

# **Report to Develop the CIRR-system for Financing Finnish Exports**

**Finnvera's standing as a Promotional Bank and Finland's export performance  
need to be on par with Sweden and Germany.**

Three proposals are made in this report to achieve the above:

- 1. The laws relating to Finnvera must be unified and clarified to ensure that its status and mandate from the Finnish government as a Promotional Bank is as strong as the similar organizations Germany and Sweden.**
- 2. It is recommended that the management of the CIRR-system be centralized in Finnvera, while the financial accountability of the State remains.**
- 3. Finnvera already has many successful training and information programs for SME's, but more intensive and focused marketing and training to stimulate SME growth and export growth by SME's, as well as new approaches in working with other partners who train, support, invest and finance with SME sector to achieve these goals.**

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## 1. Toimeksianto

Ministeriö asettaa selvitysmieheksi Nicholas Andersonin, jonka tehtävänä on selvittää nykyisen vienninrahoitusjärjestelmän kehittämistarpeet sekä antaa ehdotuksensa kehittämistoimenpiteiksi. Selvitysmiehen tulee:

1. selvittää vienninrahoitukseen liittyvän varainhankinnan ja siihen liittyvien suojaustoimenpiteiden nykyistä tehokkaampaa järjestämistä,
2. selvittää nykyisen korontasausjärjestelmän toimivuutta ja kehittämistä, toteutettavien suojaustoimenpiteiden nykyistä tehokkaampaa järjestämistä sekä korontasausopimuksiin liittyvien korkomarginaalien tarkoituksenmukaista tasoa ja
3. tarkastella kiinteäkorkoisen OECD-ehdoisen luotonannon hinnoittelua sekä yksityisen ja julkisen rahoituksen roolia vienninrahoituksessa.

Tarkastelussa tulee ottaa huomioon Suomen valtion näkökulman lisäksi keskeisten kilpailija- ja verrokkimaiden järjestelmät sekä myös järjestelmän läpinäkyvyys, asiakasnäkökulma ja markkinoiden toimintaan liittyvät vaikutukset.

## 2. Definitions and Abbreviations used in this report

### Definitions

#### **Promotional Bank**

The term “Promotional Bank” is a commonly accepted and used expression in most OECD countries and means a specialized financing company owned by the State that strengthens the operating potential and competitiveness of national companies by offering Export Financing, and provides financing for SME’s to start, grow and internationalize as steered by the industrial and ownership policy mandate and goals laid down by the State.

Among these goals are:

- i. increasing the number of starting companies;
- ii. enabling financing for changes encountered by SMEs;
- iii. and promotion of company growth, internationalization and exports;
- iv. and as such promotes higher levels of employment

Promotional Banks normally operate when there are clearly perceived gaps in the markets.

#### **The CIRR Offering**

The term “**CIRR Offering**” includes Finnvera’s **CIRR loans and the Interest Equalization offerings**.

The Finnish government is financially responsible for the CIRR system and this is directly included in the State budget. The initial pricing of practically all individual CIRR-Offerings, including a possible State Margin above the relevant CIRR interest rate, are managed by Valtiokonttori, with Finnvera being responsible for the customer interface, meaning that Finnvera’s staff works directly with the banks, and clients associated with the CIRR Offering.

Finnvera is liable for those credit risks of the CIRR Offering for which it is contractually liable through export guarantees as the state-owned Promotional Bank. Finnvera’s equity capital, and the State Guarantee Fund are available to Finnvera as the first line of defense. However, the State assumes the ultimate responsibility for guarantee losses that exceed the reserves on Finnvera’s balance sheet and the State Guarantee Fund.

Finnvera funds its operations under the explicit guarantee of the State like other Promotional Banks, explicitly or implicitly thus securing easy access to funding at the lowest possible cost.

#### **Export Financing**

The term “**Export Financing**” includes Finnvera Group's export credits and export credit guarantees.

## **Direct Lending**

The term “Direct Lending” is used here to refer to lending to large Finnish export related investments and Finnish large foreign buyers of Finnish exports. These loans are naturally decided upon on case-by-case basis and almost always made with banks and their legal advisors.

“Direct Lending” for domestic SME’s is already an activity but this should also be reviewed if funding is not readily available because of a market failure or market gap is seen to develop.

## **Lending**

The term “Lending” is used here to refer to lending as defined under Finnvera’s current mandate and normally refers to SME’s and export credits whereby the agent bank assigns its commitments to FEC on day one such that that part of the export credit is not on the bank’s balance sheet.

## **Domestic Guarantees**

The Act on Finnvera (443/1998) stipulates that domestic operations must be kept separate from export credit guarantee and special guarantee operations. In consequence, losses from domestic operations are covered from the reserve for domestic operations, while losses from export credit guarantees and special guarantees are covered from the reserve for export credit guarantee and special guarantee operations – the State Guarantee Fund.

## **State Guarantee Fund**

According to the Act on the State Guarantee Fund (444/1998), the State is responsible for export credit guarantees and special guarantees. Should the reserve for export credit guarantee and special guarantee operations lack sufficient assets to cover the losses incurred in the respective operations, the losses are covered from assets in the State Guarantee Fund, which are supplemented, whenever necessary, by an appropriation from the State Budget.

The above separation prescribed by law, and the State’s responsibility for export credit guarantees, explain why Finnvera calculates its capital adequacy, i.e. the ratio between capital and risk-weighted items, only for domestic operations.

## Abbreviations

*(Note that abbreviations, English names and occasional Finnish names are used to clarify and avoid misunderstandings.)*

<b>ALM</b>	Asset Liability Management
<b>Board</b>	This refers to Finnvera's Board
<b>CIRR</b>	The OECD stipulates that minimum interest rates shall apply to official financing support for export credits. These are the minimum interest rates called Commercial Interest Reference Rates (CIRRs), established for each currency and which are set on the 15th of each month.
<b>EIF</b>	The European Investment Fund
<b>EFSI</b>	European Fund for Strategic Investments
<b>ECA</b>	Export Credit Agency
<b>EKN</b>	Swedish abbreviation for the Swedish Export Credit Agency
<b>FEC</b>	Finnish Export Credit – 100% owned by Finnvera
<b>Fiva</b>	Finnish abbreviation for the Finnish Financial Inspection Authority
<b>ICAAP / ILAAP</b>	Internal capital adequacy assessment process / Internal liquidity adequacy assessment process
<b>IFI</b>	International Financial Institutions like World Bank, IFC, Multilateral Investment Guarantee Agency, African Development Bank, Asian Development Bank, Inter-American Development Bank, etc.
<b>National Audit Office</b>	“Valtiontalouden tarkastusvirasto” in Finnish or VTV for short
<b>SME</b>	Means Small- and Medium-size Enterprises.
<b>SEK</b>	Swedish Export Credit Corporation
<b>SSA</b>	Supranational, sub-sovereign and agency borrower/issuer
<b>Suomen Yrittäjät</b>	Finnish for the Federation of Finnish Enterprises
<b>TEM</b>	Finnish abbreviation for the Ministry of Economic Affairs and Employment
<b>Treasury</b>	The word “Treasury” is used in this report to mean Finnvera's Treasury
<b>Valtiokonttori</b>	Finnish for Finland's State Treasury

### 3. Yhteenveto

Suomi kilpailee globaaleilla vientimarkkinoilla ylläpitääkseen korkeaa elintaso.

Suomen vienti on kuitenkin selvästi jäljessä tärkeimmistä kilpailijamaista, Saksasta ja Ruotsista, joiden vienti tänä päivänä ylittää 46-48%:iin BKT:sta. Suomessa vastaava luku on vain 39%. Ero on suuri sekä suhteellisesti että absoluuttisina lukuina.

Lisäksi liian monet suomalaiset pk-yritykset ovat liian pieniä – 93% työllistää korkeintaan 10 työntekijää ja koko pk-yrityssektori kattaa alle 15% kokonaisviennistä. Molemmat luvut ovat huomattavasti pienemmät kuin Saksassa ja Ruotsissa. Tämän raportin toimeksianto on rajattu vienninrahoitukseen ja CIRR-järjestelmään, mutta tehokkaammalla vienninrahoituksella ja CIRR-järjestelmällä voidaan merkittävästi edistää vientitoimintaa.

Suomen on positioitava itsensä globaaleilla markkinoilla vaativammille vientisektoreille saavuttaakseen menestyksellisen ja kestävä tavaraj- ja palveluviennin tason. Viennin tulisi täyttää seuraavat ominaisuudet:

1. Lopputuotteen tai tuotantoprosessin täytyy tuottaa merkittävää lisäarvoa.
2. Tuotteilla on oltava vahva, pitkäkestoinen kysyntä asiakkailta, jotka vaativat korkeaa laatua ja jotka ovat valmiita maksamaan parhaan hinnan tuotteista.
3. Tuotteiden täytyy sisältää innovatiivisia ratkaisuja, jotka hyödyttävät ostajia ja jotka mahdollistavat viejille tilaisuuksia esitellä uusia innovaatioita olemassa olevien vientituotteiden elinkaaren aikana.
4. Vientituotteiden on oltava vaikeasti kopioitavissa.

Tällaisten kilpailuetujen saavuttaminen ja ylläpitäminen edellyttävät seuraavien ennakkoehtojen täyttymistä:

1. Korkeasti koulutettu, osaava ja joustava työvoima.
2. Tehokkaat myynti- ja ylläpito-organisaatiot.
3. Kustannustehokkaat, vahvat ja toimivat tuotantokumppanien ja alihankkijoiden toimitusketjut, ekosysteemit tai klusterit...
4. **...jatkuvasti saatavilla oleva, riittävä, pitkäaikainen ja kilpailukykyisesti hinnoiteltu vienninrahoitus suurille vientiyrityksille...**
5. **...ja riittävän suuret pk-yritykset, joilla on kapasiteettia investoida, halua ja osaamista lisätä vientiä ilman mittavaa riskinottoa.**

Tämän raportin tärkeimmät suositukset ovat:

- 1. Vienninrahoituksen ja CIRR-järjestelmän kehittämisen kannalta keskeistä on, että Finnveran asema ja organisaatio valtion omistamana “Promotional Bank”:na nostetaan samalle tasolle kuin Saksan KfW:n ja Ruotsin SEK/EKN:n asema. Tähän liittyy Finnveraan liittyvän lainsäädännön yhtenäistämistä ja kirkastamista sekä sen varmistaminen, että Finnveran mandaatti toimia “Promotional Bank”:na on täysin selvä.**
- 2. Tässä raportissa kuvattu ruotsalainen ratkaisu CIRR-järjestelmän hallinnoimiseen on läpinäkyvämpi kuin nykyinen jaettu toimintatapa Suomessa. Niinpä on suositeltavaa, että CIRR:n hallinnointi keskitetään Finnveraan, ja CIRR-järjestelmän voitot tai tappiot, pois lukien 25 korkopisteen hallinnointimaksu, maksetaan voitot Finnveralta valtiolle, ja tappiot valtiolta Finnveralle. Tämä ei muuta valtion taloudellista vastuusta nykytilanteeseen verrattuna.**
- 3. Finnverassa on jo käynnissä useita menestyksekkäitä valmennus- ja viestintäohjelmia pk-yrityksille. Jotta tavoitteet pk-yritysten kasvun ja pk-viennin kasvun vauhdittamiseksi saavutetaan, tarvitaan kuitenkin vielä intensiivisempää ja kohdennetumpaa markkinointia ja valmennusta samoin kuin uusia yhteistyötapoja pk-sektorilla valmennusta, tukea, investointeja ja rahoitusta tarjoavien kumppaneiden kanssa.**

Nämä kolme kohtaa ovat avainasemassa tässä raportissa, joka antaa keskeisiä ehdotuksia ja suosituksia samoin kuin monia pienempiä huomioita, joiden toimeenpanoa voi harkita.



## 4. Keskeiset johtopäätökset ja suositukset

### Keskeiset johtopäätökset

Raportin päätteemana on, että Finnveralla ei edelleenkään ole vastaavaa asemaa tai organisaatiota kuin Ruotsin ja Saksan "Promotional Bank":eilla ja organisaatioilla (ECA).

Raportin näkökulma TEM:n toimeksiantoon on laaja, sillä CIRR-järjestelmän ja vienninrahoituksen kehittäminen vaativat sekä lisäresursointia että muutoksia prosesseihin Finnveran sisällä ja suhteessa kumppaneihin. Muutokset edellyttävät riittäviä tuloja, jotka varmistavat Finnveran toiminnan itsekannattavuusvaatimuksen.

Järjestelmän hallinnolliset kulut ja tuotot näkyvät CIRR-järjestelmän kilpailukyvyssä, jonka taso on globaalisti joko hyväksyttävä tai liian kallis. Ostajan kannalta kiinteä CIRR-flat -korkotason hinta verrattuna kilpailijamaiden vaihtoehtoisin tarjouksiin on todennäköisesti merkittävin päätöksentekoon vaikuttava tekijä.

### Keskeiset suositukset:

1. Finnveraa koskevat useat lait tulisi yhdistää yhdeksi laiksi, jossa Finnveran mandaatti Suomen valtion kokonaan omistamana erityisrahoituslaitoksena (tässä tekstissä käytetään tästä lähtien käsitettä "Promotional Bank") on selkeästi esitetty ja sen tehtävät määritelty. Uudessa lainsäädännössä eduskunta tulisi vahvistamaan vuosittain Finnveralle 6-8 miljardin euron pitkäaikaisen luottolimiitin SEK:n ja EKN:n ratkaisun mukaisesti.
2. Valtiokonttorin nykyiset CIRR-järjestelmään liittyvät tehtävät tulisi siirtää Finnveran Treasuryn vastuulle. Tämä edellyttää jonkin verran lisäyksiä henkilöstöresursseihin, riskienhallinnan ja sisäisen tarkastuksen IT-ratkaisuihin sekä jonkin verran lisähenkilöstöä sisäiseen tarkastukseen ja sisäiseen ohjaukseen. CIRR:n ALM:n hallinta on kustannustehokasta, kun se hoidetaan yhdessä liiketoimintayksikössä, jolla on vahva ammattilaisista koostuva organisaatio ja joka toimii mahdollisimman lähellä asiakkaita.

