

NOTE

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/cst-ekf

Danish comments to the draft Communication on short-term export credit insurance

Denmark welcomes the new draft Communication, which we believe in many ways accommodates the challenges Member States have experience under the current Communication. However, Denmark is still concerned that the new Communication, if the current draft remains unchanged, will not eliminate some important issues associated with the existing Communication and the Temporary Framework¹.

In the following, Denmark will first give some overall comments to the draft Communication, followed by some concrete technical drafting proposals to the text.

With regard to the Danish translation of the current draft, we have noted some linguistic errors. Denmark stands ready to comment on the translations in the final version of the Communication.

DEMARCATIION LINE FOR MARKETABLE RISKS

The demarcation of marketable risks presented in the draft Communication does not correctly reflect the market reality faced by European exporters at this point in time, where the financial markets are weak and private market players are risk adverse.

It is inconsistent that the draft Communication on the one hand identifies that a market gap for credits between 180 days and two years exists; goes on to specify a set of minimum conditions for the provision of cover for credits between 180 days and two years, including minimum premiums set above private market prices; but then concludes, on the other hand, that these risks are generally marketable, and requires prior demonstration of “temporary non-marketability” in individual Member States.

As stated in §4, one of the aims of the draft Communication is to “create a level-playing field among exporters”. Denmark fully supports minimum conditions as a mean to achieve a level-playing field. However combining minimum conditions with a system that builds on individual evidence from the Member States is self-contradictory.

¹ OJ C 16, 22.01.2009

A system of individual notifications, where Member States must prove non-marketability would lead to excessive bureaucracy and added expense for all parties involved. And this is especially so, when it has already been concluded in the draft Communication that these risks are non-marketable.

Denmark proposes a demarcation line of non-marketability at 180 days. However, we recognise that markets change, and in order to meet the goal of not distorting competition, we can support a demarcation line of 2 years, provided that ex post reporting will replace ex ante notification. Ex ante notification should only be required when a Member State wishes to use a different set of conditions for cover other than the minimum standards specified in the draft Communication. This approach would be in line with other EU state aid legislation, e.g. the “Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees”², which sets up a framework for conditions and demands ex ante notifications, should these conditions not be met.

ENSURING COMPETITIVE CONDITIONS FOR EUROPEAN EXPORTERS

Denmark is concerned that the current draft Communication does not sufficiently consider the needs of European exporters in a global trade perspective.

A vast part of the European enterprises are relatively small and need simple and practicable instruments to facilitate trade on a global scale. If the systems become too obscure and bureaucratic, exporters are more likely to just stop their trade³. In the present economic situation this is not desirable and emphasises the need to underline the trade perspective in the Communication.

As the draft Communication also recognises, credit periods above 180 days for single risk transactions cannot generally be considered marketable. Cover for credits between 180 days and 2 years are not regarded as core business for the private operators. The product requiring single risk credits between 180 days – 2 years are anomalies in the ST market and until that changes availability of cover is too uncertain. This leaves EU exporters with a financing gap and thus with a competitive disadvantage vis-à-vis non EU exporters.

In the Danish market, whether a transaction is considered marketable is decided by the type of transaction and the credit period. The Danish pri-

² OJ C155, 20.6.2008, p.10

³ This was, for example, brought forward at the short term workshop in Berlin this June “Perspektiven der Absicherung kurzfristiger Exportgeschäfte – Auswirkungen der anstehenden EU-Kommissionsmitteilung”

vate insurance market – which is considered highly competitive⁴, and therefore a good yardstick in a European context – covers an exporter’s portfolio of repetitive deliveries usually with credit terms of 30-90 days and occasionally up to 180 days, while EKF covers exports of single transactions to single buyers.

Denmark recognizes that the current draft simplifies how ECAs can step into the market for credits between 180 days and 2 years. However, this will not lead to a level playing field between

- EU exporters (since notifications are only valid for the notifying country).
- EU exporters vs. non-EU exporters (since non-EU exporters can obtain cover from non-EU ECAs for credits between 0 days and 2 years without time delays due to notification-procedures).

