

2018

GLOBAL TRADE – SECURING FUTURE GROWTH

ICC GLOBAL SURVEY ON TRADE FINANCE

Trends in international trade and supply chains >

Developments in trade financing operations >

Regulation and compliance >

Digitisation and transformation >

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Foreword

By John W.H. Denton AO

John Denton is Secretary General, International Chamber of Commerce

As the ICC Banking Commission held their Annual Meeting in Miami last April, the chosen theme—“Navigating trade in a world of disruption”—could hardly have been more prescient. In the weeks preceding the meeting, the world’s two largest economies had announced new sets of trade-restricting measures, prompting stock markets to tumble and concerned voices around the world to warn of an impending “trade war”.



The ICC Banking Commission began its work in the 1930s, as the world was facing a different tide of nationalism and protectionism, and in many ways neatly encapsulates much of ICC’s mission and track record of setting global standards and rules that enable and govern world trade.

Since their publication, ICC’s rules for documentary credits have since become the most successful privately-drafted rules for trade ever developed. Every year, trade transactions of over US\$2 trillion are conducted on the basis of these ICC rules. ICC’s uniform rules for forfaiting—the first ever developed—were officially endorsed by the United Nations (UN) in July 2017, recognising the important place already occupied by the rules in the private sector.

A better vantage point to drive growth

Reliable and cost-effective financing is integral to the global trading system, helping companies to mitigate the risks and costs involved in the international flow of goods. This role makes the trade finance industry particularly sensitive to the politics of world trade, and—as this tenth anniversary edition of the Global Survey report demonstrates—this is only one of many trends that that banks are factoring into their risk assessment as they gauge the economic horizon.

Digital technologies, from big data to blockchain, are also transforming the global trade finance industry, bringing in a new generation of players and business models and driving the movement towards paperless trade.

From its creation ten years ago, the Global Survey has offered an unparalleled snapshot of the many challenges and opportunities facing the trade finance industry and, most importantly, puts these trends in their private sector context. To take digitalisation for example, the Global Survey moves beyond the much-heralded forecasts of how ripe trade finance is for digital disruption to assess the extent to which banks around the world are actually going paperless on the ground. A better view of where businesses are at will allow public and private stakeholders to more effectively drive sustainable growth for trade finance in the 21st century.

Mapping challenges for collaborative solutions

The same can be said of regulation. This year’s Global Survey consistently shows that regulatory issues are among respondents’ top concerns. Looking at further research from ICC and other actors, it is also clear that some financial regulations governing banks have had the unintended consequence of widening the trade finance gap, making it more difficult for smaller companies and traders in the

developing world to access much-needed financing.

As one standout finding of the Global Survey demonstrates, banks headquartered in Africa are now almost twice as likely to expect the trade finance gap to widen. Following ICC engagement with the UN and national governments in 2017, the trade finance gap and its negative implications for economic development were recognised, with the UN committing to carry out an official review of the gap and its causes. Bringing a greater number and diversity of companies into the international trading system will be key to building popular and political support for trade in the years to come and in turn unleashing trade’s enormous potential to help us collectively reach the UN’s Sustainable Development Goals.

As the only private sector Observer to the UN General Assembly and a leading voice for global business across intergovernmental forums, ICC has long held that an inclusive and evidence-based policy process can drive global economic growth and further development goals. The ICC Global Survey is a concise demonstration of this conviction and it is my belief that its findings will contribute to informing an international policy process that aims to share the gains of trade more widely among countries too often see each other as zero-sum competitors. Happy reading.



Message from the report Chair/ Global Trade – Securing Future Growth

By Alexander R. Malaket CITP, CTFP

Alexander R. Malaket is Chair, ICC Banking Commission Market Intelligence



Trade deficit bad. Protectionism good. Exports good. Imports bad.

Surely we can do better, even in these highly politicised, cynical times.

Informed, thoughtful and statesman-like dialogue on international trade is more urgent than ever. That is the backdrop against which this 10th anniversary edition of the Banking Commission's flagship edition is being published.

Trade today is about much more than one nation or one trading partner winning at the expense of another. It is about much more than straightforward imports or exports, and the simplistic, zero-sum rhetoric of the day.

So experts must communicate clearly and compellingly on trade - and move beyond dispassionate, academic discourse.

Trade is on its way to regaining its familiar, pre-crisis position as an engine of global GDP growth. The fundamental role of trade-related financing and risk mitigation is now broadly acknowledged, and there is a more informed view of the importance of sustainability in trade and global supply chains. Above all, there is greater appreciation for the importance of equitably distributing the benefits of trade around the globe.

Digitalisation of trade, both in the physical supply chain and in the financial supply chain, will reshape trade in fundamental ways. The application of disruptive technologies, increasingly ubiquitous platforms that enable trade, and the common application of the latest technology to expand

delivery channels: these all expand execution and accelerate transaction lifecycles. Combined, they offer the promise of true transformation, and spreading the benefits of trade more fairly, and into the deepest links in global and regional supply chains.

In these new realities trade will help secure global economic growth.

Sustainable success demands more than developing and deploying technology; more than adopting new business practices, and even more than rebuilding trust with society, so business can do well by doing good, so trade can be win/win.

Success in fulfilling the promise of trade demands thoughtful, effective advocacy: tell the story in a compelling way of why trade matters and is worth pursuing in an open, rules-based, and more open architecture, and why it is imperative for leaders and influencers to take a wider view of international commerce.


This year's edition of the ICC Banking Commission's "Global Trade – Securing Future Growth" report contributes to this dialogue, viewed through the lens of trade finance and supply chain finance, which trade relies on.

The core analysis of key findings from the annual survey is enriched by contributions from leading thinkers and influencers on global trade and trade financing. The report presents a powerful combination of messages for a more thoughtful, inclusive and mutually beneficial outlook on international trade for all.

We asked these experts game-changing questions: how can we safeguard the planet, its inhabitants, and global economic growth? Can we achieve effective and balanced regulation with Ethical Business Regulation (EBR)? The report provides data and fact-based assessments of digitalisation's effects on trade finance and the 200 billion data filed interactions, and gauges the impact Berne Union members have on 14% of global merchandise trade. It also brings into relief the annual trade finance gap, now US\$1.5 trillion, and the economic value and potential it represents to make trade more inclusive.

This anniversary edition is rich in market data, observations and analysis. Readers can look at the information provided from a practical, transaction and operational view or a strategic view. Readers can use the insights and data to advocate internally or engage influencers and leaders at the highest levels of policy, political and international circles.

Our sincere thanks to all who made this 10th edition, including our Editorial Board, the Banking Commission team in Paris, the authors and contributing partners, and the partners and sponsors cited on the acknowledgements page. And above all, thanks to our readers. We hope this publication will help you navigate and better understand the trade corridors, supply chains and global architecture that enables trade flows worth many trillions every year.



“Free trade is not a philosophy for the narrow minded or the faint hearted”.

Douglas Hurd, UK Foreign Secretary

“We have to get back to basics on trade: explain to people again and again trade benefits both parties, and is at the heart of our welfare and that of emerging economies of every generation throughout history.”

Karel De Gucht, European Commissioner designate,
Trade College of Europe

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EXECUTIVE SUMMARY

Wrap up of 2018 report/

Boosting growth, prosperity and inclusion through trade

With the 10th anniversary title, “Global Trade – Securing Future Growth”, the annual publication shifts from its previous title “Rethinking Trade & Finance”, also highlighting the linkages between trade financing and the successful pursuit of international trade, now well established, to bringing back into focus trade as a driving force in global economic growth, prosperity and inclusion. An overview and executive summary of the report’s key findings - with a global context and macro view; results from the ICC Global Survey on Trade Finance 2018 and further insights into trade financing matters; regulation and compliance; digitisation and technology and transformations in sustainable trade finance; as well as a spotlight on trade, finance, and digitisation in Singapore and China. [Page 9-20 >](#)

Wrap up of 2018 report/ Boosting growth, prosperity and inclusion through trade

The annual ICC Banking Commission survey and report on trade and trade financing, originally titled “Rethinking Trade and Finance”, now adopts a new focus. With the 10th anniversary title, “Global Trade – Securing Future Growth”, the annual publication shifts from highlighting the linkages between trade financing and the successful pursuit of international trade, now well established, to bringing back into focus trade as a driving force in global economic growth, prosperity and inclusion.

This year’s publication is underpinned by the most comprehensive and authoritative survey on global trade finance, with views collected from 251 banks headquartered in 91 countries.

But it is much more than the ICC global survey on trade finance and its analysis: it is a platform for trade and international commerce to share perspectives. The insights and views will help drive strategy, shape policy and regulation, conceive of and carry out innovative solutions. The publication aims above all contribute to trade-based growth and economic inclusion globally.

The report also touches on the major areas of Banking Commission activity, including globally-

recognised, rule-making and standard-setting, regulatory and policy advocacy, and contributions to make trade and trade financing more inclusive and sustainable.

The ICC Banking Commission advocates and champions trade and trade financing at the most fundamental, transactional level and at the highest level of business and policy.

As John W.H. Denton AO, ICC’s new Secretary General, notes in his Foreword, ICC is the only private sector Observer to the UN General Assembly and a leading voice for global business across intergovernmental forums. It has long held that an inclusive and evidence-based policy process

can drive global economic growth and further development goals. The ICC Global Survey is a concise demonstration of this conviction and its findings also intend to contribute to informing an international policy process to share the gains of trade more widely.

**An inclusive and
evidence-based
policy process
can drive global
economic growth**

Through numerous expert contributions also summarized below, this report is an important part of the commission’s efforts

to advocate and champion trade and trade financing at the most fundamental, transactional levels and at the highest strategic levels of business and policy.

Context and macro view

Leading market observers say trade is on the cusp of regaining its place as a driver of the global economy, and finally showing signs of keeping pace with global GDP growth and even poised to outpace it. Even as there are worries about damage to the global recovery from ill-informed and ill-advised protectionism, isolationism, and a return to mercantilist, zero-sum views of international commerce, there are more positive, constructive signs shaping the future of trade and trade financing.

Protectionism and the risk of a trade war could put the recovery at risk

In the report, WTO Director General Roberto Azevêdo points to a five-year period of growth and recovery, noting that protectionism and the risk of a trade war could put the recovery at risk. At the same time, Azevêdo says the historic achievement of the Trade Facilitation Agreement has the potential to advance the conduct of global trade.

After a decade of collaboration between the WTO and the ICC, the WTO Director General still strongly advocates in support of trade financing, including for more access to trade finance for SMEs. As the debate continues about trade and its impact on jobs and national competitiveness amid misinformation and distortions, the WTO states what others have hinted at: the challenge to some occupations and economic activity is more from technology, not trade.

With more than 400,000 industrial robots to be installed on shop floors in China this year, Chinese “smart factories” show the potential

impact of automation. Yet as the World Bank suggests, the attention on technology and job loss ignores that even in developing economies, the risk from technology is much less than portrayed, and estimates show it will affect 2% to 8% of jobs.

In developing economies, automation will affect 2-8% of jobs

Arancha González, Executive Director of the International Trade Centre in Geneva, emphasizes why closing the US\$1.5 trillion trade finance gap really matters and the key role international institutions must play. In that vein, she mentioned the last WTO Ministerial in Buenos Aires which produced a Declaration on Women and Trade, backed by over 120 member states. The declaration referred to access to trade finance for women, to redress the disproportionate, gender-skewed rejection rates for women entrepreneurs seeking credit.

Financial institutions reject 2.5 times more applications from female than male entrepreneurs

This is the latest sign that international development organisations recognise how important women are to boost economic growth in developing countries.

World Bank analysts expect economic growth to be robust, especially in developing and emerging markets. Analysts forecast global GDP will grow 3.9% in 2018 and 2019, with emerging Asia to grow 6.5% over the same period. World trade grew faster in 2017 than in the five previous years, at about 4.5% during the first 10 months, they estimate.

World trade grew faster in 2017 than in the five previous years

More work is to be done, and thoughtful stewardship of the global trade and economic system is more important than ever. Before the global financial crisis, trade grew twice as fast as GDP from 1990 to 2007. In recent years, from 2011 and to 2016, trade and GDP growth were comparable. While trade is showing signs of becoming an engine of growth again, it will take much effort to reach historical levels.

Systemic factors such as mature global value chains and the slow pace of trade liberalisation (to say nothing of possible reversals) will make it difficult to reach similar growth rates in trade, without supportive developments, such as signs of recovery in commodity markets, says long-time practitioner and globally-recognised expert, Jean-Francois Lambert.

Analysis by the Boston Consulting Group estimate global trade flows will hit a record US\$24 trillion by 2026; with the most optimistic scenario projecting trade finance revenues will reach US\$48 billion in the next three years, at growth rates just exceeding 6% a year. BCG says dynamics worth monitoring are increased flows of RMB-denominated trade and a potential pickup of asset securitisation in trade.

Trade finance revenues projected to reach US\$48 billion in the next three years

According to SWIFT data, the US dollar is still the most frequently-used currency in the SWIFT network for trade finance activity. For example, just over 83% of documentary credit traffic is denominated in US dollars. The

euro is a distant second at less than 9% and the RMB (CNY) is used in less than 3% of L/C transactions.

SWIFT data clearly show the US dollar's dominance in trade-related SWIFT traffic. However, the fast growth of the RMB across all forms of trade activity – that is, beyond traditional trade finance covered by the SWIFT MT400 and MT700 Messages – merits attention, particularly as the geopolitical implications of currency use in international commerce get more attention.

Signs are positive for economic growth and recovery, and the trajectory of trade growth and trade-based development is promising

The takeaways at the macro level are: signs are positive for economic growth and recovery, the trajectory of trade growth and trade-based development is promising. Also, there are positive signs for large upside potential in trade financing, both in capacity globally and in growing revenue pools for the provision of traditional trade finance (TTF) and supply chain finance (SCF).

On the more sobering side, the global recovery is still vulnerable to large swings and unexpected shocks. These include protectionism through non-tariff measures (NTMs), ill-considered and inflammatory rhetoric, and a return to narrow views of international commerce and cross-border investment flows.

The global recovery is still vulnerable to large swings and unexpected shocks

Trade financing: market research and data

The report presents the perspectives of 251 banks in 91 countries in the ICC Global Survey on Trade Finance and 65 senior export finance leaders in the TXF-conducted survey. The usual, data-rich and informative contributions of the Berne Union provide a detailed and comprehensive view on the state of trade financing globally.

Contributions from our partners, the multilateral development banks, were coordinated by Thierry Sénéchal of Paris-based Finance for Impact, in a comparable and easy-to-read table, plus an overview of activities from each organisation, with their contributions and views on trade financing in developing markets.

In the ICC Global Survey on Trade Finance, 47% of respondents report traditional trade finance (TTF) and supply chain finance (SCF) are organized in the same business unit. The survey shows there is still a clear focus on traditional trade finance, with 85% of respondent activities in this area, versus 15% in SCF. This is, of course, the reverse of the market: in the vicinity of 80% of trade activity is on open account and better suited to SCF solutions than traditional mechanisms.

Two thirds of banks reported values increased of traditional trade finance provided to the market, while 43% reported their book of business in SCF grew the previous year. 83% of banks reported they had explored at least one new market in 2016, with a large portion reporting increases in their trade credit lines, particularly for mid-cap clients, where 48% of respondents saw an increase in available credit facilities.

The large corporate and multinational segment fared nearly as well. However, financial institution (FI) clients saw their access to trade finance-related credit contract, the least favourable trend year-on-year. 22% of respondents reported reduced FI

lines to support trade financing. Notably, insufficient credit facilities remain a major reason for the continued dropoff in trade financing.

Digital trade and trade financing are top of mind among leading practitioners. While there is promise and progress in technical capability and the degree of market readiness for significant uptake, most observers recognise that achieving meaningful degrees of digitisation is possible in the medium-term in the best case. Survey results indicate that only 15% of respondents see transformative potential in applying technology to digitise and increase trade finance sales.

15% of respondents see transformative potential in applying technology to digitise and increase trade finance sales

The study also measures real progress toward digitised processes in trade finance. It presents an assessment of banks' maturity in using technology solutions to achieve benefits (reduced time and costs, improved precision associated with trade-related due diligence) with results indicating that 12% would be rated as mature, 49% a developing phase and 37% noting that they do not currently have digitalisation on their agenda.

Nearly half of respondents are in the process of implementing technology solutions

Paper is still widely used in documentary transactions. About 35% of respondents acknowledge that removing paper in the initiation stage and the settlement stage

of a transaction, the two more automated parts of the transaction lifecycle, is incomplete. In document verification, where the impact of using paper is most costly and time consuming, 52% of respondents indicated that no solution has been implemented in this very mature area of TTF.

52% indicate no solution has been implemented for document verification in trade finance operations

The commitment to TTF runs contrary to global trade trends. The shift to open account and by extension to SCF-related solutions, is all but universal across geographic markets and client segments. The underlying reason may be the profile of banks surveyed and the reality that deploying SCF programmes is limited to large global banks and a few technology-enabled, platform-based fintechs.

Whether focusing on TTF is a defensive measure, a strategic misalignment or partly systemic reticence around innovation is worth further analysis.

Interestingly, a large number of respondents noted, for example, they broadly use the same risk and credit policies for traditional business as for SCF. This may be appropriate, but worth considering if it is a core challenge for developing the SCF operating model and value proposition.

To shine a light on an issue trade financiers often cite, this year's survey explicitly raised the issue of the support trade finance (and SCF) receives from partner areas within banks.

Practitioners often believe trade financing is poorly understood by most non-practitioners and often faces more resistance than support from credit and risk specialists, for example. Except for the most global

institutions, trade finance is granted little more than passing attention from executive management, they believe. Some banks cite CEO engagement as a competitive advantage in trade financing.

It was surprising that a vast majority of respondents report very good to excellent support from key internal stakeholders. That might lead one to conclude respondents fear presenting a candid picture of reality on the ground, on the possibility that their responses could be tracked back to them. It should be noted here that participation in the survey is confidential, but the ICC encourages banks to coordinate internally so that only one response per bank is submitted in the study in order to avoid duplication or multiplication of inputs and data received.

The survey raised this issue of trade finance support and understanding to start a dialogue internally in banks and in the industry. As discovered a decade ago, regulatory authorities were not persuaded by anecdotal descriptions of the credit quality of trade finance activity, and challenged industry leaders to provide objective, robust data and to apply solid analytics. As a result, the ICC Trade Register Project continues this annual exercise.

To accelerate the evolution of trade-related financing, a similar exercise is needed to educate and engage business partners, senior leaders and executive management in banks.

But success will demand banks be more candid about their concerns, such as about internal support to trade financing lines of business, even at bank CEO level.

The TXF-ICC survey found export finance had a difficult year, but respondents expressed a positive outlook for 2018 and beyond. The survey shows deal volume and the number of deals in 2017 fell sharply: 290 deals were signed for a volume of US\$85.7 billion, compared with US\$133 billion on 378 deals the year before. Nearly half of respondents

expect the export finance market will grow as much as 10% in 2018.

Pricing was a focus in this year's survey. One practitioner said export credit agency (ECA) finance "has always been expensive". When asked about what prices will be in the next year, nearly half (46%) expect prices to stay the same, while one third see an increase, and 23% see prices continuing to fall. Some expect key reference rates to rise, which would help improve and stabilise margins.

Practitioners should be worried that export finance is showing some signs of a 'race to the bottom' on pricing – a scenario that has all but commoditised traditional short-term trade finance and eliminated the opportunity for value-based pricing discussions with clients.

Nearly half of respondents expect the export finance market will grow as much as 10% in 2018

ECA business reflects other issues in common with short-term trade finance, including the negative impact of regulation and compliance on underwriting business, particularly in the developing markets. Another issue is the perennial political demand for ECAs to provide better service to SMEs engaged in international commerce.

While a third of respondents believe ECAs adequately address SME demand for export finance, others are concerned about limited technical skills and the profitability of SME business, and feel pressured to highlight SME support and activity to assuage political leaders and policymakers.

The Berne Union article also highlights some positive macro developments likely to benefit international trade financing, through a risk mitigation lens that closely complements the activities

of export financiers profiled in the TXF-ICC survey.

Berne Union members, largely but not exclusively public sector or hybrid ECAs (in contrast to ICISA, which skews more to private sector members) report business was up in nearly all areas. This was also true in the medium and long-term, after five years of decline. Investment cover is one exception, which aligns with a 16% drop in foreign direct investment (FDI), particularly into developing markets.

The Berne Union assessment showed commercial and trade flows were on the upswing. With direct linkages to the US\$2.3 trillion in new business underwritten by members, the organisation has a major impact and comprises facilities flows of more than 14% of global merchandise trade. While claims paid on short-term business dropped 10%, total claims paid were again more than US\$6 billion.

ECAs, ECA variations and risk insurers represented by the Berne Union enable global trade flows directly and by supporting banks and boutique finance firms to leverage credit and risk capacity for underwriting more business, because of the availability of ECA cover. The pre-crisis debate that ECAs are an anachronism is well put to rest in most jurisdictions, except possibly the US.

Multilateral development banks (MDBs) are closely related to ECAs in their role of bringing net extra capacity to market at times of crisis and with non-commercial objectives. MDBs reported on the state of trade financing through the lens of development. MDB guarantee programs and risk mitigation back-stops help countries and regions engage in international commerce, in part by boosting the technical competence of local financial institutions in international banking.

This allows, for example, global banks to accept developing market bank risk, complementing the financing and product solutions of

private sector banks and ECAs. This is equally true for TTF and even more so for SCF.

MDB support totalled over US\$168 billion and over 100,000 transactions in 10 years

Over the last decade, MDB support in trade finance totalled more than US\$168 billion representing about 100,000 cross-border transactions. In 2017 alone, trade finance programmes helped facilitate 11,720 cross-border trade transactions valued over US\$30 billion in markets with the biggest gaps in provision. One of the newest trade finance programmes, launched by the African Development Bank (AfDB), is helping African economies conduct international trade and helping these economies reap the benefits from trade.

Since its inception, the AfDB programme has supported 1650 trade transactions worth over US\$6.6 billion. More than 100 financial institutions in 30 African countries, mostly low-income countries or fragile states, have benefited from the programme, including Guinea, Liberia, The Gambia, Ethiopia, and Zimbabwe. AfDB published the second edition of its “Trade Finance in Africa” survey in October 2017.

AfDB is contributing to trade financing capacity, promoting better understanding of trade finance by the market, whether by providing technical support in gaps in unmet demand or in availability of trade finance.

Whether by research, data-gathering or advocacy, as the Asian Development Bank has effectively done or by conducting analysis to assess unmet demand for trade financing, MDBs have made transformative contributions to trade-based international development and inclusion.

Their achievements are many. The EBRD and its technical assistance. IDB Invest and its activities in Latin America and the Caribbean (LAC) to offset de-risking and make sure the region continues to trade. The ITFC with its innovations in high-growth Islamic finance, to enable more trade between Organisation of Islamic Cooperation states (OIC) and its fund management with a focus on energy and trade finance.

The scope and range of activity and impact of MDBs is global. The activities of the IFC make this point compellingly: the IFC facilitates 57,000 transactions worth US\$64 billion in 85 countries through its GTFP program.

It is in the context of the work of the MDBs that the persistent and potentially very damaging issue of de-risking again makes its appearance most strikingly in industry discourse. The regulation and compliance-driven exit of banks from markets, FI relationships and corporate/commercial client relationships may have abated somewhat, as major banks imply that the process is largely complete, but it remains a serious concern. Observations from Latin America and the Caribbean, the Pacific Region and parts of Africa for example, suggest that de-risking as an unintended adverse consequence of regulation is having serious impact on the ability of businesses – and countries – to engage in trade-based recovery and growth.

The contributions of the multilateral development banks, broadly and on specific issues such as de-risking, can only be recognised, applauded and further supported by all stakeholders. The same is true for the invaluable contributions of ECAs of all types. Their efforts to advance positive policy and to address market failures or gaps are widely appreciated.

Regulation and compliance

Regulation and compliance, including capital adequacy, anti-money laundering, due diligence and sanctions monitoring, remains at the centre of activities linked to international trade, including trade-related financing and risk mitigation.

From banks to ECAs, from short-term deals to medium/long-term transactions, the impact of regulatory and compliance expectations and requirements (both noted because an expectation and a requirement may not be the same) is ubiquitous. The staffing and infrastructure needed by banks to meet these requirements is giving rise to the term “compliance empires”.

Informed, proportionate regulation is critically important for the health and growth of the global economy

This year’s report focuses on regulation and compliance, with Sir Michael Rake, Chair of ICC UK, calling for informed, proportionate regulation, as critically important for the health and growth of the global economy. Noting the argument long championed by the ADB and the ICC Banking Commission and now part of regular discourse that trade finance is low-risk from a credit standpoint, Sir Michael says the deep integration of global supply chains is another argument for appropriate regulation, to ensure access to adequate levels of liquidity in global trade and cross-border supply chains.

A pathway charted to develop trade finance as an investable asset class

The report focuses on the importance of attracting non-bank capital to finance international commerce. HSBC’s Krishnan Ramadurai, Chair of the ICC Trade Register and a member of the Banking Commission’s Executive Committee and Surath Sengupta Managing Director & Global Head - Portfolio Management & Asset Distribution, Trade Finance, make a compelling argument, with specific, actionable recommendations. They chart a pathway to develop trade finance as an investable asset class. The arguments are well timed, as cash-rich investors seek more attractive and uncorrelated returns linked to the real economy in their portfolio optimisation strategies.

Ivan Zasarsky of Deloitte’s Asia Pacific Financial Crime Strategy and Response Center presents an overview of trade finance regulation and outlines three methods to more efficiently deal with anti-money laundering, terrorist financing and sanctions: blockchain, data analytics, robotic process automation to enhance transparency and efficiency in trade finance compliance; better cooperation between banks and regulators, and shipping agents, ports and customs, along with the many other links in the chain of international trade; and greater collaboration through shared KYC registries, collaborative pricing data, and a clearer picture of cargo movements and whereabouts – including ships transferring goods at sea.

Echoing the stance on appropriate regulation, Eric Sohn of Dow Jones, revisits a risk-based approach to regulation, but proposes refinements in definitions and explains what this would mean in practice.

Starting from a ‘means, motive and opportunity’ view of criminal and illicit activity, Sohn says those of limited means or opportunity are less likely to be involved in major criminal acts. He says this distinction can be applied in designing and delivering approaches to meet regulatory and compliance programmes. Sohn acknowledges there is an art to his proposed approach, which he bases on analysis in the OECD’s Foreign Bribery Report that says 94% of all bribes were made to executives of state-owned companies, heads of state, government ministers and defense officials. He adds that regulator buy-in is critical to the success of a risk-based approach.

Also on the regulatory front, HSBC’s Félix Prévost and Krishnan Ramadurai give an in-depth update on Basel IV, on upcoming changes to capital adequacy requirements. They note the Basel Committee and national regulators should consider the impact of planned updates on access to trade financing for SMEs and developing markets, and their impact on narrowing the trade finance gap.

Corporate culture is at the root of success or failure in regulation and compliance

Professor Christopher Hodges of Oxford University and Ruth Steinholtz, founder of AretéWork LLP, follow with a provocative piece on ethical regulation, based on the notion that corporate culture is at the root of success or failure in regulation and compliance. They hypothesize that the current approach of big penalties and investigations, as noted by the UK FCA (Transforming Culture in Financial Services, 2018), is clearly not working.

To wit: “...tempering the single-minded pursuit of shareholder value with achieving the objectives of all stakeholders. It is about

fairness and doing the right thing...” Will this concept resonate today, when basic integrity and moral character escape leaders in the most powerful offices in the world? When financial institutions and other businesses have failed to earn and keep the trust of their clients and the societies they serve?

The authors argue that ethics and sustainable, successful outcomes for business go hand-in-hand. They go on to say that for business, ethical conduct and trust-building should directly translate into more supportive and engaged regulatory authorities. This is what is meant by Ethical Business Regulation (EBR). There is no need for huge fines or class actions, the authors say, proposing instead that the way to shape the behaviour of businesses and people is to encourage and support those who show they are clearly and genuinely attempting to behave ethically.

Technology and digitalisation

Technology, like regulation and compliance, is getting a lot of attention in trade-related financing. So much so that the inexorable if slow digitisation of trade and trade financing is driving initiatives as fundamental as e-enabling, the long-established rules and guidelines of the ICC Banking Commission on traditional instruments and practices in trade finance.

It is in this sort of partly speculative attempt to “see around the corner” that the survey findings and report contributions can help, there are clear indications that technology is moving from a quasi-peripheral topic as a tool or enabler, to a core strategic consideration. Banking has inevitably had to reconsider the role of technology on familiar business models, and trade financing is reaching a similar inflection point. Even relatively unproven technologies like distributed ledgers are seen as a fundamental disruption, not incremental evolution: a leap in

approach that is unfamiliar but long overdue.

Daniel Schmand, ICC Banking Commission Chair makes a call to action for collaboration to the trade finance industry, as it sits on the cusp of a digital revolution.

BCG gives an overview of digitalisation in trade finance in the wider context of digital trade after discussions with industrial specialists. These specialists reported methods such as Robotic Process Automation (RPA) and machine learning (ML) have matured enough to advance the digitisation of trade finance processes, and to support the automation of compliance processes, such as sanctions screening.

The application of these technologies to trade finance has reduced human involvement to final validation and authorisation, cut processing times 60%, and reduced the need for operational staff by 70% for entering data and conducting scrutiny, BCG says.

BCG estimates an integrated digital solution would save global trade banks between US\$2.5 billion and US\$6.0 billion on a cost base of US\$12 billion to US\$16 billion, with the potential to increase revenue by 20%

BCG brings the power of digitalisation into focus by showing interactions between a small number of parties in trade finance can involve 5,000 data field interactions, perhaps 200 billion globally, adding only 1% in value. The report highlights the importance of standards and

consistency, addressing regulatory and compliance issues amid digitalisation and the potential impact of Distributed Ledger Technology on aspects of trade financing.

There are 4 billion pages of documents circulating in documentary trade

The ICC Banking Commission’s Working Group on Digitalisation gives an update on the state of trade and trade finance-related digitisation, outlining the working group’s key activities and initiatives. An estimated four billion pages of documents circulate in documentary trade, the working group said, but digitalisation can reduce the manual and error-prone processes for document and compliance checking. According to the working group, progress from technology will have the greatest impact on GDP levels by 2035, accounting for an extra 20% of GDP in Brazil and an extra 55% of GDP in China.

The scope of the working group’s mandate covers the e-enablement of ICC rules, a review of the state of the bank payment obligation (BPO) and applying BPO lessons learned to other technology-driven innovation and transformation, and to digital documentation.

The working group observes that digitalisation, largely initiated by banks and technology companies must demonstrate its value more widely across the trade transaction lifecycle and demonstrate clear value to corporate clients.

On the legal front, Angelia Chia, Partner at Mayer Brown, raises the issue of conflicts of laws and the importance of well-crafted contract clauses, including for digitised trade finance. She emphasizes consistent clauses need to be part of the terms and conditions in a documentary credit. She also details the emerging impact of

electronic platforms on enforcing electronic contracts, including the legal status of electronic signatures, with reference to UNCITRAL model laws and global adoption of consistent legal standards and interpretations.

Sean Edwards, Chair of the International Trade and Forfeiting Association (ITFA), highlights the potential benefits of Distributed Ledger Technology (DLT) and the opportunity in digitising promissory notes to improve security and efficiency in forfeiting transactions. Noting the existence of eIDAS (electronic IDentification, Authentication and trust Services), an EU regulation and related standards for electronic identification, and trust services for electronic transactions in the EU single market, Edwards points to this development as illustration of the desire among policymakers to advance digitisation, and to integrate cyber-security that is sufficiently robust to enable the creation of promissory notes as legally recognised digital assets.

DLT is highlighted as a technology that may be well-placed to best align and address the wide-ranging needs of the trade finance ecosystem, with digital promissory noted capable of increasing the use of trade finance, and the supply and availability of various forms of trade financing.

The digitalisation of trade finance depends on the pace and degree that trade activity and interaction is digitised. While fully digital trade is at least several years away, even by the most optimistic projections, industry leaders must internalise the idea that the time for conservative, incremental advances that do little more than marginally enhance operating models is passed.

Sustainable trade and trade financing

Reflecting the evolution in its remit to keep pace with major developments in international commerce and financing cross-

border commerce, the ICC Banking Commission now includes issues like economic inclusion and sustainability in its strategic plan.

Voluntary Sustainability Standards are gaining ground and uptake globally

Along those lines, a contribution from the Geneva-based International Trade Centre points to the consumer-driven proliferation of Voluntary Sustainability Standards (VSS), to mitigate sustainability-related risks in global supply chains. While some VSS's have been around since the 1960s, the standards are gaining ground and uptake globally. The impact of these standards can be seen in the Better Cotton Initiative's certified cotton initiative: volume rose to 2,086,000 metric tons in 2015 from 35,000 metric tons in 2010 while the land area increased to 2,217,000 hectares in 2015 from 65,000 hectares in 2010.

Industry initiatives such as the Sustainable Agriculture Initiative (SAI) launched by Nestlé, Unilever and Danone show how standards are evolving. The SAI platform is used to share knowledge and best practices for developing and carrying out sustainable agricultural practices at a precompetitive level. ITC points to the Farm Sustainability Assessment developed by its members, suppliers, farmers and external stakeholders as a common framework of leading food and drink companies that use the SAI platform to source sustainably-produced agricultural materials.

The ICC Banking Commission's Working Group on Sustainable Trade Finance rounds out the discussion by asking a question on the breadth and implications of sustainability, and ICC's preparedness to take on big issues that present huge challenges but have massive opportunities for positive impact.

The working group asks: "How do we safeguard the planet, its inhabitants, and global economic growth?"

In their joint contribution to this report, Ruediger Geis who serves on the Banking Commission Executive Committee, and co-Chair Harriette Resnick identify some elements of a response to this big question and challenge the banking industry to contribute by providing sustainable trade finance that helps safeguard the planet. Sustainable trade finance is defined as 'financing that supports goods or services produced in a manner that minimises adverse environmental or social impacts or risks, or that promotes environmental protection or social benefit.'

The working group notes its alignment with the ICC's 2015 Charter for Sustainable Development, which says business must take a wider view, considering financial, societal and environmental factors in a triple bottom line framework of people, profits and planet. The Sustainable Trade Finance Working Group includes commercial banks, multilateral institutions and other stakeholders and organisations, and its mandate is to look at issues as far-reaching as standards and certification in sustainable trade, sustainability-related risk assessments in trade financing, and the need to educate finance professionals about sustainable trade.

Countries in focus: Singapore and China

The report concludes with contributions from Singapore and China, two countries with huge impact on the state of trade and trade financing.

Singapore is developing a holistic digital strategy

A joint contribution by Enterprise Singapore, the Monetary Authority of Singapore and the National Trade Platform brings into focus Singapore's efforts to develop a comprehensive, holistic digital strategy in support of trade and trade financing. With trade flows worth three times GDP, Singapore is a regional hub with a long history of openness to trade. The platform aims to advance connectivity and collaboration across the region.

MAS and the HKMA are collaborating on the design and deployment of The Global Trade Connectivity Network (GTCN): an information superhighway to be built, using distributed ledger technology (DLT), between Singapore's National Trade Platform and the Hong Kong Trade Finance Platform. The GTCN aims to make cross-border trade and trade financing cheaper, safer and more efficient.

The China-focused article, contributed by members of the Banking Commission's Executive Committee, Vincent O'Brien and Jun Xu, acknowledges that the pro-trade and pro-globalisation stance of President Xi Jinping, helps fill a leadership void at a pivotal moment in the global economy.

The article outlines the unique characteristics of China's trade finance market, such as the risk perception of confirmed L/Cs, the inclusion of remittances in trade financing operations, and the robust growth of supply chain finance. The article also gives an update on developments in regulation and compliance, ecommerce, and platform-based trade in China.

The final contribution to the report, by China's Export Credit and Insurance Corporation, or Sinosure, is also on trade and trade financing linked to China. As the world's largest exporter and the second-largest importer in the last eight years, China has a huge influence on trade and the global economy.

Sinosure points out that the Belt and Road initiative, along which US\$3 trillion in trade flowed from 2014 to 2016, together with China's expansion of overseas engineering projects, are the main ways China is restructuring its foreign trade.

US\$3 trillion in trade flowed between 2014-2016 along the Belt and Road initiative

As Xu notes, ecommerce is growing very fast in China, including cross-border ecommerce, and the Chinese government has approved the setup of 13 pilot zones to further boost cross-border ecommerce.

Conclusion

The last ten years have seen trade financing evolve from a highly specialised, largely underappreciated specialism in finance, to what is now widely understood to be an indispensable enabler of global commerce, facilitating 80% or more of annual merchandise trade flows.

The next ten years will be more transformative, fast-paced and disruptive than the last ten. It will be important to ensure that our dialogue, deliberations, advocacy and vision are bold enough to keep pace, or ideally even to keep what we do just ahead of the major forces that will shape trade, drive economic growth and enable inclusion over the coming decade.

This is a crucial moment in the history of ICC as it approaches 100 years

The ICC will soon celebrate its first hundred years in operation, from the initial vision of the Merchants of Peace, to the recent achievement of Official Observer Status at the United

Nations General Assembly. The combination of research, analysis and advocacy work, together with the activities of multiple working groups, rulemaking and market guidance will continue to shape the landscape of global commerce but will need to do so with a more holistic perspective and the ability to respond more and more rapidly and collaboratively to market evolution, expectation and demands.

2





MACROECONOMIC CONTEXT FOR TRADE AND FINANCE

The global economy is picking up the pace, as the recovery enters its fourth, even a fifth year. But trade protectionism and the risk of a trade war could really slow it down. At the same time, trade flows have reached a turning point: they are outpacing global GDP, after years of sluggishness. But the outlook for trade finance is mixed. On the commodities front, speculation abounds of a new supercycle. But dig deeper, and not all sectors are looking as hale and hardy, and markets once deemed rock solid are showing signs of wear.

Setting the scene/Roberto Azevêdo, Director-General, WTO

Unmet demand for trade finance leads to a loss of economic growth and global trade, but the international community is stepping up efforts and working together to improve trade finance. [Page 23-24 >](#)

Global Economic Outlook/ Protectionism and reform complacency could imperil a sustained recovery

The global economic recovery is hardy by many measures. But economists see many risks in the not-too-distant future, and much remains to be done to capture the jobs of the future. Economists from the World Bank give their own views. [Page 25-00 >](#)

Global trade and supply chains/ Growing anew, but for how long?

Global trade may be flowing faster, but in the long-term, anti-trade rhetoric could have an impact. [Page 31-34 >](#)

Commodity trade finance/ La vie en rose? Not quite

Commodities are attractive again to investors. But the effects of depressed prices in 2015 are lingering. [Page 35-36 >](#)

Setting the scene/ What we need to do to boost trade finance

By Roberto Azevêdo

Roberto Azevêdo is Director-General of the World Trade Organization.



Unmet demand for trade finance leads to a loss of economic growth and global trade, but the international community is stepping up efforts and working together to improve trade finance.

Opening the benefits of trade to more people is a central aim of the World Trade Organization, and in recent years we have made real progress on this front. Achievements like the Trade Facilitation Agreement, which cuts trade costs and red tape around the globe, show that the organization can make a very positive and concrete impact to help more people to trade, especially micro, small and medium-sized enterprises (MSMEs). But, of course, many barriers remain, preventing these companies from making the most of the opportunities that trade provides. A lack of access to trade finance is one such barrier - and it demands our attention.

Up to 80% of trade is financed by some form of credit, guarantee or insurance. For many years access to this finance was taken for granted, but the financial crisis changed all that. Major global banks have pulled back from developing markets, thereby restricting access to trade finance. As a result, the gaps in trade finance have widened. Globally the gap has been estimated to be now around US\$1.5 trillion - and the smallest companies are affected the most, hitting MSME traders disproportionately. In fact, around half of MSME requests for trade finance are rejected by banks, and

in more than 70% of the cases they seek no alternative financing, simply because it is not available. Persistent gaps in trade finance can mean exclusion from the trading system and that major trade and development opportunities are missed.

This is of particular concern as MSMEs are the backbone of many economies and act as major employers. At the WTO's Ministerial Conference in Buenos Aires in December 2017, 87 members issued a joint statement declaring their intention to focus on tackling the obstacles that prevent MSMEs from trading. As outlined above, there is no question that access to trade finance represents a significant obstacle.

At the WTO, we are working with a number of partners, including the International Finance Corporation, the regional development banks and the Financial Stability Board to examine what can be done to improve the supply of trade finance for the smaller players and move this debate towards a solutions-oriented approach. We also need to ensure that this issue is fully acknowledged in the regulatory dialogue so that the essential steps taken by regulators after the financial crisis do not have unintended consequences for the supply of trade finance.

In all of this, the private sector has a very important role to play. As the users of the trading system, businesses can help to highlight major challenges and focus policymakers' minds on developing practical solutions that respond to the real needs on the ground. Therefore I welcome the ICC's continued focus here. Working together with a range of partners, I have no doubt that we can reverse this worrying trend in access to trade finance and build a trading system that is more inclusive. By doing so we will have taken a significant step towards ensuring that the opportunities of trade can be seized by all.

80%

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US\$1.5
trillion

1/2

of all MSME requests for
trade finance are rejected

70%

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access to alternative
financing

Global economic outlook/ Protectionism and reform complacency could imperil a sustained recovery¹

By Jakob Engel and José Guilherme Reis

Jakob Engel, Economist; José Guilherme Reis, Practice Manager for Global Trade and Regional Integration, World Bank Group.

The global economic recovery is hardly by many measures. But economists see many risks in the not-too-distant future, and much remains to be done to capture the jobs of the future. Economists from the World Bank give their own views.

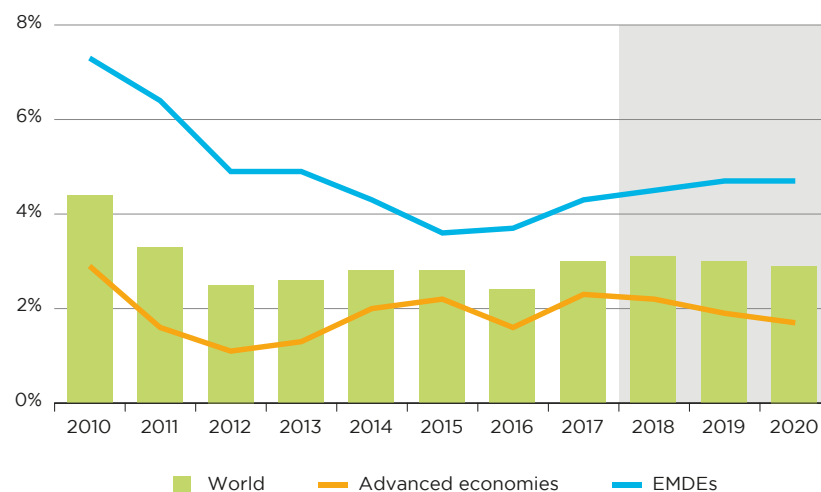
1. Global economic prospects

According to the most recent assessments of the world economy (IMF 2018, World Bank 2018), the recovery that had begun in late 2015 has continued, driven by an upswing in investment, manufacturing activity, and trade. The IMF's most recent update of its "World Economic Outlook" finds that global GDP increased by 3.7 percent in 2017, 0.1 percent faster than projected last year and 0.5 percent higher than in 2016. These improvements have been relatively broad-based, with most countries experiencing either increasing or unchanged GDP growth, and with Europe and Asia growing faster than expected. Global GDP growth forecasts for 2018 and 2019 have been revised upward by 0.2 percentage points to 3.9 percent. This has been driven in part by increased business growth momentum, coupled with the expected impacts of the recent US tax cuts. This is likely to stimulate economic activity through an investment response and in turn temporarily raise US growth through 2020.

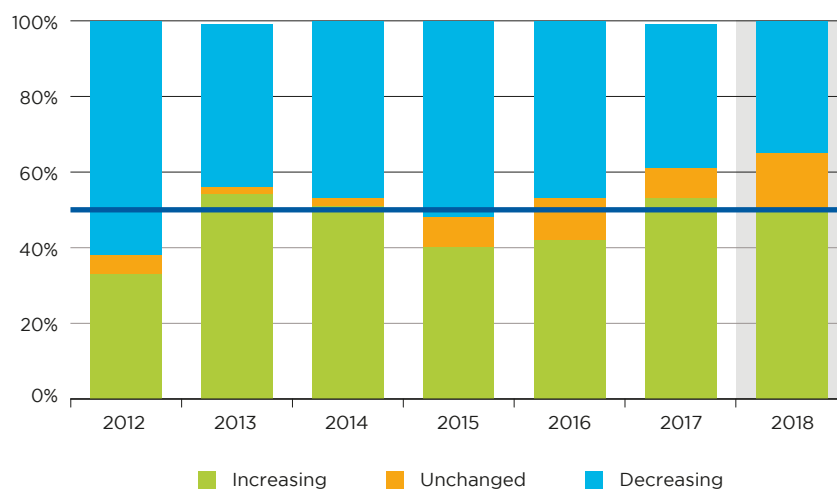
Growth is expected to be particularly strong in emerging and developing Asia (6.5 percent over 2018-19) and emerging and developing Europe (over 5 percent) driven by higher forecasts for Poland and Turkey. In Latin America, the ongoing economic recovery is expected to continue strengthening (1.9 percent GDP growth in 2018; 2.6 percent in 2019), boosted by a recovery in commodity markets. A growth pickup relative to recent years and last year's projections is also expected for sub-Saharan Africa (from 2.7 percent growth in 2017 to 3.3 percent in 2018 and 3.5 percent in 2019). According to the World Bank's latest Global Economic Prospects, the current year, 2018, is likely to mark a turning point for the global economy as the negative global output gap is expected to be closed for the first time since

Figure 1: The global economy

A. Global GDP growth rate and for advanced and emerging markets and developing economies



B. Share of countries with increasing/decreasing growth



Source: World Bank (2018)

Notes: Shaded area indicates forecasts. Aggregate growth rates calculated using constant 2010 U.S. dollar GDP weights. Data for 2017 are estimates

the onset of the Global Financial Crisis in 2008. Finally, despite concerns about jobless economic growth, labour force participation rates have remained relatively constant across most high- and low-income countries, although they have decreased in middle-income countries. This, the 2017 World Trade Report (WTO 2017) argues, is in part due to increased participation in the secondary and tertiary education system among the growing middle class.