Huolellisesti toimeenpantuna muutoksen ei pitäisi aiheuttaa lisäriskiä valtiolle – ks. Part 7.

3. Jos kohta 1 ja 2 hyväksytään, Finnveran tulisi harkita CIRR-varainhankinnan politiikan muuttamista SEK:n ratkaisun mukaiseksi. Finnvera hankkisi CIRR-järjestelmän varat osittain lyhytaikaisilta rahoitusmarkkinoilta. Finnveran Treasury hoitaisi tehtävää valtion puolesta, ja valtio maksaisi Finnveralle 0,25% vuosimaksun.

Huolellisesti toimeenpantuna muutoksen ei pitäisi aiheuttaa lisäriskiä valtiolle – ks. Part 7.

4. Finnveran tulisi myös etsiä uusia tapoja jakaa riskiä monipuolisemmin yksityisten sijoittajien ja rahastojen, IFI:en, ulkomaisten ECA:den ja "Promotional Bank":ien kanssa silloin, kun myönnetään suuria rahoitussitoumuksia ulkomaisessa omistuksessa oleville, Suomessa toimiville yrityksille.
5. Raportti suosittelee, että projektien hallinnassa käytettäisiin ulkopuolista konsulttia. Finnveran tulee hankkia ja ottaa välittömästi käyttöön tärkeitä liiketoimintoihin liittyvien IT-järjestelmien päivityksiä useilla kriittisillä alueilla. Tämä parantaa johdon, asiakasrajapinnan ja riskienhallinnan tiedonsaantia sekä tehostaa resurssien hyödyntämistä.

6. On selvää, että Fivan määräysten ja ohjeiden noudattaminen soveltuvin osin on tärkeää, ja sitä voitaisiin jatkaa TEM:n tarkastusosaston tekemänä tietyin ehdoin, kuten alla on kuvattu. Valvonta vahvistaisi ja ylläpitäisi Finnveran luottokelpoisuutta ja vahvuuksia "Promotional Bank":na. ICAAP- ja ILAAP-sääntelyyn liittyvät avoimet kysymykset on käsitelty raportissa, ja on selvää, että niiden suora soveltaminen Finnveraan olisi vahingollista ja ristiriidassa nykyisen valtion mandaatin kanssa. Ei ole olemassa esimerkkejä yhdestäkään valtio-omisteisesta vientitakuulaitoksesta, joka olisi alisteinen ICAAP-sääntelylle. Tämän raportin loppupäätelmä on, että Fivan valvontaa soveltuvin osin voitaisiin harkita.
7. "Promotional Bank":na valtiolla on kaupallista osakeyhtiötä suurempi intressi varmistaa, että mandaatti on täytetty. Näin ollen Finnveran hallituksen on varmistettava, että yhtiö noudattaa mandaattia tarkasti ja epäröimättä. Hallituksen jäsenillä täytyy olla syvä teollisuuden tai finanssialan asiantuntemus. Heidän on myös varmistettava, että Finnveran johtohenkilöt ovat huippuammattilaisia ja sitoutuneita yhtiöön.
8. Tarvitaan intensiivisempää ja kohdennetumpaa markkinointia ja valmennusta, samoin kuin uusia yhteistyötapoja pankkikumppaneiden kanssa, sillä pk-yritysten yhteenlaskettu vienti kattaa alle 15% Suomen kokonaisviennistä. Osuus on alhainen verrattuna muihin Pohjoismaihin ja Saksaan. Pk-yritykset ovat tärkeitä talouskasvulle ja työpaikoille. Tukemalla pk-yrityksiä hallituksen mandaatin mukaisesti Finnvera voi vauhdittaa niiden kasvua ja mahdollistaa pk-yritysten viennin volyymin kasvattamisen. Finnveralla onkin merkittäviä syitä jatkaa vienninrahoituksen ja takuiden markkinointia pk-yrityksille näiden liiketoimintamahdollisuuksien parantamiseksi, sillä raportti osoittaa suuria puutteita yritysten tietotaidossa tällä alueella.
9. Suora luotonanto suuryrityksille ja pk-yrityksille tulisi sallia hallituksen mandaatin rajoissa, kuten alla on kuvattu.
10. Valtion omistamana "Promotional Bank":na Finnveran pitäisi jatkaa varainhankintaa valtion takaamana. Valtion takaus on maksuton Finnveralle. Tämä raportti ehdottaa, että Suomen valtio ottaa käyttöön samanlaisen, lainmukaisen ratkaisun Finnveran varainhankinnan takaamiseen kuin KfW:ssa Saksassa, myös EU:n jäsenvaltiossa.

## 5. Executive Summary

Finland is competing in the global export markets to maintain high living standards.

However, Finland's export performance is considerably below those of our most important competitors, Germany and Sweden, who manage to export today between 46% and 48% of GDP while Finland only achieves 39%. The difference is big in relative and absolute terms.

Furthermore, too many Finnish SME's are too small - 93% having 10 or fewer employees, while the whole SME sector accounts for less than 15% of the total volume of exports. Both figures are well below Germany and Sweden. Although, the remit of this report is limited to Export Finance and the CIRR Offering, much can be achieved to increase export performance by a more efficient Export Finance and CIRR Offering.

In the global markets Finland must position itself in more demanding and complex export sectors to achieve successful and sustainable levels of exports the products and services. These exports must have the following characteristics:

1. High added-value must be incorporated either in the final product, or in the process producing them.
2. The products must see strong long-term demand from customers, who require high standards and who are prepared to pay a premium price for these goods.
3. The products must incorporate innovative developments and solutions that benefit buyers, as well as allowing exporters to introduce new innovations during the life cycle of existing exported products.
4. The export products should be difficult to replicate by foreign competitors.

Such competitive advantages can only be achieved and maintained with the following prerequisites:

1. A highly-educated, skilled and flexible work-force.
2. Effective sales and maintenance organizations.
3. Cost efficient, robust and well-integrated supply chains, eco-systems or clusters of production partners and sub-contractors...
4. **... where there is the continuous availability of sufficient volumes of long-term competitively-priced Export Finance for large exporters...**
5. **... and SME's must be big enough to have the investment capacity, the willingness and knowledge to export more, without excessive risk-taking.**

The most important recommendations for this report are the following:

- 1. The key to developing Export Finance and the CIRR Offering is to bring the standing and organization of Finnvera as a State-owned Promotional Bank to the same level as Germany's KfW and Sweden's SEK/EKN. This involves unifying and clarifying the laws relating to Finnvera and ensuring that Finnvera's mandate from the government is perfectly clear as a Promotional Bank.**
- 2. The Swedish solution for the management of CIRR, as described in this report, is more effective and transparent than the present split system in Finland. Thus, it is recommended that the management of CIRR is centralized in Finnvera, while the profit or loss of the CIRR Offering, minus the 25bp management fee, should be paid to or by the State, which does not change the financial accountability of the State compared to the current situation.**
- 3. Finnvera already has many successful training and information programs for SME's. However, there should be even more intensive and focused marketing and training to stimulate SME growth and export growth of SME's, as well as new approaches in working with other partners who train, support, invest and finance with SME sector to achieve these goals.**

These three points are the focus of this report that sets out the main proposals and recommendations, as well as including many other minor measures that can be considered for implementation.

## 6. Main conclusions and main recommendations

### Main Conclusions:

**The major theme of this report is that Finnvera does not have an equivalent standing and organization as the Promotional Banks and Organizations in Sweden and Germany.**

This report takes a broad approach to the remit from TEM because the development of the CIRR Offering and of the Export Finance require investments in specific resources as well as some changes in the work processes within Finnvera and with their partners. These development changes require sufficient income to support the sustainability of Finnvera's operations.

The costs and income resulting from the management of this system reflect the level of competitiveness of the CIRR-system, which is best described as being rather binary in these global markets. Achieving the cost of funding of CIRR-flat, is probably the biggest element in decision-making for exporters and buyers when faced with alternative offers from competing countries.

### Main Recommendations:

1. The many laws relating to Finnvera should be amended into a single Act of Parliament where its mandate as a Promotional Bank, wholly owned by the Republic of Finland, is stated clearly with a list of the functions to be performed. Under the same new legislation, Parliament should be given the responsibility to approve each calendar year a long-term credit line of €6 billion to €8 billion to support Finnvera in a similar manner to the SEK and EKN solution.
2. Finnvera's Treasury (referred to as "Treasury" in this report) needs to take over all the activities currently performed by Valtiokonttori for the CIRR Offering. This requires some modest investments in Treasury staff, IT solutions for risk management and internal audit. There can be no doubt that CIRR's ALM is cost efficient only in single business unit with a robust organization manned by professionals who are in direct contact with clients and banks.

If carefully implemented there is no reason to believe that such a change will result in any significant increase the risks for the Government. The reasons for this are set out in Part 7.

3. If Recommendations 1 and 2 are implemented, then Finnvera should consider changing its CIRR's funding policies to resemble SEK's solution. This would entail Finnvera funding the CIRR-system partially from short-term sources, under the guidance and management of Finnvera's Treasury for a management fee of 0,25% from the government.

If carefully implemented there is no reason to believe that such a change will result in any significant increase the risks for the Government. The reasons for this are set out in Part 7.

4. Finnvera should also look into finding more ways to receive risk cover from a more diversified selection of private institutional investors and funds, International Financial Institutions, foreign ECA's and Promotional Banks when a large financing commitments are made to foreign-owned companies operating in Finland.
5. The report recommends that an outside consultant should be employed to assist in management of the IT projects. Finnvera must procure and implement immediately important business operation IT-systems upgrades in several critical areas that can improve the flow of information to management, client interface, risk management and resource productivity.

6. There can be no question that the appropriate application of Fiva's Supervisory standards, regulations and guidelines need to continue to be implemented by TEM's Inspection Department based on certain prerequisite conditions as set out below. Such supervision will only strengthen and maintain the creditworthiness, and perceived strengths of Finnvera as a Promotional Bank. The open question relating to ICAAP and ILAAP are dealt with in the report and it is clear that their direct application to Finnvera would be harmful and contravene the State's mandate. There are no cases of any State-owned ECA being subject to ICAAP regulations. The conclusion of this report is that there is a case to consider Fiva's supervision of Finnvera by the application of applicable standards, regulations and guidelines that fully recognize Finnvera's special position as a Promotional Bank working under a clearly defined government mandate.
7. As a Promotional Bank, the State has a much greater interest in ensuring that the mandate is observed than would be the case of a normal commercial company. Thus, the Board must ensure that this mandate is being fully implemented without any hesitancy. The members of the Board must have deep industrial and/or financial expertise. They must also ensure that the senior staff at Finnvera are of the highest professional standard and that they are motivated to stay in the employ of the company.
8. More intensive and focused marketing and training is required from Finnvera, as well as new approaches in working with banking partners because the SME sector's exports account for less than 15% of total exports. This is well below our Nordic and German neighbors. SME's are important for economic growth and jobs. By supporting SME's in line with the government's mandate Finnvera can increase their pace of growth as well as bringing them closer to exporting bigger volumes. Thus, there are important reasons for Finnvera to continue to market that export financing and guarantee facilities to SME's because that can only improve business opportunities for these clients, since the above report clearly illustrate major short-coming in know-how and knowledge within the sector.
9. Direct lending to large corporations and domestic SME's should be permitted within Government's mandate, as described below.
10. Finnvera, as a State-owned Promotional Bank must continue to issue short- and long-term debt under the same explicit Guarantee of the Republic of Finland. This report proposes that the government should introduce a similar approach to guaranteeing Finnvera's debt by a similar law to the one used by KfW, in Germany, another member state of the EU.

## 7. Rationale for approach of this report

This report takes a broad approach to the remit from TEM because the development of the CIRR Offering and of the Export Offering require investments in specific resources as well as some changes in the work processes within Finnvera and with their partners. These development changes require sufficient income to support the sustainability of Finnvera's operations.

Finland depends heavily on exports because the domestic national market is small with a population of only 5.5 million. The value of exports equals some 39% of GDP. As a developed country with a high standard of living, Finland has relatively high labor costs relative to the rest of the world, so it is important to achieve high productivity and cost efficiency in all possible areas associated with the export sector, especially with regard to Export Finance.

The economic impact of the export sector is huge for Finland and it is quite useful to take a simplistic approach in calculating its positive impact. This is probably more transparent than complex theoretical economic modelling calculations that leave practitioners arguing over less important details. A rough estimated example of the important economic impacts can be derived from very basic calculations as a reasonable guide, and an example of this is set out in summary form in *Appendix 3*.

Finnvera, as Finland's Promotional Bank, is exposed to a small number of large foreign credit exposures over very long periods as well as having a highly diversified credit exposure on thousands of SME's. It is impossible to guarantee with 100% certainty that large credit losses can be avoided, but it must be recognized by taxpayers, government, and Parliament that Export Finance is a necessary part of the export business, and that these risks are best evaluated and borne by a professionally managed organization that works in partnership with exporting clients, banks other professional partners and advisors.

This report points out that there is a significant market gap in the provision of Export Finance for the foreign buyers of Finnish exporters – *see Appendix 2*.

This report also notes the serious deficiency of knowledge and skills regarding export risk cover and finance amongst growing SME's – *see Appendix 4 "SME's too small and share of exports too low"*.

The Finnish government has always recognized the importance of the export markets and provided the support of its broad shoulders with various policies over the past decades. However, these support policies have been chequered over the years and not carefully crafted and developed as in Germany and Sweden strategic where KfW and SEK/EKN have been designed to fulfill the needs of its exporters and the nation – *see Appendix 1*.

Customers will use Finnvera either because it can offer CIRR-flat or because the export product is superior and the customer is more concerned about having the product than worrying about the last basis point of CIRR pricing. However, during interviews made for this report, many large exporters expressed the view that the cost of funding as close as possible to CIRR-flat is probably one of the biggest elements in decision-making when faced with alternative offers from competing countries for reasonably equivalent products.

