

*Summary*

The Swedish Export Credits Guarantee Board – efficiency in the export guarantee system? (RiR 2014:21)



# The Swedish Export Credits Guarantee Board – efficiency in the export guarantee system?

## Background of the performance audit

The Swedish Export Credits Guarantee Board (EKN) is an important part of the state's efforts to promote Swedish export. The agency offers Swedish companies guarantees in the event of non-payment in accordance with agreements it has with purchasers in other countries. In this way, EKN enables export deals which would perhaps not have been realised otherwise. EKN may provide export credit guarantees of a total of SEK 500 billion. The organisation is funded by companies paying premium fees on the guarantees, which partly covers the risk in the guarantee and partly EKN's expenses. The premiums should be higher the higher the risks. Over the years EKN's initiatives have been important in establishing new Swedish export markets and for mitigating the effects of recessions and financial crises for Swedish export companies.

*Motive* for conducting an audit: In comparison to most other agencies, EKN has a large leeway, through a very broad mandate and because the agency is financed with fees and therefore not subject to review in the state budget process. During the pre-study certain issues were revealed which the Swedish National Audit Office (NAO) assessed could be of importance to EKN's efficiency. They related to, for example, whether the large financial surpluses which EKN has accumulated over recent years are compatible with the principle that EKN should break even over time. At the start of 2013, EKN's funds amounted to SEK 26 billion in total, which by SEK 17 billion exceeded the required capital needed to cover risks for issued guarantees, which EKN specified in its annual report. The surplus derived from administrative fees, amounts to four to five years of operating costs for EKN. Another issue which emerged during the pre-study related to initiatives targeted towards small and medium sized enterprises, where the results of EKN's efforts were not obvious. The pre-study also showed that the consequences of the EKN's mandate amendment implemented in 2007 have not been highlighted. During the main study, the Swedish NAO also identified that the issue of whether EKN's service meets the needs of different customer groups, has been inadequately attended to.

*The aim of the audit:* The Swedish NAO has conducted an audit on whether the Government and EKN have created good conditions for efficiency in the export guarantee system. The following are sub-questions of the audit:



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1. Has EKN offered a service which is adapted to the various conditions and needs of different customers?
2. Is EKN's handling of the surplus in the organisation compatible with good management with state funds?
3. Are EKN's premium levels appropriate to reach the goals of the organisation?
4. Have EKN's initiatives to support small and medium sized enterprises been efficient?
5. Has EKN interpreted and applied the extended mandate in a manner which conforms to the intentions of state authorities?

*Implementation:* The audit is based on interviews with managers and administrators within EKN, representatives of the Ministry for Foreign Affairs and Ministry of Finance, the Swedish National Debt Office, other organisations which have been commissioned to support Swedish exports, customers of EKN and members of EKN's board. The Swedish NAO has conducted approximately 30 interviews in total. The audit further builds on extensive written material mainly from EKN, consulting reports, international comparisons and reviews of a number of documents from completed guarantee cases.

## Audit conclusions

The overall conclusion of the Swedish NAO is that the export guarantee system can become more efficient. EKN's surplus (currently SEK 26 billion) has been accumulated and handled in a manner which does not conform to the Swedish Budget Act's formulations of good management with state funds.

More detailed conclusions of the audit are provided below.

### *Identified problems left without measures*

The Swedish NAO's audit shows that EKN and the Government Offices of Sweden have identified different problems in the organisation, but measures have not been taken within reasonable time. The audit shows, for example, that EKN's premium levels are too high as a result of, among other things, central assumptions in the model for guarantee pricing not being updated.

Since the 1990's EKN has built up a large equity. According to the agency's representatives, the equity is required to guarantee major transactions in the future. However, it is a key foundation of the state credit guarantee system that EKN periodically is able to cover losses with loans from the Swedish National Debt Office. Therefore, the Swedish NAO assesses that it is not obvious that EKN must be able to cover all possible future losses with its own equity, and that EKN has built up an unjustifiably large financial surplus in relation to the needs of the organisation.