However, while the economic outlook through 2019 remains favourable, there are numerous downside risks over the medium term. US tax cuts are likely to contribute moderately to a pick-up in US growth (estimated by the IMF at 1.2 percent cumulatively through 2020) and is likely to have favourable spillovers to trading partners, but the temporary nature of many provisions, as well as their substantial fiscal impact (estimated to add \$1.45 trillion to the federal debt between 2018 and 2027 by the Joint Committee on Taxation, assuming those provisions set to expire are not made permanent), will require contractionary fiscal policy in the medium term. Moreover, there are downside risks stemming from the financial sector which already became visible through increased equity market volatility in early 2018 (in February 2018, the CBOE Volatility Index reached its highest point since August 2015) and – if aggregate demand in advanced economies continues to accelerate – rising core inflation figures are likely to lead to a normalization in monetary policy through gradual upward adjustments of interest rates. As will be discussed in more depth in Section 3, there are also substantial downside risks from the growing threats of increased protectionism and even a ‘trade war’ that could dampen the positive impacts of a recovery in global trade.

2. Financial stability and credit conditions

The overall recovery in the global economy is also mirrored by improvements in the strength and robustness of banks in many advanced economies according to the most recent Global Financial Stability Report (GFSR; IMF 2017). This is indicated by stronger balance sheets due to improved capital and liquidity buffers in light of tighter regulation and greater market scrutiny. Moreover, further progress has been made in addressing legacy issues and resolving weaker banks through consolidation, while systemically important institutions are moving to less risky business models by changing product mix and asset allocation (primarily moving away from shadow credit products and interbank funding). However, within the context of a sustained low-interest rate environment, the search for higher yields has been intensifying and vulnerabilities are shifting to lower rated and less liquid assets in the nonbank sector, most notably insurance companies. Less than 5 percent (\$1.8 trillion) of the current stock of global investment-grade fixed-income assets yield over 4 percent, compared with 80 percent (\$15.8 trillion) before the Global Financial Crisis. Levels of indebtedness are also increasing with leverage in the non-financial sector in the G20 higher than it was before the crisis.

In this context, the GFSR argues that policymakers should take advantage of relatively calm financial markets to address medium-term vulnerabilities, including requiring banks and insurance companies to further strengthen their balance sheets in advanced economies, ensuring a smooth normalization of monetary policy through well-communicated plans on unwinding their holdings of securities and providing guidance on potential changes to policy frameworks. There is also a need to strengthen the nonbank financial sector through tighter regulation,

especially in highly leveraged segments, and a transition to risk-based supervision. In emerging and developing economies, there is a need to gradually rebuild buffers through countercyclical fiscal policy and deleveraging of the corporate sector. Policymakers in commodity-dependent emerging market and developing economies should address relevant structural reforms to raise productivity, increase labour force participation and increase the resilience of the financial system.

3. The state of global trade

In 2017, world trade volumes grew at the fastest rate since 2012, mirroring the pickup in economic growth across a wide range of both developed and developing countries. This improved performance is, however, fragile as the factors underlying the global trade slowdown of recent years – weak growth in global value chains, the lack of progress in trade liberalization, and high trade policy uncertainty – remain present. Most regions have seen an increase in trade growth in 2017, but the largest contributions to global trade growth are East Asian countries and the Euro Area. The recent pickup in trade growth is primarily due to rising merchandise trade volumes. Preliminary high-frequency data indicate that merchandise trade volumes grew by 4.5 percent in the first 10 months of 2017 relative to the corresponding 10 months in 2016, driven by machinery, electronics and semiconductors.

The rebound in trade growth was especially notable, because in recent years its responsiveness to GDP growth had waned. Real trade grew on average twice as fast as real GDP from 1990 to 2007, but from 2011–2016 trade has grown at about the same pace as GDP. Most economists expected trade growth to slow because of lower income growth, but they had presumed the relationship between trade growth and income growth would remain unchanged. Since 2008, trade in services (which

accounts for roughly 20 percent of total trade) and of goods have followed different trajectories. Growth in services trade has been more resilient during the Global Financial Crisis and the global trade slowdown of recent years. Part of this different dynamic may be due to the lower sensitivity of services trade to short-term inventory and production cycles.

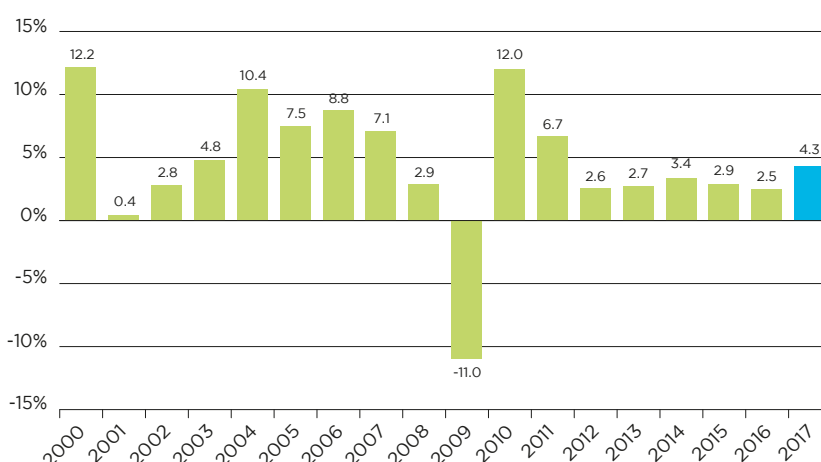
Cyclical factors are an important determinant of the improved merchandise trade performance in 2017. Three cyclical factors played an important role in 2017:

- **Investment growth:** Capital goods represent 40 percent of merchandise trade and thus the rebound in global investment growth accounted for three quarters of the acceleration in trade growth.
- **Recovering commodity prices:** Prices of commodities, particularly fuels, which experienced large declines starting in mid-2014, bottomed out in early 2016. While commodity prices and global trade values remained low relative to the period before 2014, they saw a recovery throughout 2017, improving the terms of trade of commodity-exporting countries in Eastern Europe and Central Asia, Africa and the Middle East.
- **Developments in China:** Chinese exports grew on the back of the global recovery, and imports jumped in the last months of 2016 responding to internal monetary and fiscal stimulus deployed in China since 2015, as the economy is shifting towards more consumption. Indeed, China and East Asia are significant factors in the recent trade recovery.

Yet, two structural factors are likely to limit world trade growth, as compared with the period from 1995-2007, when trade soared. Firstly, the maturation of Global Value Chains (GVCs) has led to a deceleration of trade growth.

Figure 2: What is happening to international trade?

A. Goods and services trade volume (percent change)



B. Contribution to growth in goods export and import volume, by country group, percent



Source: World Bank (2018)

Secondly, trade agreements are estimated to have accounted for around 40 percent of world trade growth in the period from 1995 to 2017. The relatively slow pace of further liberalization, and the risk of reversal, could weaken prospects for trade.

The picture on protectionism for 2017 is mixed though US threats of a “trade war” are a significant cause for concern. While the stockpile of trade-restrictive measures may still be clogging world trade, the incidence of new trade-restrictive measures (such as new or increased tariffs or quotas) for the first 10 months of 2017, was the smallest since 2009 (the first year of data collection). Moreover, the share of merchandise trade covered by trade-restrictive measures has declined to about 1 percent in 2017, and is of a lesser magnitude than the share of merchandise trade affected by trade facilitating measures. But the number of trade remedy initiations, such as antidumping duties or safeguards (e.g. restricting imports of a product temporarily to protect a specific domestic industry), has increased significantly since 2015, indicating that a larger share of trade may be subject to protectionist measures in 2018.

The share of trade covered by trade remedy initiations surged in 2016 and remained stable in 2017 (see Constantinescu et al. 2018). Overall, the number of trade-restrictive measures declined by one-third, driven in part by the number of trade remedy initiations which peaked in 2016, due to an increase in antidumping measures and appears to have declined slightly in 2017. The share of merchandise trade covered by trade-restrictive measures remained at approximately 1 percent in 2017, although the past two years have seen compositional changes, with the share covered by other types of restrictions halved and the share covered by trade remedy initiations more than double relative to the 2015 reporting period.

Reinvigorating trade, together with domestic policies to share gains from trade more widely, needs to be a priority. This includes removing trade barriers and reducing subsidies and other measures that distort trade. But reforms to reinvigorate trade also require thinking about those workers and communities that are being negatively affected by structural economic changes. Even though job losses in certain sectors or regions have resulted to a larger extent from technology than from trade (see IMF/WBG/ WTO 2017), policy packages should ensure that trade gains are shared widely. Without the right supporting policies, adjustments to structural change can bring social and economic risks that are often geographically concentrated and long-lasting. This is why governments must find better ways of supporting workers through job search assistance, retraining, and vocational training, policy measures such as unemployment insurance and other social safety net measures, as well as investing in education systems. In addition, housing, credit, and infrastructure policies (such as improving transit systems) could be designed so as to ease worker mobility.

4. Special thematic focus: The Future of Manufacturing-Led Development

The potential impact on industries and workers of ongoing technological changes in the nature and location of production is addressed in the recent World Bank report *Trouble in the Making: The Future of Manufacturing-Led Development* (Hallward-Driemeier and Nayyar, 2017). The increasing adoption of industrial automation, advanced robotics, smart factories, the internet of things, and 3D printing are transforming the manufacturing process. In some manufacturing sectors, robots and other technological advances are automating jobs once done exclusively by people. In China, for

example, factories are projected to have more than 400,000 industrial robots installed by 2018, the highest number of any country in the world.

By reducing the relative importance of wages, robotics and “smart” factories can change what it takes for locations to compete in global manufacturing markets. There is a risk that manufacturing may no longer be an accessible pathway for low-income countries to develop. However, the future is not all doom and gloom. Although dramatic, media reports of massive job losses due to automation may be overblown in developing countries. In fact, according to the report, the threat of automation to today’s jobs may be a relatively modest two to eight percent for developing economies. The bigger unknown, according to the report, is “tomorrow’s jobs.” On the one hand, there is a real risk that countries will lose out on jobs that are never created. On the other hand, new technology could also lead to entirely new occupations that can’t be predicted today.

Despite a rising bar for economies to be globally competitive, there are opportunities ahead for developing countries. The production of tradable goods such as textiles, garments, and footwear continues to be labor-intensive and do not feature much automation yet. Ethiopia is an emerging hub for this type of textile production, attracting large amounts of investments from China and serving as a garment source for major European brands such as Zara. Commodity-based manufactures, such as food processing, wood and paper products, and basic metals will also remain an entry point for less-industrialized countries. Finally, services, including those related to businesses – such as call centers and data centers – and those related to manufactured products – such as design, marketing and distribution – are another area where developing countries can take advantage of future opportunities.

The report suggests a policy agenda focused on three dimensions: competitiveness, capabilities, and connectedness.

- Competitiveness: Shift from a focus on low wages to broader considerations of the business environment, the rule of law and the use of technology to complete financial transactions.
- Capabilities: Equip workers with new skills, build stronger firms, and develop the necessary infrastructure to adopt new technologies.
- Connectedness: Improve logistics and lower trade restrictions on manufactured goods and services.

Manufacturing will remain a part of development strategies, but its contribution to inclusive economic growth is likely to be lower than in the past. In part due to the reasons described above, the feasibility of attracting production and enabling local firms to use new technologies is becoming more challenging. As countries adjust to the changing global economic environment, policymakers need to identify concrete ways for developing countries to position themselves to address the disruptions of technology and take advantage of globalization. Not being prepared could prove to be costly.



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Global trade and supply chains/ Growing anew, but for how long?

By Sukand Ramachandran, Jarryd Porter, Ravi Hanspal, Teck Hsien Ho, Ankit Mathur
Sukand Ramachandran is a Partner and Managing Director of Boston Consulting Group, Jarryd Porter is a Project Leader at BCG, Ravi Hanspal is a Project Leader at BCG, Teck Hsien Ho is a Consultant at BCG, Ankit Mathur is Lead Knowledge Analyst at BCG.

Global trade may be flowing faster, but in the long-term, anti-trade rhetoric could have an impact.

Trade returns to growth

The year 2017 marks a break in the recent trend of falling trade flows. The BCG Trade Finance Model estimates trade grew 8.7%, well outpacing global GDP growth. The Middle East and non-EU Europe regions grew fastest at 16% and 13%.

While work remains to be done before global trade returns to pre-2015 levels, there is room for optimism. Barring bad economic conditions, annual growth in trade flows is expected to be 4.0% from 2017 to 2026, with growth highest in South-South corridors.

Trade peak is high

This returns trade to its historical 2014 peak by 2019 and pushes global trade to a new record peak of USD\$24.0 trillion in 2026.

The recent rise is a welcome change from the overall drops from 2014 to 2016 of 7.6%. US saw flows fall 5% from 2014 to 2016, while Asia and EU trade flows fell about 6%. Given trade volume was fairly consistent, these declines were likely driven by falling commodity prices.

Trade is growing faster than GDP

The BCG Trade Finance Model relies on estimates of global GDP growth, commodity prices, and macroeconomics. Short-term correlation with global trade politics was fairly limited in 2017, as trade seemed relatively unaffected by anti-trade rhetoric from major trading nations.

But longer term these issues could have greater impact, especially if rhetoric is translated into

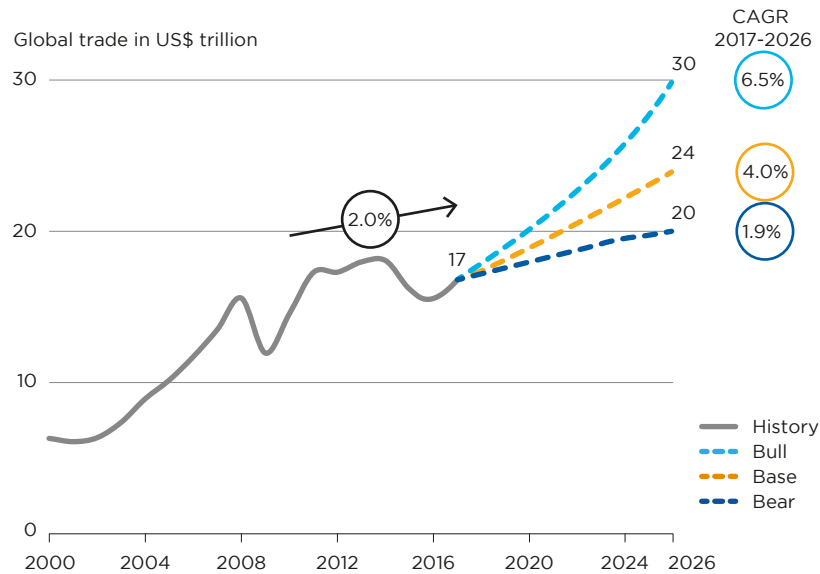
trade policy actions. Given this macroeconomic uncertainty, BCG created three scenarios.

The base scenario forecasts 4.0% yearly growth in trade flows, and assumes a mature market GDP growth above 3%. Chinese GDP growth is a factor in the BCG model, given China is the world's largest exporter. This scenario assumes Chinese GDP growth continues at recent levels from 2017 to 2026.

New high of US\$24 trillion in trade seen by 2026

The model also projects that commodity prices, such as copper, aluminium, and crude oil, will rise steadily, driven by broad-based increases in demand, and a stable and supportive policy regime.

Global trade flows to grow by 4% per year



Source: BCG trade finance model (2017)



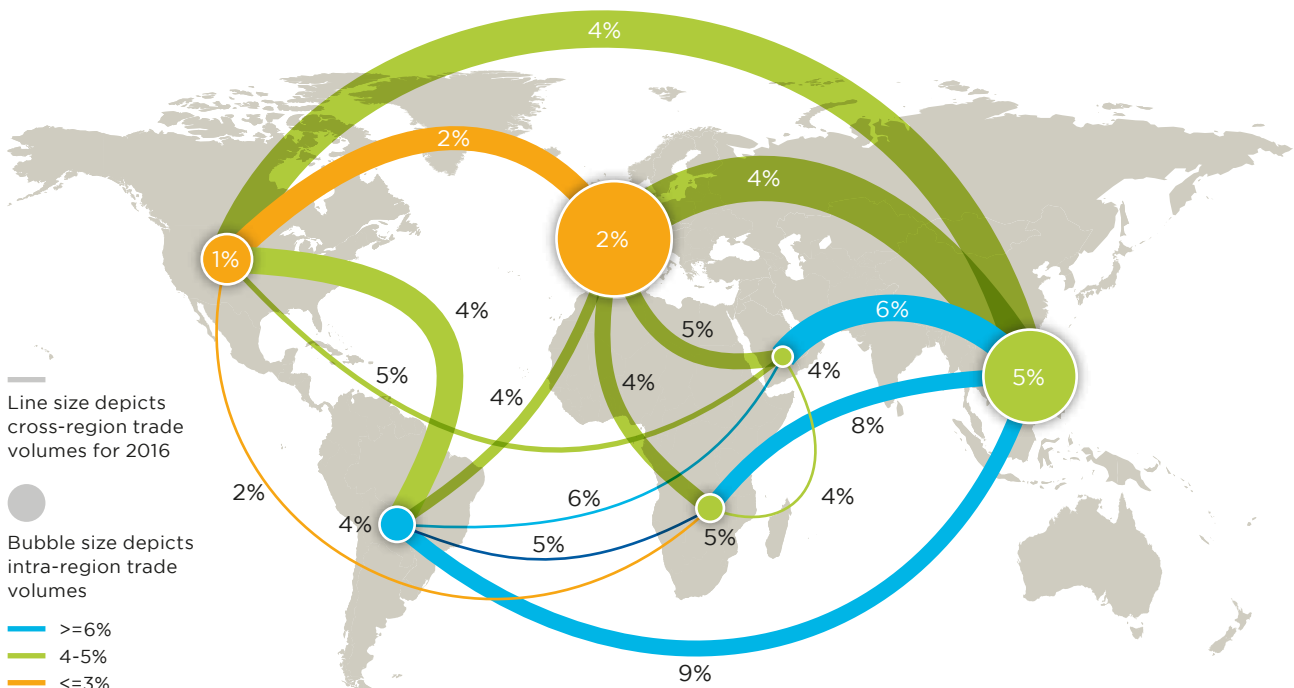
Robust global trade growth could be sustained

Trade rose 8.7 percent in 2017, a return to pre-crisis levels for the first time.

Reasons to be optimistic

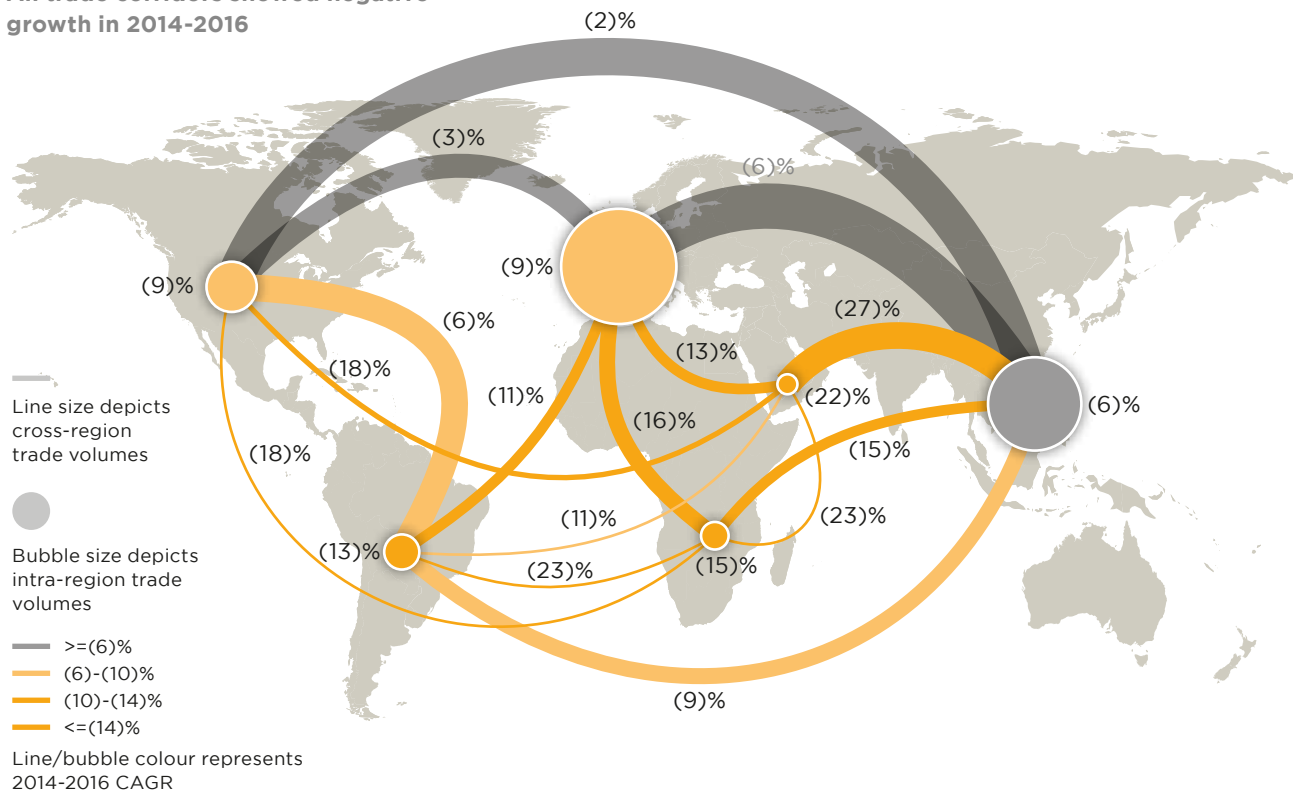
Trade has not yet been affected by anti-trade rhetoric and actions. Trade finance revenue growth is forecasted to outpace trade flows growth at 4.1% per year.

South-south trade corridors will see higher growth



Source: BCG Trade Finance Model 2017

All trade corridors showed negative growth in 2014-2016



Source: BCG Trade Finance Model 2017

The bull scenario forecasts a 6.5% annual rise in trade flows, driven by higher mature market GDP growth and Chinese GDP growth. It also assumes a quick recovery in commodity prices and more policy actions encouraging open markets.

The bear scenario pegs annual growth in trade flows at 1.9%, propelled by lower mature market GDP growth and lower Chinese GDP growth. It also assumes commodity prices remain flat, and fewer supportive trade policies and macroeconomic events.

Trade finance fortunes mixed

Sentiment is mixed among trade banks on the prospect of improved trade finance margins. From BCG's conversations with internal and external trade finance experts, margins in Asia have been pushed down by intense price competition and by the difficulty of passing on higher compliance costs.

However, trade banks in other markets seem to have boosted margins. BCG forecasts trade finance revenue over this period rising about 4.1% a year, slightly outpacing the growth in trade flows.

Trade finance revenues may slightly outpace trade growth

In the base scenario, with annual growth of 4.1%, trade finance revenues reach US\$45 billion in 2021. The share of documentary trade falls slightly, offset in part by strong growth in trade flows in regions where documentary trade is higher, such as Asia Pacific, the Middle East, and eastern Europe.

The bull scenario sees trade finance revenues growing 6.1% a year, hitting US\$48 billion by 2021. In this scenario, the share of documentary trade falls further

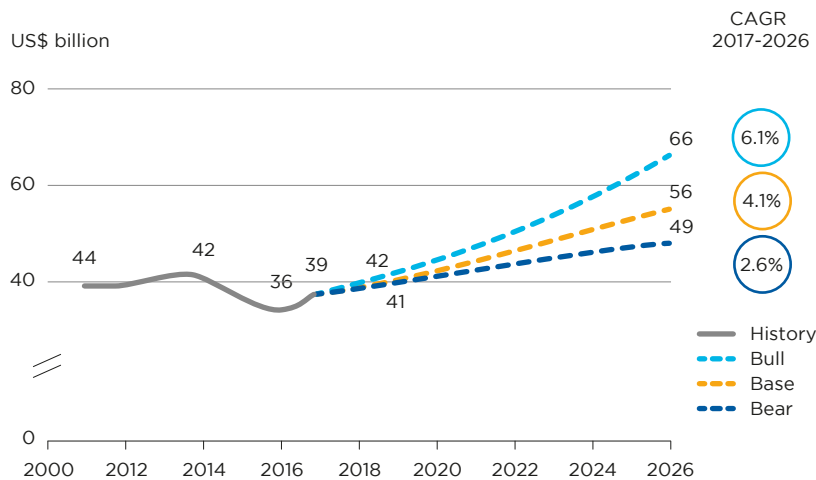
than the base case as trade risk eases. This encourages the use of non-documentary trade.

The bear scenario sees revenue growth of 2.6% a year, reaching US\$43 billion by 2021. This forecast assumes greater risk in global trade prompts greater use of documentary trade products, relative to open account transactions.

Another trend affecting trade finance is securitisation and the evolution of secondary markets. These two developments could expand the capacity of trade banks to support trade finance by freeing up balance sheet capital.

Securitisation has historically been the preserve of major trade banks. However, non-bank institutions have also entered the fray, with a US\$150 million securitisation last July. This could build momentum for more securitisation.

Trade finance revenues to outpace trade flows growth



Source: BCG Trade Finance Model 2017

Securitisation and secondary markets could free up capital for trade finance

Secondary markets for trade finance assets are developing, as seen (inter alia) by the launch of a platform in Asia developed with support from the regulator.

Asia takes a bigger role

Recent geopolitical and economic developments may shift the focal point in global trade from the US to Asia. The US has made conflicting statements on trade. But its most recent trade action was to put tariffs on steel and aluminium imports and signal the imbalance of payments with China.

On the plus side, Japan, Australia, Canada, and eight other countries agreed to sign the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, from which the US withdrew. What is more, China's One Belt One Road initiative is developing trade networks in the region.

A new centre?

Internationalisation of the Renminbi could further support a shift in the centre of trade towards Asia. Renminbi use in international transactions could focus attention on trade in the Asia Pacific.

This pivot is reflected in trade growth. Asia-based corridors are expected to grow between 4% to 9% a year from 2017 to 2026. US-based corridors are expected to grow only 2% to 5%.

Asia will represent 38% of global trade flows by 2020, up from 36% in 2016, while the US share will fall to 8.7% in 2020 from 9.2% in 2016.

Asia will represent 38% of global trade by 2020

Though major governments in Asia have historically preferred documentary trade, future trade flows could be financed more through Supply Chain Finance (SCF) and open account transactions.

Commodity trade finance/ La vie en rose? Not quite

by Jean Francois Lambert

Jean Francois Lambert is Founding Partner of Lambert Commodities a consultancy on the impact of trade flows and optimizing trade finance.

Commodities are attractive again to investors. But the effects of depressed prices in 2015 are lingering.

Commodity prices and risk perception underpin commodity trade finance. Prices affect financing requirements. Risk perception is more subjective but also helps gauge the appetite for credit.

On the bright side, commodity financing was sustained in 2017, thanks to robust commodity prices, notably in the energy and metals sectors. This consolidated a trend which kicked off in 2016. Agriculture commodities prices, in contrast, continued to be depressed, due to record crops and despite pressures from an ever more challenging climate.

Overall, the Bloomberg Commodity spot index rose a mere 8% in 2017, after a sharp rise of 31% in 2016. But this trend hides some big ups and downs. To illustrate this, a cargo of 250,000 metric tons of Brent crude oil was worth slightly over US\$100 million in early 2017 compared with US\$55.0 million in January 2016. At the end of 2017, the cargo's value reached US\$123million. Financing

requirements per cargo followed the same pattern. In the metals and mining sectors, utilisations were also sustained by stronger prices: for instance, the price of coking coal jumped 8% in 2017, while iron ore and copper rose 26%. The agriculture sector was much less conducive to financing, as soybean prices fell 2%, sugar dropped by 11% and cocoa prices were down by 30%.¹

Agriculture commodity prices are still depressed

Risks rack up

If the utilisation level gave banks and investors some comfort, risks have had the opposite effect. A major fraud exposed banks to a potential US\$400 million loss from US cocoa trader Transmar at the end of 2016, triggering a shock wave and shaking the belief that borrowing base facilities was bullet-proof, especially in North

America. Many commodity bankers around the world had to revisit and revalidate their guidelines.²

In Asia, the troubled Noble Group, a Singapore-listed trader once seen as an emerging global trading house just a few years ago, also sent worrying signals all year. As a result, some commodity bankers³ were kept busy restructuring and selling down their working capital and trade finance facilities.⁴

Another blow was dealt when Chad tried to challenge the validity of a US\$1.0 billion prepayment, granted by global trader Glencore with several commodity banks on the country's future crude oil production, in an attempt to renegotiate the terms amid low crude oil prices.⁵

The challenging market on 2015 has weakened some players

These are isolated cases, and lenders can swiftly say they are by no means representative of overall commodity finance activities. But they highlight that if the challenging market in 2015 did not immediately harm corporate actors in the commodities sector, probably made more resilient after years of a supercycle, they have weakened some players.

This was bound to eventually translate into credit risk events. The insurance industry was hit as soon as 2015 and again in 2016. Banks were luckier, but 2017 did not end without several casualties.⁶

Commodity finance is looking robust in 2018

Burning bright

Most of the forecasts made earlier this year have been more favourable. Barring major geopolitical events, the commodity finance market will be healthy and buoyant in 2018 for these reasons:

A rosy macroeconomic outlook. The OECD estimated all 45 countries that make up 80% of world GDP were in growth mode this year, an exceptional situation. What is more, most economists are confident 2018 will be the first of the goldilocks years, meaning the world economic growth engine, sputtering since the end of the great financial crisis, is roaring again. The growth momentum is evident in China, India and in the developed economies. If global growth proves as resilient as experts suggest, many developing countries should pull ahead.

Commodities are back in fashion

In an environment of low interest rates, with inflation low and the US dollar weak, commodity demand will rise, pushing up prices. Investors are already taking a more positive view of the commodity sector and rediscovering it as an

attractive asset class: investors, for instance, have made a billion-barrel bet on higher oil price as of March 2018 compared with slightly more than 300 million barrels in July 2017).⁷

But major challenges loom on the geopolitical front that could jeopardise this bullish scenario. A trade war is brewing, triggered by President Trump's decision to raise tariffs 25% on US\$60 billion of Chinese exports.⁸ There is still a heavy atmospheric pressure in the geopolitical landscape due to difficult talks planned between the US and China with North Korea. What is more, the US administration's cancellation of the nuclear deal with Iran could trigger more tensions in the Middle East, and provoke oil price volatility.

If the worst is avoided, a sustained strong economy would boost demand, prop up commodity prices, and increase the use of commodity trade finance facilities. Overall supply chain risks would be reduced, especially if the US dollar stays low and inflation subdued. For commodity bankers, a good scenario all around.

The most objective measure: commodity prices



Two factors underpin an activity such as Commodity Trade Finance: The absolute level of commodity prices and the perception of risk. The former provides a very practical clue of what will translate into financing requirements. The latter, more subjective but equally important dictates the overall credit appetite of lenders.



References and notes

1. Metal and agri trends calculated on average 2017 prices vs. average 2016 - source Cercle Cyclope
2. See "Impact of Transmar bankruptcy goes beyond soft commodities", Emiko Terazono, FT, Mar 2017
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6. Noble, Transmar as discussed but also Universal Energy in Singapore, Ruchi in India to name but a few.
7. Source FT, 27 February 2018.
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3



FINANCE FOR TRADE

ICC's Global Survey on Trade Finance for 2018 shows where banks stand on strategy and operations for traditional trade finance and supply chain finance provision, digital processes and key areas of focus to secure growth in trade finance.

As an indicator of global trade, and especially of letters of credit (L/C), the SWIFT trade messaging system signaled trade finance traffic fell in 2017. Export finance's fortunes were mixed last year, but the outlook is brightening. In another important gauge of global trade, the Berne Union, a trade association for the global credit and investment insurance industry, reports strong growth, but the longer-term outlook is uncertain.

To help meet the US\$1.5 trillion in unfilled demand for trade finance, multilateral development banks are ambitiously scaling up funding, expanding training and introducing new funds.

Setting the scene/ Arancha González, Chief Executive, International Trade Centre

Governments are helping to bridge the gulf in trade finance, especially in developing countries, evidenced by recent declarations on financing for development and to expand trade finance support for under-served groups, such as women. [Page 39-40 >](#)

ICC Global Survey on Trade Finance/ Where banks stand on strategy and operations

The 10th edition of the ICC Banking Commission Annual Survey presents key findings from a comprehensive survey of leading providers of trade finance and supply chain finance. Qualifications aside, the survey is the most comprehensive, authoritative and regularly published survey on trade financing globally, with retrospective and future-looking perspectives. [Page 41-60 >](#)

SWIFT trade traffic/The year in review Trade messaging standards/a major category 7 upgrade is underway

The SWIFT interbank payment system offers a birds' eye view of global trade activity in the last year. It also reveals upcoming changes in messaging standards for trade finance. [Page 61-74 >](#)

TXF-ICC Export Finance Survey/ Profits hold up amid mixed views on the market

A total of 65 senior professionals share their views in the annual TXF-ICC survey on the export finance market on a range of measures. [Page 75-80 >](#)

Export Credit and Investment Insurance/Strong performance, but political risks cast a long shadow

2017 was a good year for underwriters of export credit and investment insurance, but the current environment for political risks remains delicate. [Page 81-90 >](#)

Multilateral development banks/ No letup in expansion

A deep dive into multilateral development banks on trade finance activities, and what's in the pipeline. [Page 91-108 >](#)

Setting the scene/Levelling the playing field for access to trade finance

By Arancha González

Arancha González is Executive Director of the International Trade Centre.



Governments are helping to bridge the gulf in trade finance, especially in developing countries, evidenced by recent declarations on financing for development and to expand trade finance support for under-served groups, such as women.

Trade financing is an essential tool to enable the trade of goods, and increasingly services, allowing local firms and value chains to sell into global markets - 80% of global merchandise annual trade flows rely on such financing.

Trade finance is traditionally far safer than other banking products, with a default rate of less than 1%. Nevertheless, there is a significant and persistent gap between the demand and supply of trade financing, estimated by the Asian Development Bank to be worth US\$1.5 trillion, mostly related to micro, small, and medium-sized enterprises (MSMEs) in low-income and emerging economies.

This gap leads to a loss of international trade and reduced economic growth. The ADB reports that a 10% increase in available trade financing would be associated with a 1% increase in employment by surveyed firms. Governments have committed to improving the trade financing ecosystem, such as through the 2015 Addis Ababa Action Agenda on Financing for Development.

The main reasons for the gap are due to the impact of regulation, requirements for collateral and information management, as well as the quality of bankable transactions.

In the trade finance ecosystem, a few trends are emerging:

Impact of regulatory requirements

Anti-Money Laundering (AML) and Know Your Customer (KYC)

rules render many trade finance transactions too risky from a compliance and reputational perspective for financial institutions, while Basel III requirements reduce the transactions' profitability. The impact of these regulatory requirements has been to shrink the network of correspondent banks. Global banks report an 11% reduction of trade finance in high-risk markets over 2014-15 and a 5% reduction in trade finance capacity between 2011 and 2015, sparking concern from the International Monetary Fund. The regulatory burden for trade finance should not be unduly onerous. In addition, there may be a role for non-bank institutional investors to experiment with providing smaller-scale trade financing.

Improving the bankability of transactions

Anecdotal evidence suggests banks are reluctant to lend to SMEs in developing countries due to low profitability and difficulties evaluating firms that lack clear financial records. Multilateral development banks are expanding their supply chain finance programs to allow more MSMEs from developing countries to connect to international value chains. For example, the International Finance Corporation has brought suppliers, buyers, and international banks together providing financial guarantees to fill the gap that often exists in developing countries for interim financing between suppliers and buyers in international value chains.

Business, technological and financial innovation and small businesses

Technological advances, including block chain, promise to reduce collateral, operational and compliance costs, automate verification, and digitize paper-based information management for financial intermediaries. This would cut costs and increase the profitability of financing trade for small businesses.

Improving access to trade finance for women

Financial institutions reject 2.5 times more applications from female than male entrepreneurs, despite the fact that women entrepreneurs have been consistently shown to be more financially efficient. During last December's WTO Ministerial Conference in Buenos Aires, over 120 WTO members and observers backed a Declaration on Women and Trade that mentions redressing gender inequality in access to trade financing. Work that the ITC is doing in countries such as Kenya with local financial institutions shows that the gap can be bridged through action on both demand and supply.

While MSMEs are the engines of growth and job creation in developing countries, insufficient access to trade finance is keeping them from seizing the opportunities presented by international markets. Governments, international organizations, and technology providers should work with banks, regulators, and institutional investors to close the trade finance gap.

The infographic features a dark blue background with a blurred image of a modern building at night. A white line graph with three data points is visible on the left. Three circular callouts are connected by thin white lines. The first callout contains the statistic '80% of global merchandise annual trade flows rely on trade financing.' The second callout contains an icon of a hand holding a plant and text about MSMEs. The third callout contains an icon of a globe and text about a US\$1.5 trillion gap. The background also has some faint, blurred text and numbers, including '289.33'.

80%

of global
merchandise
annual trade flows
rely on trade
financing.



mostly related to micro,
small, and medium-sized
enterprises (MSMEs) in
low-income and emerging
economies.



US\$1.5
trillion

gap between
demand and supply
of trade finance

ICC Global Survey on Trade Finance/Where banks stand on strategy and operations

The 10th edition of the ICC Banking Commission Annual Survey presents key findings from a comprehensive survey of leading providers of trade finance and supply chain finance. Qualifications aside, the survey is the most comprehensive, authoritative and regularly published survey on trade financing globally, with retrospective and future-looking perspectives.

Data gathering and market intelligence

Methodology

The survey took place over 12 weeks, from December 2017 to February 2018, gathering insights from 251 respondents in 91 countries. The survey was administered by PwC Research who also undertook data collection and aggregation of results, with guidance and validation from the ICC Banking Commission staff and the report Editorial Board. A restructuring of the survey with two separate sections on the strategic implications and the operational ones, together with a robust follow-up process, resulted in higher levels of fully completed answer sets and a more comprehensive view of the market.

The profile of survey respondents ranges widely, from the world's largest global institutions to small local entities with limited business volumes. This wide spectrum of profiles reflects the structure of the trade financing market, particularly in traditional trade finance (TTF), such as

World regions and respective participating countries (bank headquarters)



Austria
Belgium
Denmark
Finland
France
Germany
Ireland
Italy
Luxembourg
Malta
Netherlands
Norway
Portugal
Spain
Sweden
Switzerland
United Kingdom



Albania
Armenia
Belarus
Bulgaria
Croatia
Czech Republic
Georgia
Hungary
Republic of Macedonia
Romania
Russia
Serbia
Turkey
Ukraine



documentary credits, collections, standbys and guarantees, in which market share is concentrated among a few major providers.

The range of responses in the dataset and the very different profiles of the banks participating in the survey which led us to using the median at times to provide a more accurate indication of central tendency of the responses, rather than the mean.

This also affects the way data groups, such as regional analysis, must be interpreted: as illustrative or indicative, not definitive.

Strategic and operational outlook on trade finance

This year's survey distinguishes between strategic, forward-looking issues shaping the business of trade and trade financing, including supply chain finance (SCF), and the more operational, transactional aspects. This clear separation of topics meant survey sections could be targeted within organisations, which improved the quality of responses, and the analysis and conclusions that flow from the survey section of this report.

Many of the key findings in the 2018 edition of the Banking Commission Survey Report were consistent year on year, supported anecdotal observations in some areas, and led to some new findings in others.

Europe

Middle East

Bahrain
Cyprus
Iran
Kuwait
Lebanon
Oman
Palestine
Qatar
Saudi Arabia
UAE

Africa

Cape Verde
Ivory Coast
Egypt
Kenya
Malawi
Mauritius
Morocco
Mozambique
Nigeria
South Africa
Sudan
Tunisia
Uganda
United Republic of Tanzania
Zambia



Asia Pacific

Afghanistan
Australia
Bangladesh
Bhutan
China
Hong Kong
India
Indonesia
Japan
Korea
Malaysia
Mongolia
New Zealand
Pakistan
Philippines
Singapore
Sri Lanka
Thailand



For example, while 47% of respondents report their traditional trade finance and supply chain finance businesses were in the same business unit, survey findings show a clear focus on traditional trade finance, with 85% of respondent activities in this area, versus 15% in SCF. This is in contrast to the market: roughly 80% of trade takes place on open account – better suited to SCF solutions than traditional mechanisms.

Profile of participating banks and the trade finance market

Compared to 2017, this edition includes more participation from Latin America, with proportionately less from the Asia-Pacific region, but aligns well in terms of response rates across Europe.

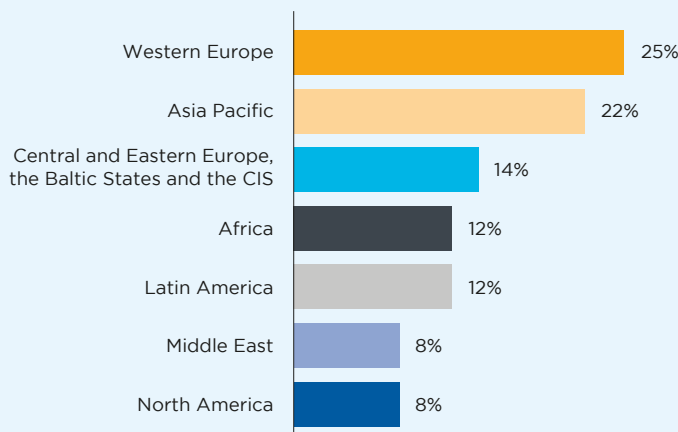
The survey shows 13 banks (about 8% of the survey respondents) provide about 90% of trade finance. Asia-Pacific is still in a pole position: as an anchor for large portions of trade financing globally, which reflects the fact that major global supply chains and trade corridors are anchored or linked to the region.

The aggregate profile of respondents reflects how global trade finance capability is highly concentrated. Taking staff complement as a proxy for market share, the makeup of the market is also reflected in the profile of respondents.

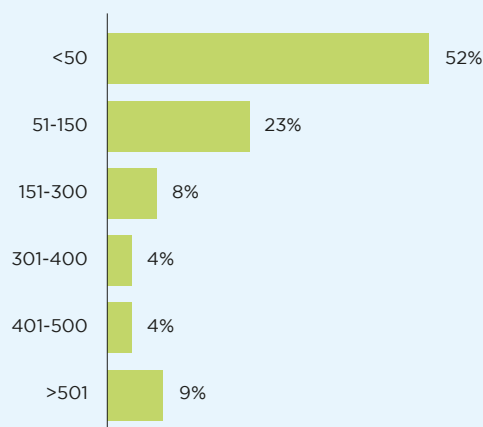
As in past surveys, the majority of participants had less than 50 staff. A total of 13 banks had 500 or more staff, while in the 2017 survey, 16 institutions reported these staffing levels in both TTF and SCF.

A total of 47% reported TTF and SCF are organised in the same business unit, while 31% of institutions said trade financing was restricted to TTF. Interestingly, 2% reported an exclusive focus on SCF.

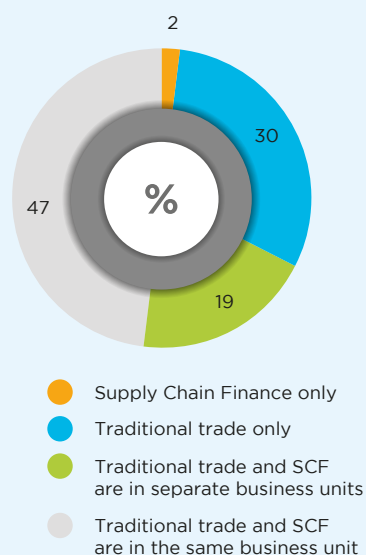
World regions participation



Number of employees involved in the selling, processing and delivery of trade finance products and solutions



Configuration of global trade finance operations



Trade finance processed in 2017

Over 31 million trade finance transactions and over USD\$9 trillion in trade finance processed in 2017

Almost a quarter of banks surveyed said they provided trade finance of at least US\$10 billion each, and 8% of banks at least US\$100 billion each in 2017. The median value of trade financing provided by each of the 251 respondents is about US\$1.2 billion for 6,000 transactions processed globally.

Trade finance provision by region

Transaction volume data showed a similar range of results across institutions and concentration among the largest providers. The median transaction volume reported in the Asia-Pacific region was about 36,000 transactions for the year, nearly double the level processed in North America, and about 10 times the median volume reported in Africa.

North America ranks first for processing the highest value, double that of Asia-Pacific, which ranks third in value processed. Latin America and central and eastern Europe (CEE) rank sixth and seventh respectively in volume and value processed.

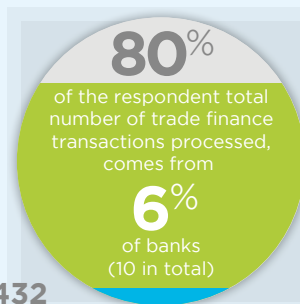
90% trade finance processed by 8% of respondents

How many trade finance transactions were processed by your banks trade finance departments in 2017?

Over
31 million
transactions
processed in total



6,432
transactions
processed
(median value)



Globally what was the estimated value (US\$) of trade finance transactions processed?

