



RIKSREVISIONEN

*Summary:*

AB Svensk Exportkredit

---

RiR 2010:15

## **AB Svensk Exportkredit**

### **Summary**

*Riksrevisionen* (the Swedish National Audit Office, SNAO) has audited AB Svensk Exportkredit (SEK), which is a fully state-owned enterprise. SEK was established in 1962 to create better financing conditions for Swedish exporting industry through credit provision. Its present mission is to promote, on commercial grounds, activities that are of interest to Sweden and which are directly or indirectly linked to Swedish exports.

### **Background**

Since SEK was established, the credit market has undergone major changes. The enterprise's mission has been progressively modified and developed.

SEK has grown into one of the largest state-owned enterprises, with a balance-sheet total of 371 billion *kronor*. The only fully state-owned enterprise with a larger balance-sheet total is the energy company Vattenfall AB. During the most recent financial crisis, the government injected capital to increase SEK's lending volume.

SEK's operations now include export credits and other lending in various forms, mainly to private businesses and financial institutions but also to public entities. In addition, it offers advisory services and the intermediation of capital-market transactions for businesses. SEK finances its operations from extensive borrowing as well as investments using sophisticated financial transactions.

The aim of the SNAO's audit was to assess whether SEK's operations are conducted in line with the decisions and intentions of the Riksdag (parliament). The starting point of the audit is therefore the statements made by the Riksdag about SEK. The audit covers the way in which the Government controls SEK, the work of SEK's board of directors and the operations of SEK.

As part of the audit, interviews were carried out with officials at the Government Offices (ministries) who represent the central government in its role as owner, all board members and with several representatives and employees of SEK. Other sources used in the audit include Riksdag publications, minutes of board meetings, annual reports, supporting documentation for SEK's credit assessments and other internal SEK material. The SNAO also commissioned a study of SEK's financial targets and internal operations.

### **The SNAO's conclusions**

The SNAO's audit of SEK shows that SEK's operations have progressively expanded and that SEK has been allowed to expand heavily without any inquiry into the reasons for the government's involvement. From initially offering export credits to Swedish businesses, SEK's mission has been broadened to include virtually all types of financial activities except

actual banking services for private individuals. As a result of its broadly worded mission, SEK has expanded into areas where there are private actors. This includes lending to local government and advisory services. Because of its broad mission and the fact that its financial targets have been low compared with those of comparable private financial institutions, SEK has enjoyed considerable freedom of action.

SEK's strong expansion has led to shortcomings in its internal control environment. During the course of the audit a number of changes have taken place at SEK, meaning that the enterprise has started addressing some of the weaknesses identified by the SNAO, but there is a need for additional efforts.

### **The expansion into new activities can be called into question**

The purpose of creating SEK was that it should promote Swedish exports. At the time, private banks were deemed unable to offer long-term credit. Since SEK was founded, the capital market has undergone major changes. This makes it relevant to question what role SEK plays in the market today. During periods when the financial market does not work well, government actions become important and SEK has a prominent role to play. In normal conditions, however, SEK not only provides government-backed credit but also operates in areas where there are private companies. The SNAO finds that the private actors may sometimes perceive SEK as a competitor.

SEK's board has recently chosen to narrow down its mission, such that SEK will primarily support Swedish export-credit financing and engage less in other activities.

There have been cases where SEK granted credit for transactions that neither had links to Sweden nor could be deemed to support Swedish exports even indirectly – although its primary mission has been to promote activities of interest to Sweden.

Considering the developments outlined above, the SNAO finds that there is reason to carry out a review into SEK's role. The starting point of such a review should be an analysis to determine why the government is involved in SEK and how large resources should be spent on this involvement.

### **The financial targets indicate that the enterprise should be able to grow**

Prior to April of 2008, the government had not formally set any financial targets for SEK. However, SEK did have its own targets before this time, which had been addressed in informal dialogue with the government and adopted by its board.

The government's financial targets for SEK are lower, or on the low side, compared to those of Scandinavian commercial banks. Even though SEK's operations differ in several respects from those of the commercial banks, there are also similarities. Furthermore, they largely operate in the same markets.