The draft Communication’s strong focus on ensuring a level playing field for the private credit insurers vis-à-vis the public credit insurers comes at the expense of the European exporters.

TECHNICAL PROPOSALS

In order to obtain a more balanced approach Denmark has below provided some concrete text proposals to the draft communication as well as some technical comments. These points follow the structure of the draft Communication.

DEFINITIONS (2.2)

1. §9: The definition of “co-insurance”. As it stands in the current draft, the term seems to refer to “the uninsured portion”. “The uninsured portion” indicates the share of risk retained by the insured. The term “co-insurance” appears again in §24, where it does not correspond with the definition in §9. In §24 it rather refers to a type of reinsurance. As such, Denmark proposes to delete the definition of “co-insurance”, and replace it with a definition of “quota-share” (see below)
2. §9: The definition of “credit period” should specify that exporters not only grant export credit to buyers, but banks do as well. Denmark proposes the following wording:

⁴ Marsh Report: “Do Danish SMEs exporting goods with credit terms between six months and two years within OECD/EU have access to sufficient coverage from the private credit insurance market?”, January 2011

- (i) “Credit period”: The period of time the insured creditor ex-
porter gives to the buyer to pay for the delivered goods.
3. §9: The definition of “export credit insurance” needs to be further clarified. At the moment it is uncertain whether Letters of Credit (L/Cs) are included in the scope of the draft Communication. The present definition of “Commercial risks” (as used in the definition of “export credit insurance”) appears to concern solely the traditional relationships between exporter and buyer, and does not consider the risk of default of an issuer of irrevocable L/Cs. Guarantees for L/Cs are generally not an area of business for the private insurers, and during the financial crisis, the need for public insurance of L/Cs has become particularly evident. It should be made explicit in the future definition of “export credit insurance” that cover for L/Cs is not included.

Furthermore, it should also be made clearer that the “trade transaction” in question should involve exports. Denmark proposes the following wording:

- (i) “Export credit insurance”: an insurance product whereby the insurer takes over the commercial and/or political risk, as defined in the Communication, of protracted default, insolvency or bankruptcy of the buyer in an export trade transaction. For the purpose of this Communication, commercial risks covered by irrevocable letters of credit are not included.
4. §9: The draft Communication lacks a definition of reinsurance in its standard form of “quota-share” as opposed to the reinsurance dealt with in §12f. Quota-share refers to cases where the insurer, for example, transfers 90% of its liability and premiums on every risk to the reinsurer, who must pay 90% of any loss sustained. Denmark proposes the following definition of “quota-share” based on the EKF reinsurance model:
- (i) “Quota-share”: Automatic reinsurance that requires the insurer to transfer, and the reinsurer to accept, a given percentage of every risk within a defined category of business written by the insurer.

As an alternative, ICISA uses the term “proportional reinsurance”, which could also be applied:

- (i) “Proportional reinsurance”: Proportional Reinsurance means that the Primary insurer and Reinsurer share liabilities (i.e. sums insured) in a clearly defined proportion as described within the underlying treaty. Premiums and claims are also split up according to the respective share of the risk (i.e. proportionally).

EXCEPTIONS TO THE DEFINITION OF MARKETABLE RISKS (4.2)

5. §18c: To fulfil the aims of the draft Communication (not distorting competition in the private market and ensuring a level playing field for exporters), state provision of single risk cover in so far as the stated conditions (premium levels, quality of cover and underwriting principles) are met, should be allowed. Member States should inform the Commission and other Member States if this option is used within [one] month of its implementation. If a Member State wishes to provide other conditions better than those stated in this Communication, this should be notified ex ante to the Commission.