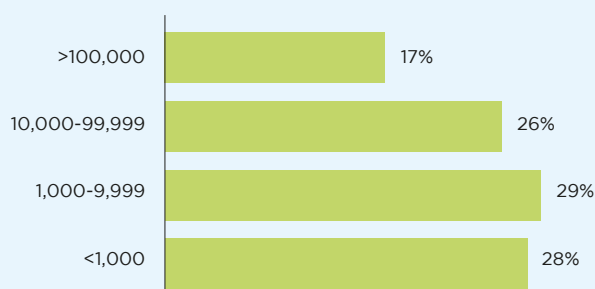
Over
9 trillion
generated
in total value



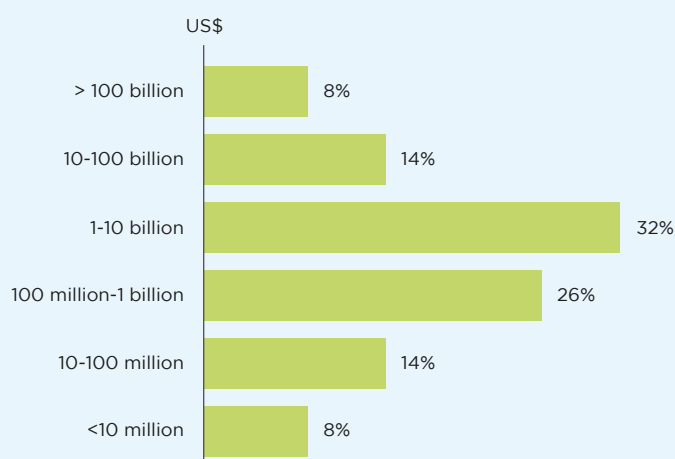
1.2 billion
estimated value of
trade finance transactions
(median value)



Number of trade finance transactions processed



Value of trade finance transactions processed



Traditional trade finance versus supply chain finance

The continued major focus on TTF merits attention, as it runs counter to market developments, and given TTF is often referred to as a commoditised business.

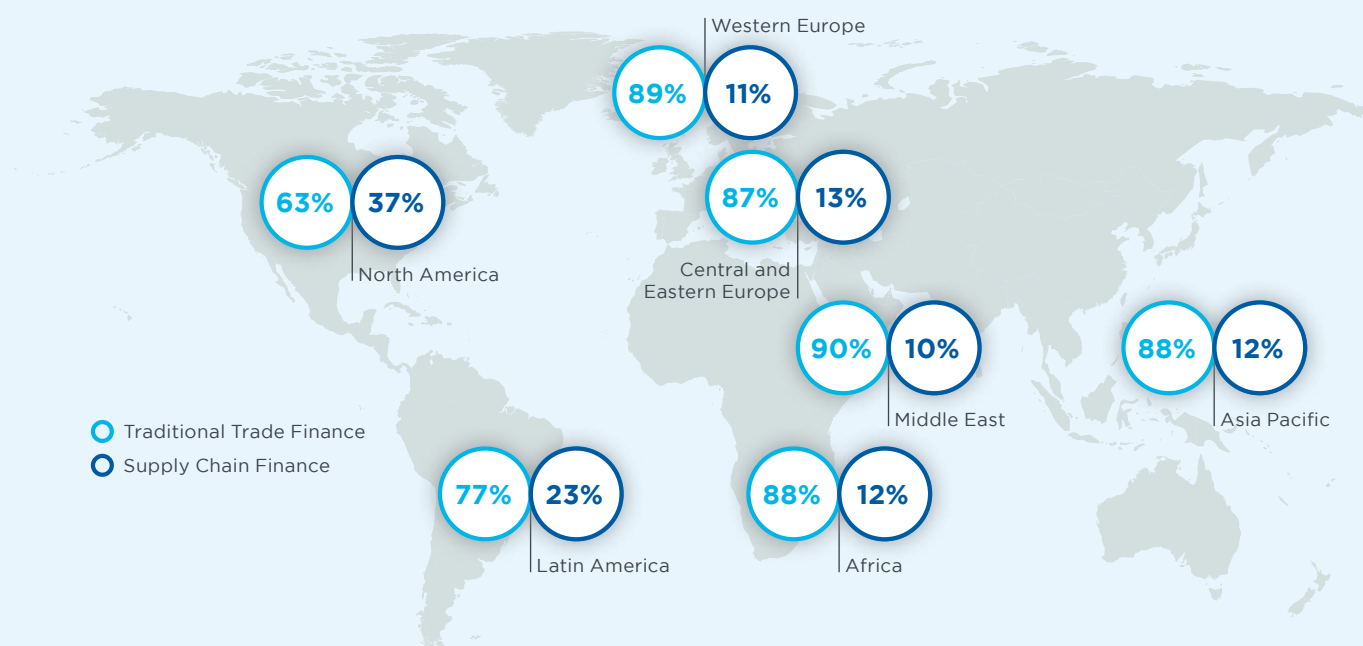
Price has driven competition in TTF for years. Many leading institutions consider this activity a loss leader, to be used in pursuit of other business or to meet overall share-of-wallet targets.

It is interesting to note that five banks (2% of banks responding) said their trade financing business is entirely focused on SCF. This may reflect the coming evolution in how international commerce will be financed. Just as some businesses and jurisdictions are leapfrogging the technological capabilities of competitors, by circumventing legacy technology and constraints, could new entrants be carving out differentiated value propositions in SCF, focusing on high-growth, open account flows and bypass developing TTF offers altogether?

Trade finance volumes and values by region

REGION	MEDIAN VOLUME	MEDIAN ESTIMATED VALUE (US\$)	TOTAL VALUE (US\$)
Asia Pacific	35,979	3,143,174,686	2,151,338,487,916
Africa	3,571	408,928,760	145,256,084,814
Central and Eastern Europe	519	190,436,519	293,120,517,801
Latin America	1,640	267,100,895	121,529,556,535
Middle East	5,714	1,000,000,000	506,894,228,092
North America	20,000	6,314,903,500	524,211,167,315
Western Europe	23,500	4,224,696,775	822,771,643,418

Traditional trade finance vs. SCF by region



The value of traditional trade finance respondents provided in 2017 was over US\$4.6 trillion, and US\$813 billion in supply chain finance, with their portfolios split between about 85% in TTF and about 15% in SCF.

In the Americas, the proportion of SCF-related activity is somewhat higher, whereas 72% of banks based in Africa said they preferred commercial letters of credit (documentary letters of credit).

Of the eight SCF techniques in the Standard Definitions for Techniques of Supply Chain Finance, activity was concentrated in the four most popular techniques: payables finance, receivables discounting, factoring and loans or advances against receivables.

The most notable uptake in North America was for payables finance, identified by 52% of respondents, while factoring was the most cited in CEE, identified by 57% of respondents.

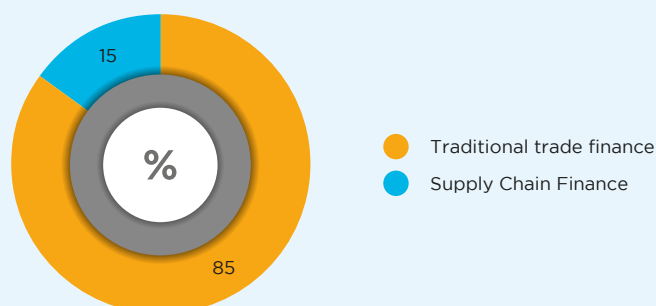
Major trends in 2017

Trade finance provision is on the upswing

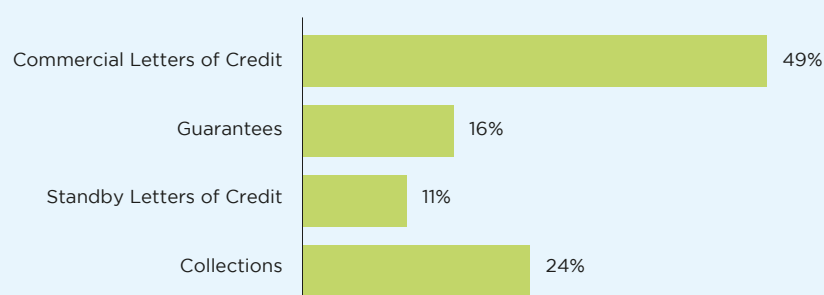
A total of 66% of respondents said the amount of TTF they provided in 2017 was higher than the previous year, while 24% said they saw a drop in TTF-related activity. Given the flat trendline in TTF business, it is noteworthy that a large majority reported an increase.

In contrast, it is reasonable to expect to see growth in SCF: 43% of respondents said SCF business rose, with 46% reporting no change. Respondent banks processing the largest values of trade finance reported the biggest rise in SCF activity, more than 30% year-on-year.

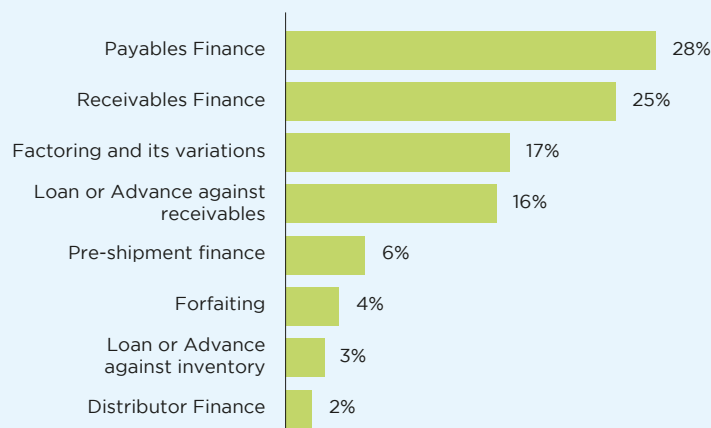
Portfolio distribution of traditional trade finance and SCF



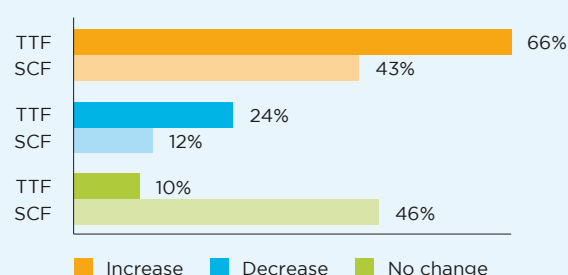
Traditional trade finance



Supply chain finance



Traditional trade finance and SCF provided in 2017 compared to 2016



The findings and data points from the survey indicate the industry is still largely shaped by the most mature parts of the global value proposition. The continued ability of trade banks to extract growth and revenue from TTF contributes to continued focus and investment in this area. By virtue of familiarity, this may be a factor in a lower uptake in SCF by a wider range of trade financiers.

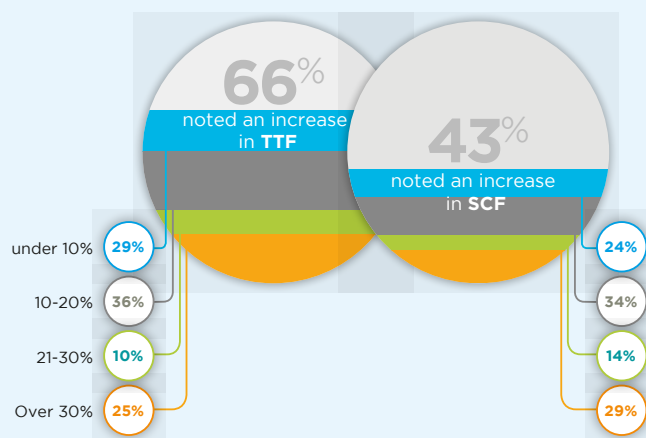
Unsurprisingly, banks reporting the most growth in SCF activity have the most trade financing capability. Deploying SCF requires technical competency and the means to access or deploy enabling platforms and technologies.

The opportunity for TTF growth will come in part from fulfilling the huge unmet demand for SCF. The trade finance gap is estimated at US\$1.5 trillion annually. Based on how the queries are phrased that underpin this number, this likely represents unmet demand for TTF that excludes or undercounts unmet demand for SCF.

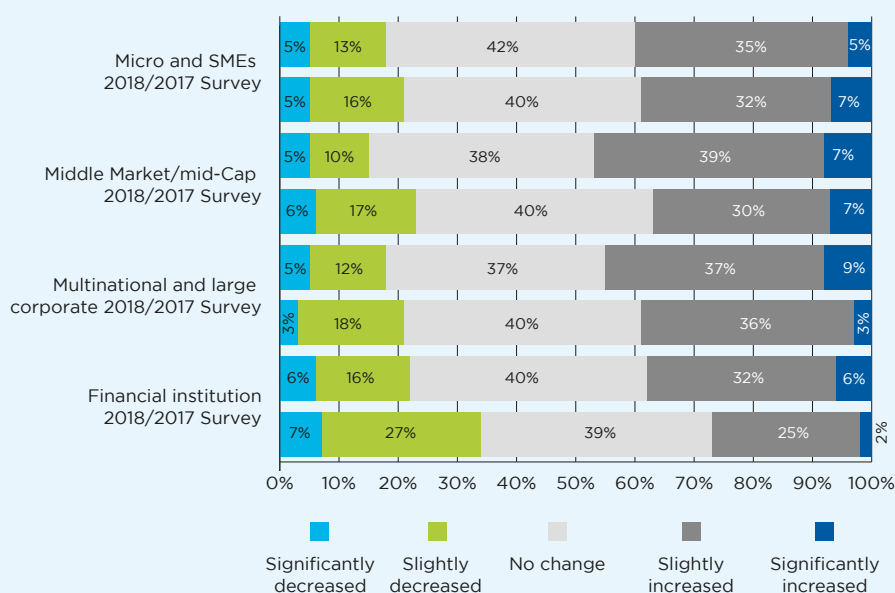
A significant portion of respondents reported a rise in trade credit lines, especially for mid-cap clients: 47% noted an increase. Large corporates and multinationals fared nearly as well.

But bucking this trend were financial institution (FI) clients: 22% reported lower FI lines to support trade financing in 2017 from the year before. Notably, the lack of available credit facilities remains a major reason for the continued dropoff in trade financing.

Increases in trade finance provision



Trade lines by client type 2017 vs. 2016



The most common reasons for rejections: Insufficient credit lines, unacceptable risk profiles

When asked about main reasons for rejecting trade finance transactions, 27% of banks said limitations on credit line availability (country, bank, or company), while for 23% it was unacceptable risk profile, especially for banks based in the Middle East and Latin America. Credit capacity challenges were especially cited by banks headquartered in western Europe.

In the aftermath of the global financial crisis, multinational clients (MNC) have consolidated core bank relationships, which has put pressure on the prices and margins of the banks they still do business with.

In this context, survey respondents showed a notable interest in the mid-cap client segment, including the provision of greater credit capacity in support of the segment. The North American and Asia-Pacific regions showed the most interest, in what is called the 'mid-market sweet spot' (cf. Figure: most important clients in terms of growth prospects for the next 12 months).

Most-requested client services in 2017

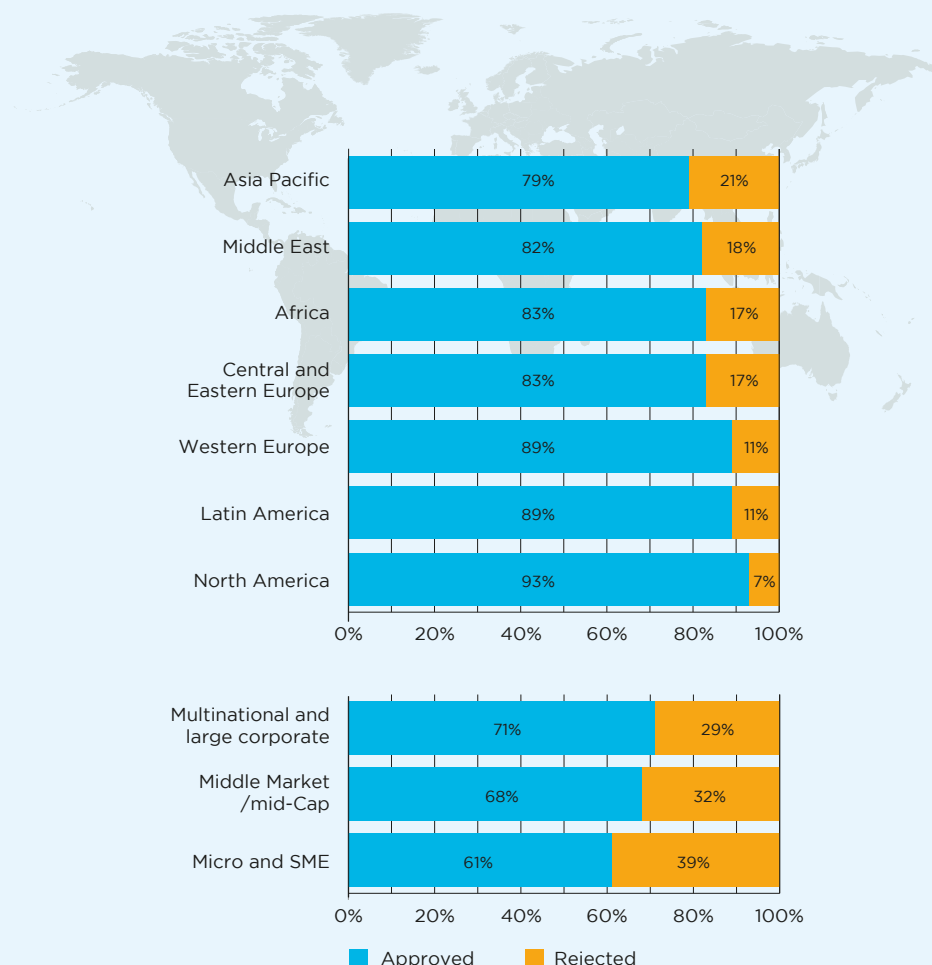
A total of 34% of respondents said the most valued aspect of quality service that clients request is favourable pricing; 5% more respondents cited price versus last year's survey.

Increased risk appetite and greater market coverage were highlighted by only 10% of respondents, despite how often this is mentioned as a gap in the value banks bring to their trading clients.

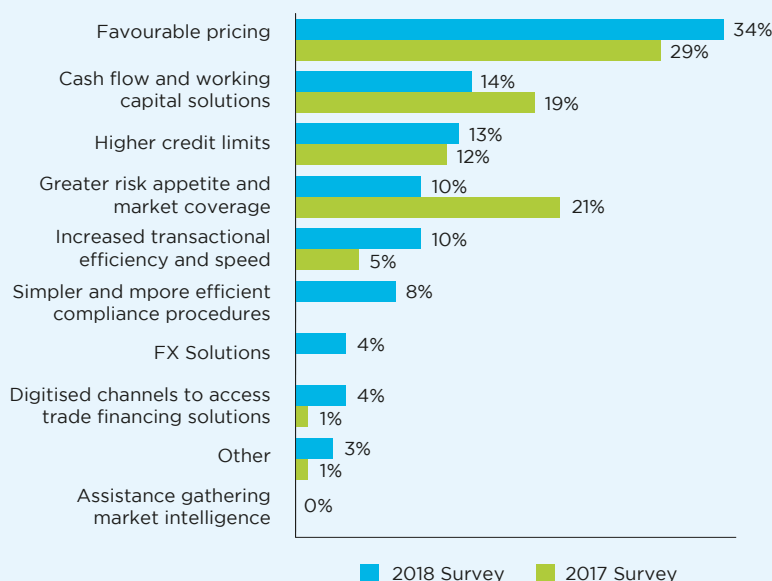
New markets

Interestingly, 83% of respondents reported exploring at least one new market in the last year: of those banks making movements, 88% in explored new markets in the Asia-Pacific, 87% in western Europe, and 82% in North America.

Trade finance transaction approval and rejection rates



Clients' most requested services



A total of 38% said they reduced their presence in one or more markets: 31% said they retreated from central and eastern Europe 28% from Latin America, and 27% from Africa.

Looked at in more detail, banks in all regions reported Asia-Pacific as one of the top three areas where they are exploring new markets. Banks headquartered in Asia-Pacific were most likely to expand in their own market (93%), alongside banks headquartered in the Middle East also looking to expand in Asia-Pacific (79%).

Western Europe and the Middle East were the only regions where banks reported a greater interest in exploring a market outside their own. Banks in western Europe were most likely to have explored Asia-Pacific (54%) versus their own market (35%). Similarly, for respondent banks headquartered in the Middle East, almost 79% said they have explored Asia-Pacific, almost twice as much as their own market (43%).

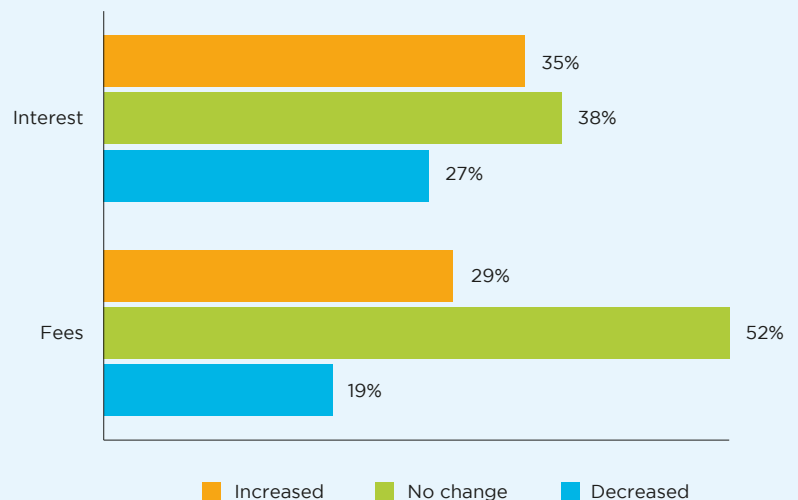
Trade finance costs rise

At the same time, 35% of respondents, especially large institutions, said interest rates affected international trade financing, by driving up the cost of trade finance for clients. A total of 38% reported maintaining the same rates as the previous year. So it appears the rise in financing costs is at least partly driven by bank-specific pricing strategies, and is not entirely or maybe even mostly driven by an increase in key benchmark rates. A total of 60% of respondents in Africa and 54% in North America reported an increase in interest rates related to trade financing.

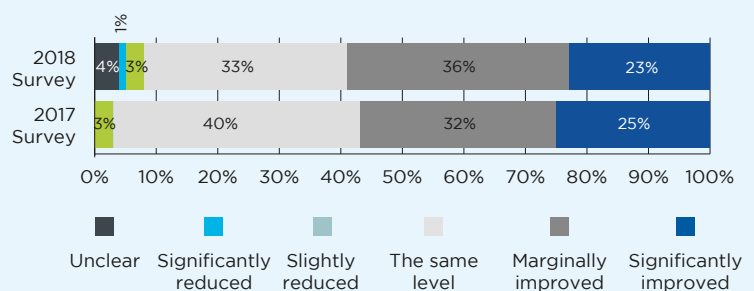
Operational risk and error rates

23% of banks noted a significant improvement in operational risk and error rates, a marginal increase from last year. Banks who have implemented technology solutions were also more likely to have experienced a significant improvement in performance in this regard (28%).

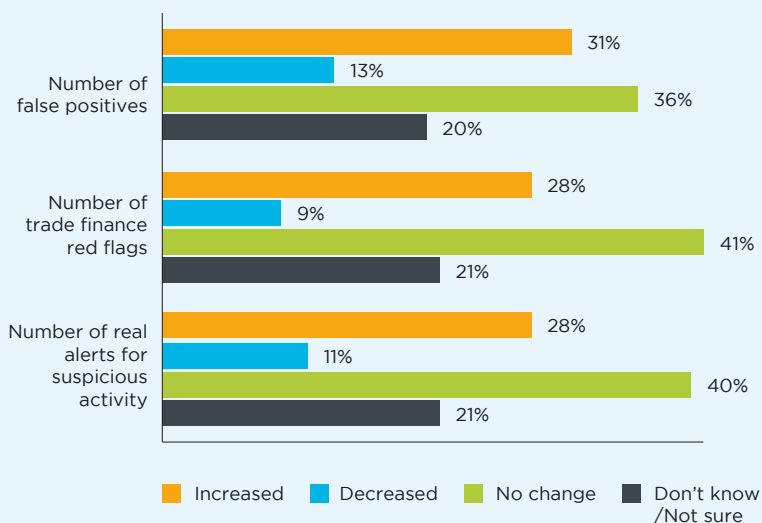
Cost of trade financing in 2017



Bank performance in terms of operational risk and error rates in 2017 compared to 2016



Due diligence transaction monitoring in 2017 compared to 2016



Due diligence transaction monitoring

Although the banks surveyed continue to flag the impact of regulation and compliance on the business of trade financing, nearly 20% said they have no visibility on whether their efforts linked to monitoring due diligence and transactions have improved results, or not. These respondents, somewhat worryingly, were unable to say if the number of due diligence-related alerts, red flags and false positives had risen, fell, or remained the same compared with 2016.

A similar proportion of banks monitoring or reporting this information saw an increase in real alerts (28%), false positives (31%) and red flags (28%). A large share, or 40% of banks, said the number of real alerts and red flags stayed mostly the same.

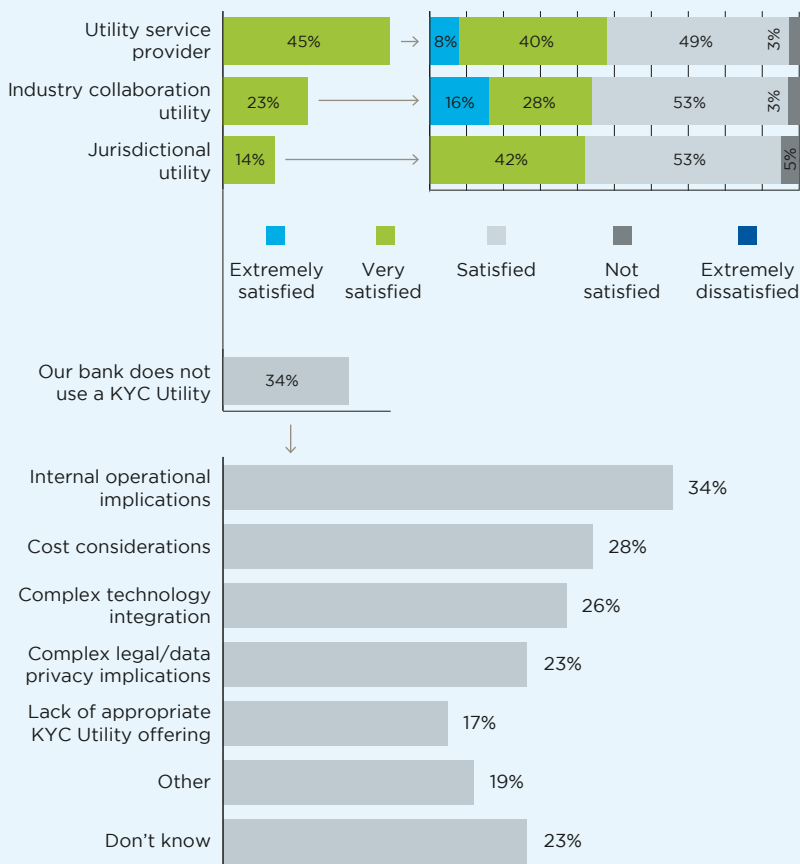
Over one-third of banks do not use a KYC utility

Despite the challenges of due diligence and KYC, 34% of respondents said they do not use a KYC utility, due to cost, operational considerations, and the challenge of complex technical integration. Almost 70% said they work with a specialised service provider of KYC and due diligence, while others use an industry utility.

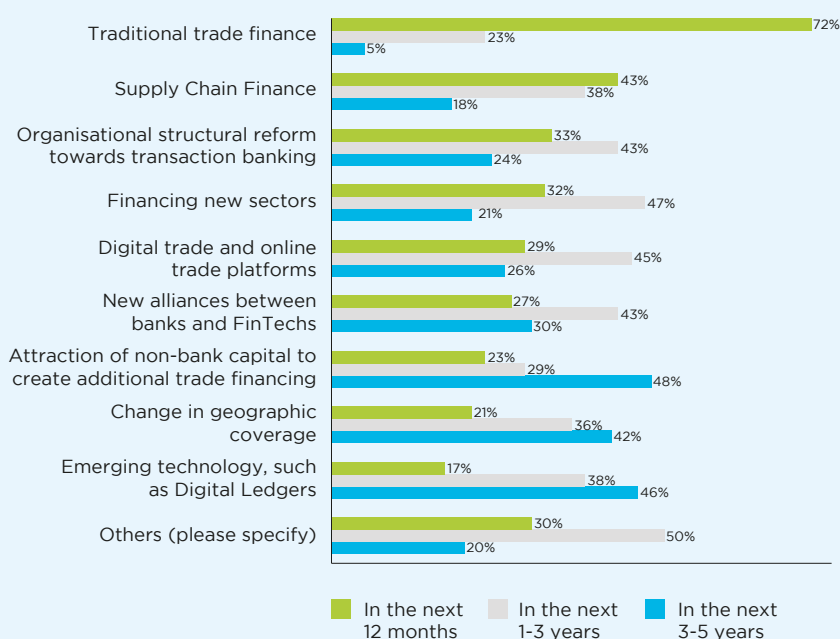
Survey findings suggest the industry is rather satisfied with available KYC utility options, but there is room for improvement, as the proportion of 'extremely satisfied' is rather low. The importance of KYC and KYCC practices and processes is clear: the survey showed that 18% of trade finance rejections in 2017 were directly linked to incomplete or failed due diligence checks, specifically related to KYC and KYCC requirements.

Due diligence requirements are a matter of major concern, due to cost and resource needs. What is more, consistency is lacking in regulatory requirements across borders. These fundamental issues must be addressed, in parallel with developing KYC utilities.

Type of KYC utilities used, if any



Priority areas of development and strategic focus in terms of growth and evolution in financing international trade



As industry discussion and aspirations for greater inclusion brought about by trade are translated into greater TTF and SCF capability, issues of due diligence and KYC will amplify.

Reaching deeper into complex global supply chains to provide financing and risk mitigation solutions to SME and MSME suppliers, especially the long tail of supply chains, will bring due diligence and KYC requirements to the fore.

Future trends

The major themes and responses from banks when asked to look ahead are in line with the topics trade finance leaders are concerned about today. Although there are differences when projecting one year and three years ahead, respondents overall did not voice concerns there would be a fundamental transformation of the trade finance industry.

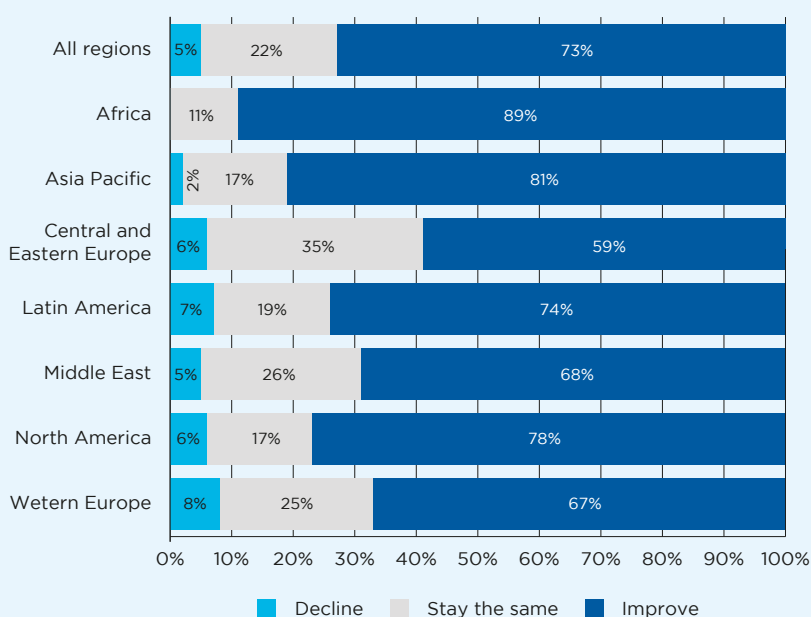
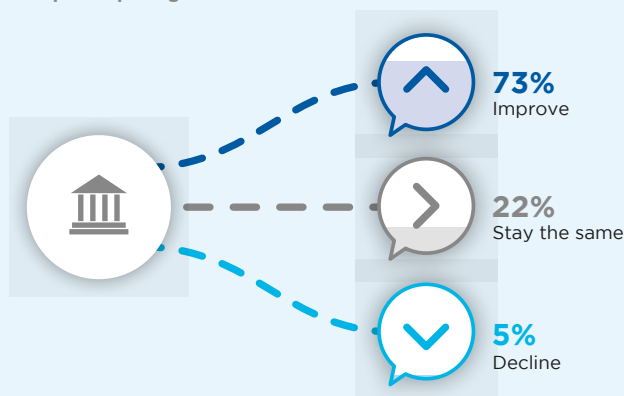
This is almost certainly due partly to the robustness and staying power of products and propositions in TTF. This has a tendency to foster an entrenched view of the long-term stability and sustainability of the business, with operating models that evolve incrementally. It is also no doubt because efforts to transform the industry over the last three decades have underestimated the complexity and detail of transactions, while over-estimating the market's preparedness. This is true for clients and providers alike, in their ability to adopt new solutions, value propositions and operating models for financing international trade.

Outlook for the year ahead

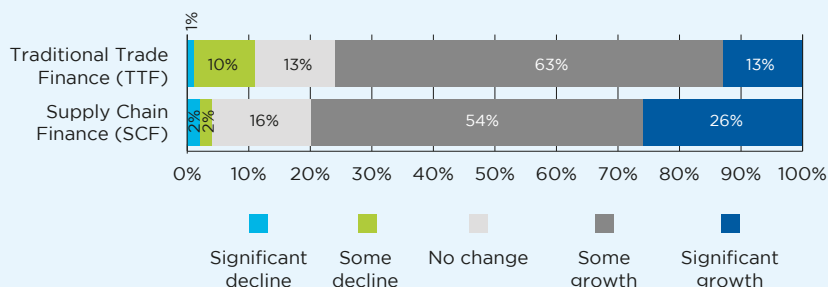
TTF and SCF to grow

Almost three quarters of banks are optimistic, believing global trade finance will improve over the next year. This is consistent across all regions. Banks headquartered in Africa and Asia-Pacific had the most positive outlook.

Outlook for global trade finance growth in the year to come – Average results and by region of participating banks



Expected revenue position in the next 12 months



Looking ahead, 73% of respondents expect trade financing to grow over the next 12 months. At the same time, 41% expect SCF to grow substantially over the next three years, which likely reflects a degree of conservatism, given the clear trend in trade on open account and the disproportionate focus of banks on TTF.

While SCF has attracted the attention of non-bank providers, the degree to which banks need to step up their engagement in SCF for the market to achieve critical mass bears careful monitoring. Some 29% of respondents said SCF business rose, 30% or more than the year before, but at a pace which may reflect a modest starting point. Or it may be because financial institutions recognize and are responding to the urgent market demand for SCF solutions.

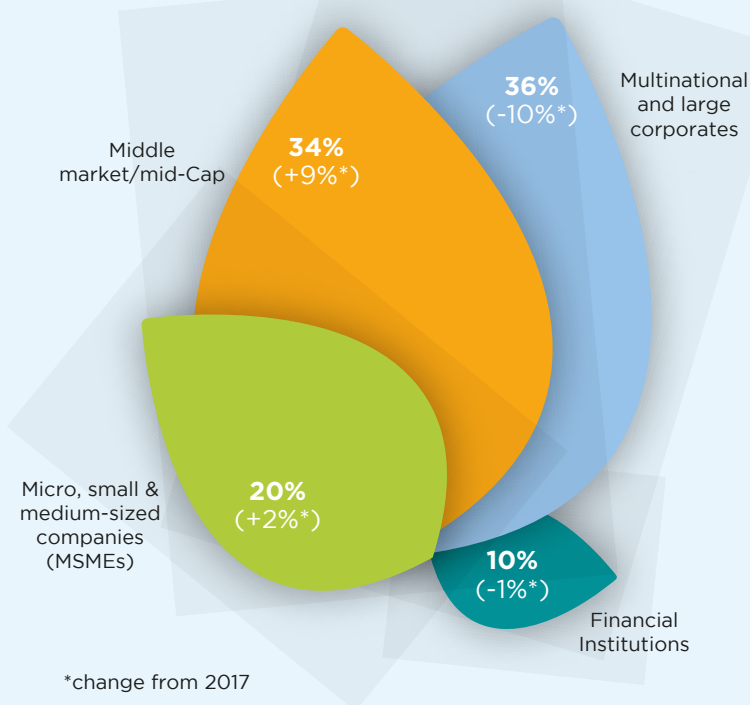
TTF remains a priority in developing trade financing capabilities: 72% of respondents say it is a strategic priority for the next 12 months, versus 43% that take the same view of SCF.

Over the next year 76% of respondents say they expect revenues to increase in TTF while 81% expect SCF revenues to grow. Unsurprisingly, larger institutions tend to prioritise SCF more than smaller banks, and larger firms are more positive about the prospects for SCF-based revenue growth. Respondents in North America (41%) and Africa (39%) are the most optimistic for SCF revenue growth.

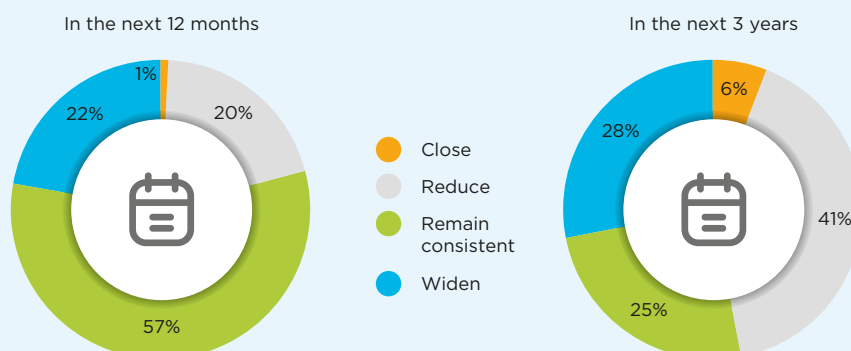
Priority clients

Perhaps due to greater attention to trade on the basis of global supply chains, priority by client segment is evenly split between MNC and mid-cap client relationships, compared with the 2016 survey results. These two client segments now vie for the attention of banks on a near equal footing, with banks in Europe paying extra attention to mid-market corporates.

Most important client segments for growth prospects in the next 12 months



Outlook on the trade finance gap



Outlook on the trade finance gap

The global capacity for trade financing is expected to worsen. About 22% of respondents said over the next 12 months unmet demand will increase, and 57% said it will be largely unchanged. These responses together suggest advocacy to address the trade finance gap must be stepped up, and that global trade financing capacity should be re-deployed down-market. A total of 43% of banks in Africa expect the gap to widen.

The outlook is more positive for the trade finance gap over three years: over 41% of respondents expect the US\$1.5 trillion in unmet demand to shrink. Given the attention paid to trade financing today in policy circles worldwide, and the broader appreciation for the linkages between trade financing (TTF and SCF), trade conduct, trade-based development and economic value-creation, this outlook is positive and meaningful. Especially given efforts have been minimal to attract and engage non-bank capital in financing international commerce.

The outlook for the next one to three years

When the horizon is extended to three years, the picture changes in several important ways:

Revenue growth seen gaining momentum

A total of 91% of banks surveyed expect revenue growth from SCF. This suggests not only a view that lines up with the market on the potential of SCF, but also the likelihood banks will take proactive steps to develop propositions in SCF. This is consistent with the survey, where 45% of respondents said they intend to prioritise digital trade and the design, development and deployment of platforms to facilitate trade and trade financing.

Priorities for development and strategic focus

About 43% of survey participants said they will put some degree of emphasis on assessing and developing partnerships with fintech firms. The same proportion of respondents expect to see changes in the structure of their transaction banking businesses in the next three years.

This is consistent with the observations and expectations of survey respondents: 41% expect the global trade finance gap to narrow. Deploying SCF capabilities, restructuring lines of business in which trade financing typically resides, together with partnering with fintech and deploying technology suggest trade financing propositions, channels and capabilities will create new capacity for trade financing.

The longer term... three to five years

Priorities for development and strategic focus

Although a strategic focus on TTF remains a priority over the next year, that appears to change significantly in three to five years. Respondents identified three focus areas: 48% see an opportunity in attracting non-bank capital to

create net new financing capacity, while 46% believe in focusing on emerging technologies such as distributed ledger technology, and 42% indicate they see a change in geographic coverage. These responses suggest banks are focusing on the familiar and are eventually shifting focus on forces likely to shape not only the business of trade financing, but also cross-border trade.

Interest is growing in attracting non-bank capital to finance international trade, which complements this trend. This suggests there is a potentially large development in redefining the landscape for trade financing, including the kinds of capital available to support cross-border commerce. Some 43% of banks based in Africa, and 45% in North America say attracting non-bank capital to trade financing is a strategic priority.

This topic has attracted industry attention on a couple of prior occasions. At the moment, some market participants think there is sufficient balance sheet and origination capacity in the market through the banking sector. Others believe the origination/distribution of risk are cyclical, so capacity constraints will happen again, underpinning the demand for extra, non-bank capital.

While global capacity and appetite for trade finance depends very much on the credit and risk capacity of banks, it also depends on balance sheet capacity and assessments of reputational risk, and the risk of unintentional non-compliance with

the expectations of regulators. The capital treatment of trade finance by the Basel Committee and national regulators implementing the Basel Accords and periodic updates remains a matter of discussion and concern, with clear and direct consequences for global trade financing capacity.

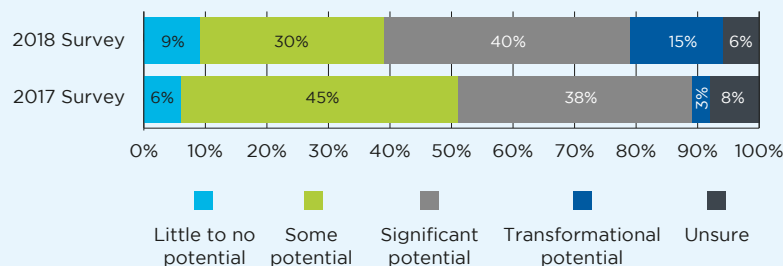
Digitisation: reality check

Digital trade and trade financing are top-of-mind among leading practitioners. While there is promise and progress in technical capability and the degree of market readiness for significant uptake, most observers recognise that achieving meaningful degrees of digitisation is possible in the medium-term in the best case. Meanwhile, pockets of progress can be observed in the use of Optical Character Recognition (OCR), and the application of Artificial Intelligence (AI) to some degree in parts of the TTF transaction lifecycle.

The importance of technology in the evolution of how international commerce is financed cannot be overstated. An indication of how priority is evolving can be seen in the proliferation of proofs of concept for TTF and SCF platforms, technology-enabled delivery models, and Distributed Ledger Technology, which could have transformative effects.

The dichotomy between a persistent focus on familiar products, delivery channels and business processes, and a desire to explore areas of innovation and transformation suggest the potential for progress

Potential for digital channels to materially impact sales volumes



in bringing more trade financing capacity to the market. This would complement efforts for developing propositions under the banner of supply chain finance.

Trade financing benefits from, and pays the price for, the robustness and long-term efficacy of its most mature products, practices and processes. Some have been in use for hundreds of years, or more. For example, thanks to the global adoption of commonly understood guidance rules and commercial practices, in the use of documentary letters of credit, the L/C has proven effective in enabling trade amid the most challenging political, commercial and risk conditions in the world.

The motivation to innovate has been modest at best - the downside to the long-term efficacy of legacy products.

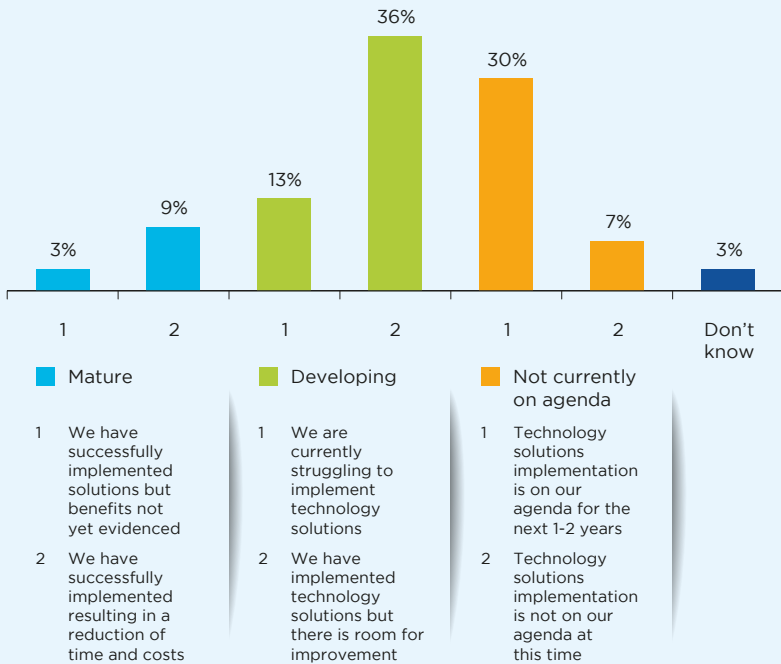
Technology solutions achieving digitisation benefits

While there have been discussions and some promising attempts to apply technology to advance the business of trade financing, especially over the last two decades or so, only 15% of respondents view transformative potential in applying technology to the opportunity to digitise and boost trade finance sales.

How mature is digitisation?

In parallel, 37% of respondents said implementing some form of technology solution or capability is not on their agenda. But the majority of these are planning to implement a solution in the next one to two years. This reflects in part that deployments can be costly, time-consuming and infrequent, and in part the risk that technology upgrade plans may not keep up with the business imperative driving these investments when undertaken strategically, rather than as part of regular maintenance of existing capabilities.

