(Preliminary draft)

<u>Ministry of Trade and Industry</u>

Chapter 934

Prop. 34 S

(2011–2012)

Proposition to the Storting (draft resolution)

Export Financing

Recommendation from the Ministry of Trade and Industry 18 November 2011, approved in the Council of State on the same date. (Stoltenberg II Government)

1 Introduction

In the wake of the financial crisis of 2008, comprehensive international efforts were made to strengthen the solidity of financial institutions, and the EU has tightened its rules for large exposures of credit institutions. This means that Eksportfinans requires a substantial increase in capital if it is to continue to have the same lending power to finance loans that are not guaranteed by the Norwegian Guarantee Institute for Export Credits (GIEK). However, Eksportfinans and its owners have not managed to arrive at a recapitalisation plan that would result in an export financing scheme that the Government considers robust enough to meet both clients' needs and future solidity requirements.

In order to ensure that competitive export financing for Norwegian exporters will be continued, the Government is proposing in this draft resolution to establish a governmental state-funded credit financing scheme for Norwegian exporters. Until the new scheme is operational an interim arrangement will be needed, in the form of a scheme administered in cooperation with Eksportfinans. Under the interim scheme the state will be the counterparty to the loan agreement, while Eksportfinans will administer the financing on behalf of the state. The interim scheme will operate until the new permanent governmental state-funded scheme is in place, which will be at the latest by 1 July 2012.

2 The present system

The present scheme subsidising fixed-interest (CIRR) loans, known as the "108 scheme", was established in 1978, and was based on the OECD Arrangement on Officially

Supported Export Credits. The Arrangement regulates competition between the OECD countries in the area of interest rate and instalment conditions for officially supported loans for capital goods exports. The scheme enables Norwegian exporters of capital goods to compete on equal terms with exporters in countries with national export credit schemes. The 108 scheme has been administered by Eksportfinans since the beginning.

The aim of Eksportfinans is to offer long-term, competitive financing to Norwegian exporters. In addition to fixed-interest (CIRR) loans under the 108 scheme, Eksportfinans also offers loans at market-based commercial interest rates for projects that qualify for CIRR rates, and other loans at commercial interest rates against a bank guarantee.

CIRR loans are fixed-interest loans based on government bonds in the currency in question plus 1 percentage point. The interest rate is fixed at the time the agreement between the Norwegian supplier and the buyer is signed, and the loan is normally disbursed somewhat later. Before drawing on the loan, the borrower may choose to take advantage of either the previously fixed CIRR interest rate or the current market-based commercial rate. Thus the borrower has an interest-rate option free of charge. The CIRR interest rate is more attractive in cases where the market-based commercial rate rises before the loan is disbursed.

CIRR loans may amount to 85% of the value of the export contract for capital goods and services, and up to 80% of the contract value for shipping contracts. The foreign share of the goods and services in the export contract may amount to 50% of the value of the contract, but in certain cases a higher share is accepted. A maximum of 30% of the contract value may come from the purchasing country (local share). The shortest permitted maturity of CIRR loans is two years. The longest permitted maturity is five years for high-income countries and normally up to 10 years for low-income countries. The OECD may be notified of maturities of 8.5 years for deliveries to high-income countries. For shipping loans and renewable energy/hydropower the longest permitted maturities are 12 and 18 years respectively.

For administering the 108 scheme, Eksportfinans takes a margin-based fee from the government for each outstanding CIRR loan. The need for appropriation over the fiscal budget arises when the interest rates on the lending do not fully cover the borrowing and administration costs of the scheme. The appropriation will then depend on the interest rates calculated on new and existing loans under the scheme, the overall volume of outstanding credits in various currencies, the interest rates on the borrowing and currency fluctuations. Thus the state bears the risk associated with the financial results of the scheme.