The nature of large export transactions that involve CIRR-based loans for long loan periods are complex and require professional skills and a deep understanding of all of the contractual

agreements to ensure that all the financial and other material contractual risks are minimized for Finnvera and the government.

Increasing the number of participants in any complex transaction has the potential to increase these risks and cause delays even when all of the participants operate efficiently and diligently, which is certainly the case today. When there are many actors involved in such complex transactions much time is taken to explain and clarify important details. Such complex transactions almost always involve new elements and material changes during the long period of negotiations. Unnecessary delays may occur because it is not uncommon for professionals to misunderstand one another even when they work in close proximity. In the present split CIRR-system the relevant actors are on different sides of the city and not in close physical contact. Furthermore, both parties must cover their own costs, implying slightly higher costs into the CIRR-system.

Finally, having one entity, Finnvera, involved exclusively in CIRR-pricing will improve transparency in the transactions for both Finnvera and TEM. At the moment, this report has noted that there is actually no information in the public domain on how Valtiokonttori has hedged and managed the pricing of each CIRR-Offering. Transparency increases here because Finnvera, as a company, is bound by internationally accepted accounting practices.

Suffice it to say that the cost of hedging each CIRR-Offering plus any relevant margin to cover all of the outstanding financial risks, are calculated using market prices from the liquid cash and derivative markets that are available to both Valtiokonttori and Finnvera from major domestic and foreign banks on basically the same terms. Both entities have the possibility and the capacity to handle such deals on an equivalent basis. Having two entities sharing the work when one can do all parts of these complex transactions is not cost or time effective in the view of this report.

It is the conclusion of this report that the CIRR-Offering is better served by having Finnvera as the sole manager of CIRR-system because it is more time and resource efficient and more transparent, with fewer risks of miscommunication.

It is the conclusion of this report that TEM, as a party to these large transactions, and as the responsible government ministry is better served by having a single source of market information for each transaction, which should result in improvements in both transparency and the time and resources used for individual CIRR-Offerings by Finnvera.

It is for this reason that the report is proposing changes in Finnvera's activities, organization and processes that will lead to improved transparencies and cost efficiencies for the CIRR-system in total, not only for Finnvera's operations. Thus, the result would mean that, over time, the government's interests will be better served by such a solution.

It should be noted that the CIRR-system has reported a modest but positive accumulated financial result for the government over the past 20 years, during which period interest rates have both risen and fallen. The annual results of the CIRR-system, as in Sweden with SEK, have been positive for the most part with occasional modest losses.

The improvements in CIRR pricing efficiency requires changes in the in-house management of risks and in funding, in modest investment in off-the shelf IT solutions, in modest investments in professional staff, and in improvements in internal and external supervision.

These elements all come with extra costs, which means that Finnvera must also seek a reasonable expansion of its customer base and an increase in loan and guarantee volumes to support these



somewhat higher costs. Such an expansion is certainly in line with the government's mandate for a Promotional Bank.

Benchmarking Finnvera against them is appropriate because KfW and SEK/EKN have been successful in their operations as Promotional Banks and have maintained sustainable financial results without disturbing the private banking market, in fact, they act as catalysts and partners for banks who are unwilling to take on all the risks of Export Finance. Applying similar solutions also means that there is "no race to the bottom" when applying what can be learnt from studying how they function with their clients – *see Appendix 1*.

Although Finnvera is now understood to be an important part of the Finnish economy, its history has been anything but systematically planned and developed. Political and commercial pressures have left it weakened, and decades have been lost when compared to the more systematic approaches of supporting Promotional Banks in Sweden and Germany, two countries that have actively strengthened and developed their Promotional Banks these over many decades. Finland is a small country with relatively less resources than our main competitors and this has meant wasted years leaving the country is more vulnerable compared to Sweden and Germany as we saw after the financial crisis 10 years ago.

The major theme of this report is that Finnvera does not have an equivalent standing and organization as the Promotional Banks and Organizations in Sweden and Germany, even though recent growth has been rapid and moved in the right direction. Even though progress has been made to strengthen their staff and operations, further improvements, as proposed in the report, are needed to improve Finland's export position in relation to our main competitors without radical changes in risk exposures.

This report's conclusion will show that these changes can be implemented gradually and achieve the several important objectives:

- a) Establish that Finnvera enjoys the equivalent standing and organization as in Germany and in Sweden.
- b) Produce a better result for the operating efficiencies and transparency of the CIRR-system and Export Finance.
- c) Increase the chances of success for large export deals and increase the relative share of Finnish exports for SME's.
- d) Keep Finnvera on a financially sustainable path.

## 8. Key Factors supporting development of Export Finance & CIRR Offering

The following should be considered when planning the development of Finland's CIRR Offering and the Export Financing system.

As of the end of 2017, the great majority of Finnvera's guarantee commitments for the large corporates totaled some €22.2 billion were granted to foreign buyers of Finnish export goods – the outstanding CIRR-based loan and CIRR commitment volume has grown rather quickly during the past years and stands at €10.9 billion in 2017. The total of volume of loans is €4.8 billion with €7.7 of loan commitments make a total €12.6 billion.

The large increase in commitments is mainly due to large cruise ships and telecom network transactions that have taken place during the last few years.

Transactions and the resulting commitments for the large cruise ships have almost doubled the balance sheet commitments of Finnvera, however it is important to point out that the decisions for these exceptionally large transactions have been taken by the Minister on the recommendation of the Ministerial Finance Committee, who in turn rely on recommendations and market analysis from Finnvera's Board and TEM.

The total balance sheet of Finnvera in is some €10.3 billion with outstanding commitments to 27 300 clients, the majority of which are SME's.

The outstanding loan and guarantee commitments to SME's is some €2.5 billion which is split rather evenly between loans, domestic guarantees and export credit guarantees. The support given to SME's by Finnvera over the past decades is one of the most beneficial activities that a Promotional Bank can perform under the government's mandate because of several important factors:

- a) Growth SME's have shown far higher economic growth than larger established companies in recent years.
- b) Only through growth-supporting policies will SME's grow and start to export. As noted above, Finland's SME's still account for relatively low shares of total exports when compared to other countries.
- c) Finnvera needs to diversify its commitments away from the rather heavy concentration of commitments with a few large companies.

There can be no doubt that long-term fixed-rate CIRR loans are important for maintaining the competitive advantage of the export sector. There can be no doubt that relatively easy access to accurately priced long-term CIRR-based funding for foreign buyers of Finnish exports is necessary because all of our major export competitors also have such access in their own markets.

Discussions with Finnvera's clients make it quite clear large long-term loans are needed to support future export contracts and that loan volumes will continue to grow in the following years. This means that the uninterrupted availability of export finance for Finnish exporters and their customers is a necessity. A repeat of the 2008 crisis, when bank lending all but came to a halt, is a risk not worth taking for the Finnish economy.

In addition, Finnvera's competitiveness, compared to SEK in Sweden, is weaker because Finnvera does not pay the 0,25% Agent Bank fee for managing the loans, which SEK provides from its CIRR portfolio. SEK has no commitment fee and KfW has a low commitment fee, etc. The list is long and complaints are often valid while others are just attempting to drive down prices.

Finnvera has only financial limited capacity to adjust CIRR loan pricing to help clients win strategically important export deals. However, it is a fact of life that clients often complain about the cost and the time taken to fix this pricing.

This report concludes that the OECD needs to make firm decisions to stop these practices where "national heroes" are given special benefits that create an unlevel playing field.

This report takes the view that the Swedish solution for the management of CIRR, as described below is somewhat more effective than the present split system in Finland. Thus, it is recommended that the management of CIRR is centralized in Finnvera, while the profit or loss of the CIRR Offering, minus the 25bp management fee, should be paid to or by the State, which does not change the financial accountability of the State compared to the current situation.

To date, no ECA that is managing the CIRR Offering on behalf of their respective government has resulted in significant losses for taxpayers over any extended time period.

Norway's Eksportfinans has been mentioned as loss-making case, however, this bank was closed down in 2011, without losses to taxpayers when the Norwegian banks, that owned 50% of the bank, (the Norwegian government owned the other 50%) refused to put in the extra required capital of this bank. After that date, the government immediately set up its own ECA system called Export Credit Norway and Norwegian Guarantee Institute for Export Credits (GIEK).

The concerns and critical comments regarding the increase in the State's liabilities for Finnvera over the last 5 years from the Ministry of Finance and from the National Audit Office are valid in the sense that experience with Finnvera, as a Promotional Bank, has a short history when compared to Germany and Sweden. During the respective 70 years and 56 years, both Germany and Sweden have seen that their Promotional Banks can help their export markets flourish and grow in importance while operating at a substantial profit, that is then ploughed back into the capital of the companies. Finnvera's life-cycle is still rather short to show such accumulated earnings. It is important to allow Finnvera to develop as Promotional Bank and allow it to grow and strengthen. Critical reports should be tempered to avoid inadvertently weakening its perceived status in the eyes of investors and banks.

Finnvera has a crucial mandate from the Government – Finland is a small country that is highly dependent on exports. Finnvera is still regarded to be a new and not so well-known issuer on the international bond markets. Finnvera lacks the political clout of Germany and automatic access to a huge German domestic bond market that is enjoyed by KfW. It also lacks SEK's stronger legal status and 56 years of uninterrupted activity on the international capital markets.

As stated below in *Part 13 "Finnvera's Funding"*, Finnvera is one of the smallest bond issuers out of the whole global spectrum of the SSA issuers. Claiming a stronger brand and receiving better relative pricing takes time, perseverance, and unwavering support from the all governmental bodies. Improving the foundations for more transparency in all transactions is extremely valuable but this should be done more discretely.

Finnvera cannot be expected to borrow from the markets without a government guarantee, nor can exporters succeed in the global markets without a government backed Export Finance system where CIRR loans are priced in the most efficient manner. The report notes that SEK is able to pay the 0,25% annual Agent Fee to agent banks from its own CIRR portfolio in addition to the annual 0,25% management fee for managing the CIRR-System.

## 9. Main proposals to develop Export Finance & CIRR cost effectiveness

### Amendment of laws relating to Finnvera

The various laws relating to Finnvera should be amended into a single Act of Parliament where its mandate as a Promotional Bank, wholly owned by the Republic of Finland, is stated clearly with a list of the functions to be performed:

1. As an Export Credit Agency (ECA) that strengthens the operating potential and the competitiveness of Finnish companies by offering loans, domestic guarantees, export credit guarantees and other services associated with the financing of exports, including financing shared between Finnvera and other providers of financing.
2. As a financier for the starting, growth and internationalization of companies and guarantees against risks arising from exports, whereby it is stated that Finnvera's operations are steered by the industrial and ownership policy goals laid down by the State. Among these goals are:
  - a. increasing the number of starting companies by enabling financing for changes encountered by SMEs;
  - b. and promotion of company growth, internationalization and exports and as such promotes higher levels of employment
  - c. and, finally that in its operations, Finnvera is expected to adhere to the principle of economic self-sustainability.
3. Parliament is to approve each calendar year a long-term credit line of €6 billion to €8 billion to support Finnvera if needed – see comments below on SEK and EKN.

### The reduction of optionality of CIRR loans

Finnvera together with the government (TEM) is doing excellent work to lobby the OECD to pass regulations that limit optionality of the CIRR Offering. Larger countries can more easily absorb the costs of options because they have bigger budgets to bear the risks and costs of free options that are now being offered in export deals. Such options are costlier for small countries to bear because the absolute costs are naturally more challenging to bear the smaller the countries absolute GDP or government budget and the bigger the export deal. In other words, the prevalence of options means that this is not a level playing field.

### Financial management and resources

1. Treasury needs to take over all the activities currently performed by Valtiokonttori. This requires some modest investments in Treasury staff, IT solutions for risk management and internal audit, as well as for some extra staff for internal audit/internal supervision.
2. Finnvera should consider changing its CIRR funding policies to resemble SEK's solution - *see Appendix 1*. This would entail Finnvera managing the CIRR-system on behalf of the State partially from short-term sources, under the guidance and management of Finnvera's Treasury, with the government receiving any profits, or liable for any losses at year end, less Finnvera's management fee of 0,25%.
3. Consideration should perhaps be given to allowing Finnvera would to pay banks the 0,25% Agency Fee, as does SEK, from the income generated by managing the CIRR-system.

4. Direct lending – this report supports the report from the German consultants<sup>1</sup> to enable a more efficient use of balance sheet and Finnvera's resources.

### Reduction of Credit Risks

1. Finnvera is already using portfolio and individual reinsurance and this work should continue.
2. Finnvera should also look into finding more ways to receive risk cover from foreign ECA's and Promotional Banks when a large Financing commitments are made to foreign-owned Finnish companies whose Finnish production capacity is being used.
3. Finnvera should examine the possibilities off guarantee and loan portfolios using a standardized approach to such transactions would reduce issuing costs and create a brand that would appeal to larger numbers of investors over time.
4. Finnvera needs to consider creating partnerships with specialized investment funds that might be interested in direct investments in the above portfolios.

### Planned investments in IT resources

1. New IT resources have already been prioritized in the far-reaching internal reports and there is a plan to procure and implement important business operation IT-systems upgrades in several critical areas to improve the flow of information to management, client interface, risk management and resource productivity. Finnvera's main financial ALM software system called Quantum, system is adequate for the take-over by Treasury of the interest rate risk management and hedging undertaken by Valtiokonttori.
2. At the highest level, Finnvera's senior management have a strong understanding of the IT needs and priorities of Finnvera and TEM, including CRM data, loans and guarantees commitments and interest rate and currency risk management, reporting and for future more complex regulatory reporting matters.

### The positive impact of appropriate regulatory supervision

The matters relating to appropriate regulatory supervision have been discussed at length with the various stakeholders and is being implemented in an appropriate manner by TEM's Inspection Department. It should be noted that overkill of supervision can have negative consequences for Finnvera's status as a Promotional Bank.

There can be no question that the appropriate application of Supervisory standards, regulations and guidelines need to continue to be implemented by TEM's inspection department based on certain prerequisite conditions as set out below. Such supervision will only strengthen and maintain the creditworthiness and perceived strengths of Finnvera as a Promotional Bank. However, there is a trend in Europe for having the supervision by the normal banking supervisory authorities by applying appropriate supervisory standards, regulations and guidelines. This is discussed later in this report.