Maturity in using technology solutions to achieve benefits such as reduced time and costs as well as improved precision associated with trade-related due diligence



One-third of banks based in North America rate their adoption of and capabilities through technology as “mature”, the highest percentage of respondents. More than half of banks headquartered in central and eastern Europe, 57% of the Baltic States and the Commonwealth of Independent States (CIS) and 52% in Africa say implementing technology solutions is not on their agenda.

Despite these observations, it is clear the size of a trade financing business, measured by staff complement or transaction value/volume, directly relates to the priority a bank places to some form of technology-based investment in trade-related financing.

Paper still widely used for documentary transactions

Digitisation and the application of technology to trade finance is still top-of-mind among trade financiers and industry leaders. At the same time, as the industry invests time and effort in assessing the potential

of leading technical solutions like distributed ledger technology, the use of APIs to enable connectivity, and the implications of technology in the physical supply chain, paper use persists in the financing of international commerce.

About 35% of respondents acknowledge that removing paper in the initiation stage and the settlement stage of a transaction, the two more automated parts of the transaction lifecycle, is incomplete. In document verification, where the impact of using paper is most costly and time consuming, 52% of respondents said no solution has been implemented in this very mature area of TTF. This is a long-recognised and persistent pain point in the physical movement and financing of trade flows. But large trade finance operations units surveyed said they have made more progress removing some paper from the TTF transaction lifecycle.

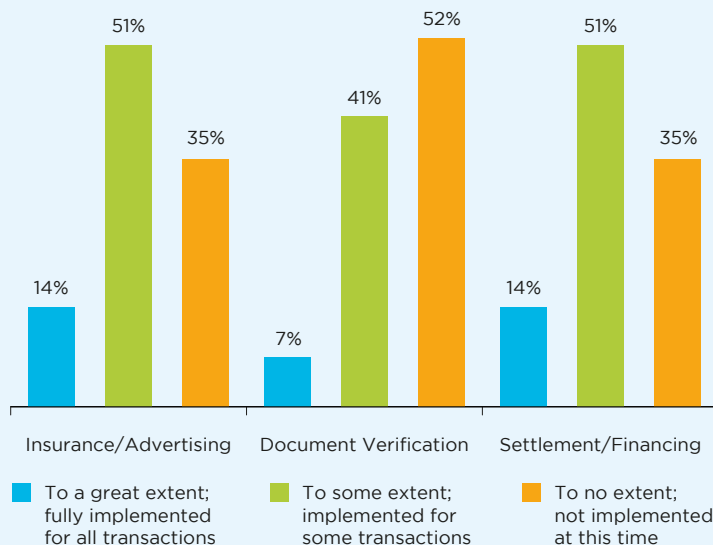
This brings into focus the decades-long effort to meaningfully dematerialise the financing of international trade. It also highlights how applying potentially transformative technology to TTF and SCF does not eliminate the need to address this basic challenge.

Despite much industry discussion about electronic documentation, including electronic transport documentation and bills of lading, only 24% of banks reported using eB/Ls or other electronic documentation, while the same percentage reported using OCR. These findings suggest there is a large opportunity to advance the application of technology to the evolution of trade financing. Although some techniques in SCF typically involve platforms and technology, there is overall much to be done in the pursuit of digital trade and by extension the digitisation of trade financing.

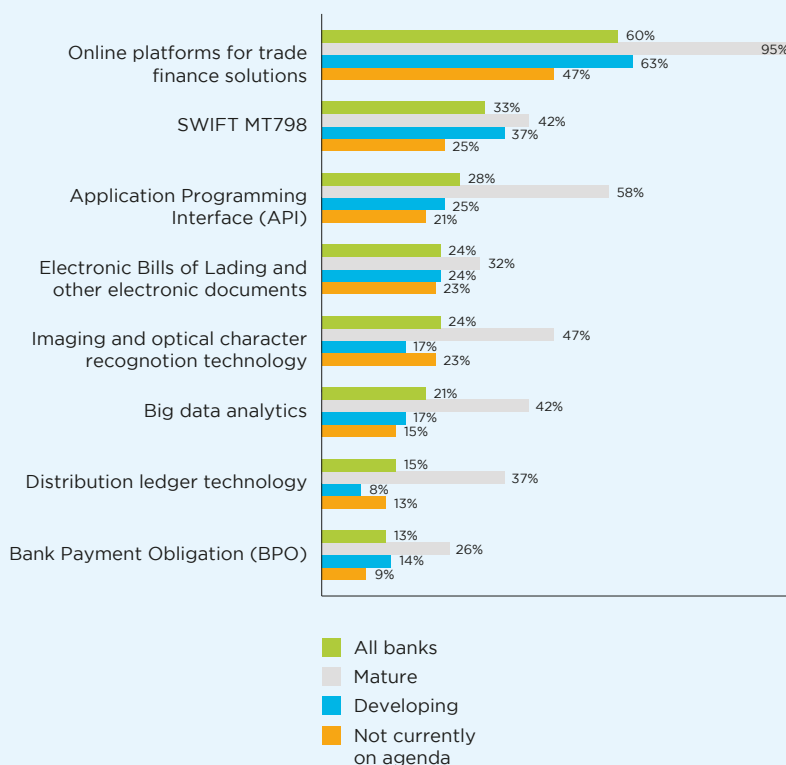
In the survey 60% said they use some form of platform-based technology, with 73% of the larger trade businesses, measured by staff complement or value, more likely to use technology for managing the business or delivering their solutions to clients.

The use of technology in many environments has shifted from a tool to enable incremental improvement, to a strategic resource that has transformed entire industries or has the potential to do so. There is an opportunity to leverage the confluence of developments in trade, financing, technology and market needs and expectations to advance a fundamental evolution in the financial supply chain, and keep pace with developments in the physical supply chain.

Removal of physical paper for documentary transactions



Instruments and solutions used to digitised trade finance



Supply chain finance

SCF is a nascent area of trade financing, a holistic, programmatic proposition even though SCF techniques, such as factoring and forfaiting, are as mature as the most familiar elements of TTF.

The 2018 edition of the annual ICC Banking Commission Survey respondents collectively had a TTF portfolio of US\$4.6 trillion and a SCF portfolio of about US\$813 billion.

Given the number of respondents and the incomplete responses from some, these numbers are not a comprehensive view of the global market for trade financing, but enough to identify major market trends, analyse key developments, and consider the strategic and operational implications of the survey's findings for stakeholders of the global ecosystem of international commerce and trade-related financing and risk mitigation.

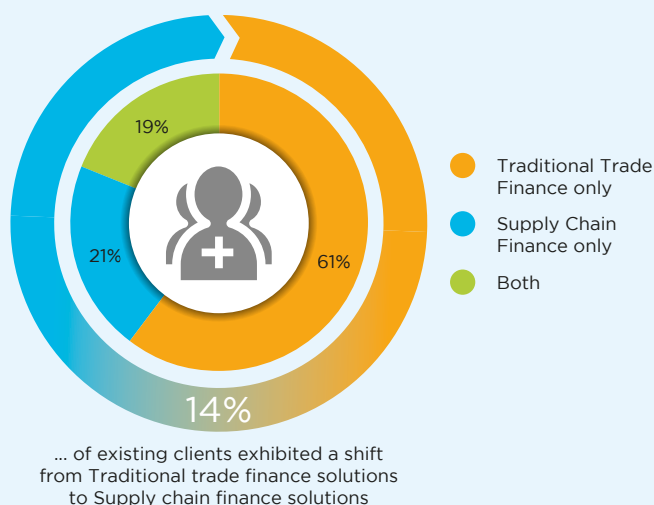
The ICC Banking Commission together with many industry associations, spent two years developing the "Standard Definitions for Techniques of Supply Chain Finance"¹. First published in 2016, it is now focused on market adoption. KYC challenges have long been at the crux of a specific SCF technique, which the standard definitions refer to as "payables finance".

Supply chain finance operations

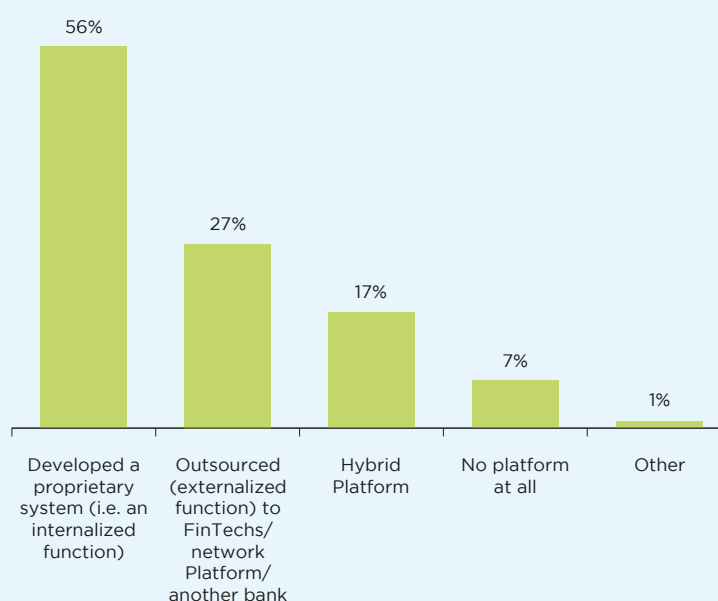
More than half of all banks, or 56%, that offer SCF have developed a proprietary system for their operations. This SCF platform has been developed by the majority of banks classified as mature in implementing technology solutions and almost two thirds or 64% of banks classified in the developing group.

Banks that do not have implementing technology solutions on their agenda are least likely to have developed this type of system (38%) and about one third (34%) are outsourcing to another bank.

Use of traditional trade finance vs supply chain finance by new clients on-boarded during 2017



Type of supply chain finance platforms used



References and notes

1. <http://supplychainfinanceforum.org/ICC-Standard-Definitions-for-Techniques-of-Supply-Chain-Finance-Global-SCF-Forum-2016.pdf> "Standard Definitions for Techniques of Supply Chain Finance"

In the survey 60% of banks do not use different credit and/or operational risk policies for SCF than for TTF or working capital finance. Only half of the remaining banks can confirm they use different policies.

Supply chain finance due diligence

Challenges around KYCC have appreciably slowed and even hindered the ability of banks to onboard suppliers to payables finance programmes, especially when suppliers are based in countries where basic credit adjudication is hampered by the lack of credit reports and other basic data about these trading partners.

Questions remain about the degree of KYCC required by various regulatory authorities and inconsistencies are rife across jurisdictions. Failure to complete adequate KYC/KYCC is cited as the reason for a drop in the provision of trade financing by 18% of respondents, a large number when considering the annual trade finance gap is US\$1.5 trillion.

Due diligence, including KYC and KYCC requirements, are still challenging for TTF and SCF providers. In the survey 40% of respondents identify KYC and KYCC requirements as persistent challenges in SCF delivery. This has long been an issue for successfully deploying payables finance programmes, as they require due diligence on suppliers invited to participate.

A total of 32% of banks with proprietary systems report challenges due to the absence of common standards for exchanging data between the various platforms in the market. The absence of interoperability across technologies, including between major industry platforms, is considered a major systemic issue. The importance of creating common standards, or at minimum building technical bridges between many digital islands is a focus area: many banks believe fintech

could enable more efficient and effective KYC and due diligence, including more cost-effective solutions to address due diligence requirements.

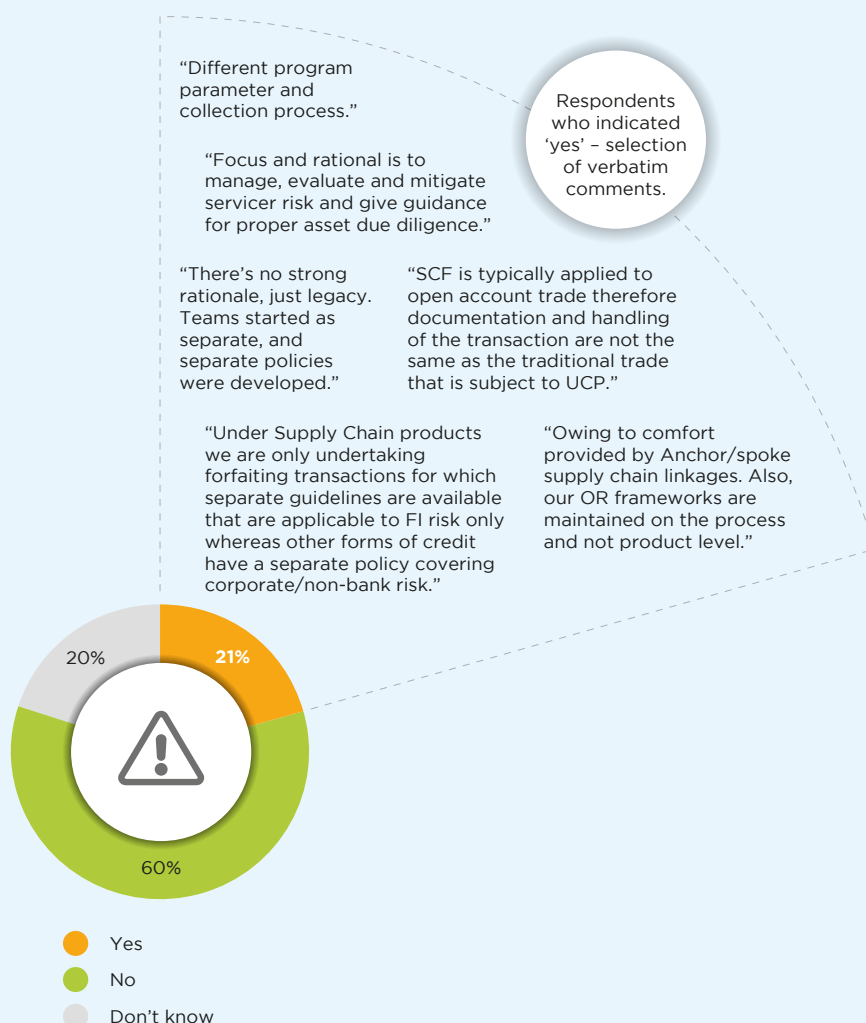
Regulation and compliance's brake on growth

Nearly 90% of respondents highlighted regulatory and compliance requirements as major obstacles to growth, including those linked to international sanctions and terrorism financing. While practitioners as a group fully recognise the imperative of regulation and compliance, they are likely concerned about regulatory

expectations, including an absence of clarity, which is at times behind excessive industry measures. They are also more generally concerned about the global financial impact and resource deployment to meet regulatory and compliance requirements.

The 2018 edition of this report however, places one issue in relief: banks expressed major concerns about sanctions and measures to counter the financing of terrorism (CFT). A total of 56% of respondents had serious concerns on the impact of sanctions and CFT could have on their ability to provide adequate levels of trade financing in support of cross-border

Use of different credit and/or operational risk policies for supply chain finance than those used for traditional trade finance or working capital finance



trade. Banks based in western Europe were very concerned about regulatory and compliance issues; 71% of respondents raised this subject, while 66% based in Asia-Pacific and 62% based in Africa voiced similar concerns.

The industry recognizes the need for and the imperatives for robust regulatory regimes and appreciates the unique role that international banks can play helping police and intelligence agencies investigating and successfully combatting illicit activity.

The concerns arise from the huge increase in resources banks must invest to ensure compliance with a wide range of often inconsistent regulatory requirements and expectations across jurisdictions. Perhaps more challenging, the interpretation of regulatory requirements can vary between senior policymakers and examiners assessing compliance. The effect is that banks apply large internal resources and incur cost to ensure compliance with standards that are at times unintended and unnecessarily stringent.

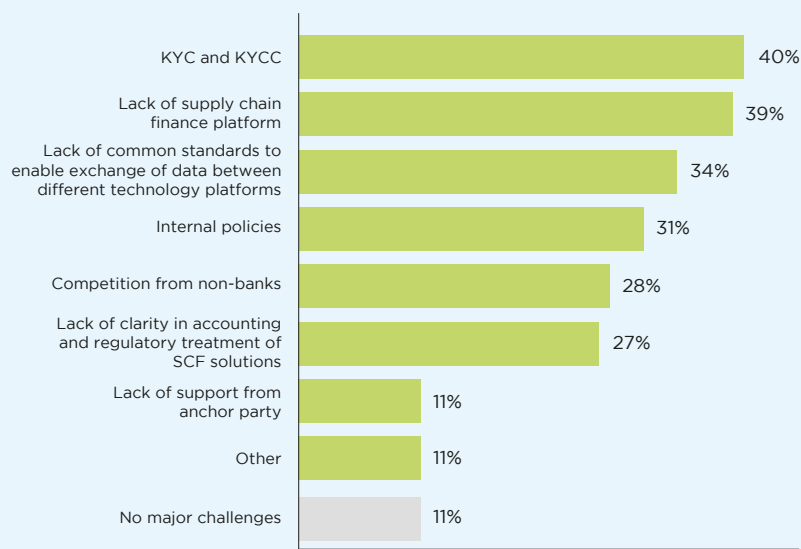
Understanding trade finance

Trade finance education

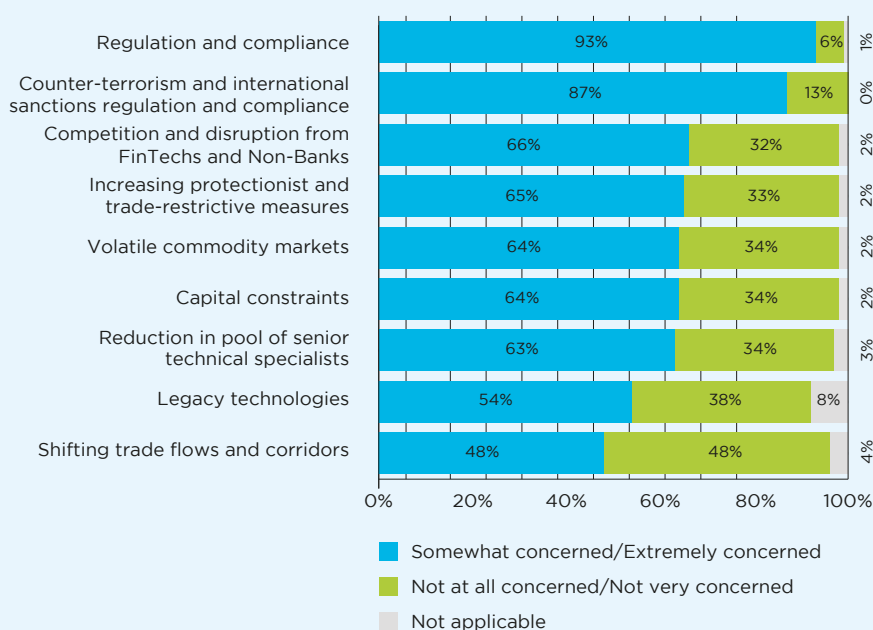
Responses on education programmes centered around advocacy, education and the need to collect metrics more representative of global industry dialogue. While 74% of respondents said they use in-house, face-to-face training, only 40% had access to external experts, and only 26% reported using online programmes developed by external third parties.

The start of this conversation is important, and fitting to add to the 10th anniversary of this publication. Asking about levels of internal support could motivate some senior bank executives to conduct candid self-assessment and prompt business line executives to consider opportunities for boosting the efficacy of internal advocacy in support of trade financing.

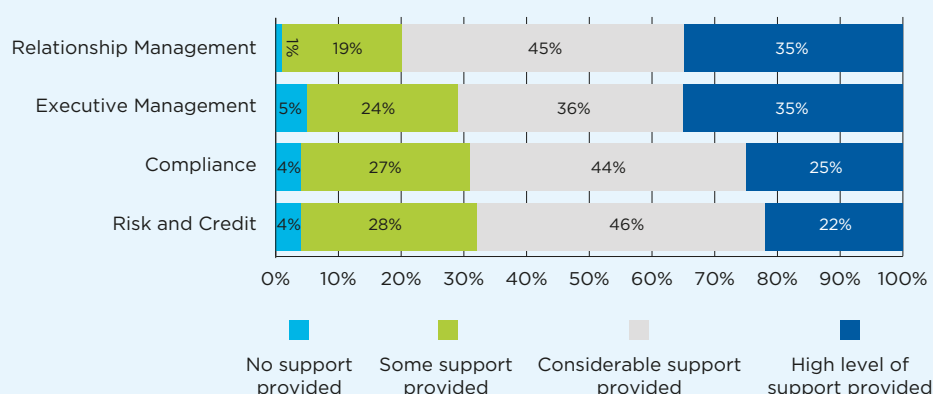
Major challenges in delivering supply chain finance solutions



Obstacles to growth and concerns



Internal level of support for trade financing from other stakeholders



In-house support

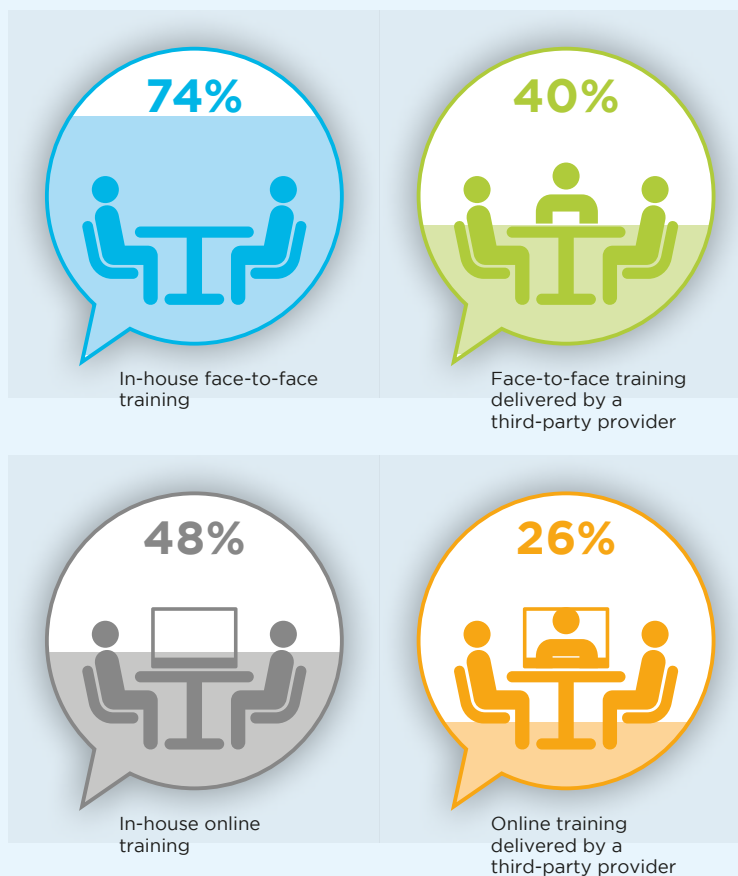
The opportunities and challenges for financing international commerce by banks of all sizes is most commonly understood and described against a backdrop of low awareness of trade finance outside a core group of practitioners.

This is true even in the most internationally-oriented financial institutions, and certainly in international trade. Anecdotal reality reported among industry stakeholders shows trade financiers routinely say senior bank executives rarely understand the nature and value of trade financing to the institution or a bank's clients. They say front-line relationship managers are too often not literate on basic trade and trade finance, and incentives to boost trade finance sales are often lacking.

In contrast, respondents to this year's survey report strong support for trade finance among relationship managers (80%) and almost equally among executive management (71%). Credit, risk and compliance functions are described by almost 70% of respondents as equally strong supporters of trade financing.

There is perhaps some contrast between these assessments, and the main recommendations on how to best support trade finance. Almost a third of respondents see the need to better articulate and champion the favourable credit risk and capital characteristics of the business, while 25% say it is important to boost education and awareness about trade finance inside their institution. A total of 19% said gathering objective data to quantify the value of trade financing to a bank was important to get sufficient internal support for TTF and SCF.

Trade finance education in banks



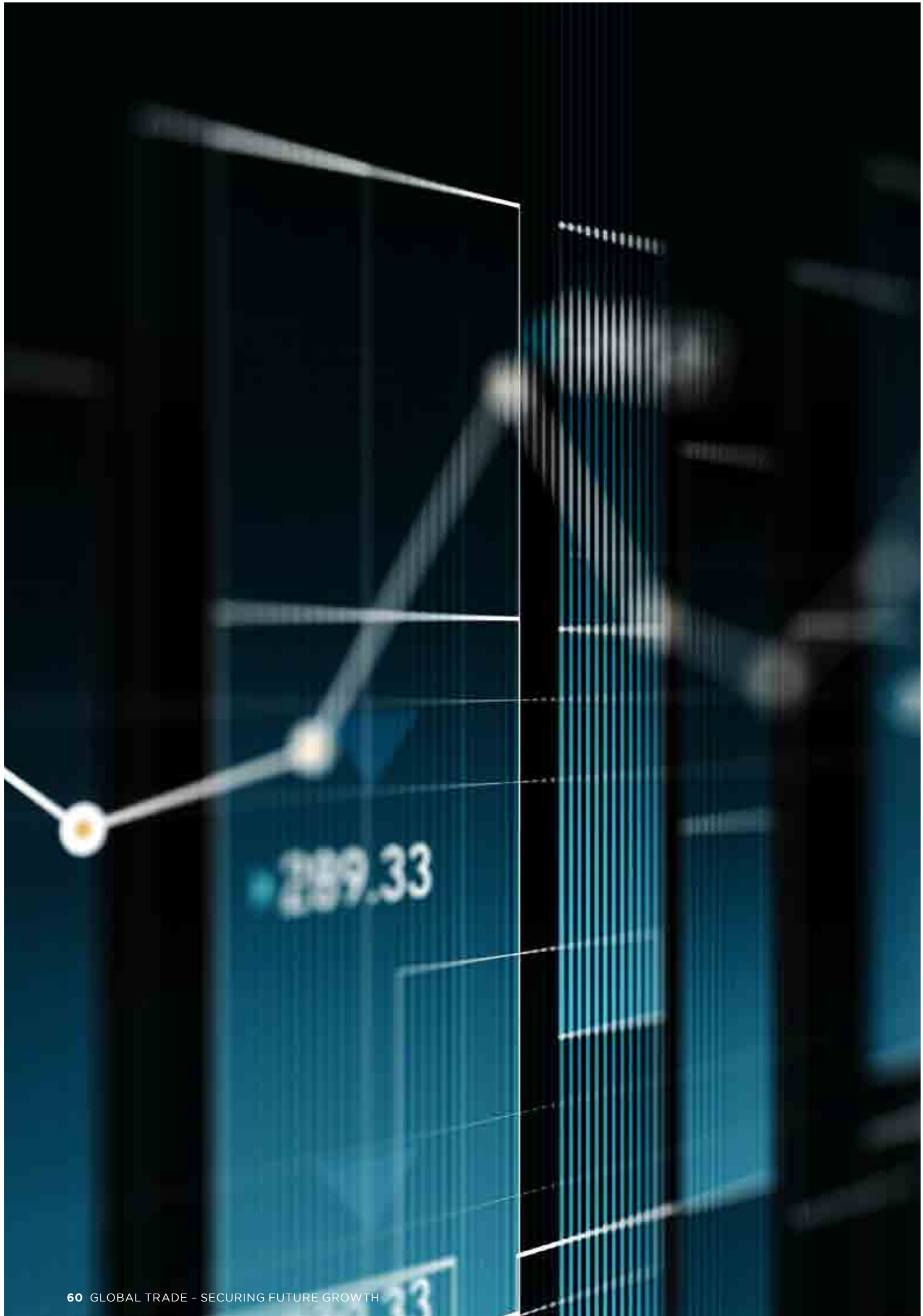
Raising the query around levels of internal support will perhaps motivate some candid self-assessment among senior bank executives and may prompt line of business executives to consider opportunities for enhancing the efficacy of internal advocacy efforts in support of trade financing.

Survey results for information and decision-making

The survey findings, together with the contributions of world-class experts in a range of disciplines, provide ample material for thoughtful reflection, strategic planning and practical, tactical action to keep global trade flowing.

Trade is crucial for economic growth, greater inclusion and prosperity. Adequate trade financing is the underpinning to keep trade growing and flowing.

This publication is rich in content and analysis. Reviewed critically, it can inform and guide practical commercial decisions, and provide an authoritative basis to develop critically important messaging and advocacy on trade and trade financing.



SWIFT trade traffic/ The year in review

By Huny Garg

Huny Garg is Head of Trade and Supply Chain at SWIFT.

The SWIFT interbank payment system offers a birds' eye view of global trade activity in the last year. It also reveals upcoming changes in messaging standards for trade finance.

While SWIFT trade finance traffic represents only a sliver of global trade, it is a good barometer of trends for letter of credit (L/C) use, since about 90% of L/C transactions go via SWIFT.

Highlights in 2017

- SWIFT trade finance volume fell 2.35% in 2017¹ from the year before, in large part due to a 1.56% drop in category 7 and a 5.30% drop in category 4². The decline was less pronounced than last year when trade finance volume declined 4.72%.
- Asia-Pacific continued to register much higher volumes of MT 700³, garnering a 73.8% share for imports and a 77.2% share for exports.
- Countries using SWIFT L/C⁴s the most for imports were: Bangladesh, South Korea, China, India and Pakistan.
- Countries using SWIFT L/Cs the most for exports were: China, Hong Kong, India, Singapore and Japan.
- Imports rose sharpest in Iran, up 23.74%, and exports rose fastest in the United Kingdom, up 5.55%.
- Imports fell the most steeply in Egypt, down 23.43%, and exports fell sharpest from Saudi Arabia, down 18.57%.
- The average value of an L/C (MT 700 only converted to US\$) rose to US\$537k last year from US\$463k in 2016.



SWIFT terms explained

Traffic - live messages sent over SWIFT

Category 4 messages - flows for documentary collections, except the three least used cash letter messages

Category 7 messages - flows for commercial and standby L/Cs and guarantees

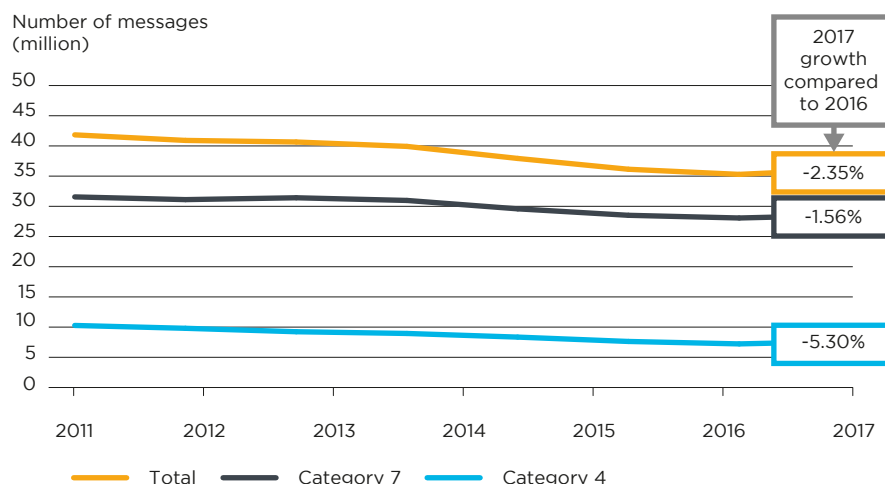
MT 700s - L/Cs or issue of a documentary credit

Trade finance traffic continues its slide

SWIFT trade finance volumes in 2017 were down 2.35%, but fell less sharply than last year's drop of 4.72%, pushed down by the decline in category 7 documentary credits and guarantees by 1.56%, and a 5.30% fall in category 4 documentary collections.

The share of total finance traffic for category 4 fell to 20.46% in 2017 from 24.56% in 2011.

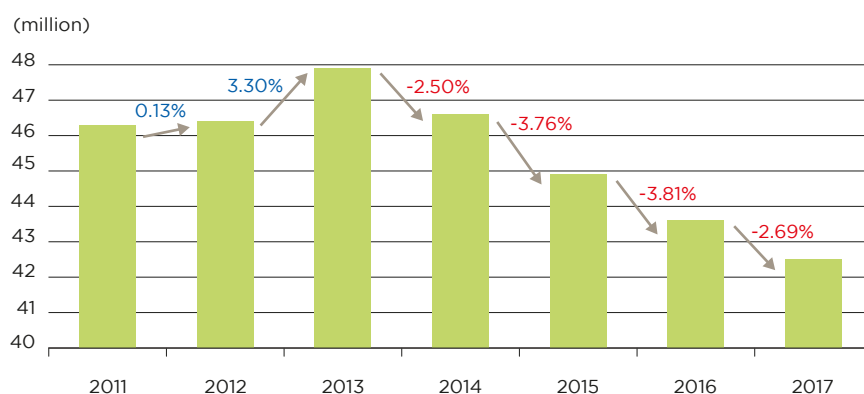
SWIFT global traffic



L/C volume - fourth year of slump

The volume of L/Cs on SWIFT fell for the fourth straight year, off 2.69%, the lowest since 2011.

MT volume

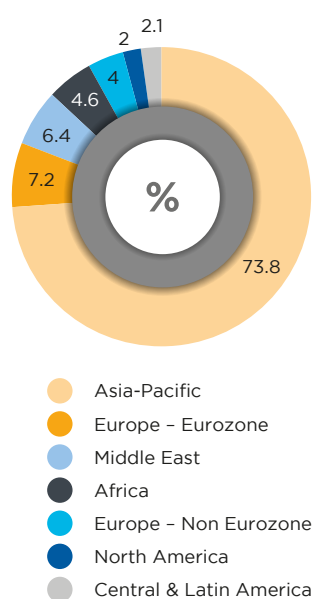


Regional analysis

Importing with L/Cs⁵

Asia-Pacific continued to register the largest volume for imports sent using MT 700s, making up 73.8% of world traffic in 2017, followed by the Europe - Eurozone (7.2%) and the Middle East (6.4%).

Import traffic

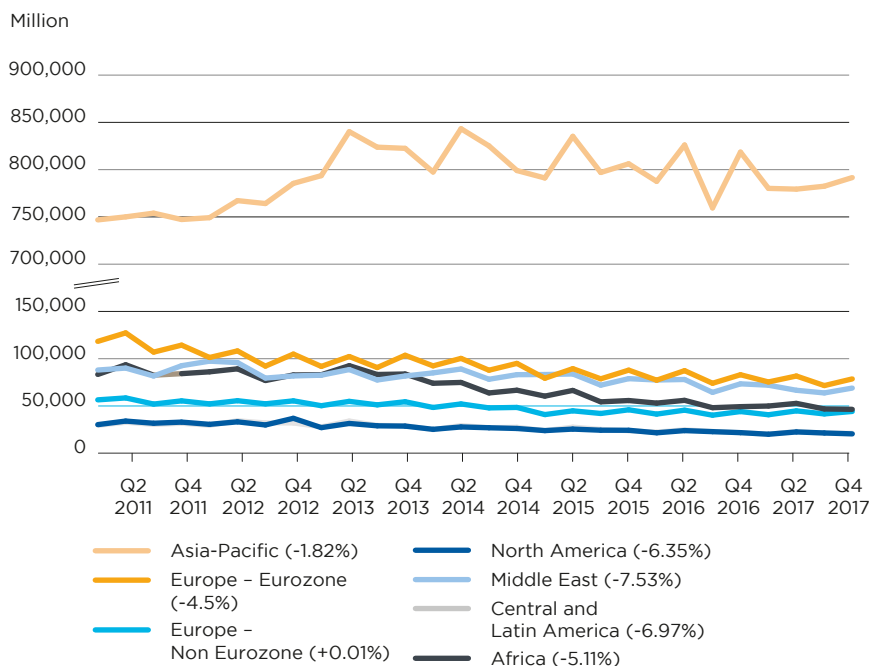


References and notes

1. Flows for commercial and standby letters of credit and guarantees. MT 700 is in this category.
2. Flows for documentary collections, excluding the three least commonly used "cash letter" messages.
3. Equivalent to Letter of Credit (L/C). A letter from a bank guaranteeing that a buyer's payment to a seller will be received on time and with correct amount.
4. Equivalent to MT 700.
5. Data includes domestic and international traffic.

SWIFT trade finance traffic fell in most regions in 2017 compared with 2016. The Middle East had the most rapid decline, down 7.53%, followed by Central and Latin America, which was down 6.97%.

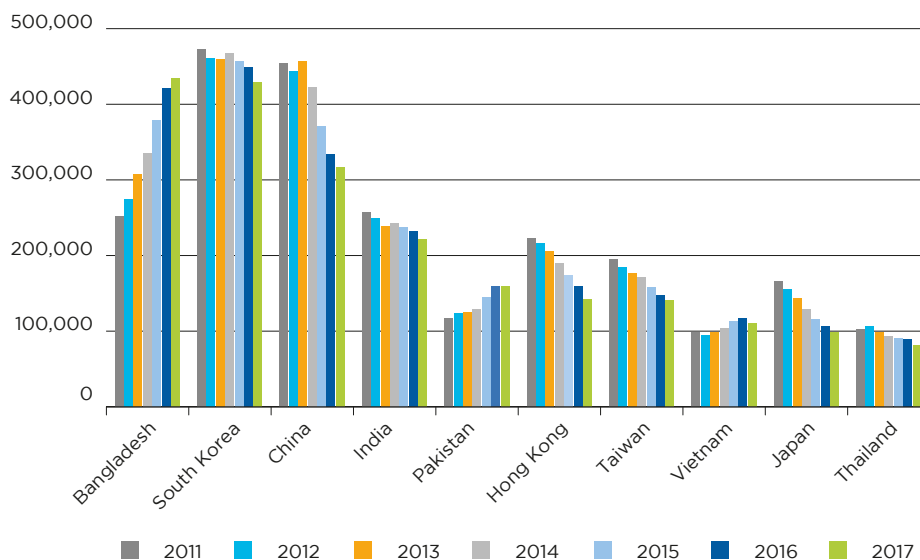
MT 700s sent



Top importing countries

Looking at the cross-border (excluding domestic flows) volume of MT 700, the countries importing the most using L/Cs were:

Top 10 importing countries

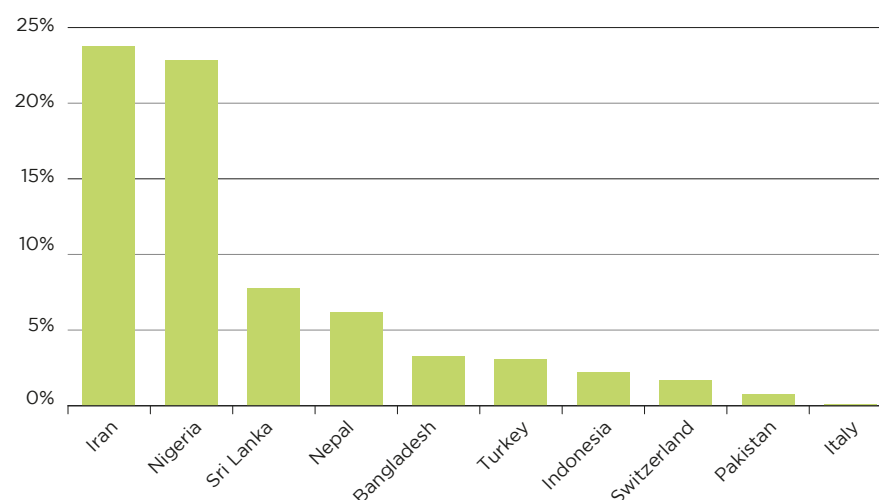


RANKING	COUNTRIES	GROWTH 2017 FROM 2016
1	Bangladesh	3.29%
2	South Korea	-4.41%
3	China	-5.11%
4	India	-4.24%
5	Pakistan	0.74%
6	Hong Kong	-10.98%
7	Taiwan	-4.40%
8	Vietnam	-5.51%
9	Japan	-7.72%
10	Thailand	-7.72%

* based on 2017 L/C volumes

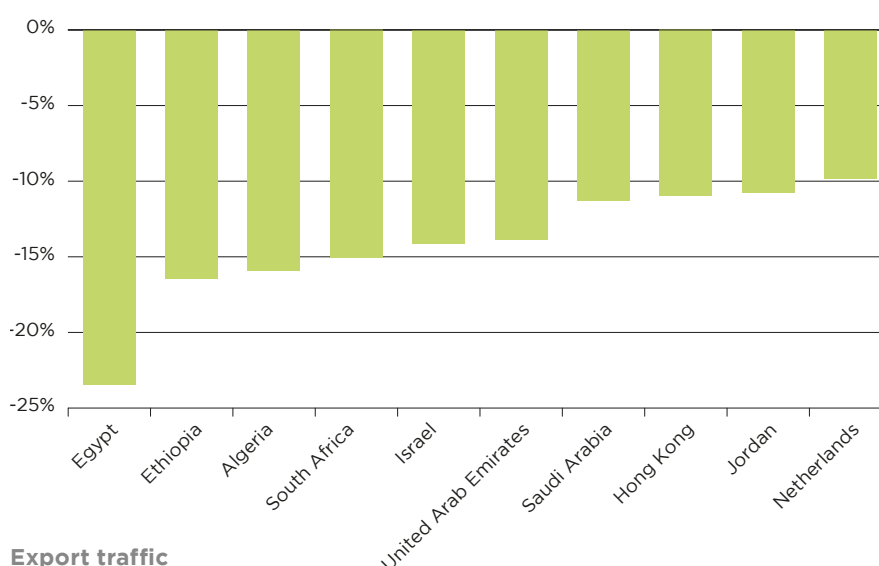
Looking at annual volume over 10,000 MT 700s sent internationally, the countries with the highest year-on-year growth in this category in 2017 were:

Fastest-growing importers



With a yearly volume higher than 10,000 MT 700s sent internationally as a gauge, the countries showing the largest declines in imports are:

Importers with the sharpest declines

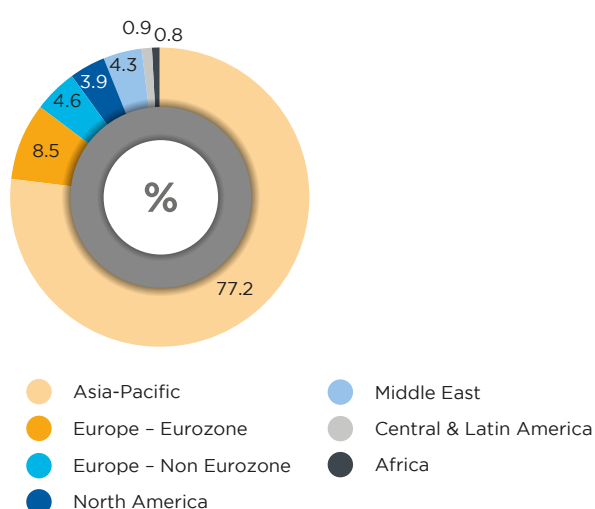


Regional analysis

Exports using L/Cs⁶

Asia-Pacific continued to register much higher volume for received (exports) MT 700s, accounting for 77.2% of world traffic in 2017, followed by the Europe - Eurozone (8.5%) and Europe - Non Eurozone (4.6%).

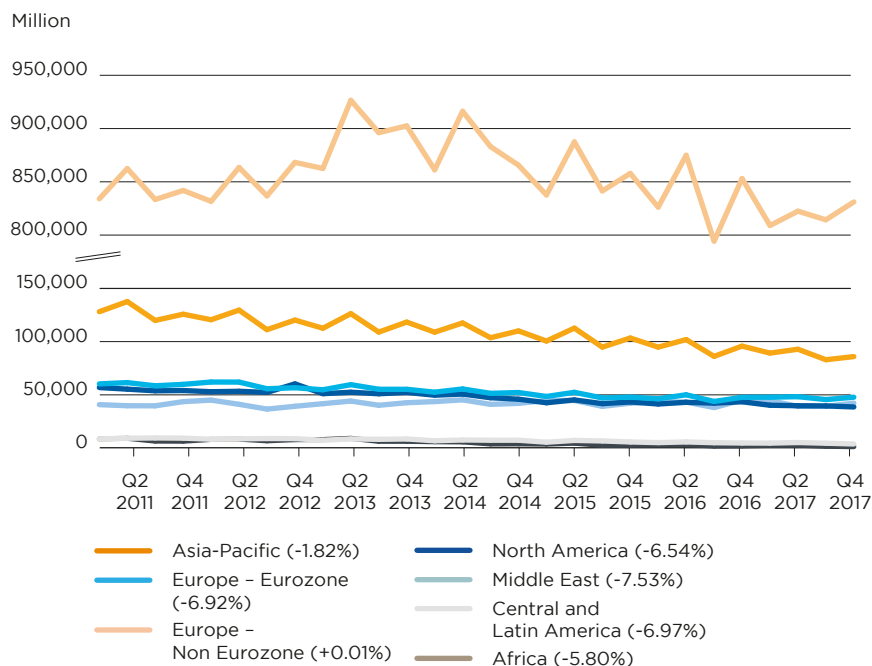
Export traffic



6. Data includes domestic and international traffic.

Export traffic was down across the board in 2017 compared with the previous year. The region that showed the steepest drop was the Europe - Eurozone, where export traffic trailed off 6.92%, followed by North America, where traffic contracted 6.54% and Africa, where traffic fell 5.80%.