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The work on widening the customer base among small and medium sized enterprises (SME) has not yet had any clear breakthrough, a notion which has been confirmed by EKN's board. This has also been known for some time through EKN's annual reporting. Despite this, the Government has not taken any measures in the management of EKN. The Swedish NAO assesses that both the Government and EKN have lacked a more comprehensive perspective on which role EKN should have for SME. The Government has neither formulated elaborated goals for which socioeconomic effects the organisation for promoting SME should strive for. The agency has internally interpreted the self-supporting principle as entailing that each of EKN's business areas should at least break even every year. It has been difficult for the business area of SME to fulfil this because, for example minor transactions entail a higher dealing cost per guaranteed volume. The Swedish NAO assesses that this creates a situation where EKN's internal financial goal risks jeopardising the mission to support the export of SME.

In the budget bill the Government uses a different and wider definition when reporting EKN's results for its SME-operations, than the definition used by other agencies. The Swedish NAO assesses that this risks leading to more a positive report on EKN's initiatives in this area.

*EKN has focused on major transactions at the expense of minor*

EKN's work has been particularly appreciated by large companies in industries which are characterised by large and complicated deals, which often last for many years (for example, power generation and transfer, telecommunications and the defence industry). For a long time EKN has also had few losses from these commitments.

However, large companies with many minor deals are frustrated due to complicated rules, slow processing and due to EKN ensuring a too low share of each deal. EKN has implemented a specific solution to facilitate large companies with many small deals. However, the company for which the solution was designed considered it to be inadequate. Other initiatives to simplify the process for small deals have ceased due to difficulties of attaining consensus on which changes are desirable within EKN.

As EKN's assignments relate to all exports with a Swedish interest, the agency should have capacity to support all types of export transactions on the same level. However, all in all the Swedish NAO notes that EKN's processes for all deals are adapted to what is functional for the largest deals.

*Already large leeway increases further in the absence of management*

In the pre-study the Swedish NAO noted that EKN in different respects has a large leeway compared to other financial agents and compared to state companies. EKN also has wide degrees of freedom relatively other agencies. As a rule, other agencies do not fully receive compensation for inflation, which means that in practice they are forced to rationalise their business continuously. As EKN is not financed by appropriation but by income from premium fees directly



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from the customers, this automatic rationalisation requirement does not exist. EKN also differs from other contributory agencies since most such agencies pay fees to the state treasury, and receive appropriation for operating. In its balance sheet EKN has instead been able to accumulate a surplus from its administrative fees which correspond to 4 – 5 years of operation of the agency (approximately SEK 1 billion).

The management of the agency has provided greater freedom to EKN. A central part of the financial management of EKN is that the agency should be self-supported over time. However, the meaning of the concept has not been specified in more detail. According to the assessment of the Swedish NAO, this has contributed to EKN being able to build a large surplus which has further increased the degrees of freedom of the agency.

EKN's surplus has been built up over almost two decades. During this time the Government has not decided whether the size of the surplus is compatible with good management with state funds. The Swedish NAO assesses that there have been lack of clarity regarding the distribution of responsibilities within Government. In 2011 the surplus was discussed between the Ministry of Finance and the Ministry for Foreign Affairs when consequences of the provisions of the Budget Act for the guarantee agencies' reserves were analysed. The Ministry for Foreign Affairs obtained supporting material from EKN which argued against intervention in the accumulated surplus. The Ministry for Foreign Affairs accepted EKN's argumentation and further communicated it to the Ministry of Finance. At that stage the discussion did not result in any major changes on the view of EKN's surplus. The Ministry of Finance states that during this process they made their assessments based on the Budget Act's specific provisions on the guarantee agencies' reserves, and not based on extensive efficiency aspects.

After an order from the Ministry for Foreign Affairs in the spring of 2013, EKN in August 2014 provided an analysis of its reserves and capital requirements, which contains the agency's assessment on how much capital is requirement to cover the concentration risk. EKN's overall assessment is that the capital can be restricted to 10 per cent of outstanding guarantees, which currently is equivalent to SEK 20 billion. However, the Swedish NAO assesses that it is unclear which considerations resulted in that specifically 10 per cent of the portfolio is an appropriate level for covering the concentration risks. It can also be noted that half of the capital requirement for the concentration risks relates to EKN's offer for one individual transaction.