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<sup>1</sup> Assessment of the Operation, Impact and Risks of the Officially Supported Export Financing System and State Guarantee Granted for the Fund Acquisition of Export Credits. ATRx. 1.2.2017.

## Developing a clearer governance policy

As a Promotional Bank, there must be a clear mandate from the State anchored in a single and unambiguous law under which, Parliament should authorize each year the granting of a large long-term credit line to be used whenever necessary.

The mandate from the State should override the need to have a Supervisory Board because the status and the necessity of Finnvera's existence as a Promotional Bank can be debated every year by the whole Parliament.

There appears to be very little benefits from having a small selection of MP's meeting a few times each year to consider Finnvera's strategic objectives whole are set in law by these same people. On the other hand, the existence of a Supervisory Board could be an important source of contacts with MP's since those MP's who are elected to the Supervisory Board may be crucial in promoting Finnvera once a year in Parliament, and it is also a sounding board for Finnvera's senior management and Board.

Finnvera's position as a Promotional Bank also has important implications for the construction of its Board. A Promotional Bank is not a commercial operation as such, although it must be sustainable in the long term and be managed in a professional manner.

As a Promotional Bank, the State has a much greater interest in ensuring that the mandate is observed than would be the case of a normal commercial company.

Finally, there can be no doubt that appropriate supervision, internal and external, is crucially important matter for successful governance, but that excessive supervision regarding capital adequacy and liquidity can damage the very existence of Finnvera. Governance should ensure that supervision is adequate but not oppressive.

## SME's – a more intensive and focused approach

There are almost 300 000 SME's in Finland employing 1.4 million people, and of these some 93% employ fewer than 10 employees, with 16 000 (5.5%) small businesses, medium-sized 2 728 (1.0%) and large enterprises 591 (0.2%).

According to Business Finland in Finland, micro companies (<10 employees) account only for 3 % of exports. In Sweden, micro companies' share of exports is 12%, in Estonia 19% and in the UK 14%. Similarly, SMEs' (<50 employees) share of exports in Finland's is around 11%, in comparison to 21% in Sweden, 36% in Estonia and 22% in the UK.

The SME sector as a whole exports some 15% of total exports, which is a low figure when compared to our Nordic neighbors. More intensive and focused marketing and training is required as well as new approaches in working with banking partners.

The proposed amendment to the laws relating to Finnvera should permit Finnvera the right to grant first loss guarantee facilities to local banks in the same manner as the European Investment Fund SME Initiative – *see Appendix 5*.

The redeeming feature about Finnish SME's is that they grow faster than the big companies and this is an important strategic matter for Finland and Finnvera.

By supporting SME's in line with the government's mandate Finnvera can increase their pace of growth as well as bringing them closer to exporting.

## 10. Amendment of laws relating to Finnvera as Promotional Bank

The last financial and economic crisis brought Promotional Banks back into the spotlight. They are seen as part of the economic policy toolkit for over-coming cyclical and structural difficulties in economies, complementing financial systems by improving their functioning and bolstering economic resilience. Interest in them to promote growth and boost investment has increased in Europe of late.

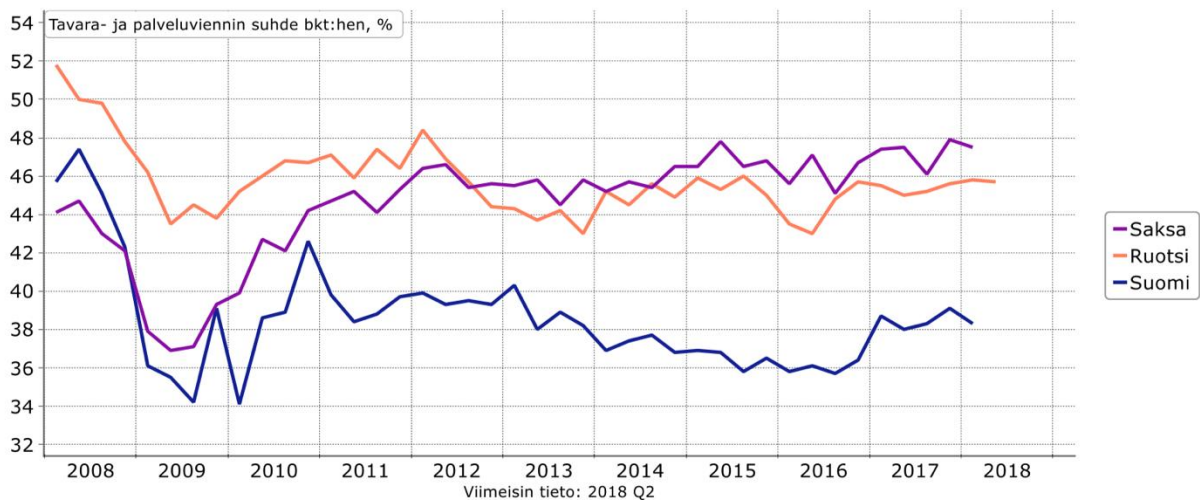
Europe's promotional landscape has developed a heterogeneous set of institutions operating between the State and the private markets. Despite their differences they pursue similar goals.

Given the current economic environment and changes in Europe's banking and financial markets, Promotional Banks will continue to play an important role in the coming years. Rather than crisis relief, their focus is shifting back to supporting structural change in economies. Here, they can play a useful complementary role, focusing on areas of market failure.

Naturally risks lie in overburdening Promotional Banks, but studies of their share of financial activities within most countries indicate that they are far from that risk level. In Finland, Finnvera share of the export market is a mere 3.7% according to official statistics, and the Germany's KfW is just above 5% and Sweden's SEK is below the 5% level.

Germany and Sweden have strong Promotional Banks (KfW and SEK) and Export Finance bodies (Hermes and EKN) both of which are directly and explicitly supported by government and Parliament. Even though the constitution of the various entities is quite different in the end they act in a similar fashion as Promotional Banks and authorities. The fact that they have been operating for many decades KfW was founded in 1948 and SEK in 1962 has clear positive results for the countries respective economies through global thriving export sectors. The shares of exports in relation to German and Swedish GDP is far superior that of Finland. Finnvera's relative weakness in the aftermath of the last financial crisis can be seen to be a major stumbling block for the export sector as evidenced in this graph:

### Tavara- ja palveluviennin osuus bruttokansantuotteesta





Unlike Finland, many European countries have a plethora of public banks and funds that are used for supporting many of the same economic objectives as Finnvera and more. There are many that are financing national infrastructure, regions and specific economic sectors that are seen by their respective governments to be underdeveloped or in need of promotional support.

Finnvera is a Promotional Bank, wholly owned by the Republic of Finland, and already has the functions of performing several promotional tasks in accordance with several Acts of Parliament pursuant to a State mandate in the following areas:

- a) Finnvera is a specialized financing company owned by the Republic of Finland and it is the official Export Credit Agency (ECA) of Finland.
- b) Finnvera strengthens the operating potential and competitiveness of Finnish companies by offering loans, domestic guarantees, export credit guarantees and other services associated with the financing of exports. The risks included in financing are shared between Finnvera and other providers of financing.
- c) Finnvera gives guarantees against political or commercial risks associated with the financing of exports. Political risks are risks that arise from the economic or political situation in a country where a Finnish export company has customers. Commercial risks pertain either to the buyer or to the buyer's bank.
- d) Finnvera provides financing for the start, growth and internationalization of companies and guarantees against risks arising from exports.
- e) Finnvera's operations are steered by the industrial and ownership policy goals laid down by the State. Among these goals are:
  - i. increasing the number of starting companies;
  - ii. enabling financing for changes encountered by SMEs;
  - iii. and promotion of company growth, internationalization and exports;
  - iv. and as such promotes higher levels of employment
- f) In its operations, Finnvera is expected to adhere to the principle of economic self-sustainability.

These laws relating to Finnvera should be amended into a single Act of Parliament where its mandate as a Promotional Bank, wholly owned by the Republic of Finland, is clearly stated including a paragraph authorizing Parliament to approve each calendar year a long-term credit line of €6 billion to €8 billion to support Finnvera's CIRR Offering in a similar manner to the SEK and EKN solution – see comments below on SEK and EKN.

Such a resolution will solve the misconception in Finland about the status and importance of Finnvera, and establish once and for all, that Finnvera will now enjoy an equivalent standing and organization as in Sweden and Germany.

## 11. Management of the CIRR Offering

The Finnish government is financially responsible for the CIRR system and this is directly included in the State budget. At present the initial pricing and hedging of the CIRR rate and the relevant State Margin is indicated in practically all cases by Valtiokonttori. The final pricing of the CIRR-Offering is explained below. Finnvera is responsible for acting as the customer interface, meaning that Finnvera's staff works directly with the banks and clients associated with the CIRR Offering.

Finnvera, as the state-owned Promotional Bank, is liable for those credit risks of the CIRR Offering under the export credit guarantee system for which the Republic of Finland is ultimately responsible. The equity capital, the non-tied capital, the State Guarantee Fund, and credit lines available to Finnvera are the first line of defense.

Under the present system, the exporter makes a CIRR application to Finnvera before signing the commercial contract. As negotiations progress, Finnvera will indicate to the buyer a fixed Interest Rate, which is the CIRR interest rate plus a Margin. The CIRR interest rate is a fixed according to the exporter's application on the date of the supply contract. The Margin is indicative and moves according to how the market rates change. Finnvera receives this Interest Rate from Valtiokonttori, which is based on prevailing market prices. Valtiokonttori calculates the Interest Rate, which is from the State's perspective a Break-Even rate that includes hedging costs. In addition, Finnvera calculates its own funding costs and then communicates an all-in rate to the customer.

Large CIRR-Offerings are prepared by the various parties for TEM that then prepares the matter for the Ministerial Finance Committee with the Minister making the final decision. The State bears the interest rate risk during the offer period.

The process is prolonged because the above Ministerial Committee have varying views on what is acceptable between Break-Even and getting the export deal done, and this uncertainty is further heightened by the different focus of Finnvera and Valtiokonttori. Finally, it is perfectly clear that it is extremely difficult to receive reliable information on the true competitive situation. In this type of situation, the State must rely on those who are close to the transaction who are also motivated to ensure that these risks are minimized as proactively and professionally as possible.

However, there can be little doubt that, as described above in Part 7, that the CIRR-System is more cost-efficient and transparent with only one business unit with a robust organization manned by professionals who are as near to clients as possible. This proposal is not meant to cast any criticism over Valtiokonttori, quite the opposite. They have a fine and professional organization that has other more important priorities. Finnvera, as the Promotional Bank is obliged to minimize all risks for the State and the addition from this proposal should not increase the Government's risks.

The present split system is a legacy of the chequered past history of export financing in Finland and there appears to be no substantive argument to continue to involve Valtiokonttori as the other counterparty because Finnvera has the capacity and skills to manage these transactions in-house. Their present Treasury has all the requisite skills, networks and systems to deal with all of the transactions that Valtiokonttori is currently handling.

As mentioned above, a Proposals 1 and 2 combined proposal relate to the manner in which the funding of Finnvera is handled for the CIRR portfolio. This report recommends that consideration be given to a hybrid version of the SEK Treasury whereby funding for CIRR lending and interest equalization is based on a mandate, whereby part of the CIRR funding is handled from the short end of the market and the rest of the funding is handled from the long-term bond markets. Other

solutions can be examined in cooperation with SEK Treasury, for example, but the outcome of both should lead to increased activity and more competitive pricing of the CIRP Offering, in the same manner that SEK has achieved.

The implementation of these 2 proposals would require several additional specialists to both the Treasury and the risk management control group within Finnvera because of the increase in the amount of work in financial management. A final satisfactory and optimal outcome can only be guaranteed with careful planning and the appropriate selection and training of staff.

### Direct lending to large companies

This report supports the views expressed in the report from the German consultants<sup>2</sup>:

*“For large transactions, decreasing levels of demand in OECD countries reflect the availability of sufficient medium and long-term funding capacity in the commercial bank and debt capital markets. On the other hand, emerging economies such as China and Brazil have substantially increased volumes over the past five years. Export credit financing for cruise ships is expected to remain high, and all interviewees expect no substantial change of market offering. A fully-fledged direct lending program should also be considered for large transactions.”*

Finnvera already has the specialized in-house knowledge to structure transactions with banks and major demanding clients. They are accustomed to working on far more complex deals with far higher drafting and financial risks than the rather standardized long-term credit deals like syndicated loans or private loan transactions.

So long as the focus of the transaction is clearly within the Governments’ mandate to Finnvera as a Promotional Bank, then there should be no substantial objection from the Board to execute such transactions for large exporters and their clients in cooperation with banks, but without disturbing the commercial banking market.

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<sup>2</sup> Assessment of the Operation, Impact and Risks of the Officially Supported Export Financing System and State Guarantee Granted for the Fund Acquisition of Export Credits. ATRx. 1.2.2017.

## 12. IT systems for Asset/Liability Management

The risk management system, Quantum, used by the Treasury has been reviewed with the Treasury management team, and its functionality and its reporting has been examined for this report.

The Treasury staff, middle office and back office are professionals and have a deep specialist understanding of its functionality in relation to the present and the presently planned future needs of their activities. The Quantum system is highly accurate, easily connected electronically to other digital systems and is fed with market prices both manually and automatically. It represents the highest quality of financial risk management systems that can be easily extended as financial risk management complexity and volume grows at Finnvera. The other data systems in the Treasury are all necessary and professionally managed and well-integrated into the daily needs of the group.

However, it must be said that the current needs of the Treasury, even though they are quite complex, are never-the-less rather modest because the number of trades is rather limited in comparison to other similar Treasury departments in companies like Kuntarahoitus and SEK.

The report proposes 2 important possible changes for the Treasury that will have important consequences for financial risk management and funding, for the pricing of CIRR and for the CIRR Offering and probably for the other lending side of Finnvera's operations.