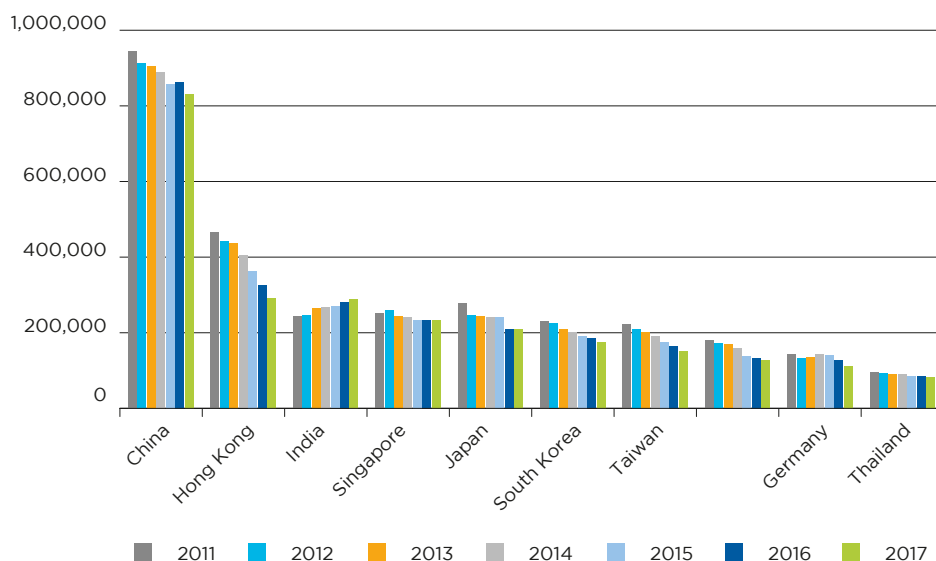
MT 700s received



Top exporting countries

Looking at the cross border (excluding domestic flows) volume of MT 700s received, the countries that exported the most using L/Cs were:

Top 10 exporting countries

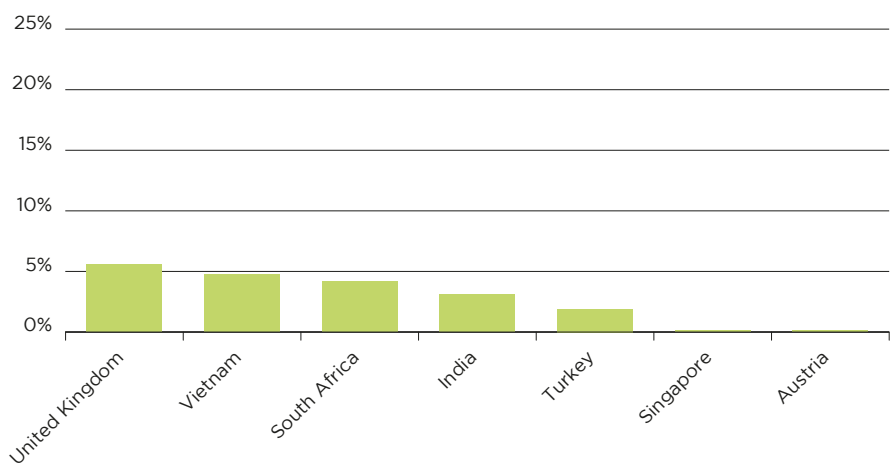


RANKING	COUNTRIES	GROWTH 2017 FROM 2016
1	China	-3.58%
2	Hong Kong	-10.61%
3	India	3.10%
4	Singapore	0.15%
5	Japan	-0.13%
6	South Korea	-4.85%
7	Taiwan	-7.70%
8	US	-5.59%
9	Germany	-11.49%
10	Thailand	-2.04%

* based on 2017 L/C volumes

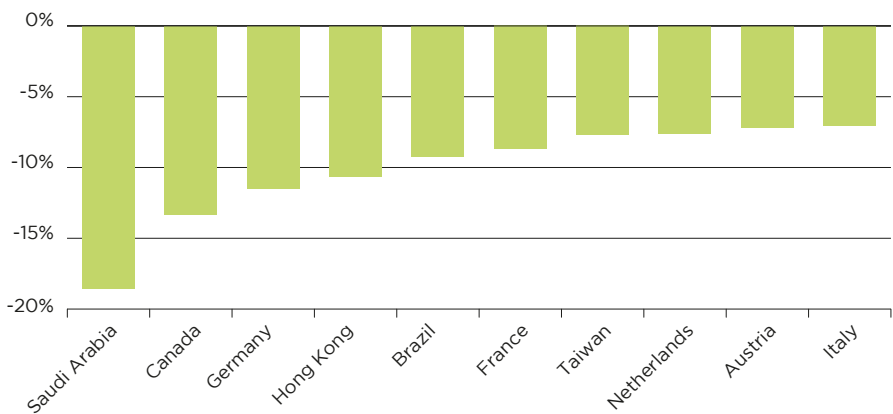
Using a yearly volume of more than 10,000 MT 700s received internationally as a gauge⁷, the countries with the fastest growth in 2017 compared to 2016 are:

Fastest-growing exporters in 2017



The countries registering the largest drop in annual volumes in 2017 , in the category over 10,000 MT 700s sent internationally, are:

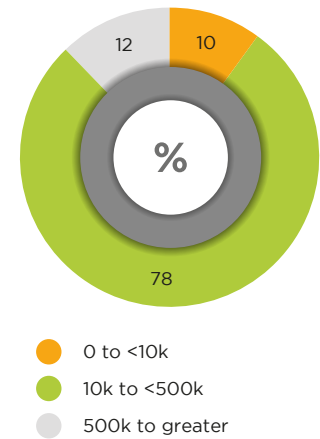
10 exporters with sharpest declines in 2017



L/C value rises sharply

The average value of a letter of credit (MT 700 only converted to US dollars) rose 15.81% in 2017 for an average value of US\$537k from US\$463k the year before.

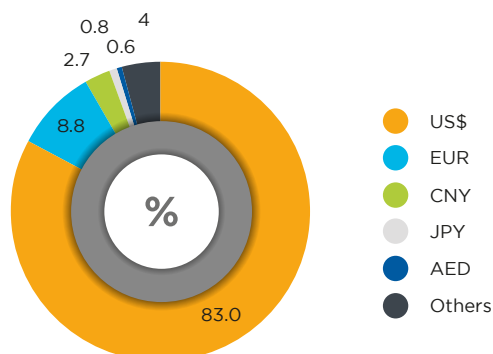
L/C volume by value buckets US\$



7. There are only 7 top exporters with a yearly volume higher than 10,000 MT 700s received internationally.

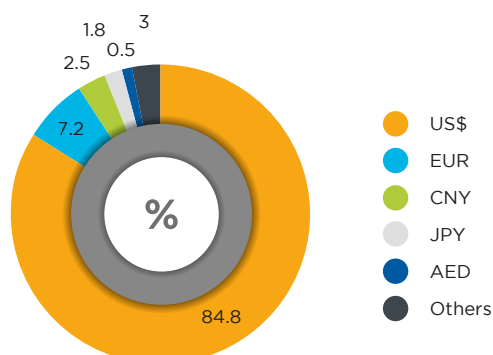
The US dollar continued as the most often used currency by far for SWIFT trade finance: 83.02% of the MT 700s (volume of L/Cs issued equals the number of MT 700). The euro was the second most often used currency for 8.94% of these transactions.

Currency for L/C by volume 2017



The same was also true of the total value converted to US\$ of L/Cs issued via SWIFT. The US dollar was used in 84.81% of these transactions, while the euro represented 7.21% and Chinese yuan or renminbi (CNY or RMB) 2.53%.

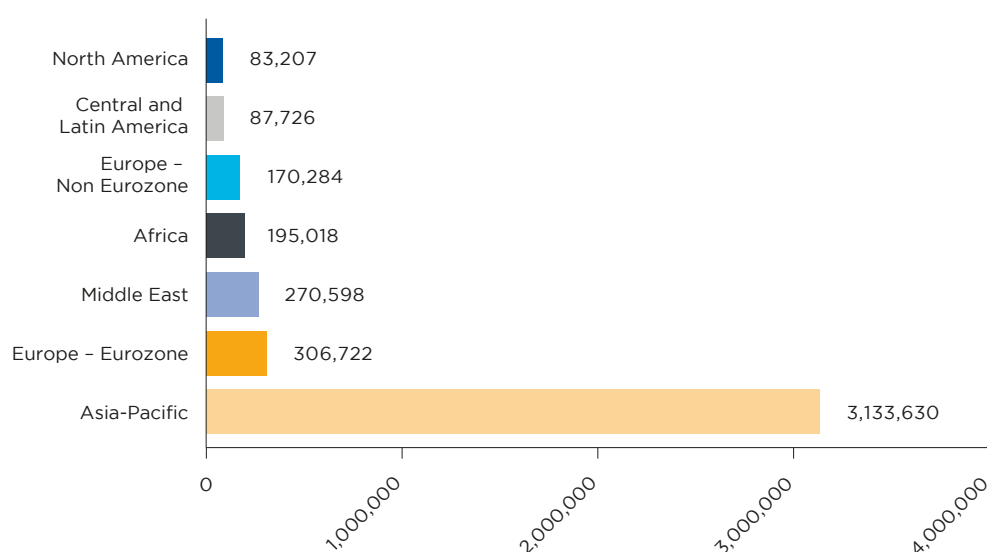
Weight of L/Cs in value (converted to US\$) by currency, 2017



Asia-Pacific

Asia Pacific issued the most L/Cs, more than 3 million MT 700s, much more than any other region.

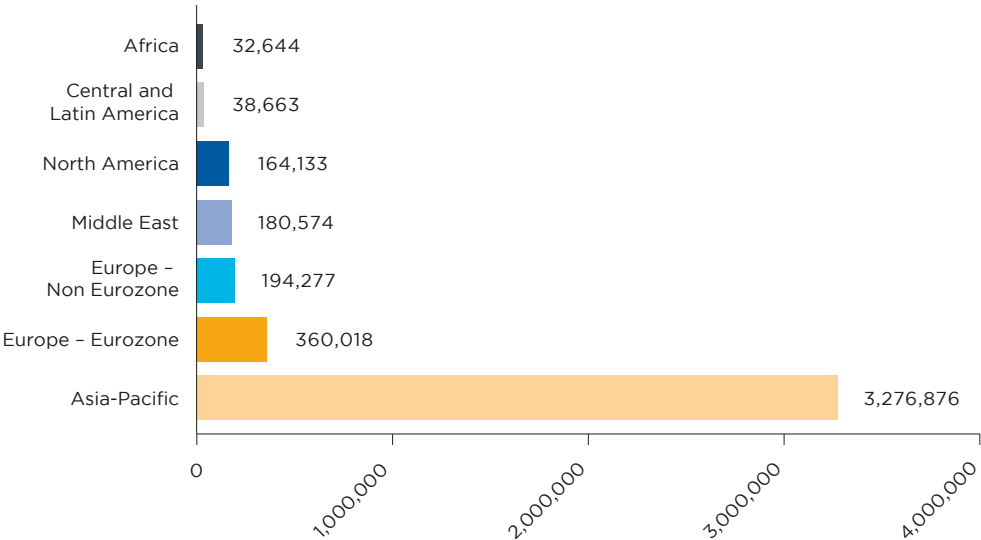
Import volume by region



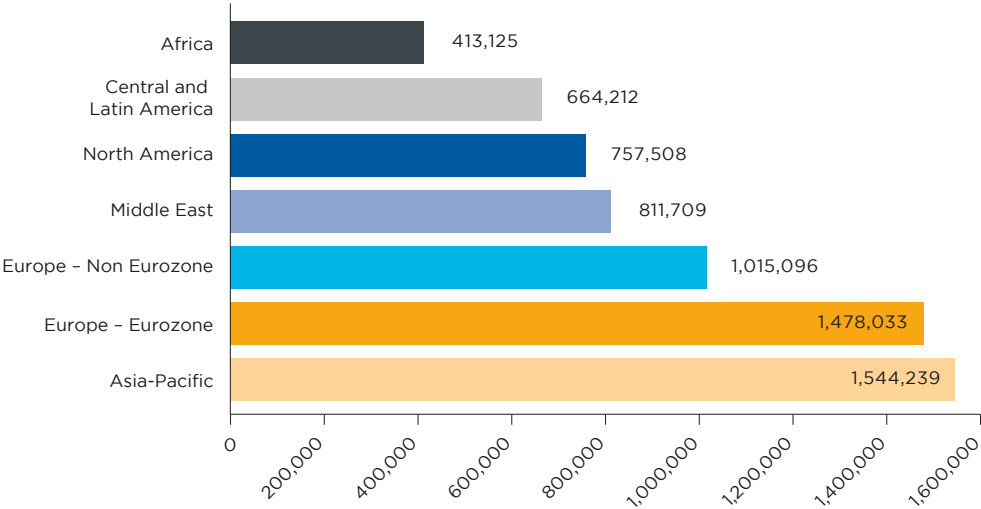
Asia-Pacific the lead exporter with L/Cs

Asia-Pacific received the most L/Cs, around 3 million MT 700s, much more than any other region. But the average value of an L/C in Asia Pacific was lowest at US\$413k for exports.

Export volume by region



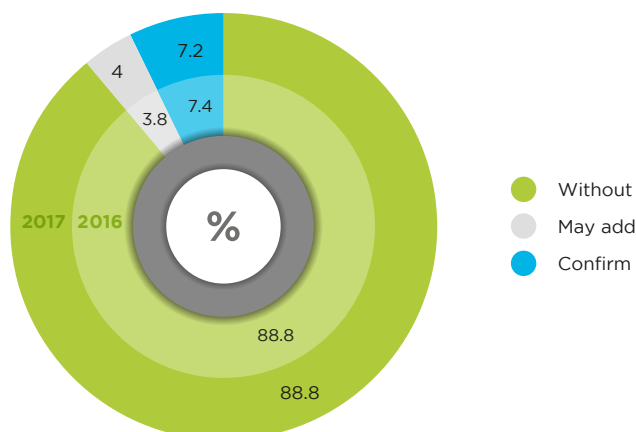
Average value of export by region (converted to US\$)



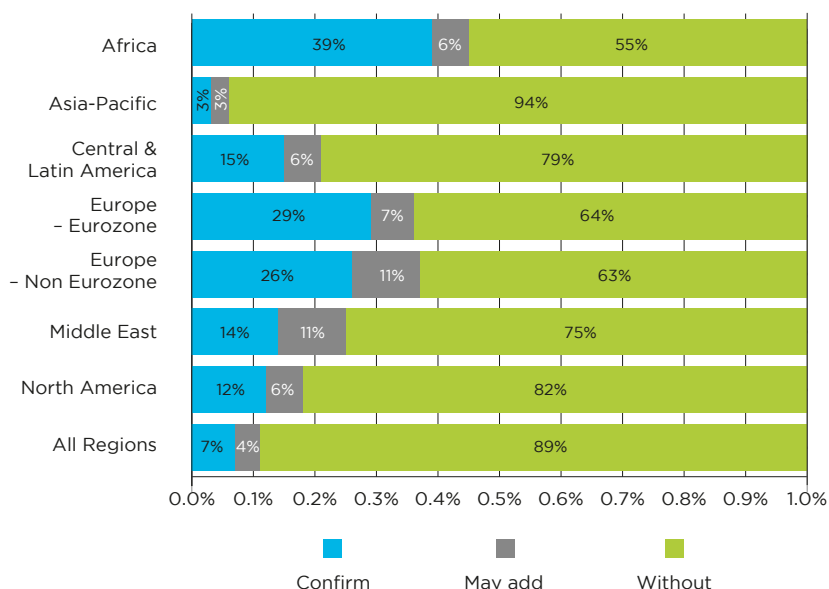
Confirmed L/Cs rose a touch

The share of confirmed L/Cs rose slightly, up 0.06% in 2017 from the previous year. Africa continued to receive the highest percent of confirmed L/Cs, and Asia Pacific the lowest.

Confirmed export volume 2017 vs 2016



% confirmed exports by region 2017

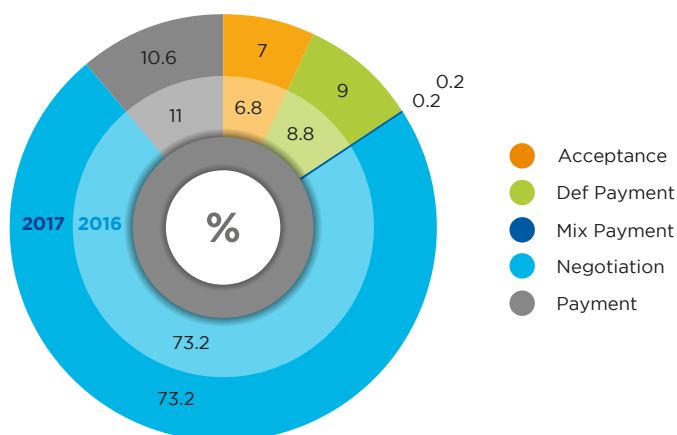


Most regions prefer negotiation L/Cs

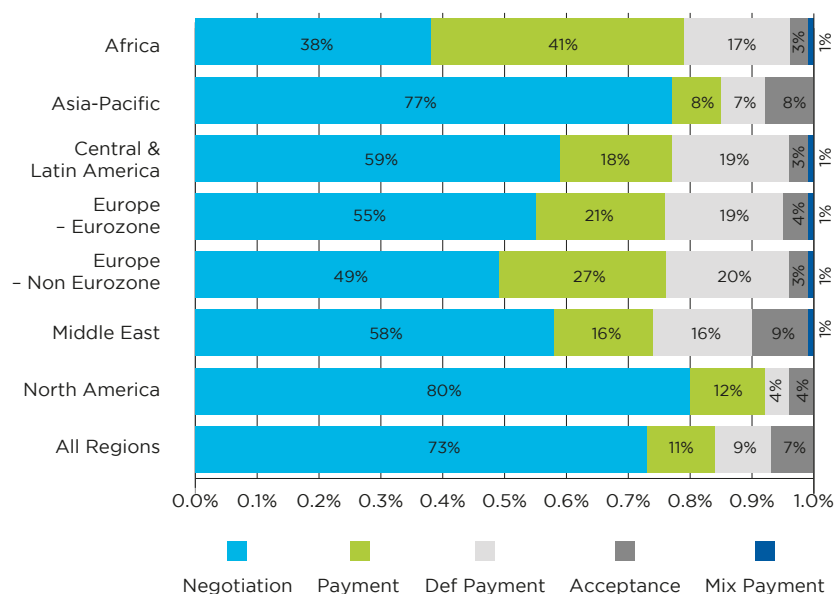
Credit rule is an indication of how credit is made available by identifying the bank, or place for presentation.

In the majority of cases, L/Cs are negotiated. The share was stable at 73% in 2017 with the previous year. Regionally, negotiation credit accounted for 80.31% of trade in North America and 77.64% in Asia Pacific. All other regions except Africa mostly used negotiation L/Cs.

Export volume by credit rule combination



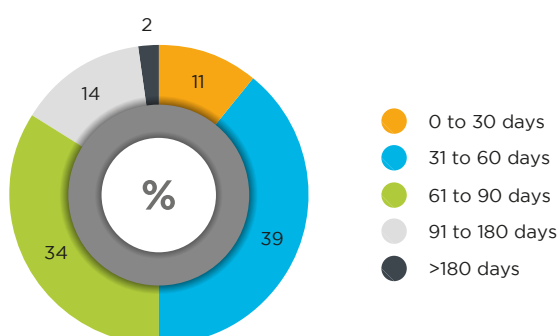
% distribution of exports by credit rule combination



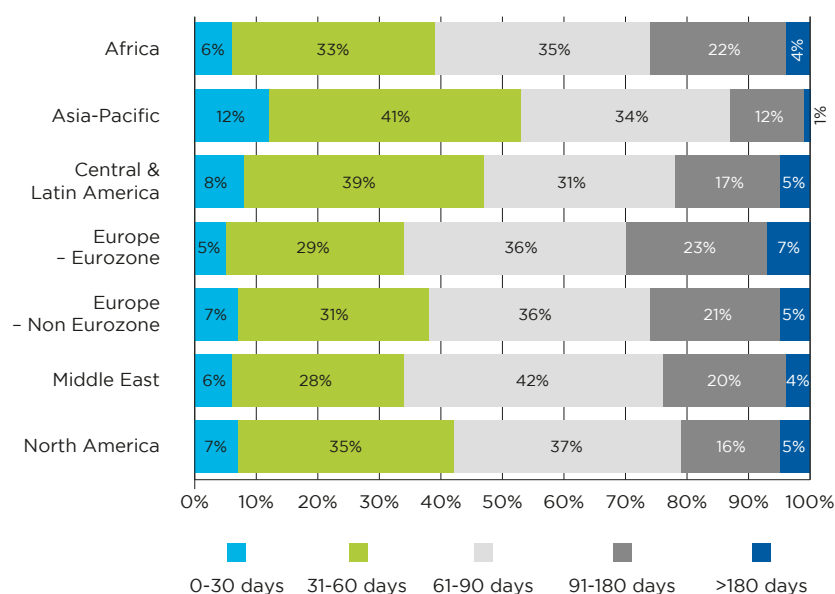
L/C credit averages 60 days

A total of 38.65% of L/Cs had credit extended from 31 to 60 days, and 34.41% from 61 to 90 days.

% distribution L/Cs by credit length 2017



Region-by-region export volume by credit length 2017



Trade messaging standards/ A major category 7 upgrade is underway

By Robert Marchal

Robert Marchal is a Standards/Business Analyst at SWIFT.

Because many change requests had been postponed in the past several years, SWIFT's working group on trade finance maintenance (TFMWG) recognized category 7 interbank MTs (letters of credit, guarantees and standbys) needed a major revision, and messages upgraded to boost automation.

The working group will achieve three aims in this project:

- analyse change requests in the past decade
- boost straight-through-processing
- fill gaps in transaction flows

The work of the group will result in SR (Standards Release) 2018 for letters of credit (MT 700-759) and SR 2019 for guarantees and standby L/Cs (MT 760-789).

Documentation

According to the annual documentation cycle, the standards release guide) for SR 2018 (LC) was published on December 22, 2017

and can be downloaded from the standards release section at swift.com.

For SR 2019 (guarantees and standby LC), advance documentation was published in April 2017 and re-published with corrections in February 2018. Please note the SWIFT community can still submit change requests (CR) on this release no later than the end of May 2018.

Testing

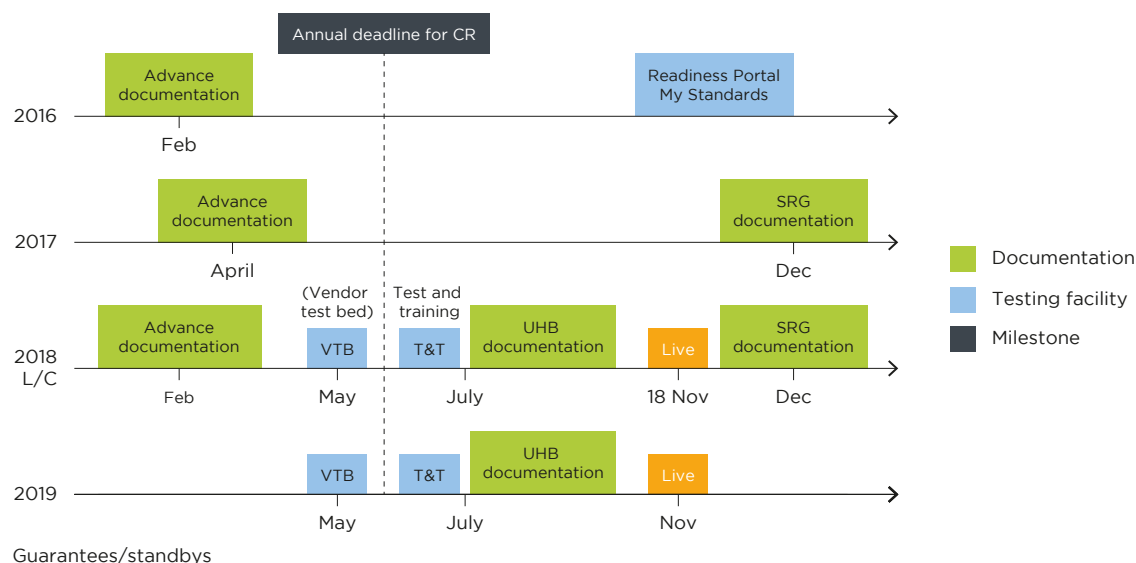
In line with the annual release timeline, testing facilities of the SR for the vendor test bed (VTB) will be available in May and SR testing and training (T&T) in July.

An extra testing facility, integrated as a readiness portal in MyStandards, has been available since 2016.

The new versions of MTs can be tested, with these limitations:

- not all NVR (Network Validated Rules) implemented
- not for volume testing

Timeline



Impact of changes

The revamp of Category 7 is the biggest upgrade ever and includes nine new messages:

Documentary credits

- MT 708 amendment to a documentary credit
- MT 744 notice of non-conforming reimbursement claim

Guarantees and standby L/Cs

- MT 761 Issue of a demand guarantee/ standby L/C
- MT 765 guarantee/ standby L/C demand
- MT 775 amendment to a demand guarantee/standby L/C
- MT 785 guarantee/standby L/C non-extension notification
- MT 786 guarantee/standby demand refusal
- MT 787 guarantee/standby L/C amendment response
- MT 759 ancillary trade structured message

Other major changes to SR2018 were made:

- MT 707 restructured as a mirror image of the MT 700
- MT 708 becomes a continuation message for MT 707

- new fields in MT 700 and related special payment conditions for the beneficiary, special payment conditions for the receiving bank, requested confirmation party

- extended character set in long text fields

Major changes in SR 2019 include:

- MT 760 becomes a highly structured message instead of free format text
- guarantee/standby LC issued can be specified, as well as the local guarantee/standby LC to be issued in case of counter and local guarantee/standby LC
- enhanced MT 767 amendment and to receive a continuation message MT 775
- extended character for long text fields

How SWIFT can help

Application vendors have worked on upgrades to their trade applications with a mandatory deadline of November 2018 and then November 2019

It is critical the community starts preparing for these changes now.

Before the end of June 2018, SWIFT is organising e-webinar sessions on

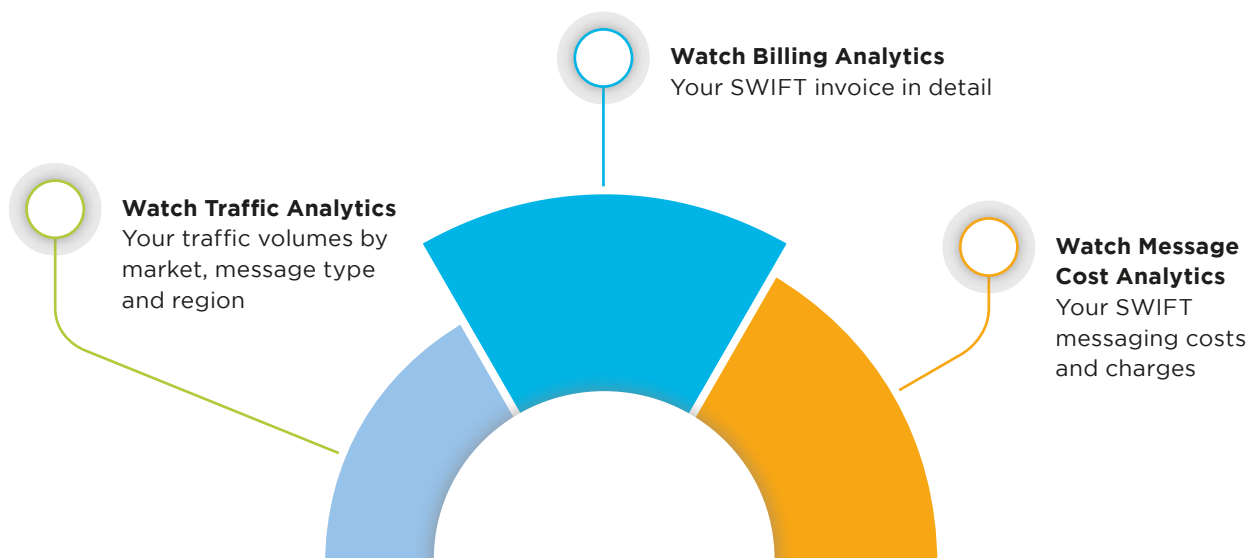
SR 2019 and MT 798 trade guideline revisions, to provide an overview of the changes. More information will be posted on swift.com

A new version of the trade implementation guidelines in MT 798, for communication between banks and corporate, is required to align with the new interbank messages. It was published in July 2017, and includes enhancements and new flows, such as:

- drafting/negotiation flow before official application to the bank to issue the instrument
- flow for a corporate to respond to an advice of discrepant presentation
- notification of transfer of documentary credit
- advice of acceptance or refusal of guarantee/standby LC amendment
- response to guarantee/standby LC amendment
- notification of non-extension of guarantee/standby LC
- demand refusal under guarantee/standby LC
- some cancellation and ancillary flows

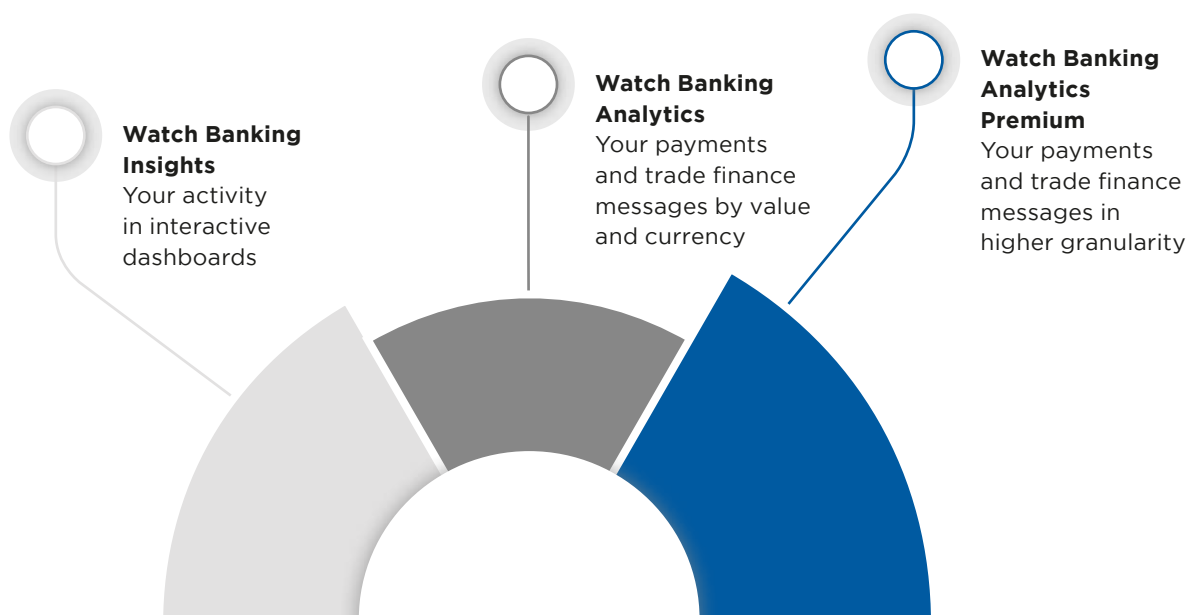
Watch Traffic

Comprehensive and dynamic analysis of global financial message volumes, message costs and billing data sent and received over SWIFT.



Watch for Banking

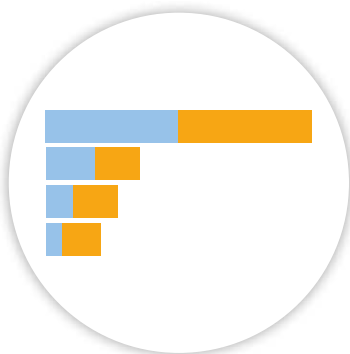
Unique analysis and insights into your correspondent banking business through volume, value and currency analysis. Compare and monitor your performance against the market.



Watch Banking Insights

Visual and business-oriented dashboards on a subset of your customer's correspondent banking business. More market segments to follow. Pre-defined yet dynamic.

Develop footprint and portfolio for Payments and Cash Management



Your top cash management reporting messages sent and received YTD

Manage correspondent network for Payments and Trade finance



The evolution of the number of counterparties and countries you have activities with

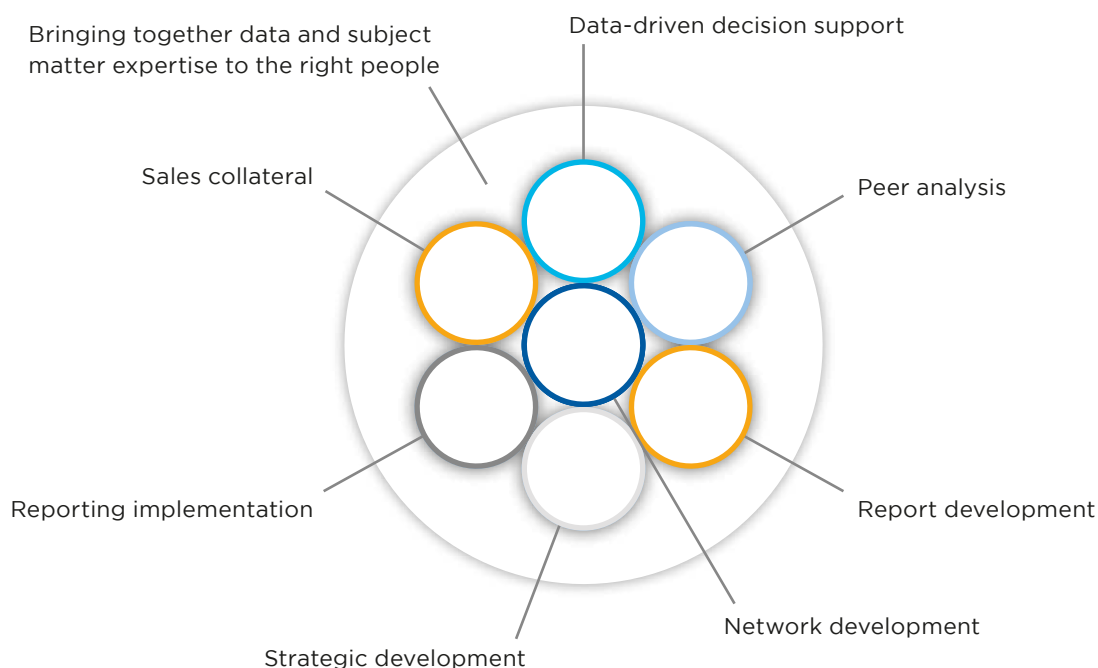
Develop footprint and portfolio for Trade finance



Your activity share in MT 700 YTD and its variations compared to last year

BI services

Our consultants bring subject matter expertise and more granular data, serving your transaction business teams with tailor-made market and anonymous competitive information.



TXF-ICC Export Finance Survey/ Profits hold up amid mixed views on the market

By Max Thompson

Max Thompson is a senior reporter at TXF.

A total of 65 senior professionals share their views in the annual TXF-ICC survey on the export finance market on a range of measures.

Export finance growth slowed in 2017, according to the TXF-ICC Global Export Finance Survey. For export finance, power and infrastructure were the most active sectors, and Turkey the most active country. Respondents said the cost of export credit agency (ECA) debt fell, which was good news for ECA-backed borrowers, but less favourable for banks.

The TXF-ICC Global Export Finance Survey outlines the trends and challenges in export finance, based on the views of 65 senior practitioners, from global heads of export finance at leading banks, to CEOs at ECAs and CFOs at major exporters and importers.

Growth slows, profitability holds

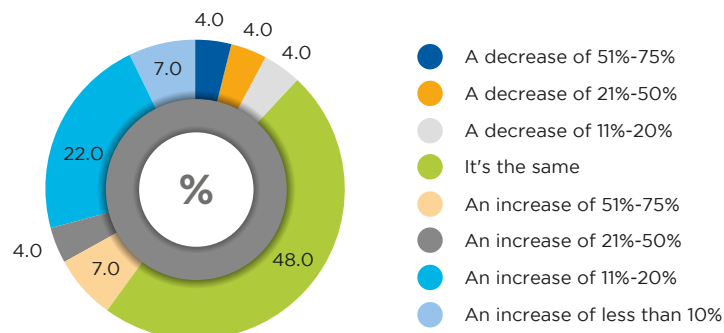
TXF Data's findings revealed total deal volume and the number of deals fell sharply in 2017: 290 deals were signed for a volume of US\$85.7 billion, compared with US\$133 billion for 378 deals in 2016.

However, respondents' views were mixed on the market in 2017 compared with the year before. About half (48%) said the number of deals was the same. Some 41% of respondents worked on as many as five export finance deals in 2017.

Total deal volume and the number of deals in export finance 2017



How does that compare with 2016?



Around a fifth (22%) said deals rose 11% to 20%, while 22% arranged six to 10 deals, and 12% said the number of deals fell by 75%.

The good news is nearly half of respondents said the market in 2018 will grow, anywhere from zero to 10%. In fact, 81% said export finance will be a profitable business line. Borrowers benefiting from low prices have contributed to profitability.

Still on top

The survey showed the top three sectors for export finance in 2017 were power and transmission (16% of respondents), infrastructure (13% of respondents), and industrial production and processing equipment (12% of respondents).

Transport was the most active sector in 2017, with a deal volume of US\$19.5 billion, TXF data revealed. Power ranked second with a volume of US\$18.9 billion, while infrastructure was fourth at US\$8.3 billion, after oil and gas at US\$17.2 billion.

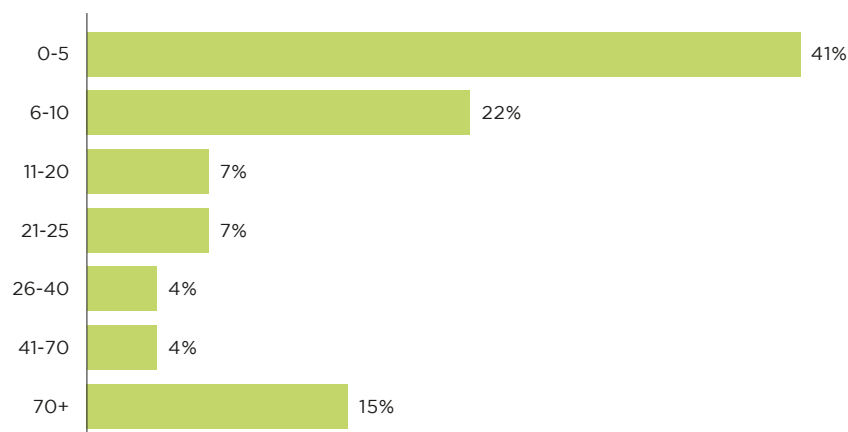
Conventional power deal volume supported by ECA in 2016 rose to over US\$30.0 billion from US\$4.5 billion in 2015. But remove the US\$18.5 billion Barakah nuclear deal from volume in 2017, and the total was around US\$1.0 billion less than the previous year at US\$10.0 billion.

Oil and gas downstream was cited by 10% of respondents as a top sector. Renewable energy was again close behind cited by 9% of participants – 2% more than the previous year.

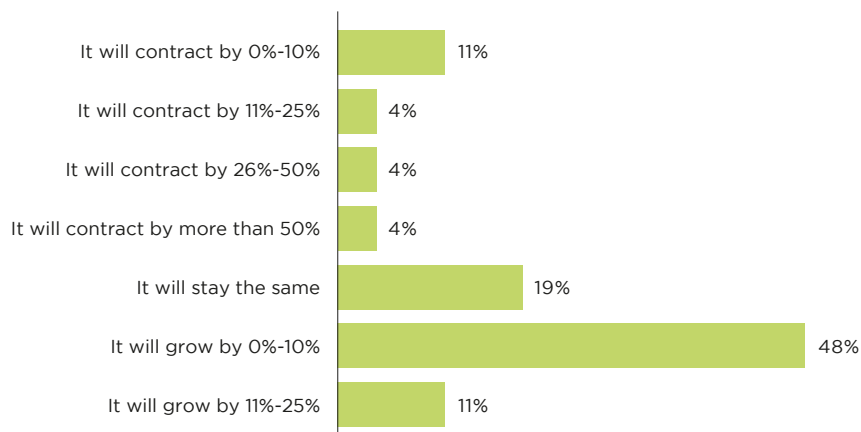
Will renewables reign?

As the cost of building renewable energy generation begins to be driven by economics rather than government subsidies - and as the cost of technology and debt for building offshore has fallen in Europe, the sector looks set for continued growth. But the future of renewables is far from certain, as the way to implement the Paris climate agreement remains under

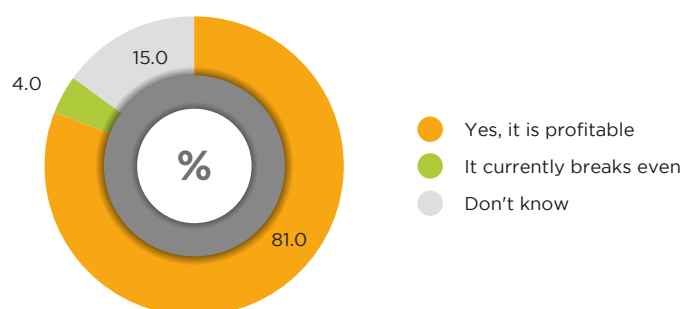
How has pricing in export finance changed over the last year?



What do you think will happen to the export finance market in 2018?



Is export finance business currently a profitable business line for your institution?



debate. But renewables developers and lenders should benefit, as banks have to adhere to stricter limits on coal-related lending and emerging markets such as India and China diversify their energy mix away from fossil-based power generation.

Shipping was lower ranked in 2017: only 6% said it was a top sector compared with 8% of respondents the previous year. But TXF data showed the cruise ship sector had another record year in ECA-backed supported volume – breaking the US\$18.0 billion ceiling. That is up around US\$3.0 billion on the previous record in 2014, when volume just tipped US\$15.0 billion, and up nearly US\$5.0 billion from 2016. The 40% jump in volume reflects new orders from cruise lines, included US\$1.0 billion-plus financing for Carnival, Royal Caribbean and Disney.

The survey results reflect TXF data showing non-cruise ship supported business dropped just under US\$1.0 billion compared with 2016. The freight new build market stayed subdued in 2017. Only tankers and the dry bulk sector were a touch speculative because of higher commodities prices and the deep discounts shipbuilders offered to keep yards working.

After Turkey comes...

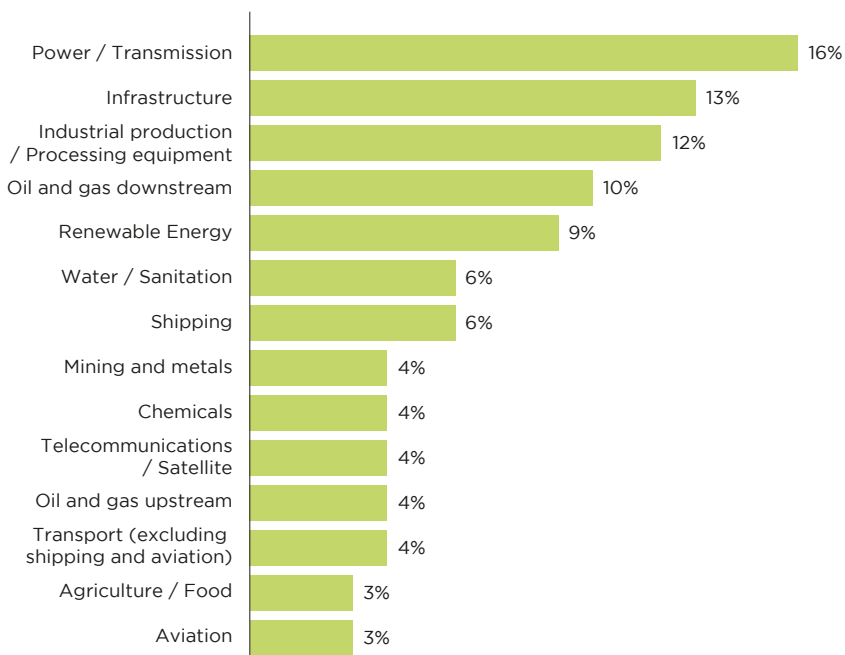
Turkey was the largest export finance borrower, followed by Russia, China, India and the United States, which was slightly more active.

Pricing – a double-edged sword

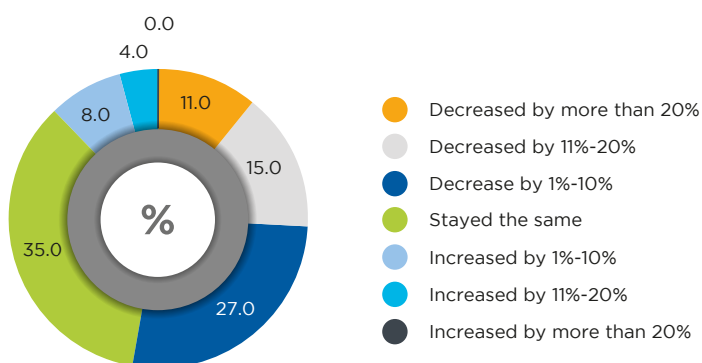
As prices are the cornerstone of profitability in an export finance deal, it was good news for ECA-backed borrowers that nearly half of respondents said the cost of debt fell last year, although two-thirds said so in 2016.

Some 27% said prices fell 1% to 10% in 2017, while 15% saw a price drop from 11% to 20% (versus 27% of respondents in 2016), and 12% said

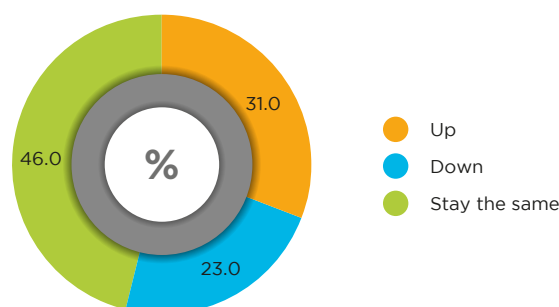
What were your top three sectors for export finance?



How has pricing in export finance changed over the last year?



Do you expect pricing to go up or down in the next 12 months?



prices fell more than 20% (versus 10% of respondents in 2016). About a third (35% of respondents) said prices stayed the same, compared with 24% in 2016, while 12% said prices rose up to 20% (versus 10% of respondents in 2016).

One respondent said prices dropped 40%, in most cases. “Bank margins were down over the last year, and fixed or floating interest rates of references had increased.” One practitioner said ECA finance “has always been expensive” and “it is much cheaper to finance through commercial facilities and private insurers.”