By an annual authorisation decision by the Storting, Eksportfinans is given a commitment for public funding of future deficits related to new loan commitments in the coming year. The deficit in a particular year is covered by an appropriation over the fiscal budget two years later, under Chapter 934, Internationalisation measures, item 73, Support for capital goods exports. Interest rate compensation is paid to Eksportfinans for the intervening period until the date of disbursement. A more detailed description of the system is given in the fiscal budget, Proposition No. 1 (2008–2009) to the Storting, Ministry of Trade and Industry, Chapter 934, item 73.

3 The current status of Eksportfinans ASA

Under the EEA Agreement, new rules governing financial markets adopted by the European Commission are normally incorporated into the Agreement and implemented in Norwegian law. The Capital Requirements Directive, 2006/48/EC (CRD), was amended on 16 September 2009 by Directive 2009/111/EC (CRD II), which became applicable on 1 January 2011. On 20 December 2010 the Ministry of Finance therefore amended the Regulations of 22 December 2006 No. 1615 relating to large exposures, and the amendments entered into force on 1 January 2011. One of the amendments provides that exposures with other finance institutions are now weighted at 100% when calculating total exposure, i.e. the same weighting as exposures with most other counterparties. Under the previous rules exposures with finance institutions could be weighted at 20%. The reason for the EU's legislative amendment was that experience gained from the financial crisis had shown that exposures with finance institutions should be treated in the same way as exposures with other types of counterparties, since the risk is in principle the same. The effects of the tightening of the rules – the requirement that finance institutions must increase their capital for exposures with each other by a larger amount than under the previous rules – were intended. As we know, the banks' solidity has been weakened from an international perspective.

In order for Eksportfinans to meet the new requirements, maximum exposure against individual borrowers or finance institutions through bank guarantees will have to be reduced from approximately NOK 7 billion to approximately NOK 1.4 billion on the basis of the company's current capital. In a letter of 1 December 2010 to the Ministry of Finance, Eksportfinans stated that the new rules pose major challenges for the company. In response the Ministry of Finance included a transitional provision in the Regulations concerning large exposures that enabled Eksportfinans to follow the previous rules on large exposures until 31 December 2011, cf. section 15, second paragraph, of the Regulations. In a letter of 19 October 2011, the Ministry of Finance notified Eksportfinans that the application of the transitional provision would be extended to 31 December 2012, and that the company would not be granted a permanent dispensation from the new rules.

The association between Eksportfinans and the state in the form of the company's administration of the 108 scheme and the state's ownership interest of 15% have probably contributed to the company's high credit rating. The high rating has made it possible to raise funding on favourable conditions in the international capital market, enabling the company to provide loans at market-based commercial rates under competitive conditions. When on 28 October 2011 Eksportfinans was downgraded two levels by the credit rating agency Moody's, it lost one of its most important competitive advantages.

The new rating and the markets' subsequent reaction have had a strongly negative effect on the ability of Eksportfinans to provide financing that ensures competitive conditions for Norwegian industry. In cooperation with its largest owners, including the state, Eksportfinans has discussed a number of recapitalisation models that would permit it to continue to provide the same service to the business sector. However, no satisfactory solution has been found. Furthermore it is uncertain whether the possibilities that were discussed would provide a sufficiently robust solution to meet the new capital requirements that are expected to be imposed by the EU in the next few years.

4 A permanent state-funded scheme for CIRR loans and market-based commercial interest rates for projects that qualify for CIRR

In order to finance lending to Norwegian exporters, Eksportfinans issues bond loans in international capital markets. The competitive financial advantage for Norwegian exporters has been Eksportfinans's very high credit rating, which has enabled it to borrow under very favourable conditions. A further advantage, especially for small and medium-sized companies, has been that the industry was being offered loans at both CIRR interest rates and commercial rates by the same institution.

If Eksportfinans is not able to continue providing this service, credit financing for the export industry will be adversely affected. The Ministry of Trade and Industry has considered a number of solutions to this problem that will have to meet certain criteria: that the service to borrowers must be equally satisfactory, that the solution must be cost-effective and that it can be implemented within the framework of existing legislation. This means for example that the new arrangement will have to meet the requirements for capital backing and comply with procurement provisions and the rules for state funding.

