

Foreign business risk coverage for spanish companies

The importance of the foreign sector for economies is capital, as it is a powerful driving force of growth and employment. As in the rest of the most advanced countries, the coverage by the Spanish State of the risks inherent to the operations of Spanish companies outside of Spain constitutes an essential instrument of trade policy. This coverage is provided through third-party institutions, or export credit agencies. In Spain this role is performed by the *Compañía Estatal de Seguros de Crédito a la Exportación, S.A. (CESCE)*. In addition, the Consorcio de Compensación de Seguros has been performing a number of functions since the sixties in the scope of State-sponsored export credit insurance, going on in the last few years to become the cash flow manager, the manager and the administrator of the new financial mechanism of the coverage program.

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1. Official support to enterprise internationalisation. International Framework

The importance of the foreign sector for economies is capital, as it is a powerful driving force of growth and employment. The share of the exports of goods and services in Spain's overall GDP exceeded 32% in 2015; the second highest in the European Union. Our country is the ninth largest world exporter of services and the eighteenth in terms of goods.

As in the rest of the most advanced countries, the coverage by the Spanish State of the risks inherent to the operations of Spanish companies outside of Spain constitutes an essential instrument of trade policy. The transactions for the export of goods and services and direct investment in other countries involve risks of generating losses, both for the exporting companies as well as for the institutions financing them. The origin of the coverage of these risks by States goes back to the severe trade crisis experienced by the most highly industrialised countries following the First World War. Since then, this coverage has taken the form of a key financial instrument for promoting exports and, in general, for the defence of the national interests of countries⁽¹⁾.

With a view to preventing the distortions ensuing from unequal conditions of access to official export support, and to offer a framework favourable to international competition among exporters based on the quality and price of their projects, in 1976 the great majority of OECD member countries signed



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In the free market context prevailing in the most developed economies, the coverage by States of the risks of overseas transactions complements the coverage provided by private companies, with the State acting as the insurer of last resort and, particularly, for transactions involving strategic interests.

(1) In Spain, export credit insurance began with the Royal Decree-Law of 6 August 1928, which also created the *Banco Exterior de España* and the *Compañía Española de Seguros de Crédito y Caución*.

the so-called “OECD Consensus”(2). This is a set of rules limiting the financial facilities which States can grant to their domestic exporters, regulating aspects such as the applicable sectors of production, maturity dates, interest rates, local expenses eligible for financing, requirements for the granting of support, among others, and even certain procedural details. Since its entry into force in 1978, the Arrangement has been subject to a continuous process of revision, having been reformed on several occasions to adapt it to the intense internationalization process undergone by the world economy during the last few decades.

Spain, the same as the rest of the European Union countries, provides its official coverage in line with the rules established by the OECD Consensus, included in the Community acquis in 1978.

In the free market context prevailing in the most developed economies, the coverage by States of the risks of overseas transactions complements the coverage provided by private companies, with the State acting as the insurer of last resort and, particularly, for transactions involving strategic interests.

The provision of coverage by States is carried out through third-party institutions, either public bodies or private companies, empowered to operate for the account of the State. In the framework of the OECD, these institutions are called ECAs (Export Credit Agencies).

The Spanish ECA is the *Compañía Estatal de Seguros de Crédito a la Exportación, S.A. (CESCE)*, a company incorporated in 1971 with majority State ownership for the purpose of managing on an exclusive basis the State-sponsored coverage of foreign trade risks. CESCE is also (as are so many other companies in the insurance market) approved for covering risks on its own account, whereby it engages in both activities, the public and the private, with an absolute separation of functions.

In addition, the *Consortio de Compensación de Seguros* has been performing a number of functions since the sixties in the scope of State-sponsored export credit insurance, going on in the last few years to become the cash flow manager, the manager and the administrator of the new financial mechanism of the coverage program.

2. The Spanish risk coverage program. The Risk Reserve Fund for the Internationalisation of the Spanish economy

The coverage of internationalisation risks has had a new legal framework since 2014, with the approval of Act 8/2014 of 22 April, on State coverage of the risks of the internationalisation of the Spanish economy, and Royal Decree 1006/2014, of 5 December, pursuant to that Act.

The new program has been created in a context of economic recovery in which the foreign demand has played a crucial role. To combine the dual objective of guaranteeing that Spanish exporters and investors operate under conditions as advantageous as those of their international competitors, and to achieve a greater financial balance for minimising the budgetary impact of the program, a new mechanism has been created for financing such coverage under the backing of the State: the Internationalization Risk Reserve Fund (FRRRI). The start-up of the mechanism took place on the first of January 2015. Up to that date, the payment of compensation derived from insurance contracts was financed by charging such amounts to the National Budget.

