BRITISH EXPORTERS ASSOCIATION

14th May 2018

PRA – Credit Risk mitigation (CRM) consultation

https://www.bankofengland.co.uk/prudential-regulation/publication/2018/credit-risk-mitigation-eligibility-of-guarantees

Overview of BExA

The British Exporters Association (BExA) is an independent national trade association representing the interests of the UK's exporters. Our membership is drawn from across the exporting community, including capital goods manufacturers and international traders (large corporates, MSBs, SMEs and Micro exporters), and their bank, credit insurance and other service providers. BExA seeks to promote the interests of its members and all UK exporters, with a particular focus on trade finance and export credit insurance.

BExA Response to the PRA consultation - Credit Risk Mitigation: Eligibility of Guarantees as unfunded credit protection

Summary

Whilst BExA generally welcomes initiatives that simplify and clarify legislation, this proposal has significant unintended consequences that BExA believes will be damaging for UK exporters and UK regulated financial services providers.

In particular, the seemingly simple clarification to the interpretation of the term "timely" will render many widely used trade finance instruments ineligible from capital relief, raising costs for our exporters and making our trade finance service providers uncompetitive against non-UK regulated entities.

In a time where the UK is looking to boost exports to help grow our economy post-Brexit these changes will create a significant headwind for UK exporters and disproportionately affect our SME exporters.

Simply put – the proposed clarifications (particularly in respect of the requirement for more extensive legal opinions and timeliness) cannot be allowed to progress further in their current form.

Consultation Scope and Objectives

We refer to your consultation paper (CP) of 16th February 2018 which sets out the PRA's proposed changes to Supervisory Statement (SS) 17/13 "Credit risk mitigation".

BExA notes that CP6/18 is intended to clarify the PRA's expectations in respect of a number of the CRR criteria including the following - that a guarantee must:

1. be legally effective and enforceable in all relevant jurisdictions and be supported by an independent legal opinion (so-called "Article 194(1) legal opinions");

2. not contain clauses that could prevent the obligor paying in a "timely" manner; and

3. cover all types of payment the obligor is expected to make or where certain types of payment are excluded the firm has adjusted the value of the guarantee to reflect the limited coverage.

This leads to the following issue(s):

In respect of the PRA's proposed position that "*timely*" should mean "*without delay and within days, but not weeks or months*" this is likely to be of concern for those institutions (and their clients) who rely on traditional trade and export finance CRMs (such as credit comprehensive non-payment insurance policies and ECA guarantees) which, as a matter of well-established market practice, have longer waiting periods before the guarantor's payment is due.

Claim waiting periods are usual (or standard) in third party guarantees from UKEF and non-payment credit insurance from the private insurance market. A claim waiting period of "… *within days* …" is not market standard. Market standard claim waiting periods for ECA and private insurance market CRMs may be 90, 120 or 180 days. The proposed clarification will render ineligible (from a capital perspective) CRMs which are widely used to support trade and export finance for UK exporters.

BExA does not support the proposed clarification of the claim waiting period due to the following unintended consequences to UK exporters and the UK's Trade Policy and Export Strategy ambitions.

Impact on UK Exporters

Fundamentally BExA is concerned that there is a significant risk that the proposed changes will have the following adverse impacts on UK exporters:

- Reduced competitiveness of UK exporters
- Reduce access to finance

- Increase cost of finance
- Withdrawal of existing CRM facilities
- Additional security or collateral requirements
- Increased cost of external legal opinions
- Increased likelihood of contract cancellations or terminations

BExA is concerned that the proposed changes will increase costs to UK exporters and will also further reduce access to finance for SME exporters. In turn, this will have an adverse effect on the competitiveness of UK exporters.

For trade and export transactions, access to finance is a key issue for SMEs[1]. In recent years, BExA members have reported concerns about the additional "on-boarding costs" which are being faced by financiers in providing finance for SME exporters. Anything which further increases the cost of and reduces access to trade and export finance will reduce the competitiveness of UK exporters. Increases in financing costs are of particular concern to SMEs who may have little or no "ancillary business" to provide to financiers to offset the impact of these increased costs making them in effect "unbankable".

Access to CRMs such as third party guarantees from UK Export Finance (UKEF) and non-payment credit insurance products from the private insurance market is key to the ability of UK exporters to gain access to finance. If access to CRMs is restricted on what have been, to date, standard terms and conditions as a result of the PRA's proposed "*clarification*", BExA is of the opinion that SMEs may, as result, struggle to get appropriate trade and export finance whilst larger exporters will face an increase in financing costs.

BExA is also concerned that exporters (and importers) will have to provide additional security. A key issue faced by SMEs in accessing trade and export finance is their ability (or inability) to provide adequate security or collateral - hence the critical importance of eligible CRMs from ECAs and the private insurance market.

For trade and export finance transactions the existence of a claim waiting period can have a positive benefit for all parties involved – the exporter, the buyer, the financier and the provider of the CRM. This is of particular importance for larger export and project financings as it gives the parties the opportunity to seek to resolve the underlying default without being forced to collapse the financing and risk the cancellation or early termination of the underlying export contract.

As an observation, even with a claim waiting period of, say, 90, 120 or 180 days the beneficiary of the CRM is likely to receive payment sooner than if it had to enforce against the underlying obligor directly through the courts or arbitration.

[1] See "UK Export Finance, Export is not the new black, October 2017, BExA's 8th Annual Benchmarking"; "Driving export growth in uncertain times, October 2016, BExA's 7th Annual Benchmarking"; "The Cole Commission on Exports An Action Plan from business" 2015.

