, the Government through the Finance Corporation for National Reconstruction initiated the creation of the NV Export-Financiering-Maatschappij (Export Finance Corporation) and provided it with a long-term loan. Seven private commercial banks also participated, contributing funds directly and apparently providing credit facilities in times of peak financial requirements. The Corporation also goes into the private market to obtain additional funds, and the Government has guaranteed it against liquidity shortages up to a certain amount. The institution gives credit on so-called normal commercial conditions for periods of one to five years. Credit insurance is apparently helpful in securing these credits.

There are two institutions outside of normal banking channels which provide export credits in Belgium. The Institut de Réescompte et de Garantie accepts commercial paper of over 120 days maturity which is eligible for rediscounting with the Belgian National Bank and also grants low interest rates in connection with dollar exports. The Société Nationale de Crédit a l'Industrie purchases export paper with over two years maturity at relatively favorable rates. Coordination of the activities of these institutions with private banks is provided through a committee composed of representatives from government, the agencies themselves, and banks. The committee is consulted when medium-term credits for exports cannot be provided through ordinary banking channels.

Other European Countries

As far as is known, the Scandinavian countries and Switzerland have export credit guarantee facilities but do not have special programs involving export financing outside normal banking channels. An export credit insurance and finance program has been proposed by the Italian Government, but has not yet been approved by Parliament.

The export credit insurance programs of the Scandinavian countries are administered directly by the Government and, from the available information, resemble the United Kingdom's program; however, less than one per cent of these countries' exports have come under guarantee in recent years. In Sweden, which has a well-developed and apparently well-known program, less than one-half of one per cent of exports came under guarantee in 1952. Swiss credit insurance facilities and the Italian proposals will be briefly described below.

Switzerland -- Political and transfer risks (including exchange rate variations) may be insured with the Swiss Government; commercial risks, i.e., insolvency and default, will be insured by the Government only if the debtor is a government or public entity. Credit insurance covering losses from insolvency and default on exports to private buyers may be obtained from a private corporation.

Unlike most of the insurance plans considered, the Swiss Government guarantee is not based on the invoice price of the shipment but on that price less the net profit on the order and any advance payment. The guarantee will usually cover about 60-70 per cent of this price and no more than 80 per cent. The premium is apparently about one-half of one per cent. It has been estimated that about 10 per cent of all Swiss exports are covered by government guarantee.

Swiss banks usually finance the guaranteed portion of export sales. On exports to foreign governments or public corporations, they advance the guaranteed sum on the basis of guarantee bills of exchange; these notes may be rediscounted with the Swiss National Bank. Credit mostly for investment goods on terms up to a maximum of five years (and recently at somewhat longer term) is provided in this way. Claims on private credit insurance corporations may also be turned in to banks in return for credit, but these claims are not eligible for rediscount.

Italy -- The proposed Italian export credit insurance apparently would not differ radically from programs previously considered. It would involve the establishment of a public insurance agency, which would insure for its own account and would reinsure private insurance companies against credit risks involving terms of payment no greater than four years. This proposal would apparently apply only to limited categories of goods, largely capital goods.

Export financing, presumably for insured goods, would be provided by a government medium-term credit institute, the Istituto Centrale per il Credito a Medio Termine, which would rediscount export bills held by the many medium-term credit houses in Italy. In the interest of preventing a possible over-expansion of bank credit based on medium-term export loans, a proposal that ordinary banks be allowed to rediscount such credits with the institute was rejected. It was thought that the distinction between short-term operations suitable to commercial banks and medium-term activities, which may not be, should be preserved.

Japan

Export credits not provided by commercial banks is provided in Japan through its Export-Import Bank, which is in many respects similar to its United States counterpart; the Bank also guarantees certain credit transactions. Its stated purpose is "to supplement and encourage the export and import financing of ordinary financial institutions for the purpose of facilitating the foreign trade of Japan through financial aid."

The Bank undertakes four types of transactions: (1) export financing, which will be described in more detail below; (2) financing of overseas investment through loans to Japanese corporations or individuals who may wish to invest in foreign corporations or lend equipment to them; (3) providing funds to Japanese who wish to install equipment overseas; and (4) guaranteeing liabilities related to loans under transactions one and three above. It only extends credits that commercial banks and other financial institutions would find difficulty in granting on ordinary terms. It was financed by a capital contribution by the Government and may borrow from the Government or foreign financial institutions.

Direct export financing constitutes the bulk of the Bank's transactions. It finances exports (of equipment mostly) by making loans to Japanese exporters or manufacturers on a participation basis, by rediscounting notes for banks that have made such loans, and, to a much smaller extent, by making loans to foreign governments or firms who wish to buy in Japan. As a usual practice, the exporter applies for a credit through his own commercial bank, which, if it cannot handle it alone or in conjunction with other banks, refers the credit to the Export-Import Bank. If the Bank takes the loan, there is usually some participation by a group of commercial banks, unless the credit matures over more than five years. The Bank usually takes 80 per cent and commercial banks the remainder. If the loan matures in six months or less, commercial banks may take 50 per cent of the credit. Maturities vary from 3 months to as high as 10 years on credits to finance exports. The standard interest rate on the Bank's export financing was 7 per cent during the twelve months ended March 1953, while the minimum interest charge was 5 per cent.

Gross disbursements by the Bank during the April 1952-March 1953 period amounted to the equivalent of $23 million. Total Japanese exports during this period were near $1.2 billion.