This is an official Fund without a legal personality, which is attached to the Ministry of Economy and Competitiveness. The Fund is managed by the *Consortio de Compensación de Seguros*, with CESCE acting as the risk manager.

(2) General Arrangement on Guidelines for Officially Supported Export Credits.

2.1. Activities of CESCE as the management agent of the FRRI

In its state-sponsored activities, CESCE performs the usual tasks of insurance management (the study, negotiation, formalisation and follow-up of the insurance contracts; risk abatement; recovery management; subscription of reinsurance and coinsurance covenants, etc.) applying rigorous technical criteria and contracting directly with the insured, with respect to whom it assumes the obligations derived from the policy, although it is not liable with its assets for the losses covered under State sponsorship. In exchange for the provision of this service to the State, CESCE is entitled to receive remuneration, which is determined as a percentage of the premiums collected.

For the efficient discharge of the duties of its public mission, CESCE, in addition to allocating the legally required material and human resources, contributes its experience in the financing of international transactions during 45 years of activity.

CESCE manages the State coverage in accordance with the guidelines of the bodies of the State Administration responsible for Spanish trade policy. The coordination and the relations between the two parties are managed by the State Risks Commission, an inter-ministerial collegial body in charge of the control and monitoring of the management performed by the company and responsible for deciding whether the transactions examined and proposed by CESCE are to be covered.

2.2. Risks covered

The State, through CESCE, can insure the following types of risk:

- Trading risks. Those risks which can occasion losses due to failure to meet the commitments acquired under contract by private debtors; principally the risks of sooner termination of contracts and defaults in payment.
- Political risks. Those risks which can generate losses derived from decisions by public institutions and from serious economic and political situations, as well as those caused by defaults in payment by public debtors: expropriation and confiscation, lack of convertibility of the currency, war and political violence, the insolvency of the public purchaser, among others.
- Extraordinary risks. Those which can cause losses for the insured derived from the occurrence overseas of catastrophic events of a natural, nuclear, chemical or similar origin: earthquakes, cyclones, radioactive leaks, among others.

With respect for the rules of fair competition, and in the context of their nature, maturity, country of destination or other elements, the State can consider, in consonance with European legislation, that a transaction is insurable on the private market and, therefore, should be excluded from official coverage.

State coverage encompasses practically all sectors of economic activity, where major infrastructure and engineering projects: high-speed railways, renewable energies, the petroleum refining industry, motorways, electricity lines, etc., characterised by high levels of added value and the incorporation of high technology, are particularly significant.

Neither are there restrictions to coverage with respect to the size of the export companies. Small family businesses through to complex business corporations have received State support through this coverage. In fact, the relevant legislation considers as transactions of strategic interest those which involve the internationalisation of small and medium sized companies.

In terms of the countries of destination of the projects proposed by Spanish companies, in accordance with the European regulations all of the countries of the world are eligible for the benefits of official coverage, with the exception of the group of higher-income countries for short-term loan transactions. The most numerous coverage transactions have as their destination the emerging countries of Africa, Asia, Latin America and the Middle East, given the strategic importance for companies of extending their presence to new markets which, although less mature, have great potential for development. Nevertheless, each country has a policy of coverage established depending on its political and economic circumstances, and contracting is closed in those countries where the situation is considered to be critical.

In the context of ethical guarantees, the examination of proposed transactions with official coverage gives particular attention to compliance with the international standards for the fight against corruption, as well as to the adoption of measures for the prevention and mitigation of environmental impacts.

2.3. Modalities of coverage

The coverage of international transactions by the State can take the form of an insurance policy or the provision of a direct surety. In practice, the great majority of the coverages materialise as an insurance contract, while the issuance of direct guarantees is very residual in number.

The insurance coverage takes the form of 14 types of insurance contract, depending, basically, on the various risks to be covered. On a general basis, we can group them together into 4 categories, referring to: pre-financing of a contract; financing, either for the exporter or for the foreign buyer; default in payment of the amount deferred; and the issuance of bid and contract bonds.

From among all of the modalities, the following two deserve particular mention due to their quantitative relevance:

- Buyer credit. Under this modality, coverage is provided to the financial institution, either Spanish or of another nationality, which grants the loan to the foreign purchaser of the Spanish supplies or services. This modality accounted for 77% of the individual policies arranged in 2015.
- Policy for the risk of enforcement of guarantees. By means of this insurance, the insured, which is also a financial institution -the one issuing the guarantee-, is covered against the risk of non-payment of the loan arising against the exporter in the event of the enforcement of the guarantee. There has been a strong demand for this product by Spanish companies during the crisis when, occasionally, the issuance of the guarantees was conditioned to having State coverage, for which reason this modality has played a very significant role.