1. The first proposal, as already discussed, is to move all of Valtiokonttori's CIRR and Interest rate hedging to Treasury.
2. The second proposal relates to the funding periods of the funding of the CIRR portfolio.

As mentioned earlier the implementation of these 2 proposals would require several additional specialists to both the Treasury and the risk management control group within Finnvera because of the increase in the amount of work in financial management. A final satisfactory and optimal outcome can only be guaranteed with careful planning and the appropriate selection and training of staff.

### 13. Finnvera's funding

The above comments and 2 recommendations relating to Finnvera's strategy and management of funding and interest rate hedging of risks are of great significance, but there are also a number of other matters that need to be considered when contemplating the future developments of the institutional bond markets and their interest rate structures and how they may impact on Finnvera's ability to raise cost efficient debt.

The international or global bond markets for government bonds, and SSA borrowers and issuers has grown considerably in size as more big agencies from big countries are created or become creditworthy enough to tap these markets. Both the size and total annual volumes of this sector's debt have ballooned because sovereign countries want to move debt "off their balance sheets".

It is interesting that KfW's state guaranteed debt and obligations are not to be found as the liabilities of the Federal Republic of Germany, even though banks and investors are explicitly covered by such a guarantee when they own a KfW bond or enjoy a guarantee from KfW on a loan to foreign importer of German exports.

This report proposes that the government should introduce a similar approach to guaranteeing Finnvera's debt by a similar law to the one used by KfW in Germany, another member state of the EU.

Big issuers like EIB, KfW, World Bank, Asian Development Bank, etc., dominate the markets with big liquid bond issuers and smaller issuers from small countries have to fight for space. The big issuers are brand names accepted by hundreds of institutional investors and can issue almost at any time with almost standard pricing. The big lead managers know that the huge volume and the standard nature of the issuance is simple to handle and suits electronic trading systems well. Profit margins are slim but big in absolute terms. Smaller issuers, even with excellent credit ratings must wait in line! The big lead managers will not easily give them priority and pricing often case-by-case.

Selling a small issuer like Finnvera is both time consuming and not that profitable. Another challenge for smaller issuers is that institutional investors need to be convinced that the bonds will be liquid in case they need to sell the bonds to raise cash. The fear of illiquidity is the curse for small issuers and will lead to a smaller pool of and less attractive pricing for the issuer.

The above means that Finnvera needs to be big enough to be seen as an interesting issuer for lead managers and big enough for institutional investors to recognize its name.

It takes years of working with lead managers and institutional investors to achieve good name recognition in these increasingly global markets.

As noted above, Finnvera does not enjoy the political clout and unambiguous legal status that Germany gives to KfW's for the benefit of their on the domestic and international bond markets. Finnvera also does not have the substantial credit limits enjoyed by SEK/EKN, nor the 56 years of uninterrupted access to the international bond markets.

All efforts to improve Finnvera's funding costs benefit Finland's export performance in the long term.

## 14. Reducing credit risks

Finnvera, like other developed ECA's, had already started to lay off risks using private re-insurance cover from the reinsurance markets. This is an excellent development and is continuing.

Finnvera has also proactively sought out possibilities to cover when planning to execute new transactions where risks have been shared systematically with other exporting countries in telecoms, shipping, power and pulp & paper deals.

There is some significant value in selling credit risk cover after the projects have started and are operating smoothly as a profitable business. At this point in time the credit risks normally decline significantly, and this creates investment interest from specialized funds, insurance companies and private equity investment firms who are able to accept such lower risk assets into their portfolios.

This report proposes that Finnvera seeks out partners who might be interested in taking on such risks that have clearly moved from Greenfield to Brownfield risk categories.

Finnvera and the Finnish government should pursue such agreements that can be negotiated between individual governments or through the OECD.

Finnvera also should examine the possibility of selling off loan and guarantee portfolios to banks or creating collateralized bond markets to sell to institutional clients. A standardized approach to such transactions would reduce issuing costs and create a brand that would appeal to larger numbers of investors over time.

## 15. Regulatory Supervision of Finnvera

### Appropriate regulatory supervision is beneficial

Finnvera is a Promotional Bank, wholly owned by the Republic of Finland, and as such it has the functions of performing promotional tasks pursuant to a State mandate as described above.

In accordance with the law on government-owned financial institutions, 443/1998 6 §, the supervision of Finnvera's organization and its operations shall comply in an appropriate manner with the principles that the Financial Supervision Authority applies to financial institutions under its supervision.

The supervision of Finnvera is under the independent responsibility of TEM's Inspection Unit, while the Innovation and Finance Department is responsible for matters relating to the State's ownership of Finnvera.

During the past few years, consultations have taken place between the relevant parties and stakeholders to agree on what standards, regulations and guidelines should be applied to TEM's supervision of Finnvera in an appropriate manner taking into consideration its special position as a Promotional Bank that acts under the State's mandate.

As a result of these consultations, TEM has decided on 5.3.2018 to apply a shorter, but comprehensive set of standards, regulations and guidelines that Finland's Financial Supervision Authority is applying to financial institutions under its supervision.

This set of standards, regulations and guidelines has been studied carefully for this report and discussed with those responsible for its application at TEM's Inspection Unit, and with Finnvera's relevant senior management. Finnvera's Chairman of the Board and Finnvera's senior management have expressed support that supervision is important for maintaining transparency in risk management and in setting high operational standards.

The conclusion of this report is that the chosen set of standards, regulations and guidelines is appropriate and that Supervision by TEM's Inspection Department is also an acceptable solution assuming the following conditions are met:

1. There must be clear obligation on Fiva to update and inform TEM's Inspection Department in a timely manner about all amendments and additions to the set of standards, regulations and guidelines used by TEM to supervise Finnvera.
2. TEM's Inspection Department must have sufficient resources to deal with its supervisory tasks.
3. TEM's Inspection Department must observe that its supervisory role is in line with the government's mandate to Finnvera as a Promotional Bank.

Another important element that needs to be addressed by the government, specifically TEM and the Ministry of Finance, touches upon the appropriate regulation of Finnvera regarding ICAAP and ILAAP.

The Basel Committee requires commercial banks to assess themselves the capital cushion and liquidity buffers they need to support current and future risks. The results of the Internal Capital

Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP) as developed by the banks are reviewed by supervisors annually.

The ECB has developed a comprehensive guidance for Significant Institutions, with the aims of improving convergence between ICAAP and ILAAP and enhancing harmonization of banking supervision in Europe.

As mentioned above, the matter of the appropriate application of ICAAP and ILAAP have been discussed between the various stakeholders and a decision by TEM needs to be decided upon in good time.

The fact that Finnvera is a Promotional Bank, fully owned by the State, and operating under a State mandate means that the appropriate application of the ICAAP and ILAAP is both important and relevant for Finnvera to ensure high standards and transparency, without limiting the State's mandate.

Finnvera, as a Promotional Bank, operates under the mandate of the State for Export Financing and CIRR Offering. The costs in terms of risk management resources, IT investments and capital could be excessive if there would be an extensive or full application of ICAAP and ILAAP on Finnvera. It is also important to recall, that according to Finnvera's senior management, there are no cases of any State-owned ECA's being subjected to ICAAP regulations.

In practical terms this would mean one of two things - Finnvera would have to receive a large capital injection from the State, or Finnvera would be unable to function as a Promotional Bank because of a lack of capital.

These two important regulations were primarily created to reduce the risk of taxpayers having to bail out banks. Bank failures have occurred mainly because they speculated on poorly, negligently, or criminally constructed housing loans, excessive derivative positions, they funded long term loans with short-term funding, or they simply paid too much for badly managed banks or had excessive exposure to badly managed banks or other financial institutions.

Promotional Banks have never stepped into these areas that caused banking failures, and no Promotional Bank has incurred large losses or been anywhere in need of emergency treatment.

Information derived from using the ICAAP and ILAAP could be useful in reviewing risks against the benefits of transactions for the Board and the government but that should be the maximum extent of the application.

Naturally, regulatory supervisors are always free to assess and criticize the Government's and Parliament's decisions but that right to speak up should not be used too frequently because it undermines public confidence in the government.



## Who should supervise Finnvera?

This report has also considered the matter of where supervision should be exercised. Would supervision be more effective and streamlined if Finnvera was supervised directly Fiva, rather than the present arrangement that is planned – TEM’s Inspection Department?

This question was specifically raised as a topic for discussion with the Financial Supervision Authority (Fiva), TEM’s Inspection Department, TEM’s Innovation and Finance Department and with the senior management of Finnvera. These discussions revealed that under the present arrangements there appears to be no possibility for Fiva to act as the supervisor of Finnvera without changes in the law, a topic already presented with concrete proposals in this report.

Fiva noted that the relationship between TEM’s Inspection Department and the Fiva is weak and not established in law. Although information can be passed along from Fiva to the TEM’s Inspection Department, Fiva stated that TEM Inspection Department cannot have the full understanding of the regulations and supervisory skills that Fiva has developed and maintained.

In support of the present arrangements of TEM’s supervision are the following arguments:

1. Finnvera, as the State’s Promotional Bank is mandated to perform promotional tasks by the government that differentiates Finnvera from the activities of normal commercial banks.
2. Finnvera’s mandate is subject to and limited to such State mandates that do not radically change from year to year.
3. The standards, regulations and guidelines that the Fiva applies to financial institutions under its supervision are amended and implemented over periods of years allowing ample time for TEM’s Inspection Department to amend and implement any necessary changes to their supervision of Finnvera.
4. The presently proposed arrangements for TEM’s supervision of Finnvera would support the ratings and perceived credit-worthiness of Finnvera because these arrangements are similar in nature to KfW’s supervisory arrangements. These standards, regulations or guidelines are important measures that provide clear assurances that Finnvera will continue to adhere to internationally accepted principles of good governance with regard to risk management.
5. To date, no ECA in Europe has the CIR system is completely under the direct regulatory supervision of its national Supervisory Authority. Partial cases exist but they are exceptional.

However, one can also present arguments in favor of changing these current supervisory arrangements from TEM’s Inspection Department to Fiva given that they have the staff and resources to monitor risks and exposure. Fiva mentioned that their current resources are insufficient for supervising Finnvera, but, as mentioned above, TEM’s Inspection Department also currently lacks sufficient resources and is not well connected to Fiva.

Supporting this is the fact that there appears to be a trend, if somewhat partial, in standardizing supervision of Promotional Banks through Regulatory Supervisors at the national or European level.

The history of Promotional Banks in Europe is long and very varied according to different needs. KfW was created in 1948 after the Second World War in connection with the Marshall Plan of 1947. CDC in France was created by Napoleon I in 1806 to pay the monarchies debts to Italian bankers, and it is still used as a public body by the State as a policy instrument. Cassa de Depositi e Prestiti was created by Napoleon III when the Spanish and Italian forces joined together against the Habsburg Empire to rebuild Italian infrastructure and later to handle ordinary post office deposits. It

is still an instrument of Italian Republic. The EIB was also founded many years ago in 1958 as the EU's Promotional Bank.

KfW has a hybrid supervision in Germany as described in this report. Furthermore, publications from the European Central Bank's Supervisory Authority and from recent other reports and media stories indicate that there are a few European governments considering extending appropriate regulatory supervision to their Promotional Banks. The rationale appears to be based on the need to have more transparency on the activities of Promotional Banks based on a standardized approach that is being set by EU's supervisory authorities.

This does not mean necessarily that Promotional Banks are being required to take on new capital but more that their activities and their commitments need to be seen and recognized transparently. This is perfectly acceptable so long as it does not lead to creeping regulatory straight-jackets.

For example, in a response to improved governance demands from Holland, Denmark and Sweden, the EIB has agreed to a series of governance changes, the biggest of which will include steps to introduce independent supervision of its lending operations by the ECB Supervisory Authority. The German Finance Minister, Olaf Scholz, said in a letter to the EIB that he "strongly welcomed the improvement to the Bank's governance and supervisory framework" agreed at an EIB board meeting on July 17, and he "would encourage (the EIB) to use the intensified contacts with the relevant bodies of the ECB and the SSM with a view to working out an appropriate supervisory framework for the future."

As a final note it is important to state that Regulatory Supervision by TEM or by Fiva does not actually reduce the risks of credit default or any other major event risk.

Such supervision is merely the application of tested mathematical ratios and of a carefully crafted inspection that the institution has followed all the correct procedures in its various activities. The Supervisors can see what has happened but they cannot see in to the future or can they make any better decisions regarding the quality of the institutions business activities. That last activity is solely the responsibility of the institution senior professional staff and its owners, in this case the government who has delivered the mandate.

Supervision is useful in normal markets but often fails to work effectively when financial crises occur. Although they are important for measuring risks, and that is important for transparency, they can lead to a false sense security. The events of past financial crisis that have occurred at the tails of the Bell Curves show how easily large market disruptions can lead to huge losses for financial institutions that were thought to be rock solid. To date no Promotional Bank has suffered significant losses. Their operations are focused without the normal incentives that banks have to cut corners in search of profits.

The conclusion of this report is that there is a case to consider Fiva's supervision of Finnvera by the application of applicable standards, regulations and guidelines that fully recognizes Finnvera's special position as a Promotional Bank working under a clearly defined government mandate.