On the basis of these criteria, the Government believes that a scheme under government auspices and funded by borrowing from the public treasury will provide the best solution. A governmental scheme will be more resistant to fluctuations in the financial markets than the existing scheme and will not have to meet the same capital requirements. Borrowers will receive the same service in good times and in bad, and there will be no upper limit for exposures. A condition for such a scheme will be that commercial lending must not involve state funding. The scheme will also represent a saving in costs for the state, since the state will not have to pay a margin on outstanding balance and any profits from the scheme will accrue to the state.

There are certain difficulties attached to the scheme, but these will be mainly at the beginning. The state will need to acquire a sufficient level of expertise and it will be necessary to ensure a lending rate for commercial loans that is sufficiently flexible and at the same time complies with the provisions on state aid in the EEA Agreement.

The most appropriate solution would seem to be to establish a government agency to be responsible for credit financing for projects that qualify for CIRR. Recapitalisation will not be necessary in the case of a government agency, since it will not be subject to capital requirements. The government agency could take the form of either a subordinate agency or a state-owned company established through special legislation. The Ministry will submit a proposal to the Storting on the form of organisation.

The planned government agency for export financing will have its own board of directors and its powers of authority will have to be specified in statutes. The board will take decisions in all individual cases and will appoint the managing director, and the Ministry will be responsible for determining goals and framework conditions. The statutes should specify that the Ministry has no authority to decide in individual cases.

The planned agency will continue to provide the same service with respect to CIRR loans for qualified projects as that currently provided by Eksportfinans. There will be no limit on the size of exposures and the funding will come from the public treasury. The agency will offer both CIRR loans and loans for projects that qualify for CIRR at market-based commercial interest rates.

If the establishment of the new agency is defined as a business transfer, the employees may acquire rights related to the transfer of tasks. If areas of operation that were previously under Eksportfinans are transferred to the new government agency, some employees will have the right to continue the employment relationship with the new employer. After examining the question of a business transfer together with the parties concerned, the Ministry of Trade and Industry will provide information to employees and discuss the practical implementation. An interim board will be appointed as soon as possible to address the question of organisation of the permanent scheme. Steps must be taken to ensure that the relevant expertise is not lost in the transfer to the new agency.

5 The interim scheme

An interim scheme will be established in cooperation with Eksportfinans until the permanent scheme is operative. The interim scheme will ensure disbursement of CIRR loans together with loans for projects that qualify for CIRR at market-based commercial interest rates for which Eksportfinans has provided a commitment but not yet disbursed the loan. The scheme will also be responsible for providing commitments for new loans for projects that qualify for CIRR and their disbursement. From the date when the interim scheme is operative the state will be the lender when the loan is disbursed, and the loans will be transferred to the permanent state-funded scheme when it becomes operative. Commitments for new loans will be provided on behalf of the state on the basis of the same criteria as before, and the state will be the counterparty to agreements. The permanent scheme will also take over the further processing of loan commitments when it becomes operative. Loans under commercial conditions will have to comply with the EU rules for state aid, and the interest rates on market-based commercial loans must be as close as possible to market-based commercial rates.

The interim scheme will have many of the same elements as the permanent state-funded scheme, apart from the fact that during the interim period Eksportfinans will be responsible for administering the financing on behalf of the state. The conditions will be further specified in an agreement between the state and Eksportfinans, and a draft of the agreement is being drawn up. The scheme will be based on the principle that the state's role as lender will be the same as the role Eksportfinans has played until now with respect to risk, margin constraints, term to maturity, etc. When administering the interim scheme, Eksportfinans cannot be expected to bear the special risk on behalf of the state under the interim scheme, which means that during the interim period the state will bear the risk. The interim agreement will also specify the remuneration Eksportfinans is to receive. When this is determined, care must be taken not to give Eksportfinans an advantage that would infringe the rules for state aid. A control function will be established at the same time as the organisation of the scheme and the signing of the agreement. The interim period is expected to last for about six months.