To the extent that the legal opinion required by Article 194(1) will now need to "… *consider the eligibility criteria* ..." BExA is concerned that financial institutions will use external legal opinions as a matter of course and will be reluctant to rely on generic legal opinions. The cost of such opinions is usually borne by the exporter. This has always been an issue for exporters (particularly, SME exporters). By requiring more extensive legal opinions BExA is concerned that this will be a further (potentially irrecoverable) cost for UK exporters.

BExA would recommend that external legal opinions are only required when strictly necessary and that their scope should be limited to minimise costs.

Impact on UKEF, banks and the private insurance market

Similarly BExA is concerned that the proposed changes will impact on the UK exporter populations' financial services providers in the following ways:

- Increase capital allocation requirements for ineligible CRMs driving increased costs
- Ineligible CRMs will cause existing financings to be revoked or cancelled
- Hiatus in decision making will cause uncertainty for overseas buyers and push them elsewhere
- Create an uneven playing field between ECA and private insurance CRMs

The UK has in UKEF one of the world's leading export credit agencies[2]. The UK also has the world's most developed private insurance markets.

If UK banks are unable to use UKEF guarantees or private insurance policies on their current, market standard, terms as eligible CRMs BExA is of the view that this will have a direct and adverse impact of the cost of providing trade and export finance to UK exporters.

In addition to increasing costs, BExA is concerned that the PRA's proposed "*clarification*" will result in the withdrawal of existing uncommitted trade and export finance lines from exporters.

BExA is also concerned that during the PRA's consultation process proposed financings will be put "on-hold" pending the outcome of the consultation process. For SMEs in particular this could have significant cash flow consequences. For UK exporters generally this may mean that they lose export contracts – foreign buyers may not wait for the PRA to reach its conclusion.

Whist there would seem to be a carve-out for ECAs as "… *public sector bodies* …" this is unclear. Without clarification, BExA is concerned that financial institutions will adopt a narrow approach and treat CRMs from "… *public sector bodies* …" (such as, for example,

[2] See BExA's Annual Benchmarking papers and US EximBank's annual competiveness reports.

UKEF) as subject to the PRA's "… *expectations regarding the eligibility of guarantees as unfunded credit protection* …".

Given that ECA guarantees and private insurance market products are, in effect, used interchangeably in trade and export finance transactions, BExA believes that the regulatory treatment of ECA and private insurance market products should be treated in the same fashion as regards claim waiting periods.

Further (and most importantly) that these periods should be as currently used - 90, 120 or 180 days. It is not clear to BExA why these should be shortened.

In the absence of such equal treatment, ECAs will have a competitive advantage over the private insurance market. Without a "level playing field" between ECAs and the private insurance market UK exporters (and their financiers) will face limited choice.

From a UK Government perspective, without "a level playing field" UKEF will need to be ready to take up the support which would otherwise have been provided by the private insurance market. Improving processing times at UKEF has been a challenge for UKEF[3]. Without the addition of significantly greater resources at UKEF, BExA is concerned that a difference in regulatory treatment between ECA CRMs and private insurance market CRMs will mean that processing times at UKEF will lengthen or that UKEF will simply focus its resources on the large export financings to the detriment of UK SMEs.

Impact on UK Trade Policy

Through the work of BExA, UKEF and UK Finance exporters have become more aware of how CRMs can help them access finance and win exports – BExA is concerned that the proposed "*clarification*" cuts across the work that BExA, UKEF and UK Finance has done to date.

UK trade policy has been to encourage UK exporters to access markets outside of the EU. To do this, access to capital effective CRMs from UKEF and the private insurance market will be critical to financing these transactions – particularly where exporters and their financiers are dealing with "new" buyers in emerging market jurisdictions.

As noted in our 2017 Benchmarking Paper "*UK Export Finance, Export is not the new black*", BExA emphasised the critical importance of a comprehensive, long-term UK Trade Policy and saw this as being key to benefitting the UK's balance of trade and to the generation of sustainable employment.

[3] See "UK Export Finance, Export is not the new black, October 2017, BExA's 8th Annual Benchmarking"; "Driving export growth in uncertain times, October 2016, BExA's 7th Annual Benchmarking".

BExA highlighted that UK Trade Policy success would only be achieved "… *as a culmination of a joined up, coordinated and cohesive approach by Government* …". BExA regards the Bank of England as playing an important role in this.

For the reasons noted above, BExA is extremely concerned that the PRA's proposed changes to Supervisory Statement (SS) 17/13 will have an adverse impact not only on UK exporters but also on UK financial institutions and the private insurance market and their crucial support for trade and export finance.

As noted above, BExA is of the view that that the PRA's proposed "*clarification*" has the potential to impose significant costs on UK exporters. Particularly for SME exporters who still report issues around access to finance. There would appear to be no analysis of these costs to UK exporters in the Consultation Paper.

If the PRA's proposed clarification were to take effect, BExA wishes to understand:

- How the Bank of England will monitor the impact on UK exporters.
- What support the Bank of England will provide to UK exporters where trade and export finance credit lines are either withdrawn or denied.
- Will there be a "safety net" for UK exporters.
- What has been agreed with the UK Government to address and monitor access to trade and export finance particularly for SME exporters.

BExA notes that the CP provides that "… *[t]he Prudential Regulation Committee (PRC) should have regard to aspects of the Government's economic policy as recommended by HM Treasury* …". It is unclear whether, in issuing its CP, the PRA has had regard to the UK Government's Trade Policy. BExA would urge the PRA to have regard to the UK Government's Trade Policy in making any "clarifications" and provide an explanation as to how any "clarification" will fit in with UK Government Trade Policy.