The general terms & conditions of the contracts are approved by the Ministry of Economy and Competitiveness, the same as the applicable premium rates.

2.4. Quantitative limits to State coverage

The State-sponsored coverage which CESCE can contract is subject to annual ceilings. The maximum amounts for new contracts are established in the annual laws approving the National Budget. In the last few years, the ceiling for the capital insured has been set at 9 billion euros.

The principal indicators of State-sponsored coverage in the 2015 financial year, the first year of operation of the FRRI, are set out below:

Concept	Amount (Bn €)
Issued coverage, total	2,641
Buyer credit	1,679
Guarantees	342
Other modalities	145
Premiums charged	166
Compensations paid	65
Risk portfolio	16,289

Main countries in portfolio:
 Turquía, México, Arabia Saudita, Angola and Cuba

3. Activity of the *Consortio de Compensación de Seguros* as manager and administrator of the FRRI

The management and administration of the FRRI has been entrusted by Act 8/2014 to the *Consortio de Compensación de Seguros*.

The functions to be performed by the *Consortio* as manager and administrator of the Fund are set out in detail in the Collaboration Agreement entered into with the Secretariat of State for Trade. The principal responsibilities are as follows:

- To invest the resources of the Fund in the financial markets. This management task is performed in accordance with the delimitations set by the Treasury.
- To make the funds available to CESCE which are necessary for meeting payments of compensation to the insured and the rest of the obligations derived from the coverage.
- To keep the accounts of all of the transactions of the Fund and prepare the annual accounts for approval by the Risks Commission for the State. The financial statements of the Fund are the result of adding the insurance transactions accounted for by CESCE to the investment transactions accounted for by the *Consortio*.
- To prepare the yearly operating and capital budgets of the Fund, on the basis of the information and estimates provided by CESCE.

3.1. Financial resources of the Fund

The resources nurturing the Fund for meeting compensation payments come, on the one hand, from the premiums and the recoveries of losses paid in the past, and on the other, from the returns obtained from the financial investments made, without government subsidies to the Fund. Since these assets do not belong to the *Consortio*, the Fund is managed according to strict criteria of accounting and operational separation from the rest of its activities.

The amount of the funds with which the FRRl was created, originating from surpluses in the budget credits used for financing the system up to the start-up of the new mechanism and the amount of the resources at the end of the first year, is shown below.

FRRl resources (million €)	01.Jan.15	31.Dec.15
Liquidity	751.35	58.67
Financial investments	0	920.32
Total	751.35	978.99

The framework of principles and parameters, in which the financial management of the funds of the FRRl by the *Consorcio* operates, is determined by the investment policy approved by the Treasury. The ultimate aim is to obtain the best returns for the system while limiting its exposure to risk. To achieve this objective, the investment policy establishes principles which are common to all insurance companies -profitability, liquidity, security, currency matching, diversification and dispersion-, and determines a number of rules, among which the following stand out:

- The funds may only be invested in fixed-income securities on a regulated market of the OECD.
- The financial duration of the portfolio has a 3-year time horizon.
- The issues must have a high degree of liquidity.
- The acceptable risk threshold is measured on the basis of the rating of the issue with respect to the government debt securities and the credit spread.
- The maximum investment for a single issuer and the investment in sovereign debt of OECD countries other than Spain are limited.
- The investments made in a foreign currency must match the commitments assumed by the insurance contracts, to prevent negative exchange rate effects.

Conclusions

During the last three decades, Spanish companies, particularly the largest enterprises, have carried out a rapid process of internationalisation. In this transformation, the backing of the State to companies through the coverage of the risks of internationalisation has been a crucial instrument, particularly in the award of major projects and in situations of scarce liquidity, such as the situation which has characterised the recent international financial crisis.

The need for Spanish companies to improve their competitiveness and efficiency in the implementation of the policies of openness to foreign markets has led the State to design a new legal framework for State-sponsored coverage of the risks of internationalisation, including a new economic-financial mechanism, the Internationalisation Risk Reserve Fund, which makes it possible to reinforce the official support to companies without incurring additional costs for the National Budget. The management and administration of the mechanism is carried out by public institutions and State-owned companies specialised in the management of insurance risks: CESCE as the operational manager of the insurable risks and the *Consortio de Compensación de Seguros* as the administrator of the Fund, through its two-fold role as the investment and cash manager, and as the body responsible for the preparation and drawing-up of the economic-financial information.

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