The interim scheme will become operative as soon as the Storting has consented to the proposals put forward in the present draft resolution, according to which the Ministry of Trade and Industry will conclude an agreement with Eksportfinans, and when the board of directors of Eksportfinans has approved the agreement. The interim scheme represents a step in the process of terminating the agreement between the state and Eksportfinans on the 108 scheme.

Eksportfinans has raised the point that before the interim scheme is in place there will be exposures that will have to be disbursed but that the company cannot disburse due to lack of funding or because this would be in conflict with the new capital requirements. If these considerations should cause an actual stopping of the service to exporters, the state should on the basis of individual assessments accept a situation where Eksportfinans disburses the loan and the state, if the Storting consents, provides security for Eksportfinans that these loans will be transferred to the interim scheme or to the permanent state-funded scheme.

6 The agreement and the prohibition on state aid under the EEA Agreement

The EEA Agreement includes a general prohibition on state aid (Article 61(1)) and the EFTA Surveillance Authority (ESA) is the competent authority to enforce the prohibition. CIRR lending is based on an international agreement (under the OECD) and is compatible with the rules on state aid. Our intention is to use the ESA reference rate as the floor for the interim scheme. If the lender bases its lending on the reference interest rate, this shows that the loan has been granted on market conditions and thus does not constitute an advantage for the borrower (as state aid would be). With regard to the market interest rate under the permanent scheme, the state intends to conduct a dialogue with ESA with the goal of being able to use more flexible interest rates.

7 The Ministry's assessment

State-funded export credits play a very central role in the financing of Norwegian capital goods exports. This is especially true in periods of financial unrest with few alternative sources of export financing, when it is essential that the state can ensure stable framework conditions for Norwegian exporters. Eksportfinans has been administering Norwegian CIRR loans on behalf of the state since 1978, but can no longer continue to provide this service. The Ministry of Trade and Industry therefore considers that the interests of the export industry are best served by establishing a governmental state-funded export financing scheme that can provide loans at CIRR interest rates and at market-based commercial interest rates for projects that qualify for CIRR. A state-funded scheme will be robust, reliable and cost-effective, and will continue to offer the Norwegian export industry financing at competitive rates. The scheme will be client-friendly and flexible in order to meet the needs of the business sector.

8 Economic and administrative consequences

The proposal will involve a certain increase in administrative expenditure for the Ministry of Trade and Industry. Eksportfinans will be remunerated for its role in organising the new scheme. The remuneration must be market-based and care must be taken to ensure that it does not constitute an advantage to the company that would infringe the rules for state aid. There will also be expenditure in connection with the control function. The Ministry will come back to the Storting with a proposal for the establishment of a new agency to administer loans for projects that qualify for CIRR on a permanent basis, including the necessary appropriations.

9 Budget proposal

The proposed interim scheme will involve commitments by the state for loans for projects that qualify for CIRR from the public treasury in 2011 and 2012. The loans will be disbursed in 2011 and later. For projects that qualify for CIRR loans and where the commercial contract between supplier and purchaser has already been signed, Eksportfinans has provided commitments for a loan volume of NOK 38.5 billion, NOK 18.2 billion of which is expected to be disbursed. However, given the uncertainty in the capital markets and the possibility that alternative sources of financing may dry up, the loan volume to be disbursed may very well exceed NOK 18.2 billion. The need for CIRR loans for qualified projects under the interim scheme is estimated at up to NOK 30 billion. Since there is considerable uncertainty concerning the times of the disbursements, the Government proposes that the appropriation is made transferable.