## 16. Appendix 1 - Comparison with other foreign CIRR suppliers

Diagram of Finnvera's typical completed CIRR Offering  
 (Note that the diagram assumes a 25bp fee from the State to cover Finnvera's funding costs)

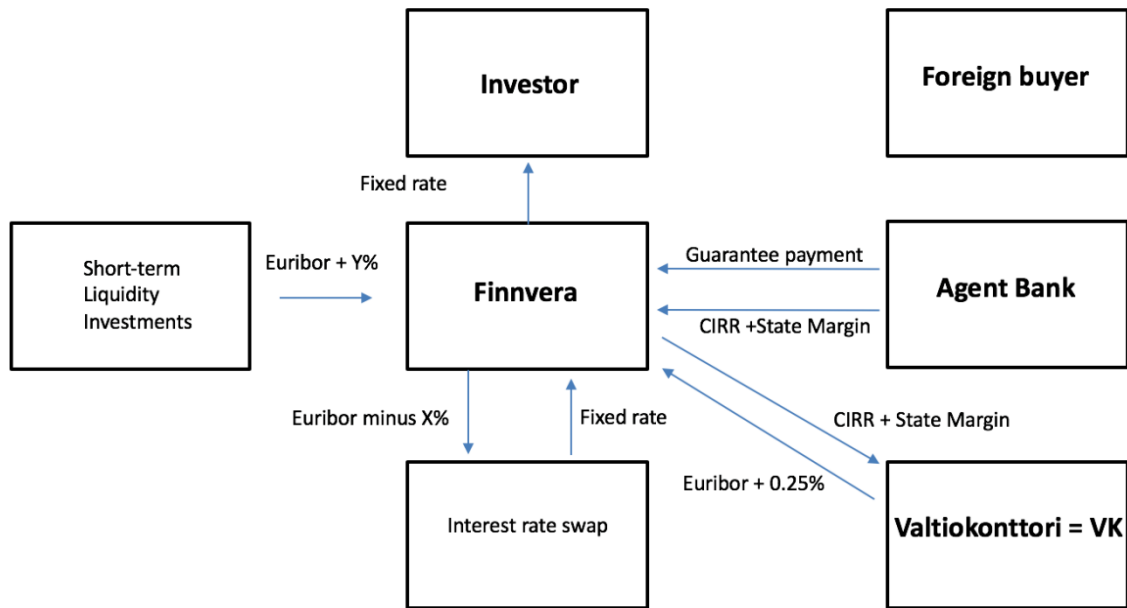
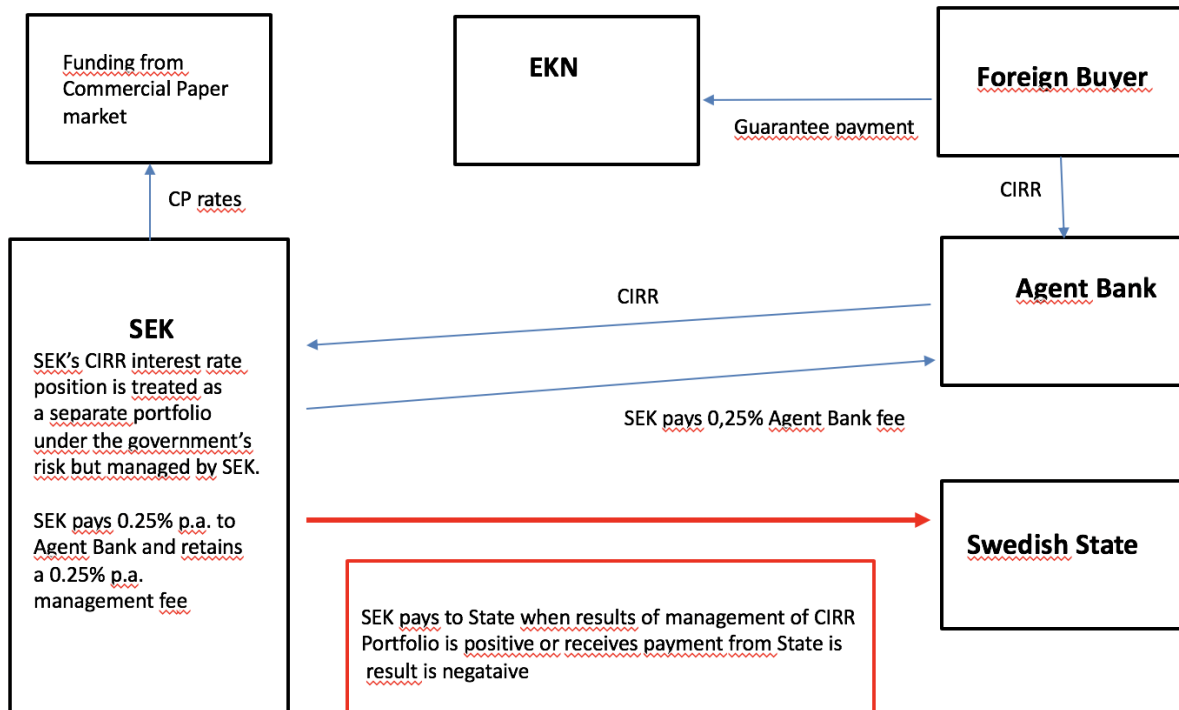


Diagram of typical completed CIRR Offering from SEK



## SEK – Swedish Export Credit Corporation

SEK's has the mandate from the Swedish government to support the country's export sector, which contributes some 45% to Sweden's GDP. SEK is wholly-owned by the Swedish government with the mission to support the Swedish export industry by providing both Swedish exporters and their foreign customers with corporate and export lending, structured financing, project financing, trade financing, and leasing solutions. SEK has recently stated that it intends to increase its participation in syndicated loans, which will lead to more direct corporate credit risk. These transactions could be end-client financing for large international clients of Swedish exporters or lending directly to Swedish counterparties.

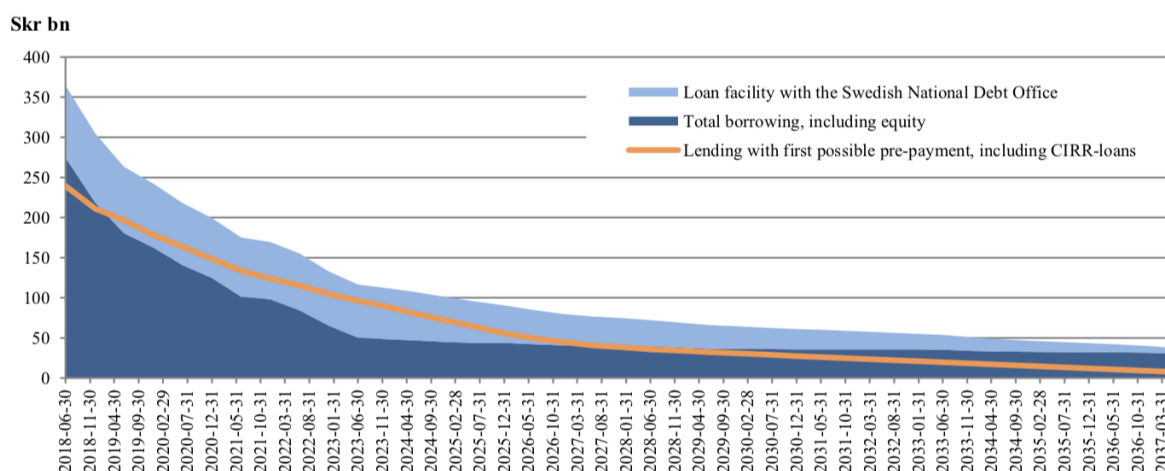
The total balance sheet of SEK at the end of 2017 was some €30 billion, of which some €5 billion are CIRR disbursed loans with another €7 billion committed undisbursed loans.

SEK manages the CIRR export credit system on behalf of the government as the government's agent and collaborates extensively with EKN that guarantees some 40% of SEK's current lending.

SEK is responsible for funding and managing the interest rate risks (and some smaller currency risks) of the CIRR loan portfolio. SEK funds most of the CIRR loan portfolio with short-term 3-month commercial paper and other advantageous short-term debt instruments from institutional investors, which creates an open interest rate position in relation to the portfolio of fixed rate CIRR loans. As of December 2017, the CIRR loan portfolio that has an average duration of seven years.

According to instructions to SEK from the State, SEK must manage this interest rate position “*as profitably as possible, with the minimum risk*”. In practice SEK's Treasury is responsible for hedging strategy, and they make decisions to hedge or not to hedge with interest rate derivatives and options for all or part of their CIRR loan portfolio at any point in time.

Chart 1: Development over time of SEK's available funds as of June 30, 2018



SEK reports that this portfolio hedging has resulted in the following positive results between the following years:

1990 - 2017 Skr 3.3 billion on average loan portfolio of Skr 17 billion  
2012 - 2017 Skr 0.9 billion on average loan portfolio of Skr 46 billion

According to the agency agreement with the State, SEK pays annually income received from managing the interest rate position from the CIRR loan portfolio to the State. If losses are incurred in any year from this activity the State will reimburse SEK. SEK pays a 0,25% p.a. Agent Fee to the Arranger Bank from the income from the CIRR portfolio together with the 0,25% CIRR management fee agreed with the State. This means that in order to go breakeven, SEK must fund the CIRR-system at CIRR flat minus 0,5% (0,25% for SEK and 0,25% to the Arranger Bank).

SEK provides detailed quarterly reports on all CIRR activities to the Foreign Ministry and the Ministry of Finance. The ministries also meet with SEK management on a regular basis to discuss CIRR and other related matters, but SEK ultimately remains responsible for all decisions.

It is important to note that SEK have most of their CIRR loans in two currencies - USD and Skr. Although the USD portfolio is very liquid and simple to hedge, the Skr is less liquid and challenging to hedge. It is worth noting that SEK has refused to finance a CIRR twice last year when the deal was seriously out of the money and they have granted CIRR loans with a margin. More detailed information was not available from the interviews.

**SEK also benefits from a Skr125 billion borrowing facility (10% of Swedish government debt) with the Swedish National Debt Office, approved annually by Parliament, to be used to finance CIRR if necessary. This facility has never been used but it guarantees that SEK has the capacity to finance exports at all times.**

This facility is treated as contingent financing and has never been used, but it reduces the need to pre-finance SEK56 billion (June 2017) in commitments for the CIRR program, a figure that increased materially in 2015 following the long-term defense lending agreement between Brazil and Sweden. The credit facility was increased by SEK45 billion from 2016 to reduce the pre-financing burden of the Brazilian deal on SEK, which otherwise pre-finances all commitments outside the CIRR program.

SEK uses credit default swaps (CDS) to mitigate credit risks. This effectively transfers the credit risks of those borrowers whose creditworthiness potentially could deteriorate to CDS counterparties. In order to minimize this credit counterparty risk, SEK has signed ISDA agreements and credit support annexes with all counterparties with whom it enters into derivatives contracts. In addition, SEK has recently started to work with private insurance companies in order to militate against credit risks.

Finansinspektion (FI) regulates SEK like any other bank. The demands placed upon SEK by FI have been rather severe, according to SEK, such that SEK has had to procure added risk management software system modules from Murex to ensure VAR calculations for the total balance sheet effectively in real time. This has been described as a massive and work intensive task that has taken several years to complete. However, the effects coming from the portfolio such as interest rate risk is considered to be hedged by the government which effectively means that it is not supervised by the FI.

## EKN - Swedish Export Credit Agency

EKN, The Swedish Export Credit Agency, is an authority with the task of promoting Swedish exports. This is done by insuring the risk of not being paid in export transactions. They also insure banks' lending to both exporting companies and their buyers. EKN's guarantees make difficult markets available and enable more secure export transactions. They work with the big global companies as well as SME's and guarantee export business to over 130 countries. EKN was established in 1933 and complements the private export credit insurance market. EKN's commitment is on behalf of the Swedish state. EKN is funded with the guarantee holders' premiums that reflect the risk in the transaction. The activities shall be financially self-sustaining over time.

The government appoints EKN's Board and Director General. The Minister of Trade is responsible for EKN in the government. EKN's mandate and mission are governed by regulations. **The activities must follow instructions from the government, as stated in the annual letter appropriation, which states that EKN has an unlimited credit facility at the Swedish Debt Office that is decided annually by Parliament.**

## EKN'S EXPORT CREDIT GUARANTEE ORDINANCE:

### Conditions for approval of export credit guarantee

**1 §** For the purpose of promoting Swedish exports of products and services, internationalization of the Swedish trade and industry and its competitiveness, the Swedish Export Credits Guarantee Board may issue government guarantees (export credit guarantees) to cover losses in conjunction with export transactions if there is a significant Swedish interest. A Swedish interest exists if the operation that is to be guaranteed is of Swedish public interest, or otherwise beneficial for the financial development in Sweden.

**2 §** Export credit guarantees may be granted to cover loss in operations concerning exports, or which indirectly relate to exports, carried out by a Swedish company, by a company with its registered office abroad in which there is a significant Swedish interest, or by a company that purchases products and services from Sweden.

**3 §** Export credit guarantees shall be granted in conformity with Sweden's international undertakings concerning officially supported export financing.

**4 §** Export credit guarantees may be granted as a supplement to the supply of guarantees available on the private market, and normally may not include such loss for which insurance cover can be obtained through customary transport, fire or theft insurance, or in any other similar manner.

**5 §** Export credit guarantees may only be granted for transactions which do not contravene with Acts or other statutes.

**6 §** Repealed by ordinance (2011:302).

**7 §** Export credit guarantees may only relate to such loss as is a result of: the failure of buyer, borrower or other debtor to fulfil its obligations towards the guarantee holder; a public authority in a foreign country having introduced a moratorium, or unexpectedly prevented or delayed exports, imports or transfer of payments, or having taken other similar measures; a public authority in a foreign country to impose confiscation or other similar measures; war, civil unrest, natural disasters, or other extraordinary events abroad; other events considered to be material within the framework of reinsurance agreements; or other comparable events.

**8 §** Export credit guarantees may not relate to such loss under 7 § which the guarantee holder has caused or contributed to.

Where the right to compensation on account of a granted export credit guarantee is assigned to another party as security for the financing of the export covered by the export credit guarantee, the export credit guarantee may relate to each and every default of payment by the buyer.

**Premiums etc.**

**9 §** Repealed by ordinance (2011:302).

**The Swedish Export Credits Guarantee Board**

**10 §** Matters in accordance with this Ordinance are to be considered by the Swedish Export Credits Guarantee Board. Where a matter is of major importance, the Board may refer the matter, including the Board's opinion, to the Government for consideration.

**11 §** The Export Credits Guarantee Board decides in which currency the export credit guarantee is to be issued.

**12 §** Decisions by the Export Credits Guarantee Board in accordance with this ordinance may not be appealed.



Ministry for Foreign Affairs  
Department for Trade Promotion, Nation Branding  
and CSR

### Certificate

This is to certify that the Swedish Export Credits Guarantee Board (EKN) is a central government authority under the authority of the Government of the Kingdom of Sweden. EKN operates in accordance with the Government's Ordinance (2007:1217) with instructions for the Swedish Export Credits Guarantee Board. EKN's Board of Directors and its Director-General are appointed by the Government. Business decisions made by EKN may not be appealed.

