
An Investment Banker Looks at Ex-Im Bank

ROBERT D. HORMATS

Capital Markets in Ex-Im's Future

How can the US Export-Import Bank transfer risk, and share risk, with potential investors, using the capital markets—utilizing such devices as securitization, insurance policies, and credit derivatives? Without going into the details of these instruments, I will highlight several general points. Increasingly, the capital markets are financing what is known as “non-traditional” risk. I put export credit risk into the nontraditional risk category. Risk-transfer techniques for nontraditional risk include catastrophe insurance, life insurance, default insurance, weather derivatives, and weather insurance. Especially since 1966, the capital markets have financed a substantial amount of nontraditional risk through securitization. The total of nontraditional risk securitized up to 1996 was under \$300 million; but in 1998 and 1999, the annual amount securitized was more than \$10 billion, and the figure is growing.

We have not yet seen a great deal of securitization of export finance paper, but interesting relevant examples can be cited: Sezione Speciale per l'Assicurazione del Credito all'Esportazione, the Italian export credit agency, securitized its portfolio of Paris Club obligations; the Korean Export-Import Bank, through a Dutch agency, established a collateralized-loan obligation system—into which it sold a large portion of its obligations—and securitized the loans. The International Finance Corporation (IFC), a

Robert D. Hormats is vice chairman of Goldman Sachs (International) and managing director of Goldman Sachs & Co.

member of the World Bank Group, has securitized some of its Latin American and Asian obligations.

Why Capital Markets Will Work for Ex-Im

But there are few examples of bundled export finance paper securitized in the way I am describing. There certainly is room for more financing in this manner. The idea is beginning to be explored. In the future, three factors argue for greater recourse of Ex-Im credits to the capital markets.

First, instruments that transfer risk, or share it with other investors, free up capital that can be used to finance more exports. When Ex-Im and other export credit agencies (ECAs) take some of the risk off their books and transfer it to capital markets, they can do more business. That is helpful to an ECA, and it is certainly helpful to all that benefit from additional export financing or guarantees.

Second, the capital markets reflect, to a substantial and foreseeable degree, the historically high asset performance of agencies such as Ex-Im Bank. If one compares Ex-Im's collection rate since 1992 with the collection rate on an average portfolio of emerging-market assets (excluding Ex-Im's loans from the average), Ex-Im's experience tends to be somewhat stronger. This is important because the collection rate is what rating agencies look at. The rating agencies will not assign to Ex-Im paper the status of a preferred borrower, such as the World Bank, but they will look at its collection track record vis-à-vis that of an average emerging-market portfolio. Against this benchmark, Ex-Im does well.

Third, investors in emerging-market debt securities look at other factors as well: the extent of "due diligence" performed before lending decisions are made, the degree to which loans are monitored, and how closely the agency works with its creditors. If one looks at the experience of Ex-Im in these areas, it is again quite positive. This is another important plus for Ex-Im credits gaining access to the capital markets.

How to Structure Ex-Im's Recourse to Capital Markets

As Ex-Im considers utilizing the capital markets, it is important to focus on the credit rating that capital markets would assign to financial instruments supported by Ex-Im, or related to Ex-Im loans. To create a market for new assets that the capital markets will judge positively, the Bank will have to attract new investors—not just traditional investors in emerging-market debt.

Traditional investors in emerging markets tend to stay away from financial assets that are bundled by third parties. These investors are good

at evaluating individual country risk, the risk relating to an individual asset, and the risk of groups of assets in a single country. They are also reasonably good at putting together their own portfolios of assets in a given risk category. But these investors stay away from portfolios composed of assets in different countries, and in different risk categories, that are bundled by third parties. This is not to say that investors in emerging markets will not buy such portfolios, but these investors are used to investing in assets with a similarly high risk, and a similarly high rate of return, in one given country. In many cases, prebundled cross-cutting categories of high-risk and low-risk assets just do not fit.

Conversely, many investors tend to buy financial assets rated higher (better) than emerging-market debt. If one can create new securities—utilizing good portfolio management, collateralized loan obligations, or some other risk-reduction approach for emerging-market debt—then investors who are used to higher-grade, or lower-risk, assets may become buyers. Getting the rating agencies to see paper related to Ex-Im as a higher-grade asset, which makes it more attractive for nontraditional emerging-market investors, is the key to this process.

In early 2000, Ex-Im Bank issued an invitation, on the Internet, to submit proposals to transfer political and credit risks in future transactions from the Bank to the capital markets. This is an extremely important opportunity for Ex-Im. By using the Internet to solicit proposals, it did something very interesting: it expanded the number of people who are aware of what it is doing, and it increased the probability of getting useful responses. Using the Internet is a terrific idea, because there is a lot of creativity in the capital markets. Ex-Im received eight proposals, made an award, and has been working with the awardee on the details of a risk-sharing facility to present to the capital markets in fall 2000.

Capital Markets as a Foreign Policy Tool

But there is a cloud on the horizon. At the same time when so many US companies depend on exports, and when Ex-Im Bank is thinking of utilizing the capital markets to a greater degree, it has become popular to suggest that the United States should expand its foreign policy sanctions to deny access to US capital markets to more foreign countries or companies. It is important to debate this suggestion head-on.

The US capital markets have functioned extremely well. By and large, they have been depoliticized over the years. Currently, there is little political (as opposed to regulatory) government involvement in US capital markets. But if wide-ranging concerns of members of Congress about China, India, Russia, or other countries create political pressure or heavy-handed legislation to deny these countries access to US capital markets, the financial markets will become political tools. That, in itself, would be

troublesome. It also would make the United States a less reliable partner in a more and more integrated world economy.

For those who want Ex-Im Bank to have greater access to capital markets, these concerns are particularly important. The United States is the only major country that faces great domestic pressures to utilize its capital market as a source of international political leverage. When a country egregiously violates international norms, it might be appropriate to impose a capital-market sanction. But the United States has tended to use its foreign policy sanctions arbitrarily, in response to myriad domestic political pressures triggered by foreign infractions that are not always egregious. Often, the sanctions hurt US companies more than the so-called target country or company. To extend these casual practices to the US capital markets would be quite damaging.

If we impose capital-market sanctions indiscriminately, we will make it more difficult for Americans to export. Other exporting countries will not sit on their hands. They will take advantage of the opportunity. When we restrict US exports, we deny US companies and US workers valuable benefits. Ex-Im Bank is equally vulnerable to these pressures. At a time when Ex-Im is thinking of utilizing capital markets to a greater degree, and when capital markets are by and large working well, this is a cloud that all of us should watch.