Loans from the public treasury are budgeted under Chapter 934, while amortisation, repayment and interest earnings are entered in the government accounts under Chapter 3934. It is not certain whether the state will receive repayments or interest earnings during the interim period, since the interim scheme is expected to last for about six months and the loans are paid in equal half-yearly instalments, with the first instalment falling due six months after the last disbursement. Loans and amortisation are entered gross, which means that the sums are expensed or credited to income every time the state grants or receives repayment of a loan. The amount of any interest earnings is very uncertain, and no income appropriation is being proposed. The Government will submit the amounts concerned to the Storting in connection with the amendments to the fiscal budget in spring 2012.

The sizes of the fee to Eksportfinans and the expenses incurred by the establishment of a control function and an interim board have not yet been determined. The Ministry therefore proposes that it should be authorised to make expenditure without grant. The Government will present the sums concerned to the Storting in connection with the amendments to the fiscal budget in spring 2012.

Chapter 934 Internationalisation measures

Item 90, Loans to an interim state-funded export financing scheme for loans for projects that qualify for CIRR interest rates may be transferred

An appropriation of NOK 30 billion is proposed, which will cover the disbursement of loans at CIRR interest rates and loans for projects that qualify for CIRR at market-based commercial rates in 2011 and later. The appropriation estimate is an uncertain one, and the Government will if necessary propose a change in the appropriation in connection with the amendments to the government budget in spring 2012.

The Ministry of Trade and Industry

h e r e b y r e c o m m e n d s:

that Your Majesty approves and signs the proposal for a proposition to the Storting on export financing.

We HARALD, King of Norway,

h e r e b y c o n f i r m:

that the Storting is requested to make a decision on a resolution on export financing in 2011 and 2012 in accordance with the submitted proposal.

Proposal for a resolution on export financing

I

The following amendments are made in the fiscal budget for 2011:

Expenditure:

Chapter	Item	Purpose	NOK
934		Internationalisation measures	

	90 (new)	Loans to an interim state-funded export financing scheme for projects that qualify for CIRR *may be transferred,* and will be appropriated in the amount of	30 000 000 000

II

Authorisation to enter into an agreement

The Storting consents to the proposal that the Ministry of Trade and Industry is authorised to conclude an agreement with Eksportfinans on an interim scheme for loans for projects that qualify for CIRR, which will be administered by Eksportfinans.

III

Authorisation to make expenditure or credit to income without grant

The Storting consents to the proposal that the Ministry of Trade and Industry may, in 2011 and 2012, without an appropriation:

- 1. Make expenditure for a control function when loan agreements are administered and signed under Chapter 900, Ministry of Trade and Industry, new item 22, *Expenditure on control function*.
- 2. Make expenditure for the fee to Eksportfinans ASA for its services on behalf of the state under the interim scheme for loans for projects that qualify for CIRR under Chapter 934, Internationalisation measures, new item 74, *Administration of interim scheme for loans for projects that qualify for CIRR*.
- 3. Credit to income interest earnings from the interim scheme for loans for projects that qualify for CIRR under new Chapter 3934, Internationalisation measures, new item 80, *Interest earnings from the interim scheme for loans for projects that qualify for CIRR.*
- 4. Credit to income repayments for outstanding claims resulting from the interim scheme for loans for projects that qualify for CIRR under new Chapter 3934, Internationalisation measures, new item 90, *Repayments from the interim scheme for loans for projects that qualify for CIRR* .
- 5. Make expenditure on an interim board of directors as part of the efforts to establish a state-funded agency that will be responsible for export financing for projects that qualify for CIRR loans in Norway under Chapter 934, new item 22, *Interim board for a state-funded scheme for export financing*.

IV

Authorisation to provide commitments and disburse loans

The Storting consents to the proposal that the Ministry of Trade and Industry may in 2011 and 2012 provide commitments and disburse loans amounting to NOK 30 billion to projects that qualify for CIRR.

V

Authorisation to acquire loans

The Storting consents to the proposal that the Ministry of Trade and Industry may acquire certain loans disbursed by Eksportfinans ASA as from 18 November 2011 until interim scheme is operative.