The Government has employed Mrs. Anna-Karin Jatko as Director-General and Head of EKN as from 1 April 2016 to 31 March 2022. Mrs. Anna-Karin Jatko has, during this period, the power to act on EKN's behalf in any current matter, e.g. to sign for EKN, to appoint attorneys and to file lawsuits.

EKN has an unlimited credit facility with the Swedish National Debt Office (Riksgälden), by decisions of the Swedish Parliament and the Government. The Kingdom of Sweden is ultimately and to an unlimited amount responsible for EKN's commitments.

EKN was established in 1933 with the task of promoting Swedish exports by issuing guarantees. EKN may issue guarantees to Swedish and foreign exporting companies, investors, banks, leasing companies and financial institutions in conjunction with export transactions, if there is a significant Swedish interest involved. EKN offers guarantees for various types of risks, such as pre-shipment risks, loss on claim, project financing risks and investments.

For further information and annual reports, we refer to [www.ekn.se](http://www.ekn.se).

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## KfW - Kreditanstalt für Wiederaufbau

KfW was established in 1948 and is owned 80% by the Federal Republic of Germany, and 20% by the German states.

KfW is Germany's main Promotional Bank at the national level. It supports financing of infrastructure, SMEs, housing and environmental projects mainly in Germany. KfW is also active in export and project financing as part of its international business and development cooperation. It also takes on special tasks like for example privatization.

Its main business areas are:

- i) Mittelstandsbank (small business banking)
- ii) Kommunal- und Privatkundenbank (municipal and retail clients/credit institutions)
- iii) Export and project finance

KfW holds several participations, incl. wholly owned subsidiaries (KfW IPEX and DEG) as well as some German companies, e.g. infrastructure providers.

KfW has played an important role in financing reconstruction of the German economy following WWII. It has traditionally operated with quite a wide mandate and continues to support German economic policy via promotional activities. Funds are mostly channeled through commercial banks.

KfW was also active in implementing Germany's fiscal stimulus package 2009/10 and assumed EUR 15.2 billion of Germany's contribution to the loan package from euro-area member states to Greece (government-guaranteed).

**Total assets:** €472 billion (2017) **Consolidated profits:** €1.4 billion (2017)

**Legal form:** Anstalt des öffentlichen Rechts (public law institution). KfW Ipex operates as an independent subsidiary conducting commercial activities

**Refinancing:** Mainly wholesale on international and domestic markets

**Public support: Statutory guarantee covering all liabilities and maintenance obligation as guarantee for KfW as an economic entity (Anstaltslast & Gewährträgerhaftung).**

**Supervision:** As a public law institution, KfW is subject to its own governing laws and statutes. It does not have a banking license. An amendment to KfW law permits the Federal Ministry of Finance (together with the Federal Ministry for Economic Affairs and Energy) to declare provisions of European and German banking regulation applicable to KfW. The Federal Financial Supervisory Authority (BaFin) has taken on supervision of such provision but KfW's legal supervision is with the Ministries of Finance and Economics.

**Governance: The Ministers of Finance and Economics preside over the Supervisory Board (Verwaltungsrat), alternating each year.** Supervisory board with 37 members includes several ministers, members of parliament as well as private sector and trade union representatives. The Mittelstandsrat – chaired by the Minister of Economics – specifies the mandated tasks of Mittelstandsbank, consults and decides on support.

## 17. Appendix 2 - Banks less active in financing exports & no change expected

### The present situation in the financial markets

As mentioned above a gap has been created when banks (both Finnish and foreign) have decided to refrain from financing large long-term export projects. The main reasons for their withdrawal appear to be related to the ones set out here below rather than the existence of regulations relating directly to the OECD CIRR agreement. Banks were happy to lend money previously to these projects under the CIRR-terms but new regulatory environment has made such lending less attractive for the banks. This appears to be an unintentional result of the new regulations. Perhaps this is a safer path to follow since the banking community needs to be more highly regulated because of moral hazard, and economic risks of moral hazard have increased as banks have grown in size through consolidation.

Finnvera, like SEK, KfW, and many other ECA's, exists to fill in the market gap left when the banks decided to reduce their lending to non-domestic clients of Finnish exporters for the following main reasons:

1. "Know Your Client" is an important regulatory demand and entails having a local presence in the buyers' countries or having your own banking officers travelling regularly to visit each client, both of which demand expensive resources at home and abroad. Banks in Finland have clearly made the decision to stay close to their home markets where they have a competitive advantage. The two largest banks in Finland enjoy a huge market share of over 60% and this gives them oligopolistic pricing power.
2. Capital adequacy requirements also imposed by national and international regulators also dampens banks' interest to grant large long-term finely-priced loans to companies at home and abroad because they consume so much regulatory capital. Banks would rather use capital for lending and other activities that use up less capital and generates more income in the short-term. Hence banks prefer less risky housing loans, short-term working capital loans and loans to highly-rated domestic companies.
3. Large, long-term loans for export credits require many demanding skills from many business sectors - financial, trade finance, guarantee insurance, legal, client credit risk knowledge at home and abroad. This broadly-based organization is clearly not easily created because it involves a considerable investment in resources and time. Banks prefer lean departments and lean solutions especially when the products are enjoying tight pricing. If the level of profitability is low and the costs of the business are relatively high, then that business will only be established by large banks in big countries with large numbers of big exporters. Finland and Finnish banks are not in that category.

These are substantial reasons not to expect any major changes in business strategy over the next ten years because regulations on banks have only recently been tightened. Banks have adapted their business models and their resources accordingly. Even if the regulations are changed it will take years before banks return to provide significant amounts of long-term funding for exports because they lack staff and networks. Large pools of experienced professionals are few in number, and normally find work relatively outside the financial sector.

Large foreign banks with widely spread international networks act as partners to Finnvera. These are the banks that act as Agent Banks in large export credit transactions where the buyer is a

customer of a Finnish exporter or the project is a factory or plant installation that uses Finnish suppliers or benefits significantly Finnish exporters. As Agent Banks they handle the documentation and payment transactions between the final buyer and Finnvera. Finnvera actively examines and comments on the documentation as well as implementing a formal “Know Your Client” process for the counterparties to the transaction.

However, these regulatory constraints above are equally applicable to foreign banks. Having a sufficient number of interested foreign banks is essential and, so far, there appears to be an adequate supply, but their number has shrunk dramatically over the last two decades and there are no signs that consolidation will cease. There are currently less than ten banks that are regular partners for Finnvera, and there are already clear signs that this number could fall by at least two in the coming year.

### What banks are now active with Finnvera, and Finnish exporters

The following pages set out the rather challenging environment in the banking and financial markets that Finnvera is currently facing in its operations to finance large long-term export projects.

Even though short-term export and smaller amounts are available when the buyer is highly rated, long-term financing for small exports for small amounts are almost often rejected by the markets.

This part of this report focuses on the financing of large long-term export financing and guarantee projects because of its significant size and importance for Finnvera, and directly the Finnish economy.

The regular cycle of global banking crisis, the consolidation within the financial sector, the challenges faced by bank regulators, and the present uncertainties brought about by increased levels of protectionism and populist political movements have created uncertainties in global trade and in access to finance during unsettled periods.

Finland is enjoying a rather comfortable economic revival following several years of poor economic performance after the last financial crisis starting in 2008. Our domestic banks and our active international banking partners are enjoying high levels of liquidity, a strategy that has been supported by Quantitative Easing and a relaxed monetary policy by the European Central Bank with the objective of stimulating investment and other economic activity.

In such an environment one would assume that there is plentiful availability of competitively priced long-term funding for large export orders from the bigger national banks. However, as has been noted above, this is not the case, in fact, quite the opposite.

Over the last decade our traditional domestic lenders have all but pulled out of this market to focus on domestic lending for housing, real estate finance, investments made by the larger companies at home and abroad, short term trade finance and for working capital loans to SME's and larger companies.

Large investments by companies and the public sector with lower credit risks are generally financed up to seven to ten years. Lending to foreign buyers and with terms longer than ten years have almost come to a complete halt not only because of the reasons given above, but also because bank shareholders and management seek faster profits and higher returns from more local business activities.

The two largest banks, Nordea Bank and OP Group no longer have departments manned for large export projects and they control a very large share the corporate. The banks have relatively small networks outside the Nordic countries and these offices are merely an extension of their current domestic, inward-looking activities. The offices are not designed to service large local clients of Finnish exporters. Naturally, all of the local Nordic banks are natural partners for Finnvera for interest rate and currency products, swaps, options as well as the whole range of capital market products.

Similarly, our large international partner banks have also been subject to the same forces of regulation and short-term profit seeking. Consolidation of big banks has decimated the number of banks with international or global networks. They probably are fewer than 20 such banks, and of that number less than ten are willing and able to finance large export orders for exporters or their customers:

US: Citibank

UK: HSBC, Standard & Chartered

France: BNP Paribas, Société Générale, Calyon

German: Deutsche Bank, Commerzbank

It is reasonable to expect that these banks will continue to consolidate, not only because of regulation, pressure on profits but also because of digitalization. It is quite reasonable to assume that this current handful of banks will probably fall over the coming five years to an even smaller number.

Other financial partners exist with Finnvera but they are not providing any new sources of finance, rather they are publicly-owned entities that have specifically defined functions like the Nordic Investment Bank, and European Investment Bank. Their impact on Finnvera are limited and not significant for the purposes of this report.

The above scenario is current and, as indicated, it is reasonable to assume that all ECA's will face the same fate as Finnvera – one of increased isolation but with a heavy responsibility to fund and guarantee Finland's exports on behalf of the government, for the benefit of the country as a whole.

This last statement has profound implications for Finnvera and the government because to remain competitive in the global market Finland needs to have a strong and robust ECA with sufficient professional resources to manage on an equal footing ECA's related activities with Germany and Sweden. The other big countries like the Italy, France, USA, Canada, and China are in another league all for different reasons, which are outside the remit of this report. Competing with them is not possible or feasible because of size and political and commercial power.

## 18. Appendix 3 - Economic Impact of large Export Projects on Economy

The traditional approach to analyzing the total economic influence of exports is based on a study their direct, indirect, catalytic, and induced economic impacts.

There are many relevant recent studies from Europe that shed detailed and adequate light on the methodology of this analysis and provide clear guidelines on how concrete results can be estimated.

However, it must be said clearly that the conclusions from this type of analysis are, at best, rough estimates. It is impossible to provide anything more than rough estimates about the future when there are so many undefined and unknown developments that may occur in future years. Even though most of recent studies are for developed economies, the Consultant sees no difficulties in extracting reasonably positive developments based on the main indicators for export finance projects.

Large export projects, like ship-building, heavy automated processing equipment for the paper/pulp industry and, mobile network equipment are job-intensive projects directly employing many people with advanced skills during their production, and with many others in the supply-chain who are indirectly employed. These workers are spending their wages on goods and services, to support more jobs - the induced impact.

These same projects are centers of innovation in both large companies and within SME's and this gives a further boost to the economic value of such projects.

In this inter-connected world and in keeping with lean processes, the buyers and operators of these products normally enter into long-term maintenance and performance contracts with the original suppliers to maintain the machinery and equipment in optimal performance over their expected lifetime, another significant direct benefit that can last for decades and bring new export opportunities down the road.

### Conservative and simplified calculation of the economic benefits of a cruise ship project:

A typical cruise ship costing €1.5 billion generally requires some 10 000 man-years for its construction. If the average annual wage of one-man year is €50 000, then the total earnings amount to €500 000 000, which are taxed at 40% giving revenue to the public sector of €200 000 000 in direct benefits.

Long-term maintenance contracts can extend the positive direct economic benefits for such projects by a roughly calculated present value of between €5 million and €7.5 million assuming 100 to 150 man-years at €50 000 annual wages.

Other direct benefits can also be some tax income from the supplying company but this, although it may be significant, it will be a highly volatile element and thus can be included as a part of the indirect and induced benefits.

For the purposes of brevity, it is useful to assume that the indirect and induced benefits are between 15% and 30%. Then taking the average of these two percentages will result in indirect and induced benefits of 22.5% or €45 000 000.

Thus, a conservatively calculated base-case can be made for economic benefits amounting to some €250 000 000 from one such project if completed successfully.

ETLA has recently produced an excellent detailed report<sup>3</sup> on the Economic Impact of the exports from the shipbuilding and telecom network sectors. The results given for these two sectors show the economic benefits for Finland, as a whole, are impressive. They differ from the above shipbuilding example which only deals with the expected income the government would receive mainly through tax receipts as the guarantor for each project.

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<sup>3</sup> Suurten vienninrahoitushankkeiden arvonlisä- ja työllisyysvaikutukset. Jyrki Ali-Yrkkö & Tero Kuusi. Valtioneuvoston selvitys – ja tutkimustoiminta. Julkaisusarja 53/2018.