When asked about prices in the next year, nearly half of respondents (46%) expect pricing to stay the same, while one-third see an increase, 23% predict a continued fall. “Rates of reference should increase again and margins will be stable,” one respondent said.

In line with the 2016 survey, prices continued their descent. While banks can cope with this short term, falling prices may be unsustainable in the long term.

The key driver of pricing was competition for 42% of respondents, including high liquidity, while a third cited compliance and regulatory requirements.

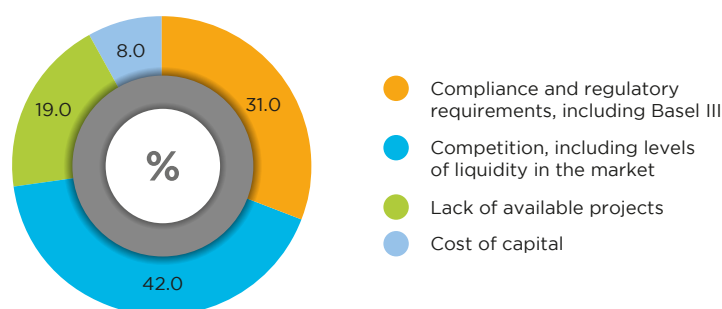
Clauses in the capital requirement leverage ratio regime, under the Basel III reforms to strengthen regulation, supervision and risk management of the banking sector, still threaten to affect the cost and availability of European ECA loans.

A total of 19% of respondents also cited prices were affected by a lack of available projects and 8% cited the cost of capital.

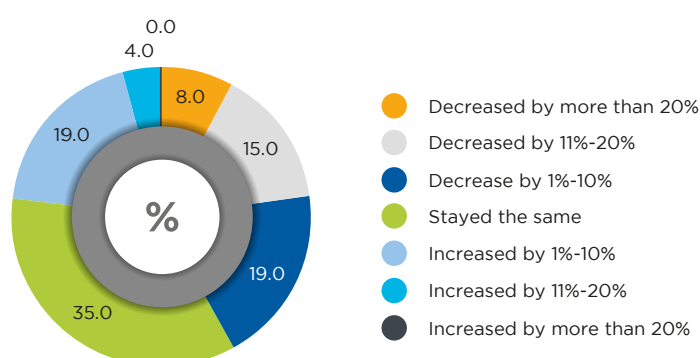
Fees fall in sync with pricing

As in last year’s survey, bank fees in export finance fell in tandem with shrinking margins. Some 42% of respondents saw bank fees drop in the past year. A total of 19% said fees fell 1% to 10%, while 15% said

Key drivers of pricing today



How have bank fees in export finance changed over the past year?



The European Banking Federation is garnering support for revisions to ensure fair treatment and a 0% leverage ratio without caveats on an ECA-covered loan.

The lack of clarity over how to define ECAs under sovereign risk exposures will have a huge effect on the applicable minimum RWA. Much higher RWA will be required for other sovereign entities and ECA loans in foreign currencies.

With no clear cut decision expected from the EU Council anytime soon, the outcome of these capital requirement provisions will have a huge impact on the cost of European ECA debt.

fees dropped 11% to 20%, and 9% said fees fell more than 20%.

Fees dropped despite the proposed introduction of capital requirements under Basel III. But 35% said fees stayed the same and nearly a fifth of respondents (19%) said fees were rising. One fifth (19%) said fees rose from 1% to 10%, and 4% said fees rose 11% to 20%. Some 4% said fees were 11% to 20% higher in the past year.

A brake on growth

A total of 54% of respondents said the biggest obstacle to executing export finance in frontier markets were legal and regulatory issues, followed by borrowers lack of export finance knowledge (46%), corruption fears (42%), and sanctions (35%).

To deal with these issues, 52% of respondents said they struggled with regulatory requirements and 42% struggled with sanctions, in line with last year's survey.

Political instability, competition, access to credit lines, taxes, liquidity and cultural issues were less concerning to respondents.

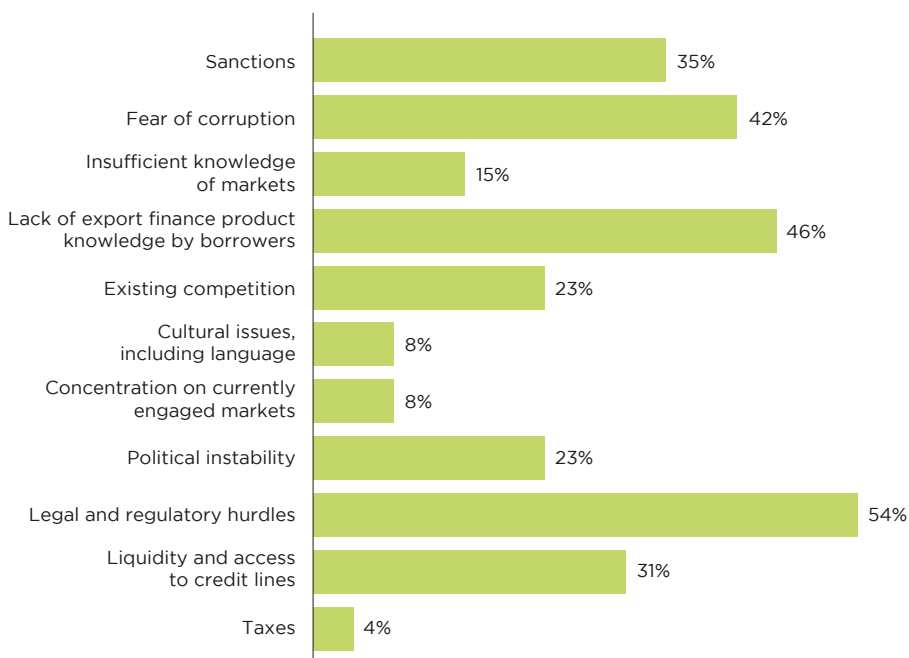
Most favoured

ECA-backed loans topped the charts as the preferred type of export finance: three quarters of respondents (74%) used ECA cover. A total of 7% of respondents said ECA direct loans and letters of credit were preferred, while 4% each preferred pre-export loans, prepayment loans, and privately insured loans.

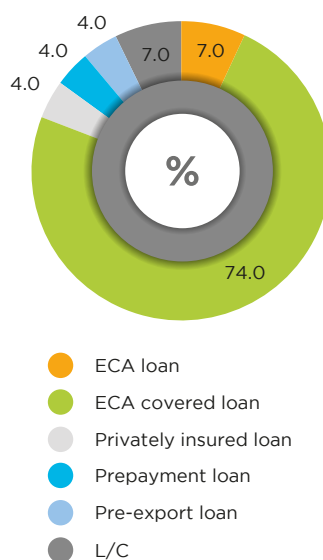
Most respondents agreed that the preferred export finance methods had not changed. But one respondent said the industry is moving more and more to privately-insured loans. "More customers asked for ECA finance and there is now more flexibility for meeting a buyer's needs," said another respondent.

While the export finance market is growing each year according to TXF data on big-ticket growth,

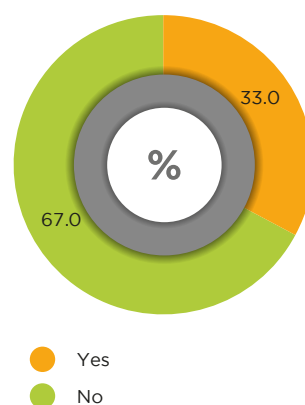
What do you see as being the most prohibitive factors to doing export finance business in new markets? (Please select your top three)



What is your preferred method of export finance?



Are ECAs doing enough to support SMEs today?



ECAs need to raise awareness and educate companies, especially SMEs, on export finance product offerings. These offerings include buyer and supplier credit agreements and direct loans. Getting SMEs access to new markets and better access to export finance goes hand-in-hand. ICC's Working Group on Export Finance can help by harmonising products and marketing.

nearly two thirds (67%) of respondents said ECAs are still not doing enough to support SMEs. Some said ECAs need to simplify product suites to cover the basic needs of SMEs in the short, medium and long term.

Gauging the gap for SMEs

Respondents estimated the gap in unmet demand for small tickets was €2.0 million to €4.0 million.

Respondents also said the reasons SMEs are not being well serviced is that many ECAs are country-risk averse, must adapt to changing markets, and that SME business may not be profitable and is resource intensive to take on.

But one third (33%) of respondents said ECAs were doing enough to support SMEs. One said SMEs are welcome to ECA processes, but added that marketing is often used for political positioning to help ECAs avoid criticism that they are only helping large corporations.

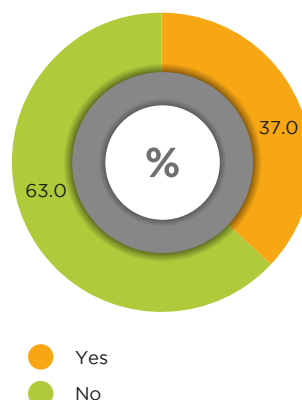
Growing pains from globalisation

Respondents also stated a need for ECAs to collaborate. “ECAs still need to fully support or co-underwrite the risks between other ECAs on the larger deals,” one respondent said, adding, “Globalisation has out-grown solutions from one country.”

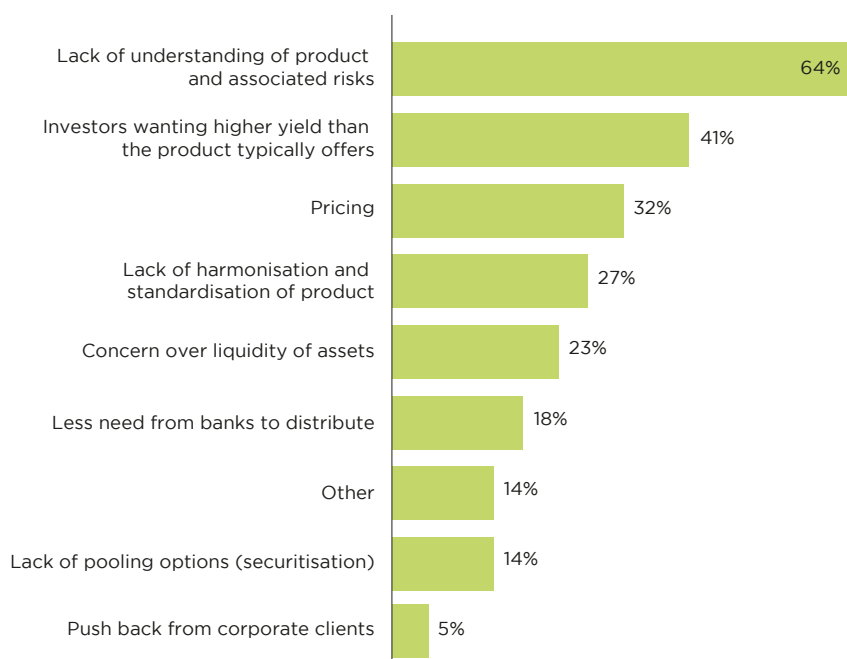
A majority of respondents (63%) said innovation was lacking in the export finance market. Respondents said ECAs need to be more flexible, make recommendations on payment security, change the 15% down payment, come up with more capital market solutions, take a less sophisticated approach to risk portfolios, and provide equity to projects.

One respondent said the private insurance market needs to be on a more level playing field with ECAs, and lenders need to look beyond export finance solutions to the private market.

Are we seeing enough innovation in the export finance market today?



Significant challenges to institutional investors entering export finance



More vision than reality?

Respondents were not convinced fintech would have an impact in the next two to three years, collectively scoring 2.54, where one point is no impact and five is very high impact.

Looking at what are the obstacles for institutional investors to enter the export finance market, some 64% of respondents said lack of understanding of the product and associated risks was the biggest obstacle, with low yields as the second biggest challenge, followed by pricing, lack of harmonisation, the need for product

standardisation, and concerns over asset liquidity.

Other issues respondents cited for institutional investors were prepayments and long draw-down profiles, since the longer the draw-down period, the less profitable the investment.



Background information

TXF provides data, news and trends in trade and export finance, and supply chain and commodity finance.

Export Credit and Investment Insurance/Strong performance, but political risks cast a long shadow

by Paul Heaney

Paul Heaney is Associate Director at Berne Union

2017 was a good year for underwriters of export credit and investment insurance, but the current environment for political risks remains delicate.

The global economy is currently in good health by a number of measures

2017 saw positive growth in both trade and GDP, exceeding expectations, following a difficult 2016. Stock markets are currently booming and oil prices are back comfortably above the US\$50 per barrel threshold, which had signalled the broader crash in commodities prices from 2014 to 2016.¹

This is good news for export credit insurers and Berne Union members, who reported an uptick in new business in almost all areas, including a return to growth in medium- to long-term (MLT) business after five years of almost steady decline. A notable exception is investment insurance: new cover fell 7% to US\$5.0 billion, the first drop since 2013.

In contrast to the positive indicators noted, foreign direct investment (FDI) fell around 16% in 2017. This was largely due to a downturn in investment into developed markets,

which dropped 27%². Investment levels in most developing markets were broadly level with 2016.

Foreign direct investment is down 16%

This may indicate investors have a lingering uncertainty about the long-term outlook, despite outward expressions of confidence. Much of this uncertainty stems from concerns relating to political risks and policy issues which could derail the current situation, rather than purely economic conditions.

In last year's review, the outcome of the US presidential elections, the Brexit vote, and divisive elections in several European countries were cited as potential disruptors to the business climate for insurers of trade credit and political risks.

While the worst fears have so far unrealised, a ramp-up in protectionist politics continues to give Berne Union members pause. A year later, the threat of trade

barriers has been acted upon rather than diminished. Traditional trade tariffs, such as President Trump's proposed taxes on metals imports to the US, and a wider discourse that is ratcheting up trade tensions are part of the news cycle³.

The real possibility of an international 'trade war' puts pressure on the world trade system and threatens to undermine the rules by which it operates. In the modern world, restrictions would apply not just to goods, but to the movement of data and people. All of which increases the cost of doing business.

Credit and investment insurance is performing well

This is positive news for both insurers of trade and for the underlying economy which depends upon this. Indemnifications are also high: which is good news for the insured and also a positive reflection of the important role export credit insurance plays in helping to maintain economic value chains, despite risks.

At the same time, industry measures of long-term sustainability (such as loss ratios) are benign, and there is no indication that claims are becoming unmanageable.

New business underwritten by members of the Berne Union in 2017 totalled US\$2,330 billion, split among these business lines⁴:

- short-term export credits
US\$2,088 billion
- medium/long-term export credits
US\$179 billion
- investment insurance
US\$64 billion

Berne Union members' share of world trade in 2017 was over 14%*, up from a 12% share in 2015. World merchandise trade grew 3.6% in 2017 to US\$16.6 trillion.

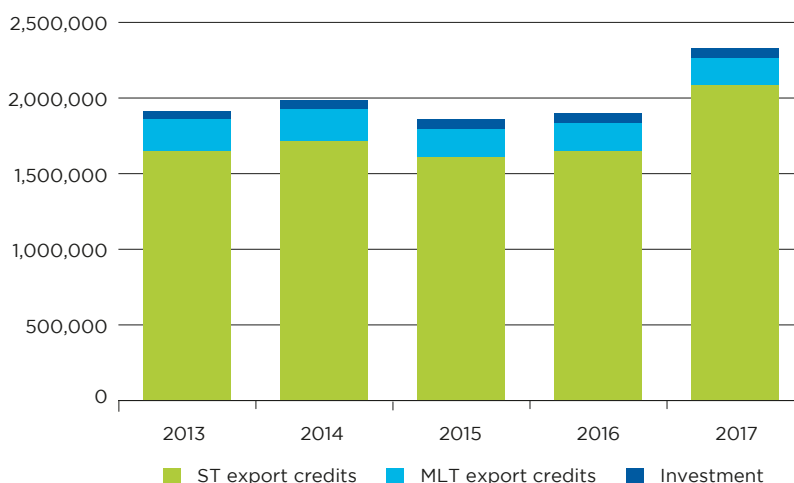


References and notes

1. According to WTO sources, estimated trade growth in 2017 is 3.6% - upgraded from an earlier prediction of 2.4%. www.statista.com gives the average price of oil over 2017 at US\$ 54.25 pb, and as of March 2018 the price of WTI crude is US\$61.14 pb.
2. See UNCTAD 'Global Investment Trends Monitor' from January 2018
3. Renegotiation of NAFTA, US withdrawal from TPP, and the demise of TTIP
4. This split gives an indication of the relative volumes recorded in each of the relevant business lines, rather than by the standard committee reporting structure of the Berne Union (whereby the 'MLT' committee includes only ECA members, and the medium/long-term business of private members is rather reported within the 'INV' committee).

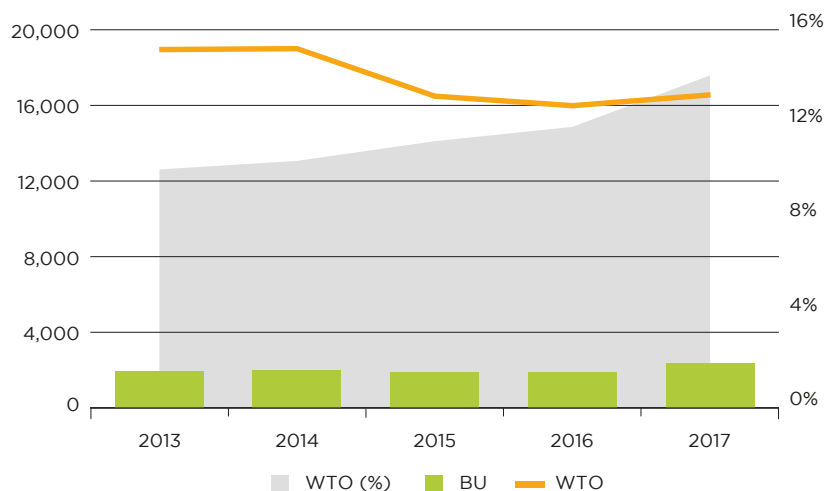
New business by product

US\$ million

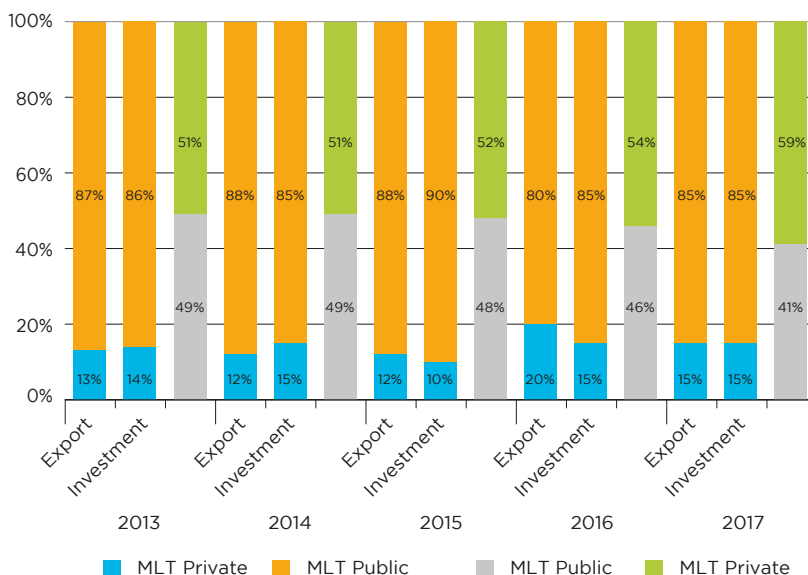


New business as a % of world trade

US\$ billion



Public and private share of new business



Reporting changes

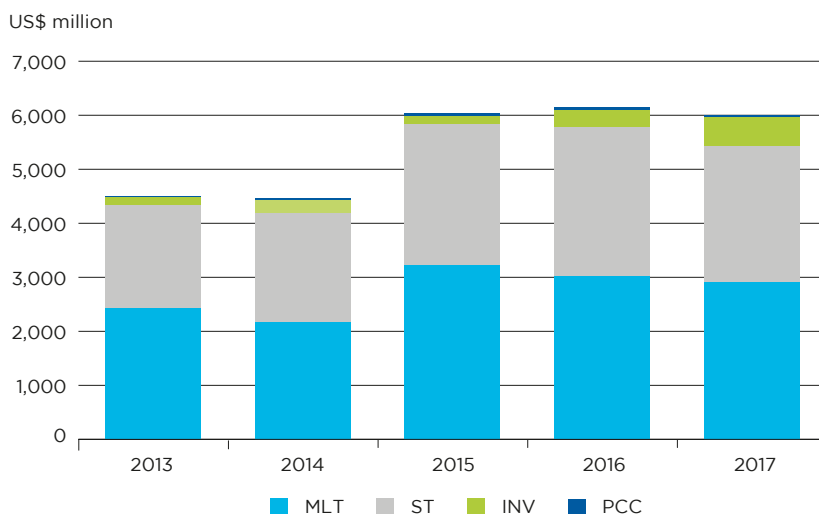
The sharp growth in new business, up 22% from the previous year, comes with a large caveat. One member of the short term (ST) committee – ST is by far the largest by business volume – previously reported on a single subsidiary but now reports at group level, which accounts for 77% of this rise.

At the same time, to improve the overall accuracy of Berne Union data, the definition of stock data for short term ‘commitments’ has been refined. This now corresponds precisely to ‘aggregate credit limits’, and is recorded separately to the ‘utilised amount’, previously reported by some members⁷. Based on the members affected, this change has caused an increase of 10% to 13% across the portfolio.

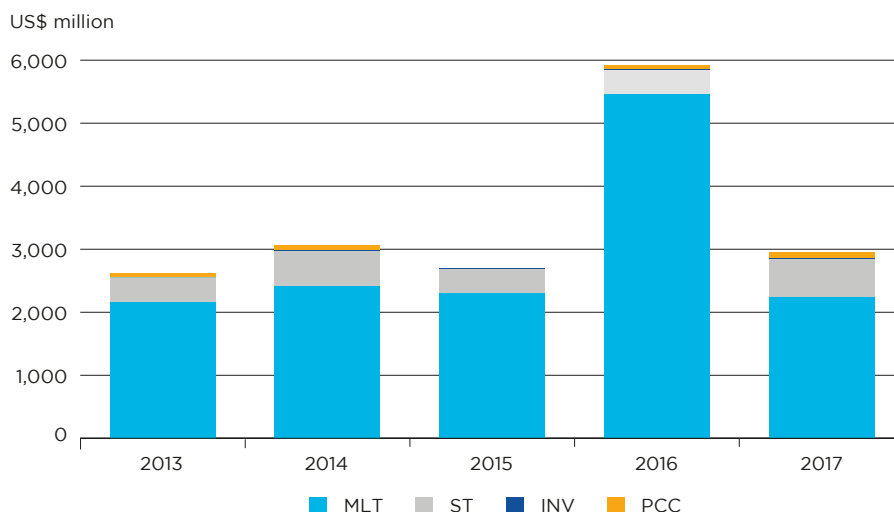
Even adjusting for these changes, the total portfolio was up around 5%, double the 2.5% growth in 2016, and continues the long-term trend of an increasing share of world trade covered.

Following the trend established in 2015 and 2016, Berne Union members again paid over US\$6.0 billion in claims in 2017. This is well above the 10-year average of US\$4.5 billion, but still 2.4% under the 2016 peak. If we look only at claims relating to short-term business we see a much more significant drop of 10%, year on year. The less impressive change seen in the overall portfolio is due to a handful of significant claims in longer term business and investment insurance, where high claims in a single year are not indicative of a more general trend.

Yearly claims paid



Yearly recoveries



Private members' share of new short term business in 2017 rose to 59% of the total

Overall, claims remain high, but in the context of larger business volumes appear manageable, and there are encouraging signs of improvement.⁵

Recoveries in 2017 totalled just under US\$3.0 billion, less than 50% of nearly US\$ 6 billion in 2016, but higher than the average in recent years. Short term business especially improved.

Short-term insured turnover rose 5%

Short-term export credit insurance

Berne Union defines short-term business as the insurance of exports with repayment terms of less than one year, and often much less is standard: 30, 60 or 90 days. Policies indemnify the insured against losses from non-payment, protracted default of a buyer due to insolvency, or due to political risks beyond the control of the buyer. Policies may cover multiple buyers and the insured's entire turnover, or single risks on selected buyers.

Short-term business typically concerns shipments of consumer goods and commodities. It is the business line most sensitive to changes in the real global economy.

Public institutions and private insurers provide short-term export credit. The share of short-term business of private members in the Berne Union rose to 59% in 2017, up from 54% in 2016.

Members collectively reported over US\$2.0 trillion in insured turnover in 2017, representing 90% of total new business; by far the dominant activity of Berne Union Members.

This insured turnover is 27% higher than the year before. As previously stated, a large portion of this is due to changes in reporting rather than organic growth. But even taking this into account, insured turnover grew 5% on aggregate, building on 3% growth on 2016.⁶

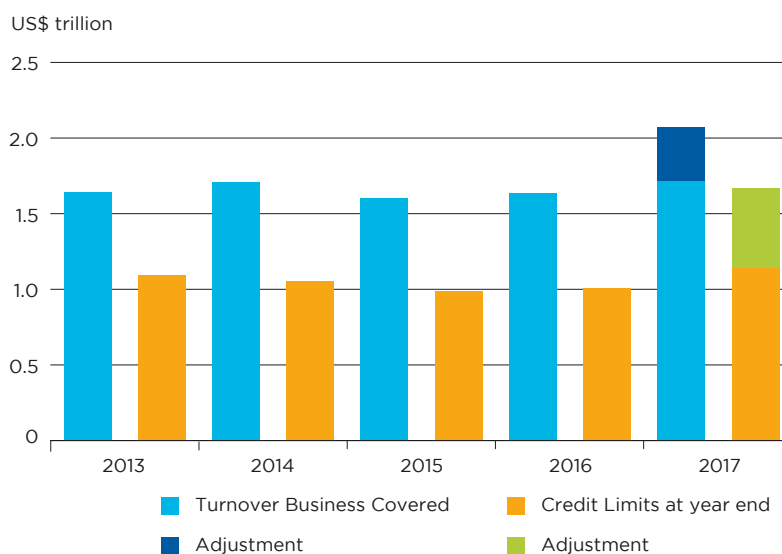
Year-end commitments are stock data which give an indication of members' risk appetite, and stood at US\$1.67 trillion in 2017.



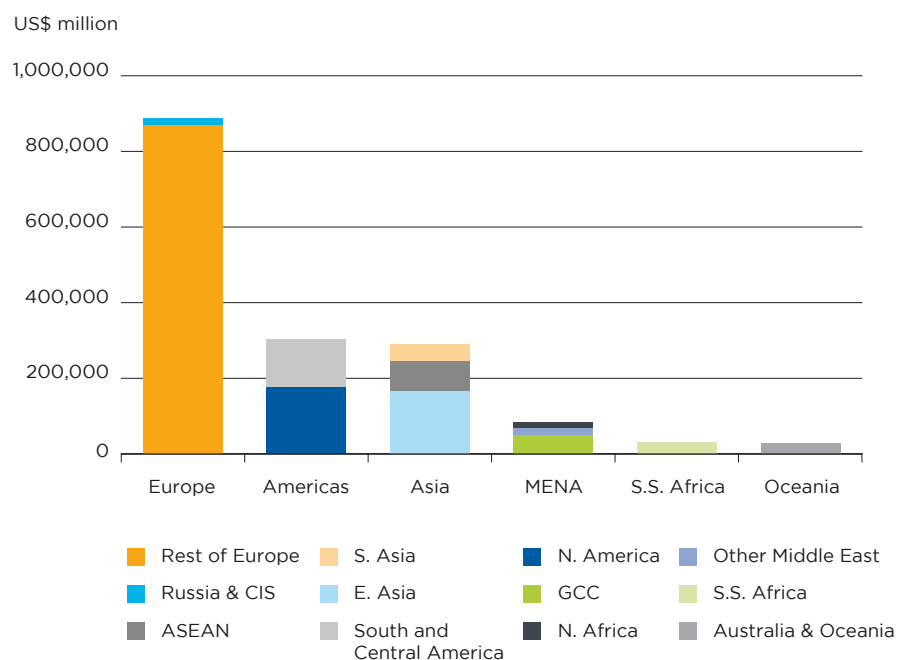
References and notes

5. Across the whole portfolio, the ratio of business underwritten to claims paid fell from 0.34% to 0.27% in ST, turnover to default ratio fell from 0.17% to 0.12%.
6. This is a conservative estimate, since at time of printing a small number of members have not yet reported figures for insured turnover, which is therefore estimated, based on credit limits outstanding at year end.
7. Aggregate credit limits reflect the maximum limit of liability of the insurer, ie. the aggregate value of credit limits set for foreign buyers under all issued policies – including self-retention portions. Utilised amount is defined as the amounts under cover at the half-year for which premium has been paid or invoiced.

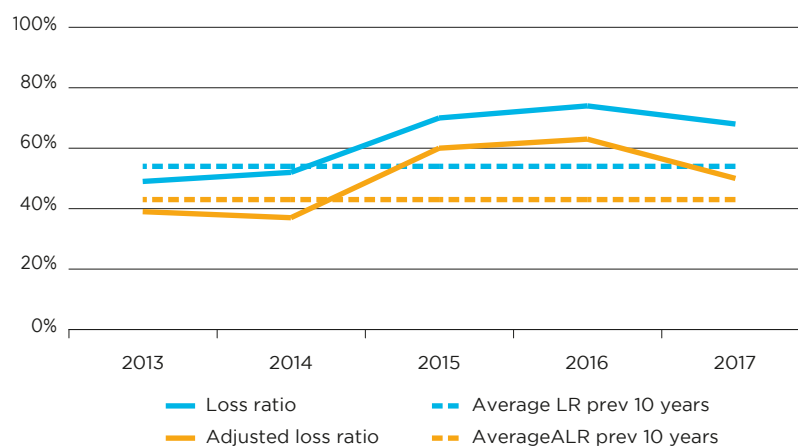
Short-term export credit insurance: Insured turnover and year-end credit limits



Short-term commitments by region 2017



Short-term loss ratio and adjusted loss ratio



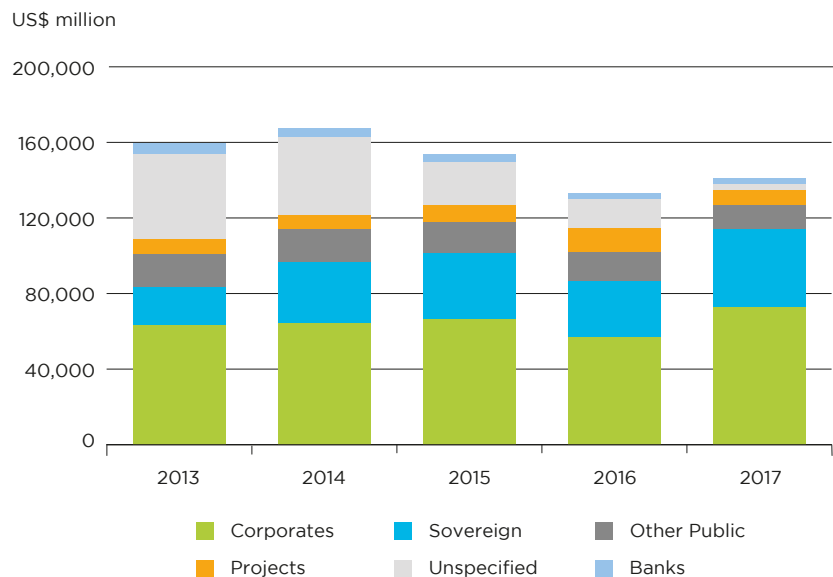
This figure has also been affected by the reporting changes mentioned above, resulting in a massive 66% increase compared to 2016. Adjusting for those changes it is estimated that commitments nonetheless grew by 13%, as illustrated in the graph adjacent.

European markets had the highest penetration of short-term export credit insurance, 55% of outstanding exposure. Asia, the Americas (split 50/40 north and south) make up the remaining 20% and the rest of the world only 5%. The largest single obligor country is the US, which alone accounts for 9% of commitments in 2017. This distribution is roughly in line with previous years.

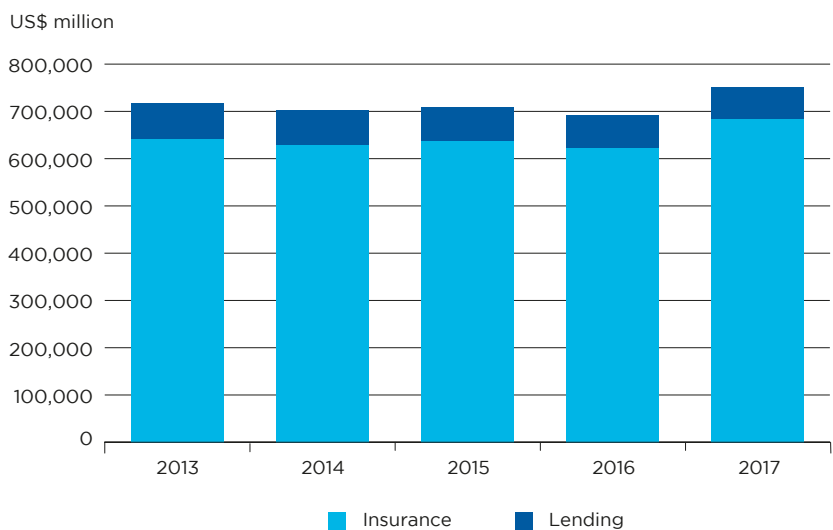
Members paid US\$2.5 billion in claims in 2017, making up 40% of the Berne Union total across all reporting committees. This is around 30% higher than the 10-year average for short-term business since 2007, but 10% lower than 2016, despite the increase in business covered.

The distribution of claims does not line up exactly with country and regional exposure. Russia and the Commonwealth of Independent States (CIS), sub-Saharan Africa and Gulf Cooperation Council (GCC) countries all received a higher share of claims compared to commitments. The claims-to-exposure ratio across the entire portfolio is 0.15, but for these regions it is 0.61, 0.53, and 0.45 respectively.

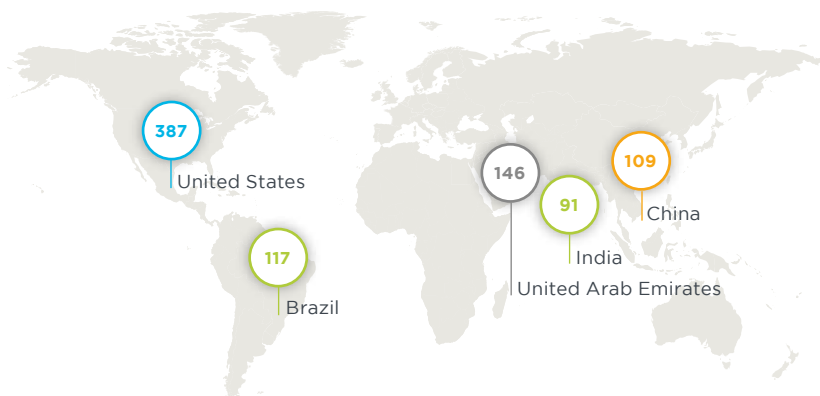
Medium/long-term new business insured



Medium/long-term exposure at year end



Short-term claims paid - top five countries (US\$ million)



References and notes

8. Claims/premium
9. [Claims-recoveries]/premium

The country with the highest exposure, the US, also has the highest volume of claims, followed by the United Arab Emirates (UAE), Brazil, China and Russia. These top five countries make up 36% of the total for the year.

Overall the default-to-turnover ratio fell to 0.12 from 0.17 and the loss ratio⁸ fell to 68% from 74%. The adjusted loss ratio⁹ improved to 50% from 63%, after strong recoveries: members collected over US\$600 million last year, at least 60% higher than the average for the decade. These indicators show that while the market is still in a period of high claims, for short-term business this has stabilised somewhat since the peak in 2016.

Despite these improvements, the insurance cycle for core markets is soft, and members still report pressure on pricing from the competitive market.

Premium income grew a slight 2.5% in 2017 lower than the 5% rise in turnover, suggesting better loss ratios were due to improved claims and recoveries, rather than higher profits. The premium-to-turnover ratio fell marginally in 2017 to 0.205% from 0.218% in 2016.

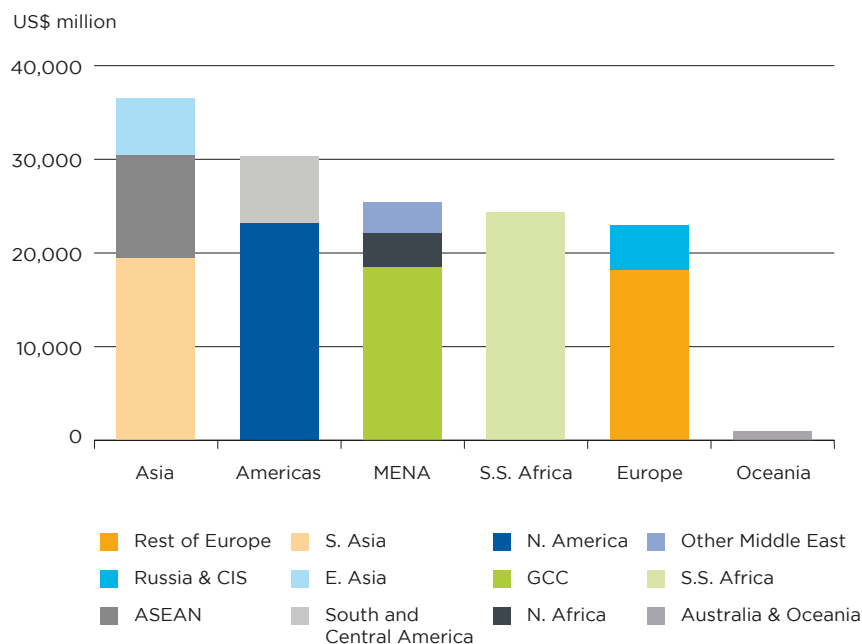
Medium and long-term export credit insurance

The Berne Union's medium- and long-term (MLT) committee records support in the form of insurance, lending and guarantees by official state-backed export credit agencies (ECAs) for capital goods exports and large infrastructure projects. These transactions have tenors longer than one year, but often three, five, and seven years and up to 10 years.

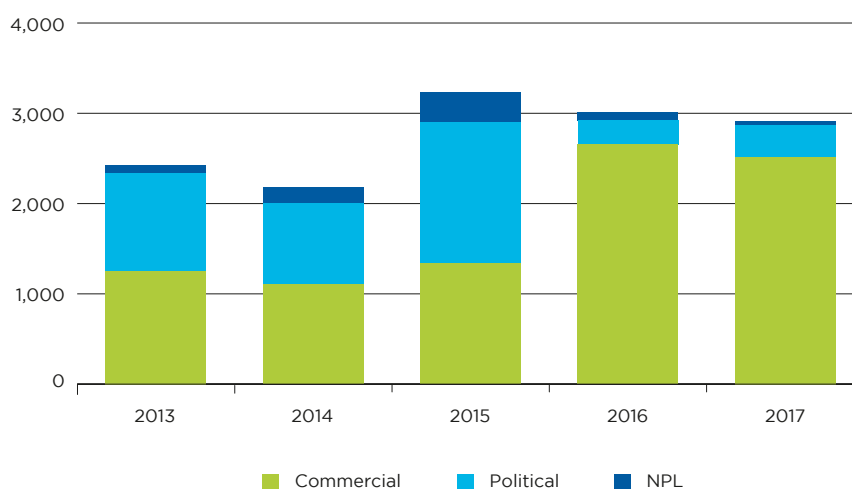
Some private members of the Berne Union are also active in medium and long-term business, but these statistics are currently reported within the 'INV' committee, and are included in the next section.

Members provided US\$141 billion of new cover in 2017, 10% of this in the

Medium / Long-Term New Commitments 2017 - by region



Claims paid



form of direct loans. New business was 6% higher than in 2016, ending a five-year run of steadily shrinking volumes. While MLT business has returned to growth, this is the lowest volume of new business recorded in the past 10 years, except for 2016.

The rise in new business also reverses the fall in portfolio exposure which kicked in after several sluggish years. Total exposure at the end of 2017 stood at US\$751.0 billion, which includes US\$67.0 billion in loans.

Around a quarter of new MLT cover was for risks in Asia, with the rest roughly divided among North America, the Middle East and North Africa (MENA), and sub-Saharan Africa. The US remains the single largest obligor country: new business in the US rose 16%. Significant growth was also seen in India (increasing by over US\$ 11 billion), ASEAN (Indonesia & Laos) and GCC (Kuwait, Qatar and UAE).

Most new business was with corporate obligors, amounting to US\$73.0 billion. Their share of the total also rose to 52% from 43%

in 2016. Sovereign commitments also increased to 29% of around US\$41.0 billion, while new commitments to projects fell over US\$5 billion to just 5% of the total. Lending activities 'maintained the performance' of 2016 at US\$14.4 billion of new commitments, mostly to corporate obligors in the US, Canada, India and Mexico.

Members paid US\$2.9 billion in claims in 2017, almost 3% lower than in 2016, but still about 40% higher than the 10-year average up to 2014, before the last period of elevated claims from 2014 to 2017.

Brazil and Russia were again the top 2 countries for MLT claims, joined by Spain, Ukraine and Germany in the top 10. But claims paid fell in all of these countries, except Germany. At the same time, claims rose in Singapore, Canada, Vietnam, Tanzania and the UK and all joined the top 10 this year.

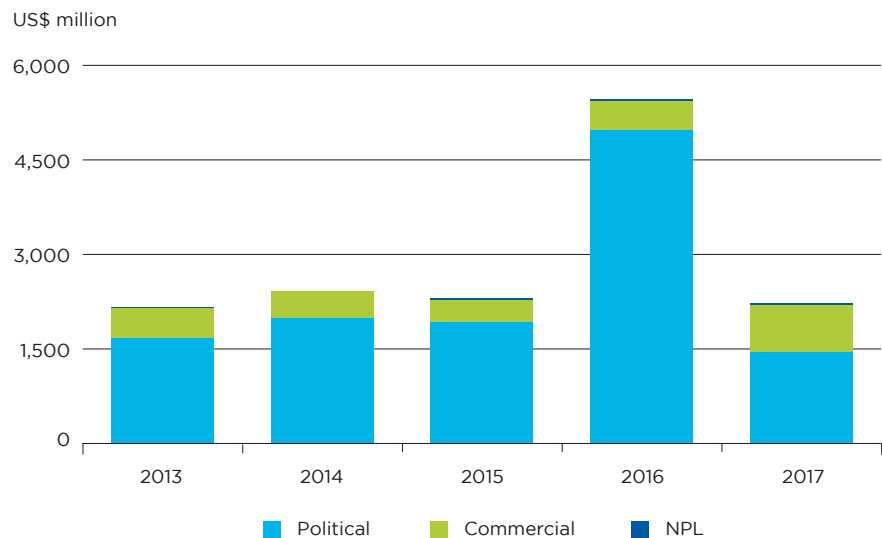
Looking at MLT claims paid over five years, 40% were in Europe, (with 40% of these in Russia and CIS countries), 24% in MENA countries (70% of these in GCC countries) and 25% in the Americas (70% of these in North America). Claims in Asia were just 8% and sub-Saharan Africa 3%.

Commercial claims still dominate, continuing the trend of the previous two years and now make up 88% of the total. For comparison, only three years ago, political claims comprised 48%.

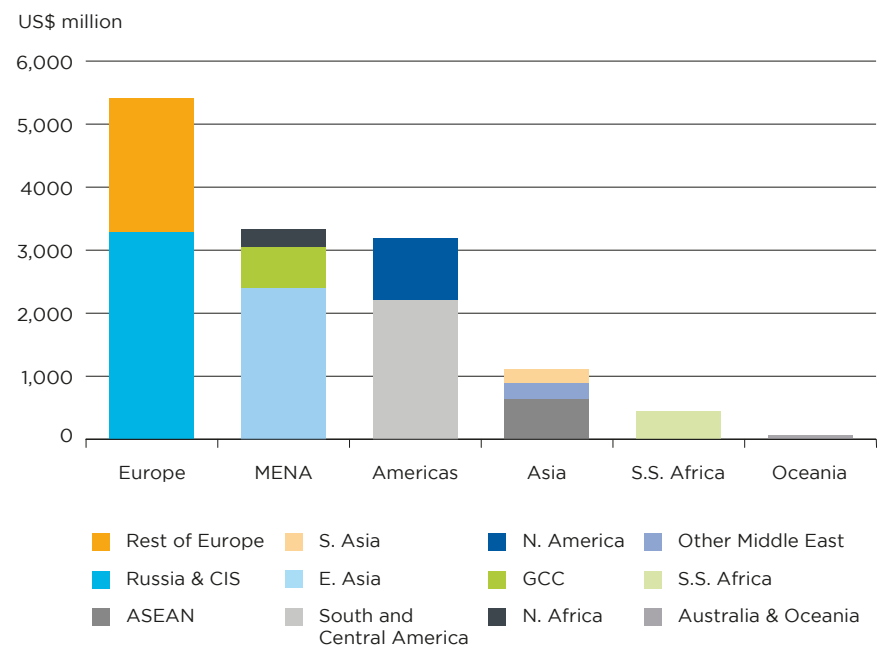
The situation is reversed for recoveries: members reported US\$1.45 billion in recoveries for political claims compared to US\$737 million in commercial claims. Overall recoveries in 2017 came to \$2.2 billion. This is back to more usual levels, following a remarkable year in 2016.

Political recoveries tend to be higher but spread over a longer period, so it is encouraging that even though recoveries in 2017 were lower than the year before, commercial recoveries were much higher - 32% more than the 10-year average.

Medium / Long-Term Recoveries by year



Medium / Long-Term Claims by Region over the past 5 years



References and notes

10. 'INVI' including: political violence, expropriation, currency transfer and convertibility risks,
11. 'INVS' - credit insurance products, providing cover against the inability or unwillingness to pay by sovereign and sub sovereign obligors
12. 'INVO' - predominantly medium/long-term untied export credit insurance.