The Government has granted EKN an exception from the requirement in the Fee Regulation. The Regulation states that agencies should provide proposals on how large financial surpluses should be allocated annually. The Government has thereby refrained from a written material which could have been important for the management of EKN during the time the surplus was accumulated. It can be noted, that EKN in the capital analysis from August 2014 proposes that a recurrent account of the need of equity is conducted in the future. The Swedish NAO assesses that it is unclear how



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large share of EKN's surplus is really covered by the Fee Regulation, and thereby also what the exception entails.

EKN's mandate was expanded in 2007 to support export deals with a Swedish interest, and thus not only transactions with goods or services produced in Sweden. In practice the new mandate imposes few limits for which deals EKN can guarantee. Supporting material to assess the wider effects of the new mandate is missing, for example, the consequences for jobs in Sweden.

*EKN has retained parts of the surplus which should be paid to the state treasury*

In accordance with current rules (the Regulation on lending and guarantees and EKN's instructions), EKN should pay premium income, which lies above the cost of expected losses and administration, to the state treasury. However, EKN has not paid the income generated by the so-called 'buffer' to the state treasury, used for price-fixing of guarantees with a low risk. The Swedish NAO therefore assess that EKN has not complied with relevant provisions. Since 2000 the buffer has generated almost SEK 800 million of EKN's surplus, of which SEK 152 million derives from when the rules, that any premium income above expected losses should be paid to the state treasury, was introduced.

*Other Nordic export credit agencies have clearer management*

The Swedish NAO's comparison with agencies equivalent to EKN in other countries shows examples of more active management, both in terms of capitalisation and in terms of the work on supporting SME.

For example, in contrast to EKN, the Danish export credit agency EKF has a maximum limit for how much capital it can accumulate on their balance sheet. Finnish agency Finnvera does not have a maximum limit but is still given some guidance by having a goal for minimum capital adequacy, through the size of the funds which will be used to finance Finnvera's operations and by the concept "self-supporting" being given a time horizon.

Regarding SME operations, both EKF and Finnvera – unlike EKN – have been commissioned to monitor their operations based on the public welfare they are expected to create, for example, by estimating the number of jobs which are created as a result of the exports.

## Recommendations

*The Swedish NAO's recommendations to the Government:*

- Clarify the meaning of the concept "self-supporting" which should be the basis of EKN's operations. Without more specification of, for example, the time horizon, the concept does not provide adequate management.



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- Clarify EKN's role based on an analysis of the general need of financial support among SME. Also clarify which socioeconomic effects the SME operations should contribute to. In addition, EKN's results should be reported with the generally accepted definition of SME, in order to increase comparability with the work of other export promoting agents.
- Take measures to adapt EKN's surplus to the needs of the organisation. The measures should be structural, so that reserves in the future cannot grow in the same way, and should take into account the Budget Act's formulations of management with state funds. The following are three examples of areas where measures could be considered.
  - In order to attain better decision data for issues related to the surplus, the Government can consider allowing EKN to provide annual proposals for how the agency's surplus (both the guarantee reserve and the administrative share of the surplus) should be allocated. One part of this can be the recurring account of the requirement of agency capital, which EKN has proposed in its capital analysis. In this context, the implication of § 25 in the Fees Regulation for EKN should also be clarified.
  - In order to prevent the administrative reserves from building up again, the Government can consider introducing an automatic rationalisation requirement for EKN, which other agencies have.
  - The Government can further investigate which advantages and disadvantages would exist for an arrangement where the Swedish National Debt Office handles the risk exposure from individual extremely large export credit guarantees.
- Allow analysis of which consequences the expanded mandate can have, for example, for employment in Sweden and for the risk of exposure in EKN's portfolio.

*The Swedish NAO's recommendations to EKN:*

- Regularly update components in the agency's premium model when there is new information, in order to prevent that guarantees are systematically price-fixed incorrectly. In order to simplify the price-fixing, the calculation of the prime interest rate should also be simplified. It should be examined in more detail the appropriateness of the current uniform assumption of how much of the share of the guaranteed amount is lost in the event of a loss (so called final loss). The administrative fees should be adapted to the actual cost.