The target for return on investment was set in 2008. SEK's historical return on investment had been higher than the level determined in 2008, meaning that it had actually already attained the set target. SEK is required to provide a return on investment corresponding to the long-term risk-free interest rate plus four percentage points. In other words, the risk-free interest rate constitutes the basis of the return target. The definition of the risk-free interest rate therefore influences the level of the return target. The definition used by SEK is based on the term of its credit portfolio, which has been three and a half years. As a result, the return target

has been lower than it would have been if SEK had used the definition of the risk-free interest rate generally accepted in the equities market, which often takes as its starting point a long-term (10–15-year) government bond.

SEK's dividend target of 30 per cent of its profits after taxes can be compared with the dividends paid by Scandinavian commercial banks, which range between 30 and 50 per cent. In the SNAO's opinion, this can be interpreted as that SEK is allowed to capture market share from commercial banks. SEK's dividend target gives it room for expansion, which is also reinforced by its considerable capital.

Given the operations that SEK conducts, its financial targets are on the low side compared to Scandinavian commercial banks with similar corporate missions. SEK's financial targets should be adapted to its mission. If that mission was to be restricted to a focus on long-term export-credit financing, the present financial targets might be better justified. The SNAO considers that the owner should assume a position on the purpose of SEK's operations followed by a financial analysis of the enterprise based on this decision.

### **SEK's administrative system has not been adapted to its expansion**

SEK has largely exploited the freedom of action that its broad mission allows. It has grown strongly and has also come to engage increasingly in sophisticated financial transactions. SEK's expansion and its sophisticated transactions place certain demands on its administrative system and on monitoring and risk management in relation to that system.

Since 2005, the average number of employees has increased by 44 per cent and the balance-sheet total has grown by 165 billion *kronor*, reaching 372 billion in 2009. SEK's operations have grown faster than its administrative-support services. The audit shows that SEK's organisation has not been adapted to meet the increasing demands resulting from its expansion. As a consequence, SEK has been exposed to operational risks which have given rise to shortcomings in accounting and reporting. One problem is that some aspects of its financial reporting have had to be handled manually. These problems have been highlighted in SEK's annual reports.

The SNAO finds that SEK's efforts to manage its operational risks have not been sufficient, though work to bring about changes is ongoing.

### **The board needs to take an overall view of operations**

The audit shows that SEK's board appears not to have taken adequate action to inform itself of the enterprise's internal operations.

The board drew attention to problems in the management of SEK's operational risks already in 2007. Top management had then taken measures to address those problems. The board has expressed uncertainty regarding the extent to which the problems are being dealt with and the progress of the ongoing improvement efforts. The audit shows that problems remain. The board should make use of the internal-audit function to obtain independent reports.

Furthermore, the board has not decided on an explicit (or distinct) policy for liquidity management. There is for example no information about the types of financial instrument in which liquidity may be invested. According to the guidelines of *Finansinspektionen* (the Swedish financial supervisory authority), the board of an enterprise should have guidelines for liquidity management. Given that SEK manages liquidity amounting to 146 billion *kronor*,

the SNAO considers that its board should decide on an explicit (or distinct) policy for liquidity management.

The SNAO also finds that the board has not been adequately informed about the flexible individual remuneration paid to employees on the commercial side of operations. The agreements relating to flexible remuneration were decided by SEK's President (managing director). The SNAO considers that the board has not had sufficient insight into the design and ramifications of those agreements. Individual remuneration programmes are unusual at fully state-owned enterprises. Since the amounts involved are substantial and since flexible remuneration may be an instrument of control, it is reasonable for the board to be involved in the design of such agreements.

### **The SNAO's recommendations**

SEK has been allowed to grow and its mission has progressively broadened without any inquiry being carried out into the reasons for the central government's involvement. The SNAO's audit shows that there is a need for the Government to review the purpose of SEK's operations, its financial situation and its financial targets.

The audit gives the SNAO grounds for addressing the following recommendations to the Government:

- The Government should carry out a review of SEK's mission to decide in what fields it should operate and what role it should play in the market;
- The Government should initiate a financial analysis of SEK, review its financial targets and adjust them to suit its future mission.

The Government addresses the following recommendations to AB Svensk Exportkredit:

- The board should review SEK's liquidity management and decide an explicit (or distinct) policy in that field;
- The board should obtain information about and regularly evaluate the ramifications of the individual remuneration agreements;
- The board should control and monitor the handling of SEK's work on operational risks.