## 19. Appendix 4. SME's too small, and share of exports too low

Finnvera's financing and decreased exposure to SME's has led to a discussion with a number of senior civil servants who suggested that the fall in Finnvera's SME commitments indicated a failure in Finnvera's operations. The comments were based on this 10-year graph of total commitments to SME's:

### Finnvera Oyj

#### Pk- ja midcap-yritykset yhteensä

Rahoitus 1.1.-31.12. (milj. €)	2009	2010	2011	2012	2013	2014	2015	2016	2017	1-5/2018
Lainat	593,0	396,6	369,3	341,8	284,5	287,2	384,7	274,7	241,4	103,4
Takaukset	474,4	446,6	496,8	408,0	379,4	476,0	521,6	569,9	539,9	250,3
Vientitakaukset	127,4	70,5	111,0	103,6	92,5	150,6	118,1	118,7	115,2	59,3
Vientitakuut	104,9	115,6	73,9	79,8	70,1	89,3	91,4	77,1	66,0	33,9
<b>Rahoitus yhteensä</b>	<b>1 299,6</b>	<b>1 029,3</b>	<b>1 050,9</b>	<b>933,2</b>	<b>826,5</b>	<b>1 003,1</b>	<b>1 115,9</b>	<b>1 040,4</b>	<b>962,4</b>	<b>446,8</b>

Vastuukanta 31.12. (milj.€)	2009	2010	2011	2012	2013	2014	2015	2016	2017	31.5.2018
Lainat	1 736,2	1 806,5	1 729,6	1 648,4	1 511,0	1 351,1	1 242,3	1 170,4	1 030,7	967,9
Takaukset	1 007,0	1 065,3	1 092,8	1 068,1	1 046,9	987,6	1 003,4	1 061,0	1 097,8	1 114,0
Vientitakaukset	110,4	91,9	105,1	98,6	114,5	136,4	141,2	125,9	128,7	135,4
Vientitakuut	206,0	245,8	263,1	215,9	238,4	249,0	239,0	191,5	182,7	186,5
Takaus- ja takuusaamiset	35,3	27,7	42,4	39,0	46,6	39,1	38,8	29,7	34,9	37,5
Osakepääomasijoitukset *)	180,0	180,0	179,5	179,5	173,3	0,0	0,0	0,0	0,0	0,0
<b>Yhteensä</b>	<b>3 274,9</b>	<b>3 417,1</b>	<b>3 412,5</b>	<b>3 249,5</b>	<b>3 130,7</b>	<b>2 763,2</b>	<b>2 664,7</b>	<b>2 578,5</b>	<b>2 474,8</b>	<b>2 441,2</b>

\*) Osakepääomasijoitusten kirjaustapaa muutettiin vuonna 2014.

*Translation: Lainat=loans, Takaukset=guarantees, Vientitakaukset=export guarantees, Vientitakuut=Export risk cover, Takaus- ja takuusaamiset=receivables from guarantees and risk cover*

This opinion is based on a simple misunderstanding of the underlying statistics and strategy over this period. The absolute fall in SME commitments occurred because Finnvera has been acting systematically to reduce lending and other commitments where there is no special need or where the banking sector is seen to be active. Historically, Finnvera's focus of domestically operating SMEs was heavily criticized in the international evaluation in 2012. Compared to its Swedish, Norwegian and Danish peers Finnvera's SME volume was large, and this was explained by their general funding of domestic SMEs. Since 2012, the strategy has been based on that evaluation to focus funding on growth companies and on their internationalization efforts, plus a few other priority areas. Non-prioritized SME's have been directed to use normal commercial funding sources.

Now more than 80 % of Finnvera's SME funding flows to the priority areas and they estimate that about half of all the real growth SMEs in Finland are their customers now. Thus, even if the total SME exposure is falling, Finnvera is doing more where they should be operating and less elsewhere.

There are other reasons why financing granted by Finnvera to SMEs decreased by some 7% from 2016. Lower volumes are partly explained by the fact that financing offered by the European Fund for Strategic Investments (EFSI) has proved to be a favored source for SME's. The utilization of EFSI financing is a good example of the diversification of SME financing options. As part of the European Investment Plan, Finnvera has, since early 2017, provided guidance on European financing.

Finnvera's goal is to shift the focus of financing to growing and internationalizing SME's, SME's seeking change, transfers of ownership, and start-ups. A total of 80% of Finnvera's financing is already allocated to these focus areas. The share of growing and internationalizing SME's out of all financing granted grew to 40 %. The program to promote transfers of ownership continued actively: the financing for transfers of ownership was nearly at the same level as in the previous year, and this financing contributed to the realization of approximately 1,000 transfers of ownership.

SME's are important for economic growth and jobs - There around 284,000 SME's in Finland employing 1.4 million people, and of these some 265 000 (93%) employ fewer 10 employees, with 16 000 (5.5%) small businesses, medium-sized 2 728 (1.0%) and large enterprises 591 (0.2%).

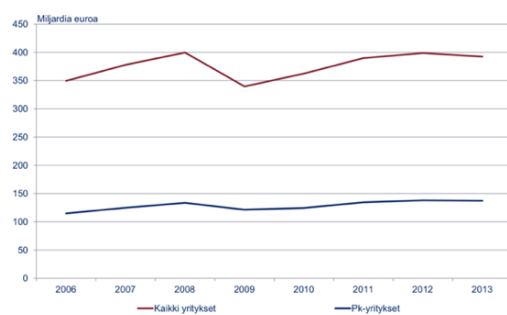
The SME sector as a whole exports some 15% of total exports, which is a low figure when compared to our Nordic neighbors. The redeeming feature about Finnish SME's is that they grow faster than the big companies and this is an important strategic matter for Finland.

However, as repeated many times in this report, the SME is still represented by too many very small companies and the share of export volume of SME's is also too small compared to most other similar countries. Mid-caps can and should be able to take advantage of the CIR Offer because fixed rate offers funding opportunities are more attractive than just floating rate offers. However, if SME's growth is stunted, exports remain low and thus there is no virtuous circle. Finnvera must continue to actively pursue policies that spur growth for SME's.

By supporting SME's in line with the government's mandate Finnvera can increase their pace of growth as well as bringing them closer to exporting bigger volumes.

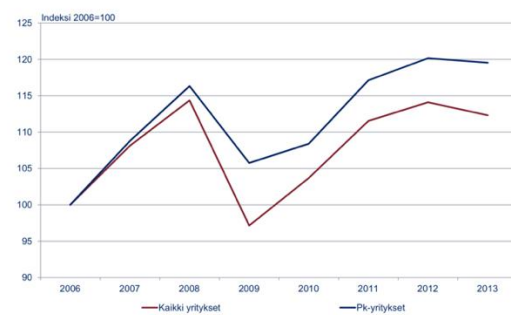
The following two graphs here illustrate their size relative to big companies and the difference in growth of the two sectors:

**Yritysten liikevaihdon kehitys**



Teknologia teollisuus Lähde: Tilastokeskus; Yritysten rakenne- ja tilinpäättötilastot

**Yritysten liikevaihdon kehitys**



Teknologia teollisuus Lähde: Tilastokeskus; Yritysten rakenne- ja tilinpäättötilastot

The above illustrate that SME's are extremely important for the economy and for jobs, however there are shortcomings with regard to SME export performance and there are good reasons for the country and for Finnvera to address these matters in this part of this report.

Finnvera has supported start-ups and SME's for decades because there has always been a gap in the financial markets, and new regulations have actually increased the size and permanence of that gap. As mentioned above, banks have limited their activities with SME's. The reasons are clear - the small size of SME's, their large numbers and diversity do not generate sufficient profits for banks



when costs are considered. Regulation has greatly increased the costs of dealing with SME's (regulations on money laundering and KYC), as well as increasing the amount of capital allocated to loans and guarantees granted (ICAAP and ILAAP regulations) to SME's by banks. Working with SME's is labor intensive and supervision requires heavy investments in IT solutions which even banks have been slow or unwilling to make.

Alternative sources of finance have become available from sources other than banks, like venture capital, private equity and crowd-funding, but costs are high and amounts are limited. Finnvera, together with Business Finland (Tekes), have filled that SME financing gap for new investments and economic growth, and Finnvera has been increasingly active in financing and guaranteeing exports from Finland.

Suomen Yrittäjät have said that they are somewhat concerned that an increasing number of SME's have been attracted to turn to alternative high cost money lenders to secure funding for working capital and investments when banks have turned them down. However, Finnvera claims that this is not a significant practice, rather they see that demand for finance has been met by banks and that demand is subdued.

Financing SME's is also costly for Finnvera because it also requires substantial investments in staff and its network. Finnvera currently has a national network with some 75 account officers who deal with 27 300 SME's, representing around 10% of SME numbers, with a total loan and guarantee portfolio of around €2.4 billion.

The above numbers for the whole sector thus indicate several important matters for consideration:

1. Finnvera may not be able to increase their SME client numbers substantially through direct marketing efforts successfully because they may already be covering a large part of the existing SME export market. At best one can estimate that they may be able to find between 5 000 new clients in the coming years, but even this would require an increase in staff numbers.
2. The relatively low 15% export volume of Finnish SME's compared to Nordic neighbors can be definitely improved and this should represent the main thrust of their efforts in the coming years.
3. There is clear evidence from the most recent report<sup>4</sup> that SME's are not sufficiently informed or educated on the various rather simple elements of export finance. The following important conclusions are noted in a comprehensive study on SME exporter:
  - a. 15% of export finance are lost because of inability to provide finance or because financial offer was too expensive
  - b. The exporter is not familiar with buyer's export finance system, and only offers delayed payment.
  - c. The exporter (35%) has not offered any type of financing for foreign buyers.

Commenting on the same report the ICC country manager at Chamber of Commerce, states that most of the SME's do not understand how to protect themselves against credit risks and thus do not use them when selling abroad. Deals are also missed because SME's are scared of suffering credit losses. Over 60% of all respondents claimed that single credits losses can cause long-term problems for exporters.

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<sup>4</sup> Finnvera, Keskuskauppakamari ja kansainvälinen kauppakamari ICC Vientikaupan rahoitusbarometri 2018

Thus, there are important reasons for Finnvera to continue to market that export financing and guarantee facilities to SME's because that can only improve business opportunities for these clients, since the above report clearly illustrate major short-coming in know-how and knowledge within the sector.

Other solutions must be examined other than cold calling on new customers - these could include the following:

1. Creating standardized SME first loss limits for defined SME portfolios with banks in a similar fashion to the EIF's SME Initiative Agreements that have been signed with Finnish banks – *see Appendix I*.
2. Start a carefully coordinated national export finance courses in partnership with Business Finland, Sitra, EK, Suomen Yrittäjät, Kauppakamari and FA/banks.
3. Start a series of export finance courses that can be loaded onto the internet for clients to use.
4. Continue with a national series export finance courses with other third parties.
5. Finnvera is planning to increase the possibilities for SME client to deal directly over the internet for loans and export finance, thus reducing the need for extra staff investments and improving productivity.

This report supports the views expressed in the report from the German consultants:

*“Interviewees mention that SMEs show an increasing demand for public support, in particular with regard to small transactions. Despite substantial efforts, Finnvera's intervention for SMEs is stagnating and seems to address the sector only partially. Interviewees emphasize the need of a fully-fledged direct lending program for domestic SMEs. As there is an ongoing discussion in other countries about direct lending programs, also in combination with innovation funds, there can be also a future need to neutralize rival export credit agencies although SME direct lending entails accepting increased risk levels compared to present risk levels. Interviewees comment that the structure with Finnvera and the financial institution arranging the credit via a co-operation agreement and supplemental agreements for every single transaction can be a deterrent for SME's. The same applies for the combination of borrower base rate, Finnvera margin, handling fee and commitment fee.”*

Finnvera already has the specialized in-house knowledge to structure transactions with banks and major demanding clients.

So long as the focus of the transaction is clearly within the Governments' mandate to Finnvera as a Promotional Bank, then there should be no objection from the Board to execute such transactions for domestic SME's.

## 20. Appendix 5 - Financing SME's with a First Loss Guarantee Facility

Finnvera is looking to implement new facilities for banks whereby it grants guarantees for various alternative solutions for first losses for portfolios of loans granted and managed by these banks. The advantages of such facilities are many and important, and they have not gone unnoticed in Europe where some 12 guarantee organizations have been granting such facilities to banks in their national markets.

SMEs often have economically sound investment projects, but do not have sufficient collateral, cannot get access to loan finance, or only insufficient funding.

A guarantee provided by a guarantor on behalf of the SME to a bank replaces this missing collateral and enables the bank to grant the loan. In essence, the guarantee is a financial commitment by the guarantor to repay a certain percentage of the loan to the bank in case the SME customer should not be able to honor his payments.

The guarantee usually does not cover more than 80% of the bank loan, leaving 20% of the risk with the lender. The SME remains liable for the loan. The SME usually pays a once-off processing fee and an annual guarantee fee, which are variable from guarantor to guarantor.

Given the importance of SMEs in the European economy and their difficulties in accessing loan finance, guarantee organizations have been set up in nearly all EU Member States. They are active as low- or non-profit organizations at national, regional or local level.

Four main types exist: Mutual Guarantee Societies, other types of Private Guarantee Societies, Public guarantee institutions and Public-Private Partnership initiatives. The specific choice for one or the other model reflects the economic and legal frameworks of the respective countries.

Finnvera is such an organization and these are found in all of main export competitor countries like Germany, Sweden, France, Italy, Belgium, Holland, UK, Ireland, etc....

Some 18% of all export guarantees in Europe are granted in this manner for portfolios.

At the moment Finnvera is unable to grant such guarantee facilities to private banks because, according to TEM, it appears that this would require a change in the law. Such a change would thus be required to allow Finnvera to grant a first loss guarantee facility for a SME loan portfolio that was granted and managed by a private bank.

The publicly available terms and conditions of the EIF/EIB SME Initiative have been reviewed for this report from the EIF's Call on the website:

[http://www.eif.org/what\\_we\\_do/guarantees/sme\\_initiative/smei\\_finland/index.htm](http://www.eif.org/what_we_do/guarantees/sme_initiative/smei_finland/index.htm)

The advantages of such portfolio solutions are as follows:

- Decision making is fast
- Easy to process
- Client friendly
- Low transaction costs
- Can be handled digitally
- Portfolio risk management is easier to handle
- Banks have tried and tested routines in loan management

While the disadvantages for Finnvera are as follows:

- Cannot choose borrower
- Cannot decide terms and conditions of guarantee

- Cannot analyze borrower – especially regarding ownership changes and innovations
- Does not work for large deals
- Moral hazard always

In the final analysis, there are powerful reasons for having Finnvera's own first loss guarantee facility for Finnish banks' portfolios of SME loans - it would be an extremely cost-efficient policy tool for Finnvera so long as the right incentives are used to limit or remove these disadvantages.

Alternative solutions can be developed by Finnvera that can offer superior results, but such other solutions are beyond the scope of this report.

## 21. Material used for report

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The writer of this report has met and discussed with the senior representatives of all the main stakeholders covered in this report.