Denmark therefore proposes the following changes to the text:

- (i) §18: Notwithstanding the definition of marketable risks, commercial and political risks incurred on debtors established in the countries listed in the annex, are considered non marketable: ~~in the following situations:~~

(a): ~~in the situation that~~ the Commission decides to temporarily remove one or several countries from the list of marketable risk countries defined in the annex by means of the mechanism described in section 5.2, because the capacity of the private insurance market in any of those countries is insufficient to cover all economically justifiable risks

(b): ~~if the Commission, on being notified by a Member State, decides that~~ in the case that a Member State offers cover for the risks incurred by small and medium-sized enterprises falling within the relevant EU definition and having a total annual export turnover not exceeding EUR 2 million under the conditions identified in section 4.3 and provided that the Commission is informed of the scheme within one month of implemen-

~~tation in the Member State, are temporarily non-marketable in the Member State concerned.~~

~~(c): if the Commission, on being notified by a Member State, decides that the in the case that a Member State offers cover for single risks cover with a credit period of between 1840 days and two years risks under the conditions identified in section 4.3 and provided that the Commission is informed of the scheme within one month of implementation in the Member State, are temporarily non-marketable in the Member State concerned.~~

~~(d): if the Commission on being notified by a Member State, decides that due to other factors, related in particular to the supply conditions of export credit insurance, certain risks are temporarily non-marketable in the Member State concerned.~~

- (ii) §29: The risks specified in point 18(a), ~~(b) and (c)~~ can be covered by export credit insurers operating for the account of or guaranteed by the State, subject to the conditions specified in section 4.3. In such cases the Commission does not have to be notified.
- (iii) §30: The risks specified in point 18~~(b), (c) and~~ (d) can be covered by export credit insurers operating for the account of or guaranteed by the State, subject to the conditions specified in section 4.3 and following notification to and approval by the Commission.
- (iv) 5.3 Notification for exceptions in point 18(b) and (c) Procedural clarifications for exceptions in point 18 (b) and (c)
- (v) §38: In the cases specified in points 18(b) and (c), the evidence currently available to the Commission suggests that there is a market gap and that those risks are therefore non-marketable. It must be borne in mind that the extent of the market gap ~~lack of cover does not exist~~ may vary in every Member States and that the situation could change over time, as the private sector might become interested in this segment of the market. State intervention should only be allowed for risks which the market would otherwise not cover.

- (vi) §39: For these reasons, when a Member States wants to cover the risks specified in point 18 (b) or (c), it may only do so under the conditions identified in section 4.3 and by informing the Commission of its decision to do so within 1 month of implementation. If a Member State wishes to apply conditions other than those identified in section 4.3 it must notify its intent to the Commission and it must demonstrate in its notification that it has contacted two major insurers in its country and given them an opportunity to provide evidence that cover for the risks concerned is available in the country. If the insurers concerned do not provide data, to the Member State or directly to the Commission, within 30 days of receipt of request from a Member State, on the conditions of cover and insured volumes for the type of risks the Member State wants to cover, the Commission will consider the risks unmarketable.

CONDITIONS FOR THE PROVISION OF COVER FOR EXEMPTED MARKETABLE RISKS (4.3)

6. §20 - §28: Denmark welcomes a set of specific conditions that must be complied with when exempted marketable risks are covered. However, since these conditions are set at a level, to ensure that public ECAs do not crowd out the private insurers, notifications should not be necessary. Market developments could be followed through ex post reporting.

Instead of notifications, the focus should be on systematic reporting, which should be made publicly available. This would allow the private insurers to follow the business of public ECAs and possibly object, should they believe that public insurers are taking over private business.

A system of reporting instead of notification would also increase transparency and thus comparability between specific ECA transactions.

7. §20: Denmark supports that whole turnover policies refused by private insurers, because they were not economically justified, should not be covered by public insurers as “single risks”. This should not mean, however, that quota-share reinsurance, where the private insurer retains part of the risk under new conditions, is not allowed.

8. §23: Denmark welcomes the introduction of a fixed set of minimum premiums. As we understand it, the ranges provided are intended for single risk cover as well as for whole turnover policies.

Denmark is concerned that the curve from the “Excellent” risk category to the “Weak” risk category is too steep, meaning that the best risks are priced too low, and worst risks are priced too high. Based on the Danish premium levels, we would suggest the following modifications to the table:

Risk Category	Annual Risk Premium (Single risk cover: percentage of insured volume, linear rate) (Whole turnover policies: percentage of turnover in relevant risk period)
Excellent	0,5% – 0,7%
Good	0,7% – 0,8%
Satisfactory	0,8% – 1,0%
Weak	1,1% – 1,4%
Bad	-

Single risk cover

It should be made explicit that the minimum premiums are linear rate premiums, meaning that no compounding should be included in the calculation of premiums for credit periods over 1 year. The premium for a credit period of 18 months should thus be calculated as: insured volume x premium rate x 1,5.