Offers outstanding are the highest since year-end 2014, and 17% higher than 2016 at US\$106.0 billion, with strong appetite in the US, Latin America (Peru, Brazil, Chile), south Asia (India, Bangladesh) and the Middle East (Iran, Saudi Arabia and Oman).

Investment and other cross-border risk insurance

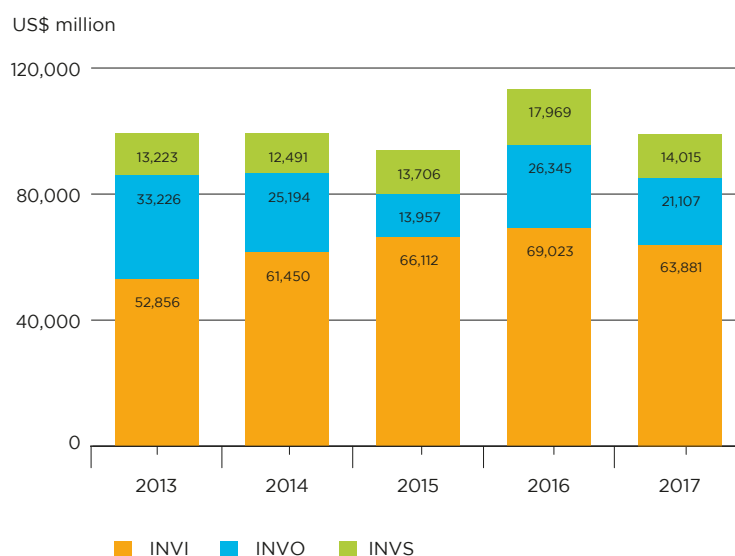
Under the investment insurance committee (INV) reporting line, Berne Union members report insurance of overseas investments against political risks¹⁰, as well as non-honouring of sovereign obligations¹¹, and other credit insurance protection against political and commercial risks for items such as bonding and untied loans.¹² This includes medium to long-term trade credit insurance of private insurers. Starting in 2018, some of these distinctions will become clearer, as Berne Union reporting shifts from reporting by committee, to reporting by business line.

New commitments reported under INV came to US\$99.0 billion in 2017. While this is some US\$14.0 billion lower than the year before, 2016 was a record year for new business. The 13% drop is probably more a correction to usual levels than a serious downturn.

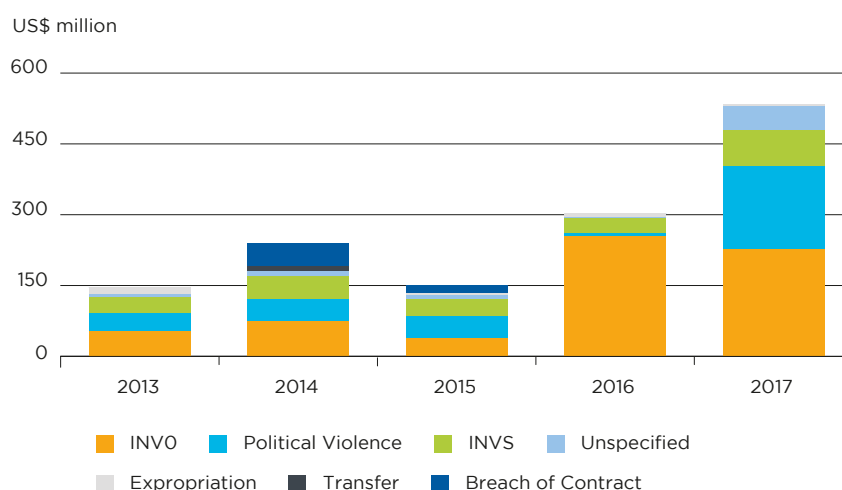
Portfolio exposure continued to rise, 6% higher at US\$289.0 billion, split roughly as follows: 55% of investment insurance (INVI), 30% of other cross-border trade (INVO), and 15% of sovereign non-payment (INVS). 40% of combined INV exposure relates to risks located in Asia, and the remainder is fairly equally divided among Africa, Europe and the Americas.

Overall claims paid came to US\$545.0 million: a huge increase, and 76% higher than 2016 due to a dramatic spike in INVI claims, combined with a high level of INVO sustained from the previous year along with a modest increase in INVS.

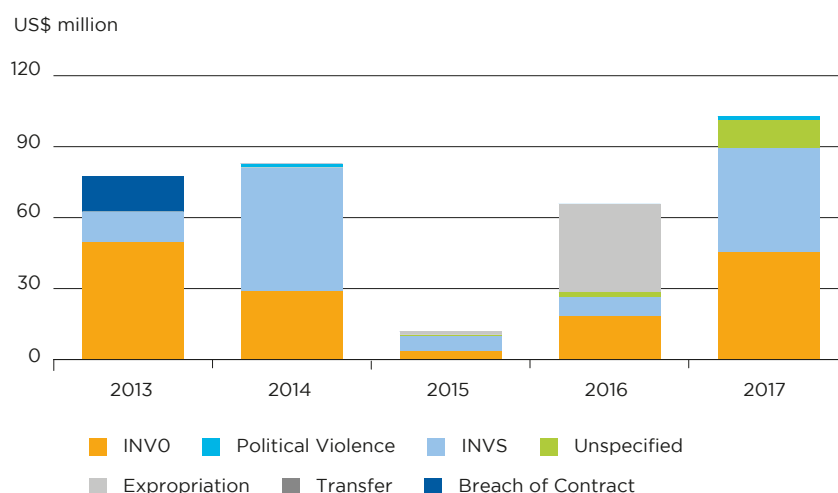
Investment Insurance New Commitments



Investment Insurance Claims Paid



Investment Insurance Recoveries



Global recoveries were impressive: US\$103.0 million for all members, relating to claims paid for sovereign and sub-sovereign non-payment in China, Gabon and Turkey, and trade transactions in the Ukraine.

Investment insurance (INVI)

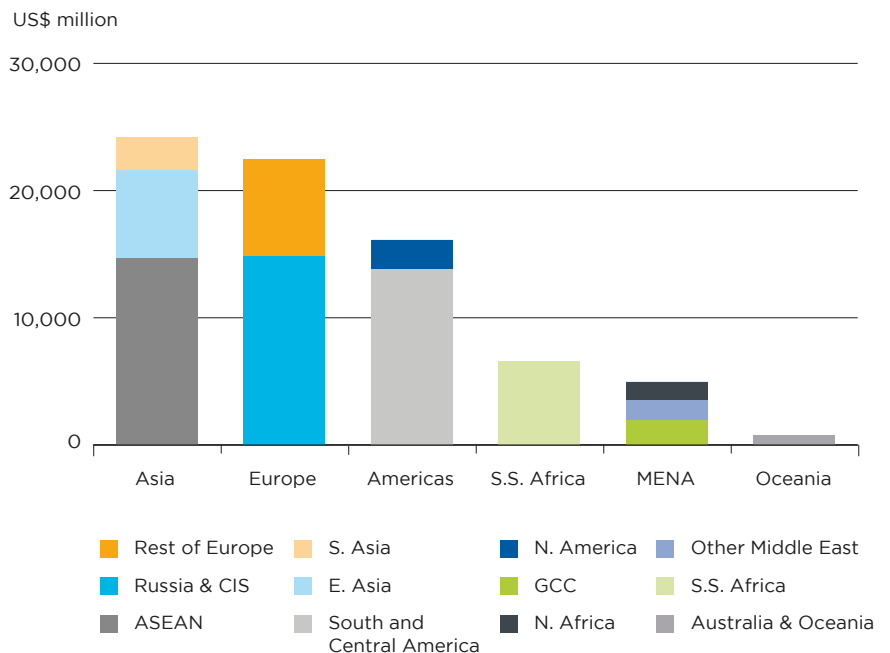
New cover for investment insurance in 2017 fell 6% from the year before to US\$64.0 billion. Efforts to harmonise divergent data reporting from some members on how new commitments are interpreted also had a small negative effect on INVI, and likely accounted for most if not all of the drop.¹³

ASEAN, CIS and Latin American countries each accounted for 20% of new business, while Asia, sub-Saharan Africa and the rest of Europe each accounted for 10%. The top countries by business volume reflects these trends: Kazakhstan, Vietnam, Indonesia, China and Uzbekistan.

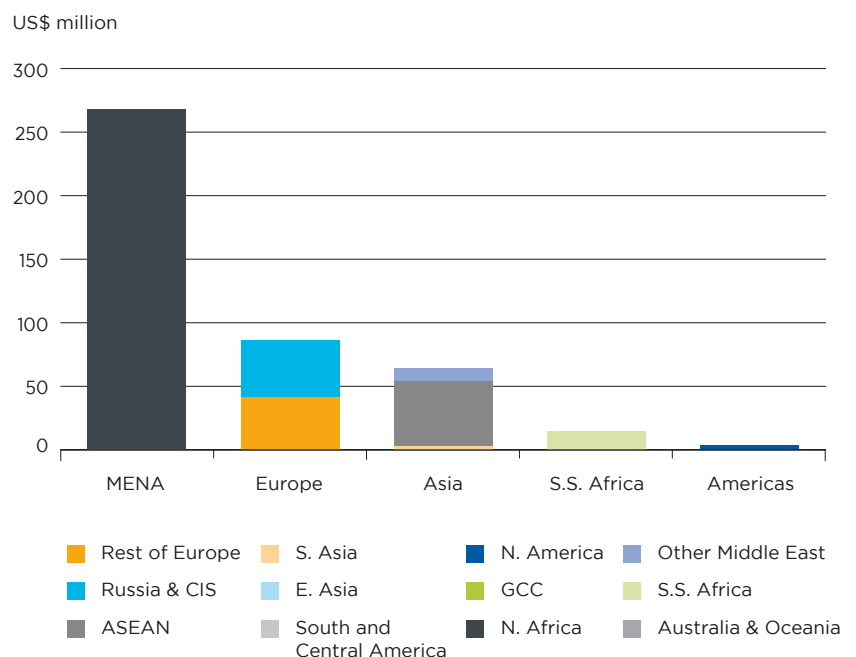
Members collectively paid US\$232.0 million in claims under investment insurance policies in 2017, an all-time record, due to a large political violence claim in Libya. That a single claim can so dominate the overall statistics underlines two essential characteristics of this business: that claims are relatively rare, and when they do occur, are often sporadic, isolated, and sometimes large – such is the nature of the underlying risks involved.

Recoveries on investment insurance claims are unusual. The only noteworthy recovery in 2017 was US\$11.0 million for a claim in Turkey.

INVI 2017: New Business By Region



INVI claims by region in the last five years



References and notes

13. In this case, one high-volume member's internal accounting classified yearly policy renewals as 'new commitments' which in previous years will have unduly boosted figures.

Trade credit insurance of state obligations (INVS)

Members provided US\$14.0 billion of new cover for sovereign non-payment risks in 2017, which was 20% lower than the 2016 high, but notably higher than any previous year.

Business continued to boom in Sub-Saharan Africa, which now accounts for almost a quarter of total new cover provided, with Kenya, Ethiopia, Cameroon and Zambia showing the most growth. Asia's share of new business also increased, up to 12%, from 9% in 2016. The share for most other regions either stayed the same, or decreased slightly. Top countries for new commitments were: Turkey, India, South Africa, Oman and Egypt.

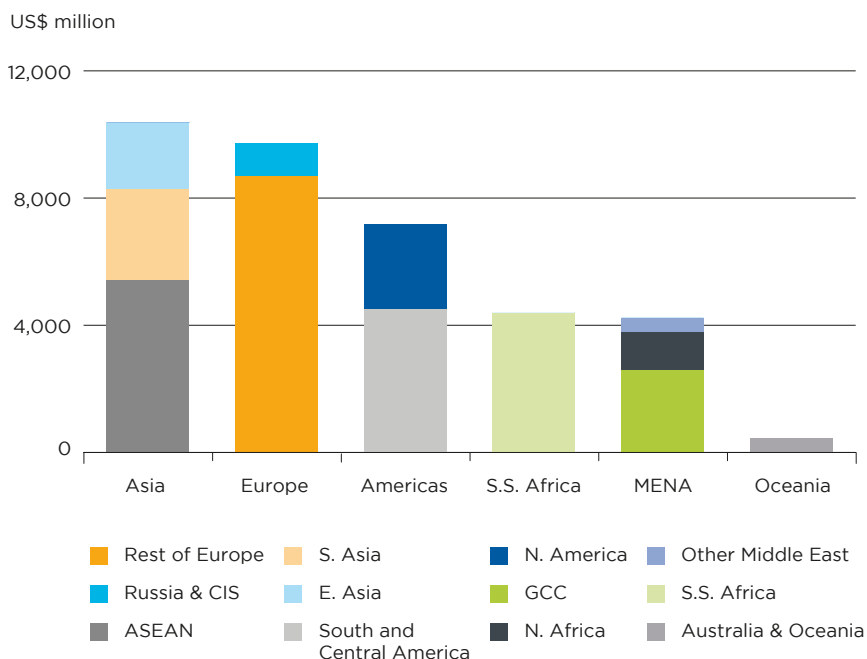
INVS also recorded an exceptionally high year for claims due to individual defaults. Two claims, a US\$41.0 million in Gabon and a US\$15.0 million claim in Venezuela, accounted for most of the US\$76.0 million recorded. Significant recoveries in Gabon of US\$16.6 million and China of US\$13.5 million contributed to the yearly total of US\$43.7 million.

Other cross-border trade (INVO)

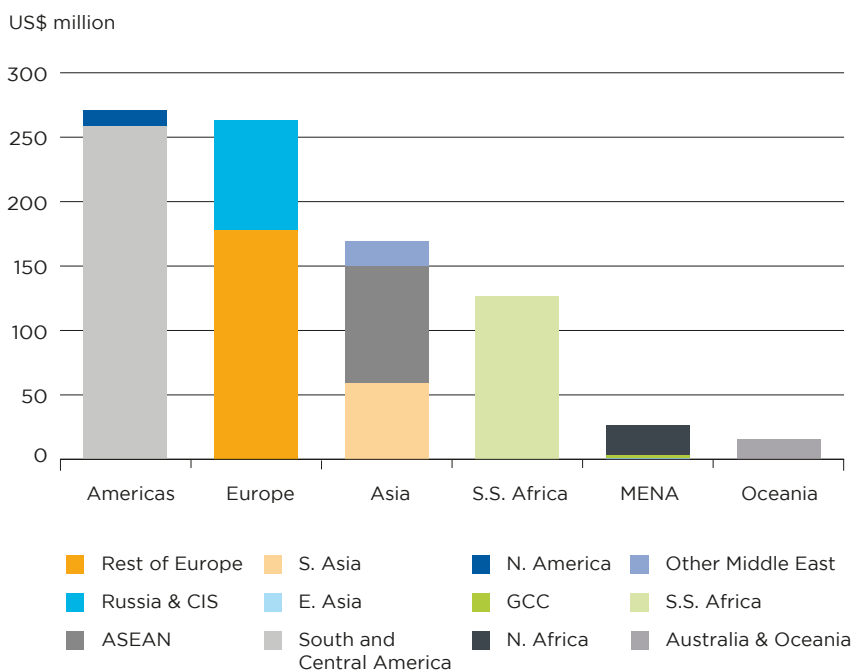
Mirroring INVS, new business reported under INVO fell 20% to US\$21.0 billion in 2017. New commitments for obligors in the United States fell sharply, knocking it off the top spot, into second place behind Indonesia. Strong performance here, along with Singapore and Malaysia, helped to increase the share of new business in ASEAN countries considerably, while a three-fold increase in commitments in India added to the total for Asia.

Europe maintained its share, thanks to strong performance in Turkey and the United Kingdom. South and Central America also registered gains, thanks to strong performance in Mexico, Colombia and Argentina

INVO+S: New Business By Region 2017



INVO + S claims by region in the last five years



Claims paid in 2018 fell by more than 10% year on year, but at US\$226.0 million are still double the five-year average. This was mostly due to a large claim in Brazil which accounts for almost 60% of the total as well as a few small but significant claims recorded in the Ukraine, Greece and Chile.

In line with the trend in other business areas, 2017 was a good year for INVO recoveries: members collected US\$46.0 billion, with the largest share collected from Ukraine, China, Thailand, Brazil and Mexico.



Multilateral Development Banks/ No letup in expansion

Compilation and introduction by Thierry Sénéchal with input from representatives of multilateral developments banks featured: AfDB, EBRD, IDB Invest, IFC, and ITFC. Thierry Sénéchal is Founding partner, Finance for Impact.

A deep dive into multilateral development banks on trade finance activities, and what's in the pipeline.

Several Multilateral Development Banks (MDBs), including the Asian Development Bank (ADB), the African Development Bank (AfDB), the European Bank for Reconstruction and Development (EBRD), the IDB Invest (a member of the Inter-American Development Bank IDB Group), the International Finance Corporation (IFC), and the International Islamic Trade Finance Corporation (ITFC), operate large-scale trade finance programmes, offering products and services to facilitate cross-border trade in emerging and developing economies.

Demand for these programmes rose sharply during the 2008 to 2009 financial crisis and have remained high, due to persistent financing gaps. According to the Asian Development Bank, the total value of unmet demand is nearly US\$1.5 trillion, with estimates approaching US\$100 billion for Africa and US\$700 billion for developing Asia.

Unmet demand for finance by SMEs in the developing world is nearly US\$1.5 trillion

MDBs have ramped up these trade finance programmes in response to financial market shocks and tightening credit conditions, that reduced the risk appetite of private financiers.

Over the last decade, MDB support in trade finance amounted to US\$168 billion, representing about 100,000 cross-border transactions. In 2017 alone, trade finance programmes helped facilitate 11,720 cross-border trade transactions for a total value of over US\$30 billion in markets with the biggest gaps in provision.

Last year alone multilateral banks helped get trade finance worth US\$30 billion in countries with the biggest shortfall

MDBs have not only raised the limits of these programmes, they have also diversified the product mix. Traditionally, most programmes provided guarantees to reduce the perceived risk of conducting trade operations in developing countries: they close the “confidence gap” between perceived and actual risk. Some MDBs, such as ADB and AfDB, also offer risk participation agreements (RPA) to provide risk protection on a portfolio basis rather than on a transaction-by-transaction basis.

Today many MDB trade finance programmes also propose funded products, such as short-term financing facilities or revolving credits. Some MDBs offer specialized solutions, including Islamic finance, soft commodity facilities, and equity support, which have been in great demand in developing countries.

This 2018 report also shows MDBs have boosted their support of small- to medium-sized enterprises (SMEs). In general, startups, and smaller enterprises led by youth and women in developing countries face major challenges in accessing credit. They often have less collateral, weaker management abilities and lack access to key data and information, reducing their likelihood of getting bank credit.

For example, globally over half of SME requests for trade finance are rejected, while only 7% of multinational company requests are turned down. As the table below shows, SMEs make up a large share of MDB trade finance programmes. In 2017 for example, in three out of the six programmes, SMEs represent over three quarters of the end beneficiaries.

MDB programmes do not take the payment risk of the local firm applying for a trade finance instrument. But an MDB can influence the risk appetite of the local issuing banks for SME banking, by providing lines of credit dedicated to this business segment.

The development impacts of these trade finance programmes are straightforward: they enable viable trade transactions that otherwise would not happen because of the inadequate supply of trade finance on reasonable terms.

More generally, these multilateral programmes are seen as a robust response to market constraints, including:

- perceived high credit risk of local issuing banks
- internal constraints to the confirming bank, such as limits for higher-risk countries or issuing banks
- international regulations that affect costs and capital requirements
- political, social and economic country risks affecting banks’ performance

By helping the private sector in developing countries overcome financial constraints to cross-border trade, MDBs play a crucial role, by giving a major push to economic growth and poverty reduction in their countries of operations.

MDBs close the ‘confidence gap’ between perception and reality of risk

FINANCE FOR TRADE

Multilateral Development Banks/No letup in expansion

	ADB	AfDB	EBRD	IDB INVEST	IFC	ITFC
Program Title	Trade Finance Program (TFP)	Trade Finance Programme (TFP)	Trade Facilitation Programme (TFP)	Trade Finance Facilitation Program (TFFP)	Global Trade Finance Program (GTFP)	ITFC Trade Finance Program (TFP)
Number of Countries of operation	22	49	26	21	85	51
Organization structure (Staff, outside consultants...)	17	1 Division Manager plus 8 staff and 1 consultant	7 trade finance bankers and 5 administrative staff	10	42	74
Program Commencement	2004	2013	1999	2005	2005	2008
Program total limit (authorized exposure ceiling)	US\$1 billion	US\$1 billion (for guarantees only)	US\$ 1.8 billion	US\$1.5 billion	US\$5 billion	No limit
Type of financial products	<p>1. Guarantee Products: Credit Guarantee; Risk Participation Agreement</p> <p>2. Funded Products: Revolving Credit Facility; Funded Risk Participation Agreement</p> <p>3. Distribution Product (Co-finance): Risk Distribution Agreement</p>	<p>1. Risk Participation Agreement (guarantees)</p> <p>2. Trade Finance Line of Credit</p> <p>3. Soft Commodity Facility</p> <p>4. Equity support</p>	<p>1. Guarantees issued trade finance instruments, e.g. L/Cs, SBL/Cs, advance payment bonds, payment guarantees, bid and performance bonds, trade-related promissory notes and bills of exchange.</p> <p>2. Short-term loans to selected banks and factoring companies</p>	Credit Guarantees and loans	<p>GTFP provides up to 100% coverage on the country and commercial risks of individual trade-related instruments.</p> <p>Other trade programs include GTLP (Funded/unfunded portfolio), CCFP, GWFP (Commodity Finance), GTST (Structured Trade), Working Capital Solutions, and GTSF (Supplier Finance).</p>	Murabaha Financing, Two-steps Murabaha Financing and Structured Trade Finance
Type of non-financial services	Active knowledge Products and dissemination to inform bankers and insurers of risks and opportunities in the TFP countries of operation. Training and seminars in trade finance and banking to build expertise	<p>1. Thought leadership – Africa Trade Finance Market Studies</p> <p>2. Training of local FIs on compliance and trade finance</p> <p>3. Technical assistance to local FIs – improvement of systems and processes</p>	Donor funded advisory services and trade finance training for partner banks and their clients and regulators	Technical assistance and knowledge creation	Training, Capacity building	Policy work, trade facilitation, trade promotion, technical assistance, capacity building, trainings, integrated trade programs
Number of Transactions since Commencement	16,607 (2009-2017)	1,650	21,000	1,774 (credit guarantees issued and loans disbursed)	57,000	602

Value of Transactions since Commencement	US\$ 30 billion (2009-2017)	US\$ 6.65 billion	US\$ 18.5 billion	US\$ 5.9 billion supporting US\$ 9.1 billion underlying transactions	US\$ 64 billion	US\$ 40.2 billion
Number of Transactions in 2017	3,505	330	1,905	178	5,750	53
Value of Transactions in 2017	US\$ 4.5 billion	US\$ 1.76 billion	US\$ 2.3 billion	US\$ 750.3 million supporting US\$ 929.8 million underlying transactions	US\$ 6.7 billion	US\$ 4.9 billion
Number of Correspondent Banks	240	14	800	100+	1400	NA
Number of Issuing Banks	150	365	95	105	285	NA
Possibility to work with public sector financial institutions?	Yes	Yes	Yes	Yes	No	Yes, on both Trade Development and Trade Finance
% of SMEs in Portfolio in 2017	81%	58%	78%	84%	NA	15%
Claims to Date	0	1 bank – due to receivership	2	0	0	0

► Asian Development Bank (ADB)

Value proposal and product mix

ADB's Trade Finance Programme (TFP) helps close market gaps for trade finance in tough markets. It does this by providing banks with guarantees and loans to support trade in sectors from commodities to capital equipment, medical supplies to consumer goods.

ADB has a large product mix:

Guarantee products

- Credit guarantees cover up to 100% of bank risk, provided within 24 hours, representing 70% of the total value of transactions TFP supports
- A risk participation agreement automatically binds TFP up to 85% of bank risk to support trade transactions, about

27% of the total value of transactions TFP supports

Funded products

- A revolving credit facility gives loans directly to banks in TFP countries of operation to support pre- and post-shipment transactions, about 2% of the total value of transactions TFP supports
- A funded risk participation agreement pilot launched in 2017, which automatically binds the TFP for up to half of bank risk to support funded trade transactions

Distribution product (co-finance)

- A risk distribution agreement that leverages capital resources and credit limits by sharing risk, around 36% of the total value of transactions TFP supports

associated with some trade transactions.

TFP also increased its share of transactions covered under its unfunded risk participation product to 85% from 50% to help the private sector assume more risk in developing Asia.

Measuring the trade finance gap and its impact

ADB's TFP is the first and still the only information source quantifying the global market gap in trade finance and its impact on economic growth and jobs. In September 2017, TFP launched its annual Trade Finance Gaps, Growth and Jobs Survey at the GTR Asia Trade and Treasury Week in Singapore. The study was discussed at the United Nations in 2017 to assess how the trade gap affects achievement of the Sustainable Development Goals (SDGs).

Market trends in 2017

The TFP programme grew exponentially in 2017, supporting over 3,500 transactions valued at US\$4.5 billion in 2017, up 68% in the number of transactions and a 43% rise in value, compared with 2016. About 2,845 of these transactions supported SMEs, a 77% lift from 2016.

Performance was driven by trade growth, high regional economic growth, new demand for power generation, longer tenor transactions to support infrastructure, and new banks and facilities.

	value of transactions supported	co-financing	number of transactions	SMEs supported
2017	US\$4.5 billion	US\$2.8 billion	3,505	2,822
2009-2017	US\$30 billion	US\$18 billion	16,607	12,026

Over 90% of TFP's transactions in 2017 were in challenging markets. Armenia, Bangladesh, Mongolia, Pakistan, Sri Lanka and Vietnam were the most active countries in the programme. Landmark transactions in 2017 included: a US\$30,000 pre-shipment loan to finance the export of cocoa beans from Samoa to Japan, one of the first transactions supported by TFP in the Pacific Islands; a US\$75 million club facility to support imports and exports for Georgia's key economic sectors: agribusiness, transportation, and energy; a EUR18.5 million guarantee to

partially cover the import of gas turbine parts to Vietnam from Switzerland; a EUR9.0 million partial guarantee to support plant machinery and equipment from Italy for a rolling mill in Pakistan; and a first transaction in Myanmar covering the import of fertilizers from Italy.

Achievements in 2017

New products and coverage

TFP launched and carried out a new funded risk participation product. The product will help international banking partners comply with evolving regulatory requirements and defray the funding costs

Gender equality

A gender initiative gathered and assessed the human resources policies of 19 banks in eight countries to see what could be done to attract, retain and promote more women in banking. Some of the recommendations have already been taken up.

First bank internship

A bank internship programme was launched for knowledge sharing between partner banks, help establish robust trade finance operations, forge new business links across regions and promote more intra-regional trade and cooperation. The participants were based in Georgia and Tajikistan.

Online training

To build the skills of trade finance professionals at TFP member banks, ADB partnered with the International Chamber of Commerce Academy and delivered two accredited and globally recognized online courses attended by over 150 bankers from 80 banks.

Market constraints

The ADB's Trade Finance Gaps, Growth and Jobs Survey identified these market constraints:

- global gap estimated at US\$1.5 trillion
- 40% of the gap is in Asia and the Pacific
- 74% of the gap affects SMEs
- a 10% boost in trade finance would create 1% more jobs
- digitisation is not narrowing the gap

What is more, the sources of finance for small- to medium-sized enterprises (SMEs) are not very diverse: some 60% of firms report that once a transaction is rejected, the trade fails. Only 20% of rejected transactions are considered unbankable.

The report shows the availability of trade finance for SMEs is affected by:

- low country and counterparty ratings
- perception of risk
- high capital costs coupled with relatively low margins
- high costs
- risk on compliance with anti-money laundering and know-your-client regulations.

Affordability of trade finance

Pricing pressures remain across the region, driven by the availability of trade credit to well-established customers. At the same time, SMEs continue to face shortages in trade finance and high borrowing costs, due to the heavier burden of compliance and due diligence processes on the financial sector and the difficulty of evaluating reliable financial data in developing markets.

SMEs

TFP-supported SME transactions rose 77% compared with 2016 to 2,822. To deepen support for SMEs, ADB launched a supply chain finance programme. A total of

81% of the portfolio relates to SME transactions.

Risk sharing and defaults

Co-financing activities are a strategic aim of the TFP, since they attract private sector financial institutions to developing Asia in the effort to reduce gaps, such as commercial banks, private insurance, ECAs and other MDBs. ADB had a record year for TFP's risk-sharing efforts in 2017: of US\$ 2.8 billion, most was distributed or shared with private insurance. Risk-sharing maximizes TFP's ability to support trade capacity in ADB's 22 countries of operation. There have been no defaults since the inception of the programme.

Development impact

TFP supported over 2,800 SME transactions in 2017. More than 850 transactions were between ADB developing member countries. TFP continues focus on Asia's more challenging countries, where market gaps are largest. ADB is now considered an excellent knowledge broker, providing the market with relevant knowledge products and services, including:

- Trade Finance Register: A tool created with ICC to provide annual default and loss rates on global trade finance transactions, helping regulators and financial institutions understand and calibrate risk parameters for trade finance.
- ADB Trade Finance Gap, Growth, and Jobs Survey: An annual publication since 2013 that identifies and quantifies market gaps for trade finance and the impact on economic growth and jobs.
- knowledge dissemination to inform bankers and insurers of risks and opportunities in the TFP countries of operation through trade finance training and feedback on annual due diligence to strengthen banks.

Outlook

TFP will continue supporting more trade in emerging Asia. In 2018, TFP will increase its total capacity and continue expanding markets. Technological innovations to improve TFP's day-to-day operations will support growth. More diverse and in-depth training for partner banks is in the pipeline, to include environmental and social goods screening and risk management. TFP will pilot the onboarding of banks to the Legal Entity Identifier (LEI), to help drive global adoption of this important tool to improve transparency and underpin future gains in fintech.

➤ African Development Bank (AfDB)

Value proposal and product mix

AfDB's AAA rating and deep knowledge of Africa help banks mitigate risk and boost access to trade finance for SMEs.

The AfDB offers the following products:

- Risk Participation Agreement (RPA): AfDB provides a partial payment risk guarantee (typically 50%) to confirming banks on a portfolio of trade finance transactions originated by issuing banks in Africa. The tenor of the facility is three years while underlying guaranteed transactions should have a maximum tenor of two years.
- Trade Finance Line of Credit (TFLOC): The Bank offers this short-term trade loan mainly to financial institutions in Africa for on-lending to SMEs and corporates engaged in international trade, in sectors such as agriculture and light manufacturing. The maximum facility tenor is three and a half years.
- Soft Commodity Finance Facility (SCFF): This liquidity support facility is targeted mainly to commodity aggregators and export marketing agencies that purchase or add value to soft commodities such as cocoa, coffee, tea and cotton for export. The maximum tenor is two years.
- on a selective basis the Bank provides debt to or makes equity investment in trade funds.

Market trends in 2017

Although commodity prices, including oil, stabilised in 2017 and even saw a gradual uptick, many major African economies continued to reel from the price depression of 2015 and 2016. Foreign currency reserves remained under stress in many oil export-dependent economies, while economic growth was lacklustre in many others, especially in Central Africa and

Southern Africa. The commodity-led downturn had a knock-on effect on Africa's international trade in 2017.

Major African economies are still reeling from low commodity prices in 2015 to 2016

Coupled with the continued retreat of many global banks from the continent due to business, regulatory and KYC compliance considerations, many local banks in Africa suffered from inadequate correspondent banking lines and insufficient foreign currency liquidity to finance trade.

For most of 2017, international confirming banks maintained their conservative approach to trade finance business development in Africa that started in 2015 and 2016. This hurt the supply of trade credit lines vital to Africa's participation in international trade.

This problem was acute in many large oil export-dependent economies, such as Nigeria and Angola, but also in fragile and transition countries generally characterised by a sector of small banks that are perceived by international banks to have high compliance risks and low economic returns.

Demand was robust from local financial institutions for trade finance liquidity support from other sources. AfDB alone approved or disbursed more than US\$1.0 billion of trade loans to financial institutions, to help cushion the foreign exchange liquidity deficit in the trade finance market. Local issuing banks made many inquiries on the availability of the Bank's trade finance guarantee instrument.

However, AfDB could not meet this demand for two main reasons: only approved confirming banks can request a guarantee under the Risk Participation Agreement (RPA) and not the local issuing banks;

and many confirming banks had adopted a cautious approach and were less willing to assume more issuing bank risk. As a result, use of AfDB's guarantee instrument was lowest since the inception of the TFP in 2013.

Case study

US\$40 million equity support to Africa Trade Insurance Agency (ATI)



ATI is an investment grade (S&P A rating) regional development finance institution established in 2001 to support investment and trade in its Africa member countries through the provision of political risk and export credit guarantee insurance.

In 2016 and 2017, AfDB provided US\$40 million to ATI as equity contribution for Côte d'Ivoire, Ethiopia, Benin, Zimbabwe and South Sudan.

This not only boosted ATI's capacity to underwrite more business, but for the first time boosted access to greater trade insurance coverage for entities in these countries. It is predicted this equity support will unlock more than US\$1.0 billion in trade in these countries.

This demonstrates the powerful leverage and development impact of this support. This facility is innovative and unique because it is not a typical intervention instrument in the product suite of MDB trade finance programmes.

Buoyed by strong economic growth in Ghana, Tanzania, Ethiopia, Côte d'Ivoire and Rwanda and macroeconomic adjustment to the realities of depressed export commodity prices in others, some confidence has returned to the trade finance market. The uptick in demand for guarantees at the end of the year is expected to continue in 2018.

Confidence is returning to fast-growing African economies

Achievements in 2017

TFP registered the lowest volume and value ever of guarantees in 2017, but approval and disbursement of trade finance lines of credit (trade loans) to local financial institutions were at their highest. In 2017, AfDB guaranteed 330 transactions for a total trade value of US\$530 million and approved and disbursed more than US\$1.0 billion of trade loans, US\$220 million in soft commodity finance facilities (SCFF) and US\$18 million in equity support. Nigeria, Egypt, Kenya and Guinea Conakry made up the bulk of the guarantees. Regional development finance institutions (the recipients of the equity support) and regional banking groups were the main beneficiaries of trade loans.

Market constraints

The AfDB estimates Africa's trade finance gap annually around US\$90 billion to US\$100 billion. Banks cite a lack of sufficient risk capital (21%), insufficient limits from international correspondent banks (18%), inadequate foreign exchange liquidity (17%), and regulatory and compliance restrictions (16%) as the biggest constraints to growth of their trade finance activities in Africa.

Regulatory and compliance restrictions and insufficient credit limits from international correspondent banks pose huge challenges to trade finance

in Africa. More than a third of banks cite these as the primary constraints to the expansion of their trade finance activities.

This is of concern given more stringent anti-money laundering (AML), know-your-customer (KYC) and international regulatory rules and requirements that tend to have a more adverse effect on banks in developing countries.

The severity of these constraints tends to vary by region, level of country fragility and economic structure. For instance, while banks in fragile countries and net oil-exporting countries view lack of adequate foreign exchange liquidity as the biggest constraint, a recent development in net oil-exporting countries because of the fall in export commodity prices, banks in net oil-importing countries accustomed to inadequate foreign exchange rank this constraint as less significant.

Affordability of trade finance

AfDB has not done a recent study on the affordability of trade finance in Africa. But there is a general perception that letter of credit confirmation fees levied on local issuing banks in Africa and trade loans provided by these local banks to SMEs and local corporate clients are among the highest in the world.

Low country risk and issuing bank (obligor) ratings, scarcity of correspondent bank credit lines, inadequate foreign exchange liquidity in local markets and perceived high risk of SMEs and local corporates all contribute to the high cost of trade finance in Africa.

SMEs

Although SMEs account for more than 80% of businesses in Africa, on average they represent only 28% of the trade finance portfolios of banks. This relatively low share is explained partly by the higher risk perception and cost of doing business associated with SME financing. There is also a high concentration of trade finance portfolios. Anecdotal evidence

suggests the top 10 customers of banks represent close to 60% of the trade finance portfolio.

The objective of AfDB's TFP is to increase access to trade finance for SMEs and local corporates in key sectors such as agriculture and manufacturing. SMEs account for nearly 60% of all transactions supported. The programme has also lent its support the import and export of essential commodities and intermediary goods vital to the socio-economic development of the continent. In sectoral distribution, agriculture, forestry and fishing (24%) and manufacturing (24%) got the most support, followed by energy (9%) and construction (8%).

Risk sharing and default

There were no default or losses in 2017. In 2016 AfDB settled claims of about US\$850,000 when an issuing bank in the TFP went into receivership. AfDB has already recovered a small portion of the settled claim and continues to pursue recovery of the balance.

Development impact

Since its inception, TFP has supported 1650 trade transactions for a value of US\$6.6 billion. More than 100 financial institutions in 30 African countries, most of which are low-income countries or fragile states, have benefited from the program, including Guinea, Liberia, The Gambia, Ethiopia, and Zimbabwe. These are countries to which international banks provide very limited trade finance credit lines due to risk considerations.

By supporting local banks in these and other countries, AfDB's TFP has contributed to deepening and development of the financial sector across the continent. The program also promotes financial inclusion by providing a lot of support to SMEs.

To promote regional integration, partner banks are encouraged to support as much intra-Africa trade as possible. So far, AfDB's TFP has supported nearly US\$1.4 billion of intra-Africa trade. This represents 21% of total trade supported and

compares favorably to Africa's overall intra-Africa trade ratio generally estimated at 15%.

AfDB is also gradually stepping up its capacity-building activities for local banks. Since 2013, in partnership with other international banks such as Standard Chartered, Commerzbank and UBAF, AfDB has provided training to staff from more than 40 local banks in financial crime, risk management, trade finance documentary credit and blockchain technology.

The trade finance gap in Africa is estimated around US\$100 billion

What is more, AfDB published the second edition of its flagship Trade Finance in Africa survey in October 2017. This report has become a valuable reference on the trade finance market in Africa.

During the course of the year, the Trade Finance Division organised two training courses jointly with UBAF Paris on examination of documentary credits in trade finance, and blockchain and digital financial technology for banks. Trade finance practitioners from more than 25 banks attended. AfDB also supported Global Trade Review's trade finance conferences in Nairobi, Cape Town and Cairo attended by more than 400 participants from 50 countries.

The outlook for trade finance in Africa is positive in the medium to long term

Outlook

The outlook for trade finance in Africa is positive in the medium to long term. But in the short-term evolving macroeconomic challenges in some countries and the adverse effects of KYC and regulatory challenges pose some risk.

There is growing demand from local issuing banks and international confirming banks for single transaction guarantees (direct guarantees) which provide 100% payment risk cover. AfDB is preparing to introduce a new guarantee instrument to satisfy this market need.

AfDB also plans to expand and strengthen its capacity-building activities to assist local banks fulfill KYC and regulatory compliance requirements, to possibly avert further paring back of credit lines from international correspondent banks.

AfDB will collaborate with other MDBs and international trade organisations such as the WTO and ICC to focus global attention on the impact of stringent regulatory requirements and AML and KYC compliance on banks in developing countries.

► European Bank for Reconstruction and Development (EBRD)

Value proposal and product mix

The EBRD's Trade Facilitation Programme (TFP), part of the EBRD financial institutions team, promotes and facilitates international trade to, from, and within central and eastern Europe, the Commonwealth of Independent States (CIS) and the southern and eastern Mediterranean (SEMED). The TFP provides guarantees to international commercial banks (confirming banks) to cover the political and commercial payment risk of transactions of issuing banks in the EBRD's countries of operation.

The TFP can guarantee any trade transaction to, from and in the countries of operation. These instruments issued or guaranteed by participating banks may be secured by guarantees issued under the programme: documentary letters of credit (L/Cs), trade-related standby L/Cs, deferred payment L/Cs, L/Cs with post-financing, advance payment bonds, payment guarantees, bid and performance bonds, trade-related promissory notes or bills of exchange.

The EBRD also extends short-term loans to select banks and factoring companies in its countries of operations to fund trade-related advances to local companies for pre-shipment finance, post-shipment finance and other financing for foreign trade contracts and domestic and international factoring.

Market trends

The economies in EBRD countries of operation did not improve in 2017. Subdued economic activity will continue affecting international and domestic trade in these countries in 2018. In some countries, the economic challenges are combined with the lack of foreign direct investment and long-term funding. At the same time, foreign commercial banks are

often reluctant to establish trade finance facilities for smaller and regional TFP partner banks, due to the high capital requirements and the cost of compliance. As a result, TFP continues to play an important role, helping smaller and regional TFP partner banks grow their trade finance business to attract trade finance facilities from foreign commercial banks.

Achievements in 2017

The EBRD in 2017 TFP supported 1,905 trade finance transactions with a record volume of US\$2.3 billion, compared with 1,359 transactions totaling US\$1.9 billion in 2015. This increase was mostly due to a sustained demand for TFP support in the SEMED region. In most other regions, notably CIS and the western Balkans, local banks reported less demand for trade finance, due to slow economic growth, lack of investment



Case study Floating dock

A letter of credit, issued by the Bank of Cyprus and confirmed by ING Belgium, facilitated construction and delivery of a floating dock from Ukraine to Cyprus, helping Ukrainian exporters generate more export revenues and a Cypriot shipyard boost its production capacity. A standby letter of credit issued under the EBRD's Trade Facilitation Programme (TFP) covered 70% of the payment risk of Bank of Cyprus to ING Belgium.

for imported machinery and equipment, and the devaluation of local currencies. The programme has 95 active Issuing banks in EBRD countries of operation and over 800 confirming banks worldwide.

Market constraints

Issuing and confirming banks in countries with high country risk access say access to unsecured guarantee lines with long tenors remains limited. In Ukraine, most foreign commercial banks are still unwilling to do any unsecured trade finance activity. The most active confirming banks have reduced their country limits and tenor lengths. EBRD's TFP facilities supports trade flows and encourages confirming banks to maintain relationships with selected partner banks until their commercial trade finance limits are reinstated to suitable levels.

Affordability of trade finance

TFP carries out regular pricing reviews to reflect country risk issues, market pricing conditions, partner bank needs, including the competitive landscape in a country.

SMEs

SMEs made up an estimated 78% on the EBRD TFP's portfolio in 2017. The EBRD also continues to support the development of domestic and international factoring activities undertaken by banks and factoring companies. This initiative is important to build up supply chain finance options and boost trade activity in this market segment.

Risk sharing and default

The TFP recorded no defaults in 2017. But risk-sharing opportunities are continually explored to increase the additionality of the TFP. Through partnerships with commercial banks, private insurance underwriters, investment funds, governments, export credit and development agencies, EBRD can offer tenors and limits not otherwise available:

- at the framework level, the TFP is supported by private insurance underwriters

currently covering a portfolio of selected TFP facilities

- two risk-sharing funds covering selected areas of the portfolio from grants given by the governments of Austria, Germany (KfW), Norway and Switzerland provide partial cover on a first loss risk basis for transactions in selected countries
- at the facility level, AKA Bank Germany and the development agencies FMO Netherlands and the OPEC Fund for International Development (OFID) have taken an unfunded participation in TFP facilities for selected banks
- confirming banks are willing at times to take a percent of the issuing bank risk, so EBRD guarantees are issued for less than 100% of the face value of an underlying eligible instrument

Development impact

The primary objective of the TFP is to help make sure partner banks have trade finance credit lines in place so they can offer trade finance to their clients, regardless of the short-term considerations of commercial banks and their risk appetite. An EBRD survey showed 73% of partner banks say they need continuous TFP support for trade finance transactions that foreign commercial banks are unable or unwilling to finance. The survey also found 46% of partner banks (all small- and medium-sized banks) need the programme to support most or all of their trade finance transactions.

Promoting sustainable trade finance means improving know-how in partner banks and in the region. For new partner banks, the TFP provides technical assistance to raise skill levels, tailored to each partner bank. Once basic skills are mastered, training helps develop staff to work with more advanced products and sustain their position over time. 87% of the partner banks in the survey asked for courses to keep up to date with industry developments.

In May 2010, the TFP launched a trade finance e-learning programme in cooperation with the ICC and Coastline Solutions, to help issuing banks under the TFP achieve best international practice in trade finance. So far, more than 3,200 specialists from 267 organisations in 35 countries across eastern Europe, Central Asia and the southern and eastern Mediterranean have taken part. In 2017, the programme registered 839 new students from 22 countries.

Three-quarters of EBRD partner banks need trade finance support

Outlook

The EBRD expects smaller banks, banks in early transition countries and banks in countries with high country risk, like Ukraine, will need TFP facilities for most or all of their trade finance business for the foreseeable future.

► IDB Invest (a member of the Inter-American Development Bank (IDB) Group)

Value proposal and product mix

IDB Invest provides support to Latin American and Caribbean (LAC) banks to access international trade finance markets by offering technical assistance, and knowledge and financial products (guarantees and loans).

Market trends in 2017

As reported in IDB's Trade Trend Estimates, Latin America and the Caribbean (2018), after four years of contraction, total exports for the LAC region in 2017 rose an estimated 13%. The recovery was mainly driven by a boost in commodity prices, especially in South American countries. The value of exports grew in all sub-regions with only four countries undergoing a contraction. The recovery was underpinned by demand in all main trading partners, notably the US and China. The value of imports also rose, due to higher economic growth in some Latin American economies.

Latin American and Caribbean exports are growing again

Banks in Brazil, Guatemala and Argentina accounted for 68.4% of the total transaction volume in 2017 supported by IDB Invest trade guarantees and loans. Transactions carried out by banks in Ecuador, Panama and Honduras represented 18% of the volume, followed by banks in Nicaragua, Panama, Chile and Peru with 110.4%, and the rest was driven by banks in El Salvador, Costa Rica, the Dominican Republic and Bolivia. Of total transactions by volume, 77.2% were for inter-regional trade (LAC trading with other regions) and 22.8% were intra-LAC trade transactions.