Whole turnover policies

It should be made explicit that premium ranges are percentages of the total turnover under the policy in the relevant risk period. That is to say that premium ranges can be split down to the risk period in question (for a risk period of 6 months, premium ranges should be divided by 2, etc.).

In the case of whole turnover policies, a downgrading of the premium levels in the draft Communication to the levels suggested above would be imperative. It should be noted that for export credits for whole turnover policies, the premium is established with regard to various

inherent mitigants and not established over a full exposure, meaning that premium levels for whole turnover policies are generally lower.

The experience from the Danish reinsurance scheme clearly shows that premium levels at 2% for the worst risks are prohibitively high. It proved necessary to adjust this to a maximum level of 1,4%.

9. It would be more appropriate to use the term “quota-share” in §24 instead of “co-insurance”. §24 should then read:

- (i) For ~~co-insurance~~, direct reinsurance, quota-share and top-up cover, pricing is considered adequate if the premium charged is at least [20%] higher than the premium for the original cover.

10. §25: Denmark does not support an introduction of compulsory administration fees. §24 states that pricing is considered adequate if the premium charged is at least 20% higher than the premium for original cover. This price-level should be considered adequate to prevent public ECAs in taking over the business of private insurers. An added administration fee would set price levels at more than 20% above private levels and result in prohibitive premiums. Today, a number of ECA’s as well as private insurers are not operating with administration fees, and any such fees should continue to be voluntary and fixed by the individual ECA.

11. §29 - §30: See point 5 (modifications to §18c)

MODIFICATION OF THE LIST OF MARKETABLE RISK COUNTRIES (5.2)

12. §33(a): The proposed 12 month observation period is too long and may give a misleading result.

The two indicators described in 33(a) will likely prove to be contradictory and give the wrong picture since both indicators (a decrease in insured amount and decrease in acceptance ratios) have to be met at the same time.

According to the Danish experience, a decrease in insured amounts and a decrease in acceptance ratios went hand in hand at the beginning of the financial crisis. This led to a smaller basis consisting of better buyers on which to measure acceptance ratios. This meant that at the second review of the indicators, the insured amounts were still de-

creasing but acceptance ratios were increasing. In conclusion, if both indicators in 33(a) have to be met at the same point in time in a 12 month period, the conclusion drawn might incorrectly be that markets are performing better.

A 12 month period is not suitable when taking into consideration that the vast part of ST credit terms are less than 6 months. It should be taken into consideration that the current financial crisis has lasted almost 5 years.

Discussions with the private insurers have revealed that the reductions in acceptance ratios witnessed in the beginning of the crisis were too severe and based on decisions influenced by panic more than rationale. In the future, decreases of the same magnitude are not likely to be observed.

Based on Denmark's experience under the on-going crisis, the levels of decrease suggested in the draft Communication are simply too high. Denmark proposes a decrease in insured amounts and acceptance ratios to the following:

- (i) "Contraction of private credit insurance capacity: in particular, the withdrawal of a major international insurer from a specific market, a significant decrease (of more than 10%) in total insured amounts* and a significant decrease (of between 10% and 12%) in acceptance ratios** for a market detected in one Member State.

* Insured amounts observed in the latest quarter should be compared with an average of at least 2 to 3 non-crisis years for that same market.

** Acceptance ratios observed in the latest quarter should be compared with an average of at least 2 to 3 non-crisis years for that same market.

13. §31: 5 Countries are excessive. Instead request from 3 countries should suffice.
14. §36: The validity of insurance policies signed during the period a country is considered non-marketable should be 6 months instead of 90 days.

15. §38 - §39: See point 5 (modifications to §18c)

ANNEX

It should be specifically stated whether EU “grey zone” countries such as Monaco, the Faroe Islands and others are within the scope of the draft Communication.