Of total LAC exports supported by the TFFP, Brazil, Guatemala and Argentina shipped 77.3%.

Of the goods exported from LAC, 39.5% were agriproducts, 22.3% were manufactured goods and 18.3% processed foods. The main destinations of LAC goods were the US (16.1%), Switzerland (12.5%), Argentina (10%), China (7.8%), Germany (4.7%) and Chile (4.4%).

Major LAC buyers of imports were Guatemala (29.9%) followed by Argentina (19%), Ecuador (11.4%), Chile (4.9%), Nicaragua (4.3%), Honduras (4.3%) and Paraguay (3.9%). In terms of imports to the region, 25% came from Brazil, 21.5% from the US, 14.3% from China, followed by South Korea (7.2%), and Japan (5.6%). The main products imported were manufactured goods (40.2%), vehicles (23.9%), agricultural products (18.7%), processed food (7%) and oil and gas (3.3%).

Achievements in 2017

IDB Invest issued 99 guarantees and disbursed 69 loans under the Trade Finance Facilitation Program (TFFP) for US\$750.3 million. A total of 1,800 underlying trade finance transactions were supported with a face value of US\$ 929.8 million. Mobilized funds through 10 syndicated trade loans reached US\$179.5 million. Transactions and volumes were much higher in 2017 than the previous year, rising 42.4% and 22.9%, up in 2016 compared with 2015 (direct loans and guarantees only).

Market constraints

The supply of trade finance in LAC is limited by cost and the complexity of compliance to KYC, AML, and Basel III regulations, especially in countries with low sovereign ratings and in smaller economies, where many global banks have pulled out.

The Caribbean has been especially hard hit by this process of de-risking. The region is seen as less profitable, and compliance costs outpace revenues, so global banks have ended many of their correspondent banking relations, hurting competition and the availability of trade finance options.

The Caribbean has been hard hit by de-risking

What is more, many global banks are targeting only tier one banks in higher-rated economies. The limited risk appetite for some countries and institutions is

Case study

Ensuring a steady stream of trade finance



As de-risking continues to restrict the availability of trade finance in the LAC region, alternative and new sources of financing, and maintaining tenors, are more valuable than ever.

A TFFP syndicated loan was the solution for a bank in the Dominican Republic to access US\$130 million for financing a wide portfolio of underlying trade transactions for importing energy, vehicles, leather and wheat, among others.

IDB Invest teamed up with a well-known global bank that acted as lead arranger, and 14 B-lenders from the US, LAC, Asia and Europe participated, generating eight new relationships, and allowing the current correspondent banks to offer extended tenors. Through this syndicated loan, the TFFP helped ensure a steady supply of trade finance for the Dominican Republic bank and its import and export clients.

constraining the availability of trade finance sources for small banks in small economies. TFFP is a risk-mitigation instrument, providing credit guarantees covering commercial and political risks and reducing the costs of capital.

Affordability of trade finance

IDB Invest closely monitors the market prices charged by correspondent banks to regional banks in funded and unfunded trade finance transactions. In countries like Brazil, Peru or Argentina, the overall price level fell in 2017, due to high liquidity and competition to enter these markets. In most countries, prices have been stable, especially in countries of Central America with some exceptions, access to trade finance has become unaffordable due to a withdrawal of correspondent banks, which has damped competition and, due to the frequent requirement of cash as collateral.

SMEs

IDB Invest is developing new trade and supply chain finance solutions to more directly reach of end beneficiaries, including SMEs, beyond direct corporate lending. These include transactional trade finance products, such as receivables discounting, unfunded trade receivable commitments, and structured trade finance products, such as pre-export finance, warehouse finance, and inventory finance.

The development goal of these products is clear: unleash cash flow for working capital that is trapped in the supply chain, to allow companies, especially SMEs, to grow and create more jobs and to improve access to finance along the whole supply chain, which is especially crucial for SMEs.

IDB Invest in 2017 set up its first reverse factoring or accounts payable facilities in Mexico, through eFactor Diez's factoring platform. Unlike most commercial banks, which prefer to discount invoices of large suppliers seeking larger volumes, IDB Invest's

discount facilities focuses on SME suppliers of the manufacturing and telecommunications sectors.

Risk sharing and default

No defaults were reported since the programme's inception in 2005.

Development impact

The TFFP's measures its commitment to development impact with five indicators:

- percent of individual trade transactions supported for small and vulnerable economies (64% since the programme's inception)



Case study

Deepening intra-regional integration

Boosting regional cooperation in the LAC region for building infrastructure, and for social or environmental projects has an undeniable impact on development.

To allow an Ecuadorian company deliver its engineering services for a road construction in Bolivia, the issuance of a performance bond by a local bank was required. Since it had no credit relationship with banks in Bolivia, the company requested its bank in Ecuador to issue a counter-guarantee to its account. The TFFP supported this transaction by covering 100% of the risk the Bolivian bank assumed by accepting the counter-guarantee of an Ecuadorian Bank.

- volume of trade transactions processed for underlying small and medium enterprises (72% since the programme's inception)
- percentage of intraregional trade supported (22% since the programme's inception)
- amount of third-party trade funds mobilized through syndicated loans and co-loans (almost US\$1.5 billion since the programme's inception)

The TFFP also achieves development impact through training. Since 2015, TFFP held 11 face-to-face training sessions for 10 financial institutions in nine LAC countries. In 2018, IDB Invest will continue its training programme.

The TFFP signs bilateral agreements with partner financial institutions that share the same commitment to improving and expanding trade finance resources in the region. Last year, 12 new financial institutions joined the TFFP as confirming or participating banks.

To strengthen accountability, the TFFP measures development effectiveness and additionality for each TFFP credit line. IDB Invest gathers data on the trade finance activities of the banks in the region, and compares them to different aspects that affect the market of each country.

Outlook

IDB's Trade Trend Estimates, Latin America and the Caribbean 2018 gives the following outlook: the consolidation of the initial export recovery in the region depends on reversing certain factors of instability in the global economy.

Economic growth of the main buyers of LAC exports, oil and commodities supply and demand, and the outcome of the current negotiations on trade agreements as well as regional integration will have a tremendous impact on the region.

IDB Invest believes this is a new era for development finance.

Target markets and their end beneficiaries are evolving faster than ever, changing the way they work and the products and services they need. This is most evident in financial services and technology, which are changing exponentially fast. Blockchain is proving a secure, transparent and reliable alternative, and fintechs transacted US\$90 billion in the region last year, equivalent to the GDP of Panama.

To best operate in this fast-paced environment, IDB Invest will stay relevant by launching new trade finance products and services, such as supply chain finance. Since restructuring in 2015, IDB Invest combines the confidence and experience of the IDB with the flexibility, agility and client-focus that private-sector clients seek. IDB Invest will supply a wide range of products tailored to client needs and trade and supply chain finance solutions, focusing on the most vulnerable economies, small countries and islands.

► International Finance Corporation (IFC)

Value proposal and product mix

IFC Global Trade Finance Program (GTFP) is a global trade platform linking emerging market financial institutions with international banks to facilitate trade and create opportunities for emerging market corporates and for SMEs to participate in global value chains. The GTFP has supported US\$64 billion in trade over the last 13 years.

IFC has expanded its emerging market trade finance support with programmes such as the Global Trade Liquidity Program (GTLP) (funded/unfunded portfolio program), the Critical Commodities Finance Program (CCFP), the Global Warehouse Finance Program (GWFP), the Global Structured Trade Finance Program (GTST), the Working Capital Solutions Program, and the Global Trade Supplier Finance Program (GTSF). The collective supported amounts to US\$154 billion in emerging market trade since the programme was enlarged in 2010.

The GTFP mitigates risk by guaranteeing trade-related payment of obligations that currently covers 285 enrolled financial institutions in more than 85 countries. About 53% of the customers served by these financial institutions in 2017 were SMEs.

The programme provides up to 100% coverage on the country and commercial risks of individual trade-related instruments, including letters of credit (L/C), standby L/Cs, guarantees, bills of exchange, and promissory notes issued by emerging market banks. The GTFP expands the amount of trade finance available to emerging market banks and their customers, and often reduces the cost of getting credit. To date, over 57,000 transactions were guaranteed with no losses.

IFC maintains relationships with client banks in Afghanistan, Benin, Burkina Faso, Democratic

Republic of Congo, Cote d'Ivoire, Guinea Conakry, Lebanon, Liberia, Madagascar, Myanmar, Nepal, Papua New Guinea, Sierra Leone, Togo, Uganda and West Bank and Gaza. GTFP continues to grow, adding emerging market banks in Honduras, Guatemala, El Salvador, Nicaragua, Lebanon, Côte d'Ivoire, Ghana, and Tanzania, among others.

IFC delivers coordinated programmes that support global trade by helping stabilize and foster trade and commodity finance. IFC focuses on supporting trade, given its contribution to economic growth and stability and the availability of goods that countries and businesses (including SMEs) need to grow and, in some cases, to maintain basic economic function and survive.

For example, IFC supports trade in capital goods, energy and energy producing equipment, agricultural goods and raw materials for production. Goods include LED lights, solar components, medicines, diagnostic medical equipment and veterinary medications. In these countries, a large part of the transactions are bundled packages of import finance transactions, or L/Cs or standby L/Cs for capital goods. The underlying trade flow to SMEs cuts across a wide range of sectors, from consumer products, agriculture and forestry to textiles, apparel and leather to healthcare.

Market trends in 2017

IFC's banking clients in emerging markets most often report their biggest challenges in 2017 were ambiguous, various and costly compliance; and stress in correspondent bank relationships from transaction refusals, request processing speeds, reduced line limits, and limited alternatives. Banks from a broad range of developing countries report cutting customers, credit lines, products, and entire geographies.

Achievements in 2017

IFC's trade programmes supported transaction volume of about US\$13 billion. GTFP supported trade

transaction volume of about US\$ 6.7 billion globally.

The 2017 regional breakdown is as follows:

REGION	TRADE SUPPORTED (US\$MILLION)
East Asia and the Pacific	937
Europe and Central Asia	1,090
Latin America and the Caribbean	1,370
Middle East and North Africa	1,163
South Asia	885
Sub-Saharan Africa	1,206
Total	6,651

In Europe, with the rebound in exports, as well as demand for country coverage in Turkey, GTFP expanded coverage in Turkey and Greece to assist a need for greater support. GTFP supported US\$1.1 billion in Europe and Central Asia.

In the Middle East, long tenors and access to reasonably priced finance remain a challenge, especially for SMEs. In 2017, GTFP supported US\$1.2 billion of trade finance in the region. For example, in Pakistan GTFP provided tenors up to three years for select lines, expanding the market's ability to import capital equipment, which is essential for growth and for upgrading production facilities. This helped boost productivity of the private sector.

The trade finance gap is still widening

In Latin America and the Caribbean, in Brazil demand remains high and Central America had a greater need for external funds to finance SME importers and exporters. This is because a relatively higher country risk left the sub-region vulnerable to global de-risking, especially the Caribbean. To support continued growth in the region, IFC provided over US\$1.4 billion.

Case study

Boosting power supply in Bangladesh



The per capita energy consumption in Bangladesh is one of the lowest (371 kWh) in the world. Only about 75% of the population has access to electricity. The country needs a yearly growth of 10% in power generation to sustain its economic growth of around 7%. More than 70% of the country's population live in rural areas where traditional energy sources such as wood are the main energy sources. Only about 40% rural household have access to grid electricity.

IFC GTFP's support for import transactions adds 500 MW of power for people living in rural areas. GTFP supported the import of power generating equipment in Bangladesh by confirming and discounting L/Cs issued by client banks. Due to the longer tenor and the larger amount, it was difficult for IFC's client banks to have access to correspondent banks willing to confirm and discount documentary L/Cs because of the current de-risking environment.

The deal supported five power plants in Bangladesh, strengthening the Bangladesh government's aim to narrow the gap between the supply and demand of electricity.

The outlook for 2018 is continued strong demand, with economic growth foreseen in Guatemala, Costa Rica, Nicaragua and El Salvador.

In sub-Saharan Africa, in 2017 IFC supported US\$1.2 billion, as upticks in oil prices and increased correspondent banking pressure threatened to widen the estimated US\$120 billion trade finance gap on the continent.

In Asia, GTFP booked over US\$1.8 billion with a focus on SMEs. Most of these efforts supported imports of capital goods, agricultural and energy products, supporting economic and business growth and stability.

As demand for international banking and trade finance continues to rise in Asia, the challenge remains adequate supply for businesses and economies to grow in the short term.

IFC promotes Climate Smart Trade Initiative (CSTI) on climate change and environmental and social sustainability, one of five pillars of IFC's corporate strategy.

In 2017, IFC carried out these climate smart trade transactions:

- imports of equipment for geothermal, hydroelectric and solar power projects in El Salvador, Georgia and Honduras
- guarantees for construction of solar power farms in Bangladesh, India and Vietnam
- facilitation of pre-export and import financing for trade in ethanol in Brazil and recycled steel in Turkey

IFC will boost its support of equipment imports to emerging markets and expand its outreach to longer tenor equipment trade transactions.

Market constraints

Correspondent banking pressure is challenging, especially for smaller financial institutions in frontier markets or for small economies. Many countries in emerging

markets have been hurt by the closing of correspondent accounts by leading international and regional trade finance banks.

According to IFC's survey in September 2017, De-Risking and Other Challenges in the Emerging Market Financial Sector, over a quarter of more than 300 banks in 90 emerging markets reported correspondent bank relationship losses. At the same time, 72% report challenges that reduce their provision of services. This immediately lowers capacity to import, to support business growth and to buy goods necessary for basic economic function and family survival. Other challenges cited include government policies, political unrest and uncertainty.

Affordability of trade finance

Before the global financial crisis, the gap between trade finance demand and supply was already wide, especially in countries getting assistance from the International Development Association. This gap has widened, hampering trade and pushing up prices. Importers in these countries have been severely affected, with less chance to access to trade finance.

SMEs

GTFP targets SME transactions though SME reach data. For example, in the Dominican Republic and El Salvador, around 90% of trade finance transactions support SMEs in agriculture, oil and gas, manufacturing, health and education.

Risk sharing and default

No losses have been reported under GTFP since its inception in 2005.

Development impact

GTFP's emerging market banking network provided an estimated US\$270.0 billion of trade finance and helped about 85,000 SMEs. It comprises a network of 285 emerging market financial institutions and a network of 1,400 correspondent banks including branches. Through 57,000

transactions, GTFP executed more than US\$64 billion in trade, which promoted trade in emerging markets in 85 countries.

GTFP's advisory services help improve the capacity of banks in emerging markets to execute and grow trade finance practices, so that when they connect to banks across borders they do so with a high degree of competence.

In 2017 a training programme in Nicaragua had participants from Nicaragua, Honduras, Peru, Panama and El Salvador. The training provided practical and operational trade finance training, covering marketing and sales of trade products, and trade finance strategy. The training in Myanmar gave an overview of standard international practices tailored to local regulations. The training also covered standard documentary products, such as collections, L/Cs and bank guarantees, as well as end-to-end supply chain financing for commodity flows.

Outlook

There is great potential to support growth in trade and trade finance across all regions. Near-term challenges include rising demand for oil, gas, and food. There is also a need for infrastructure, so a corresponding need to fund equipment flow through long tenor transactions.

There is also potential for new markets. Trade finance may be vulnerable to challenges, as seen in the pressure on correspondent banks and from de-risking, even though it remains a low risk asset class.

New facilities envisioned would support emerging market trade flows of agricultural goods, and critical energy needs in markets where needs are growing to meet local demand, production, consumption, and for financing.

› International Islamic Trade Finance Corporation (ITFC)

Value proposal and product mix

ITFC is a leading provider of trade solutions to achieve the sustainable development of Organization of Islamic Cooperation (OIC) countries. The ITFC provides direct financing to partner banks, institutions, governments and the private sector through Sharia-compliant products including pre-export financing.

Market trends in 2017

The economies of OIC member countries were affected by falling commodity prices in 2017, with overall GDP growth of 3.2%, slightly below the world average of 3.7%. Due to weak global demand, falling commodity prices, especially for oil, and an appreciating US dollar, OIC exports fell by 13.5% in 2016 to US\$1.4trillion. Trade balances and

current accounts got slightly better in OIC countries in 2017.

The top five OIC exporting member countries, the United Arab Emirates, Malaysia, Saudi Arabia, Indonesia, and Turkey, accounted for about two-thirds of intra-OIC exports in 2017. OIC imports from the rest of the world stabilized around US\$1.6 trillion. Intra-OIC imports remained modest with less than US\$300 billion in 2017, dropping from US\$350 billion in 2015. The top five intra-OIC importing countries, United Arab Emirates, Turkey, Malaysia, Saudi Arabia, and Indonesia, made up about 40% of all intra-OIC imports in 2017.

Achievements in 2017

Despite a difficult economic environment in 2017, ITFC did remarkably well. Although the economies of OIC member countries were expected to grow 3.9%, many continued to face

challenges. ITFC allocated 35% of its trade finance approvals to least developed member countries, and 88% for facilitating trade between OIC member countries.

Trade finance approvals were up by 10% in 2017 to US\$4.9 billion, from US\$4.4 billion in 2016, reflecting a modest improvement in the economy. Some member countries from sub-Saharan Africa and the CIS continued to suffer the lingering impact of low commodity prices from the two previous years and from foreign currency shortages.

Sovereign exposure continued to comprise most of the portfolio -80% of the total. ITFC's sovereign exposure is for large sovereign deals to finance the energy and agriculture sectors, mainly extended under strategic framework agreements signed with member countries, in line with their national development priorities.

A breakdown of the portfolio by security type is provided in the table.

ITFC TRADE APPROVALS BY SECURITY (US\$ MILLION)				
security	2016 actual	%	2017 actual	%
sovereign	3,064	69	3,930	80
bank guarantee	997	22	510	10
unsecured lending	-	-	159	3
STF	334	8	216	4.5
credit insurance	50	1	85	1.5
total	4,445		4,900	

A breakdown of the trade finance approvals by region is provided in the table below.

ITFC TRADE APPROVALS BY REGION (US\$ MILLION)				
region	2016 actual	%	2017 actual	%
Asia/CIS	2,166	48	2,402	49%
MENA	1,552	35	1,673	34%
sub-Saharan Africa	760	17	826	17%
total approvals	4,478	100	4,900	100
total disbursements	4,801		3,435	

In 2017, ITFC focused on partnerships with Africa. Some of these partnerships were with the African Development Bank (AfDB) and the African Export Import Bank (Afreximbank). The IDB Group renewed its partnership agreement

with the AfDB. Trade finance and trade development and a pipeline of joint interventions were part of the agreement.

ITFC took advantage of the signature of partnership agreements between the Islamic

Development Bank Group (IsDB) and development partners like the Asian Development Bank (ADB) and the Inter-American Development Bank (IaDB), to advance the agenda of international trade. This was done through the

inclusion of trade finance and trade development in the agreements, along with initiatives and joint work plans.

ITFC also strengthened its partnership with the International Finance Corporation (IFC), signing a partnership letter of intent last July, to work together on climate finance, sustainable trade, global value chains (GVCs), energy security and agriculture sector export.

ITFC continued its shift from a transaction-based model of trade support to a programme-based approach, where trade finance operations are integrated with trade development and capacity building to boost development impact.

Examples include:

- the Indonesian Coffee Export Development programme
- an initiative to support cotton producers in West Africa
- the Arab Africa Trade Bridges (AATB) programme
- the Aid for Trade Initiative for Arab States (AfTIAS)

ITFC focused on sectors with a large impact on economic and social development, notably energy and agriculture. ITFC extended trade financing facilities to support these sectors in member countries, reaching US\$3.79 billion for energy and US\$439.0 million for agriculture.

Market constraints

Despite the strengthening global recovery, OIC member countries are still adjusting to lower oil prices, commodity price fluctuations and unrest and conflict, which are denting foreign currency reserves. The supply of financing, including trade finance, is being hurt. For oil-exporting countries, spillovers from low oil prices and lower tax collection continue to weigh on non-oil growth, while overall growth is held down by the Organization of the Petroleum Exporting Countries (OPEC) led

agreement to cut oil production. For oil importers, economic growth is projected to increase, supported by strengthening domestic demand and cyclical recovery of the global economy.

Affordability of trade finance

ITFC financing is competitive: 100% of operations are funded and no guaranties are issued. Moody's assigned to ITFC a long-term issuer rating of A1 with a stable outlook.

The Islamic Development Bank has a AAA rating from the three main ratings agencies. These ratings will enable ITFC to get better access to borrowing in external markets at attractive rates. Moody's also assigned a short-term issuer rating of P-1, which reflects ITFC's strong capital position, moderate leveraging, prudent treasury investment and liquidity management.

SMEs

Assisting international trade so OIC countries develop sustainably is only possible if SMEs are included. ITFC developed a global programme to tackle the challenges facing SMEs in global value chains.

The programme is designed around three interventions:

- access to finance
- capacity building
- technical assistance

ITFC launched its first pilot programme for Saudi Arabia and a second will focus on west African SMEs.

ITFC provides trade solutions to SMEs through partnerships with local financial institutions by extending lines of financing. To reach a larger number of SMEs in OIC countries, ITFC provides Murabaha financing to local financial institutions which, in turn, extend the financing to SMEs and private sector clients. This improves access to finance and also introduces Islamic Finance instruments to partner banks.

Considering the role of the private sector, especially SMEs in development, ITFC provided two-step Murabaha financing (2SMF) and lines of financing to banks totaling US\$664 million.

Risk sharing and default

ITFC and the African Export-Import Bank (Afreximbank) signed a US\$100 million and a EUR 50million agreement to facilitate and finance exports among African countries and between Africa and the rest of the world. The facilities support procurement from suppliers in member and non-member countries, including for local purchase, and to promote trade across Africa.

This partnership is part of ITFC's commitment to support development of exports from African member countries as an important lever for sustainable growth, job creation and poverty reduction. It will finance African OIC member countries under the Arab-Africa Trade Bridges programme, a regional initiative for the challenges faced in promoting trade between the two regions and for supporting South-South cooperation.

Development impact

The trade and business development department (T&BD) was created in Q3 2017 under the new 10-year strategy for ITFC to become the leading provider of trade solutions for OIC member countries.

ITFC advances policies to advocate for the adoption and implementation of policy options to achieve the Sustainable Development Goals (SDGs) and more inclusive international trade. Climate change and climate action was an important policy theme in 2017. ITFC is developing its understanding to leverage on its expertise in order to design climate trade finance solutions and integrated programs, and to tap climate funds for mobilizing resources. After publishing a brief report on international trade and

climate change for the COP22, ITFC organized a panel discussion on trade, transport and climate change on the sidelines of the COP23.

The first Islamic-finance compatible, sovereign fund launches in 2018

Case study

Supporting cotton farmers in Burkina Faso



Cotton is a major export and an important source of revenue for Burkina Faso, which gives work to millions of people in rural areas. The cotton industry also has indirect impacts on transport, warehousing and banking, and contributes to overall economic development and poverty reduction.

ITFC is a strategic partner for developing Burkina Faso's cotton sector. To extend direct support to farmers, ITFC purchased seed cotton from local farmers and cooperatives, which is delivered to Sofitex facilities for processing into cotton fiber. ITFC raised EUR107 million, well above the initial objective of EUR100 million to fund the project.

The structure of the operation is unique, combining sovereign backing with an enhanced security package to create a self-liquidating financing structure.

Outlook

ITFC will expand its trade finance activities and rapidly expand private sector and SMEs financing. Resources will be mobilized, and policy engagement and partnerships will be reinforced in cooperation with development partners, including the private sector, NGOs and academia, to unleash the international trade potential of OIC countries.

ITFC will soon launch fund management activities, and will structure and manage by Q3 2018 the first Islamic finance-compatible sovereign energy fund between US\$300 million and US\$500 million. The fund is part of ITFC's diversification strategy and innovation focus.

At the same time, the fund will contribute to energy security in OIC countries, and generate income for ITFC from a new business line.

By offering an uncorrelated and diversified portfolio of trade finance solutions in a single offering, ITFC will strengthen and enlarge its base of investors. This is aligned with efforts to diversify partnerships and comes at a crucial time to reinvigorate economic growth. It will especially help importing member countries reduce their vulnerability to energy market fluctuations.



4



REGULATION AND COMPLIANCE

The time is ripe in this period of economic growth and stability to revisit the way trade finance is regulated. What is more, a new way forward on regulations could free up massive capital to fund the UN's Sustainable Development Goals.

Anti-money laundering rules have been a big impediment to securing trade finance, banks say. But blockchain and Robotic Process Automation may be of help.

Basel IV rules on bank capital requirements go into effect in 2022, but the effects will be felt much sooner. Will the new rules get rid of the obstacles that have damped the market for trade finance?

Billion-dollar fines and tightening regulations have done little to stop bad corporate behaviour. It's time to test a new way.

Another area in need of a reboot is risk-based compliance, so that efforts are more effectively mobilized to monitor and research only the tiny number of cases that merit closer scrutiny.

Setting the scene/ Sir Michael Rake, CEO, Worldpay

It is important that the public and interested parties understand that a more proportional regulatory regime for trade finance will boost economic growth and not backtrack on the hard-won safeguards put in place to prevent another financial crisis. [Pages 111-112 >](#)

Making trade finance attractive investments/What it would take

Remedies exist to make trade finance really catch on as an investment, put forth here.

[Pages 113-116 >](#)

Trends in trade finance regulation/ Dealing better with anti-money laundering

There are three new methods to more efficiently deal with all the new regulations on money laundering, terrorist financing and sanctions. [Pages 117-118 >](#)

Risk-based regulatory compliance/ Back to basics for better surveillance

As regulations get ever stricter, increasing time and resources required, organisations can get more efficient in pinpointing which cases to pursue, by following these actions.

[Pages 119-122 >](#)

Basel IV/ Will new rules help or harm the market for trade finance?

A decade since the onset of the global financial crisis, when overleveraged banks tipped the world into the deepest recession since the Great Depression, the Basel Committee on Banking Supervision (BCBS), an international regulatory forum that includes central bank supervisors, has revised standards to the Basel III accord on bank capital requirements. [Pages 123-124 >](#)

Regulating business/ The two pillars of ethical regulation

Two of the world's experts on ethical regulation spell out the state of play in curbing corporate malfeasance and offer a new way forward. [Pages 125-126 >](#)

Setting the scene/ A more proportional regulatory regime on trade finance will lift economic growth

By Sir Michael Rake

Sir Michael Rake is chairman of Worldpay – a global leader in payments processing technology – former deputy chairman of Barclays and chairman of ICC United Kingdom.

It is important that the public and interested parties understand that a more proportional regulatory regime for trade finance will boost economic growth and not backtrack on the hard-won safeguards put in place to prevent another financial crisis.



It is now beyond doubt that we face some real and significant challenges to free trade from populism and nationalism. Recent developments in relation to Brexit and the Trump administration, including the intent to introduce tariffs on a unilateral basis underline the threat to the global economy at a time when underlying growth is beginning to pick up across the world. So we need to do everything we can now to stimulate growth. In need of special attention are SMEs in emerging markets, which were hit hard by the global credit crunch, and are still hamstrung in their need for trade finance.

Trade finance is an obvious place for policymakers to start, by finding a way to bridge the US\$1.5 trillion gap in trade finance estimated by the Asian Development Bank, as a way to finance the United Nations 2030 Sustainable Development Goals (SDGs).

Bridging the trade finance gap would help fund realisation of the Sustainable Development Goals

It has never made sense to regulate low-risk trade finance the same

way as higher-risk investment finance. What is more, trade finance provides valuable short-term working capital for SMEs and plays a critical role in financing export opportunities.

During this decade, ICC's Trade Finance Survey and Trade Register have also provided evidence of the scale of the finance gap and shown how trade finance is low risk.

As a result, the world's policymakers are in a much better position to make informed decisions on setting out a more proportionate regulatory regime for trade finance.

The result of the regulatory regime is that fewer SMEs and mid-size businesses are able to access trade finance to grow their businesses, and fewer banks in emerging markets are able to access capital markets, such as London.

Policies to drive economic growth are needed, since global GDP is still low compared to before the global financial crisis started in 2008.

Global GDP is still below levels the Great Recession

A more proportionate regulatory regime would help achieve this goal by releasing day-to-day working capital for trading companies.

Regulatory oversight is critical to the overall health and stability of the financial system, but it has become clear that some of the requirements have albeit indirectly hampered access to finance for businesses.

Policies to address access to trade finance are urgent. Relaxing the rules on low-risk trade finance will not shift the focus away from financial stability.

Diverging priorities

Part of the problem is that national and international policy priorities on trade finance do not add up. While politicians still make SMEs and trade a top priority, regulators still favour stability over growth.

It is understandable that the public has little desire to ease regulation on banks. But the public and policymakers need a more sophisticated understanding of the finance companies need, and the companies that benefit.

There are two reasons why trade finance should be regulated differently than other forms of finance.

The first has already been touched on, but it bears repeating trade finance is low risk.

Second, in a globalised economy, supply chains are integrated and span multiple markets, across

the developed and emerging regions. Trade is a driver of global prosperity, and trade finance a building block to keeping trade flowing.

To arrive at a more proportionate regulatory regime for trade finance, a wider audience must be better educated and informed: that includes entrepreneurs, SMEs, politicians and regulators. Many of these groups share common interests, such as raising access to finance. But they are not aware how related issues interconnect.

For example, UN policymakers understand financial regulations are a barrier to unlocking the US\$8 trillion of long-term investment finance needed to deliver the SDGs.

But the role of short-term trade finance in unleashing sustainable growth, another UN development goal, is less well understood.

Above all, SMEs need short-term working capital to grow and expand in emerging markets, which creates much-needed jobs in many parts of the world, and helps make the case for free trade.

These are all UN priorities.

More dialogue, wider debate

To better support SME growth, the UN, the G20, the IMF and the World Bank, and governments and regulators must engage more deeply with each other on trade finance. We should also support the UN's review of the trade finance gap as instigated by the ICC.

Rightly or wrongly, the public, especially in G7 countries, mostly see banks and businesses as the reason standards of living have stagnated over the past 10 years. This perception needs to be challenged, and a wider debate launched so they public is better informed of the root causes and solutions.



Making trade finance attractive investments/What it would take

By Krishnan Ramadurai and Surath Sengupta

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Remedies exist to make trade finance really catch on as an investment, put forth here.

The presentation of this issue with both a demand-side and a supply-side perspective, combined with consideration of the cyclical nature of the trade finance origination-and distribution model, presents this topic in a uniquely holistic manner.

Global capital stocks are at pre-crisis levels

Demand side factors

Global capital stocks and investable assets have regained levels of pre-crisis « normal » and by some measures, have exceeded those levels, creating a scenario where investment managers seek attractive options across the spectrum of investment options. This includes alternatives designed to preserve capital whilst generating some level of adequate return: a combination of attributes most common to bond and fixed income alternatives.

Low to Negative yields

Over recent years, due to low, and at times negative yields on government and corporate bonds, there has been an increase in demand from investors for alternative investment opportunities where they can assure capital security and make a positive return.

Diminishing supply of short-term investment grade debt instruments

With interest rates at record lows, many high quality or investment grade borrowers have taken the opportunity to extend their debt – locking in low interest rates for the longest tenor they can achieve. As a result, the short-term debt market is currently characterised by many sub-investment grade corporates and high yield borrowers. Consequently, there is unsatisfied demand for investment grade non-financial assets.

Corporate cash balances at record highs

Taxation policies combined with a reluctance to invest surplus cash have led to a build-up of cash

balances. These balances need to earn a return – and investors' preference is for short-tenor assets. Note, despite recent changes to US tax policies, this still remains valid as these cash surpluses need to be reinvested.

Fixed rate vs. floating rate assets

There is currently a preponderance of fixed rate bonds in the market, compared to floating rate assets. While the numbers are hard to come by, the imbalance in the supply of floating rate assets creates an issue, particularly against the backdrop of a rising interest rate environment. As the interest rate cycle continues to turn upwards, investors in fixed rate assets are likely to earn commensurately less attractive returns. As such, a rebalancing of portfolios is required to minimise these adverse outcomes, increasing demand for floating rate assets.

Supply side factors

While opinions differ among providers of trade finance and supply chain finance, there is some degree of consensus around the existence of a material level of global unmet demand for trade finance. This gap, estimated at US\$1.6 trillion annually by the Asian Development Bank, is one that the banking sector is unlikely to be able to meet, given credit appetite risk and balance sheet constraints. Certain market leaders acknowledge the need to attract non-bank capital to the financing of international commerce, including through the distribution of trade finance assets which allows banks to underwrite additional business.

Trade finance assets are primarily a buy-to-hold asset class

Banks are major players in this market, financing approximately 35-40% of global merchandise trade. Given a bank's traditional focus on relationship banking and the financing of the working capital cycle of corporates, banks have commonly chosen to keep these assets on their balance sheets. While an "originate –and distribute"

model is observable in the market, certain leading banks have little incentive to sell these assets if the overall relationship is profitable. As a result, there is a short supply of high quality trade finance assets available for capital market investors.

Continuing compliance and capital adequacy pressures coupled with a systemic conservatism about cross-border risk may contribute to a shift in this dynamic and a related increase in available assets world-wide.

There is a short supply of high quality trade finance assets available for capital market investors

Transparency from a product and pricing perspective

It is difficult to disentangle trade finance from a product and pricing perspective due to its integrated nature in a company's working capital cycle. A classic illustration is the fact that a supply chain loan on due date will be made good by debiting the overdraft account, which is also used to fund other working capital expenses. Structured limits gives customers the flexibility they want from an operational and pricing perspective and banks flexibility in terms of structuring, pricing and credit risk appetite. Capital market investors need absolute transparency from a product and pricing perspective. As such, investor due diligence is required to overcome these issues – a costly proposition for capital market investors.

Lack of standardisation of trade products

Given the broad suite of trade and working capital products made available by banks and the bespoke nature of trade transactions, it is difficult to achieve full standardisation of products, and associated legal documentation. Capital market investors need

standard definitions and legal documents as it aids transparency and helps with the assessment of underlying risks.

The collapse of Asset-backed commercial paper

Before the credit crisis, receivables in particular non-recourse receivables were often placed as collateral with conduits, which in turn issued short-term commercial paper to capital market investors. The commercial paper issued was often backed by back-stop liquidity lines from commercial banks which enabled the Asset Backed Commercial Paper (ABCP) to get a AAA rating. This market has never recovered and these conduits no longer receive the AAA rating which was crucial to their success. The revival of the ABCP market, albeit with lower external ratings, is a potential option for receivable finance and in particular non-recourse receivables.

The current state of play for trade finance assets

The market for the sale of trade finance assets has long been a business with relationships, preferred partners, manual intervention and little in the way of automation, underlying algorithmic logic or even consistent practice (contracting, standards and otherwise) across jurisdictions. The distribution of assets has largely been inter-bank, partly due to the limited awareness in capital markets, about trade finance and the assets that result from trade financing activity.

Much of the activity in trade asset distribution today focuses on traditional trade finance: long-established instruments such as Documentary Letters of Credit and others, largely ignoring the now fast-growing Supply Chain Finance space, which addresses the 80% or so of trade conducted on open account terms.

A bilateral bank-to-bank market

Banks are the predominant players in this market though a small

number of transactions may be sold down to insurance companies with specialist knowledge of this asset class. The focus of the markets is on traditional trade products like confirmation and discounting of export letters of credit (L/C) and the syndication of guarantees which are sold down by the originating bank to other banks on a transaction by transaction basis. Standard documentation in the form of a Master Risk Participation Agreement (MRPA) are used as the legal documentation to facilitate these sell-downs.

The market has evolved primarily based on correspondent banking networks and the relationships established by this network. Risk transfer transactions, where the original exposure is retained by the originating bank and only the risk is transferred, is a feature of this market. It should be noted, however, that the market for risk transfer transactions is limited by legacy booking systems; and there is potential to grow this market in its current form if banks can address legacy system issues.

Private capital markets

This is a niche market, where a select few asset managers have built the skill set and made the requisite investments in resources and systems required to invest in trade assets. As the risk-return pay-off for these asset managers has been excellent and there is a competitive advantage in keeping this a private market as public markets would need greater transparency, which in return can erode returns currently being achieved. There is very little incentive for existing players to develop public capital markets given the direct impact it would have on their returns.

Securitisation of trade assets

To date there have been a select few transactions where the major driver has been the optimisation of capital. The underlying economics of using securitisation as an alternative funding instrument is challenging, hence the limited use of securitisation as a funding

tool. Unless the return challenges presented by these transactions can be addressed, there is limited potential to use securitisation as a funding tool.

Creating/Promoting Trade Finance as an Asset Class

Expand sell down of trade portfolios to supply chain and receivable finance

The first issue identified is the need to find a capital markets solution for receivable finance and supply chain loans. This can be expanded to include export/import loans. Our analysis indicates that while bilateral sell downs work well for L/Cs and Guarantees, in the trade loans space there is limited potential for bilateral deals, given the unique characteristics of these transactions.

A capital markets solution is needed for supply chain loans

Portfolio based approach

The trade loans space lends itself to a portfolio based approach. However, to make a portfolio based approach work, the following issues need to be addressed:

Standardisation of product definitions, structures and legal documentation

This is required to provide certainty and transparency to investors and to facilitate the benchmarking of returns against other investable asset classes. A good starting point for this is the work done by the International Chamber of Commerce (ICC) and the Bankers Association for Finance and Trade (BAFT) in defining the various trade products. From a legal documentation perspective the MRPA structure described above is a good starting point. The use of standard legal documentation for loans as defined by the Loan Management Association (LMA) is another useful reference point.

Transparency – As capital markets investors require transparency and

the ability to benchmark prices, a potential solution is to put large value syndicated transactions on Bloomberg so that transaction pricing and structures are available to capital markets investors. We see this as a key issue in the development of trade assets as an investable asset class.

Large syndicated transactions could be put on Bloomberg

Prior to the peak of the global financial crisis around 2009, trade finance was largely an esoteric and unknown branch of finance, with practitioners maintain a degree of opacity around the business that is no longer sustainable given the attention around this business over the last decade. Public and international policy, academic and international institution research, the attraction of FinTechs to this business, all combine to drive greater visibility, understanding and transparency around trade financing.

Credit process – To make the portfolio approach a success, in particular for supply chain and receivable finance loans, the need for an external rating is critical, as capital market investors need a benchmark to compare risk returns for trade assets with other asset classes to justify internal mandates and investment decisions.

Operational process – Both supply chain and receivable finance sell downs will be operationally intensive. Individual invoice values can vary from small to large and programs can involve thousands of separate invoices. Investors may deem it necessary to undertake detailed analysis of SCF program participants, including potentially hundreds of suppliers or more who could be invited to participate in a global payables finance program. A potential solution to address the issue of invoice volumes is to examine the use of a custodian to dematerialise the underlying

invoices and to issue a single capital market instrument with an ISIN number which would help in provide transparency and aid the development of a secondary market for these instruments. An alternative would be the use of lending certificates as a means for banks to sell down these portfolios to other banks, insurance companies and asset managers.

Regulatory and compliance requirements on prospective investors may reduce uptake of trade finance assets, or, solutions involving regulatory advocacy may assist – for example, reducing the standard of due diligence required of investors, given that a significant amount of due diligence would have been completed by banks prior to financing trade activity.

Other potential methods by which a capital market for trade assets could be developed are outlined below:

Revival of the Asset Backed Commercial Paper (ABCP) market

The revival of the ABCP structure, with an external rating, which now tends to be capped at the level of the counterparty's external rating, is an alternative way of funding a portfolio of loans. The issuing bank could use the external rating as a means of optimising its capital even if it chose to fund the portfolio from internal sources of funding.

Risk transfer of portfolios

Transferring risk to external investors while retaining the original exposures on the originating banks books is an alternative way of selling down exposures. Currently, bank legacy systems are the major road block to implementing this solution. Addressing legacy IT issues and the legal documentation required to transfer risk is a potential solution.

Market place and exchanges

As trade related capital market transactions and structures evolve and achieve scale we expect the final stage of this evolution to be a market place or exchange where trade based assets can be placed by sellers for buyers to purchase at

prices which are transparent to all market players. These market places or exchanges would also create a vibrant secondary market for these transactions and provide the liquidity needed by capital market investors.

Implications for making trade finance an investable asset class

Implications for the banking industry

For trade finance assets to become a more investable asset class, banks will need to originate assets on a continuous basis, to ensure that there is a consistent pipeline to satisfy demand for these assets from capital markets investors. Origination will also need to ensure that assets originated are transferable to capital markets thus structuring, legal documentation and pricing will need to change.

Banks will need to originate assets on a continuous basis

From an accounting perspective, banks may need to adopt a mark-to-market approach which will bring additional volatility to the profit and loss accounts of banks. The flipside is increased price discovery which is currently opaque because of the buy-to-hold approach.

Mindset and cultural changes within banks is also required as the current set of banks are more familiar with bilateral transaction based transfer of assets between each other.

Implications for non-bank players

The development of trade as an investable asset class is a boon for these players as it is not currently a mainstream asset class. The market for trade finance assets is a niche market, dominated by a select few players. As this market develops and more players enter the market capacity is likely to increase and there is potential for the current unmet demand for trade finance to be met.

Trends in trade finance regulation/ Dealing better with anti-money laundering

By Ivan Zasarsky

Ivan Zasarsky is a partner, Asia Pacific Financial Crime Strategy & Response Center at Deloitte

There are three new methods to more efficiently deal with all the new regulations on money laundering, terrorist financing and sanctions.

When ancient mariners sailed the seas in search of trade, they only had to worry about storms, scurvy and the figment of sea monsters.

Fast forward to 2018, and the list of a mariner's worries is much longer, and lengthening every year.

Twenty-first century container ships may be sturdier than the galleys

of old, but modern trade faces a grave threat - from criminals' intent on moving illicit funds around the globe.

To deal with the risks of money laundering, terrorist financing and violating international sanctions, a life raft of legislation has been created. But with each barrier erected, criminals are inventing new

ways to slip through the net of new rules.

Trade-based financial crime is one of the new techniques criminals are using. By harnessing the mechanisms of trade finance, and exploiting the blind spots in international cargo freight, criminals are able to work around the law.

Criminals are using trade finance mechanisms and exploiting the blind spots in cargo freight

Typically, criminals collude with overseas partners to under- or overcharge on invoices, transferring value by selling goods on the cheap, or getting extra funds under the guise of legitimate transactions.

It may be fairly straightforward for a customs agent to check the weight or number of items in a shipment, but gauging the true value can be more complex. This is really hard when abstract concepts or judgments are involved. The price of iron ore is easy to find online, but how much is a custom-designed engineering component worth, or a work of art? Of 220 jurisdictions worldwide, only 35 have specific anti money laundering (AML) rules for art and antiquities.

In the eye of the storm

So it comes as no surprise that some banks are having second thoughts about engaging in trade finance. More than 90% of respondents to the 2016 ICC Global Trade and Finance Survey identified AML regulation as a “significant impediment” to trade finance, up from 81% the year before.

Given the toll criminal networks and global terrorism are taking on the global economy, few would argue against tighter AML regulation. But the recent spate of legislation – not only AML, but also new sanctions against Russia and North Korea – are a huge burden on the financial institutions that keep world trade flowing.

Restricting trade finance really damages SMEs and legitimate businesses in developing countries.

For example, Africa has the world’s fastest growing population, but its newly established importers

and exporters, that connect the continent’s young economies with foreign markets, struggle to navigate a banking system that understandably hesitates to finance their operations.

Faced with these challenges, less-established traders may seek alternative ways to transfer funds. The rise of bitcoin, a digital currency, and other cryptocurrencies poses risks. But with limited options, traders may be tempted to bypass the banking system and transact online, with no questions asked. While cryptocurrencies create new opportunities, the emerging world of virtual fiat money brings new challenges for governments and regulators.

Inexperienced traders may be tempted to bypass the banking system

As standards are raised ever higher for AML and Counter Terrorist Financing (CTF) events on information security, few would relish transactions moving out of their enforceable jurisdiction to roam freely in the dark web.

Two solutions at hand

In the right hands blockchain technologies and cryptocurrency offer solutions to some of these threats to trade finance. More traceable funds would boost transparency in the banking system and improve KYC operations in financial institutions.

Evolving technology could aid data analytics, giving more power to regulators and banks to trace proceeds and evaluate trade in goods and services.

Compliance teams can research freight arrangements, customers and correspondent banks. But it takes time and manpower. Robotic Process Automation (RPA) uses software to replicate human tasks, at a fraction of the time and cost.

If technology offers a more lucrative platform to provide trade finance, then more institutions will enter the market. More competition and improved know-how will only benefit consumers.

To realise the possibilities of this technology, banks and regulators, shipping agents, ports and customs, and many other links in the chain of international trade must cooperate more.

But as things stand, banks are focused on knowing their own customers, with only limited knowledge of counterparties and onward customers. Likewise, more accountability must rest with other members of the industry that support international trade such as shipping agents, insurers etc, all of which have visibility into the various parties and can detect suspicious matter earlier than banks.

Banks have limited knowledge of counterparts and onward customers

But with shared KYC registries, collaborative pricing data, and a clearer picture of cargo movements and whereabouts, including ships transferring goods at sea, the industry can take advantage of new technologies and help make sure trade thrives and grows in the 21st century and beyond.

Shared KYC registries, and collaborative pricing data are a way forward

In coming years, the threat from trade-based, financial crime may well become as far-fetched as the spectre of sea monsters.

Risk-based regulatory compliance/Back to basics for better surveillance

By Eric A Sohn

Eric A Sohn is Director of Business Product at Dow Jones Risk & Compliance in the US.

As regulations get ever stricter, increasing time and resources required, organisations can get more efficient in pinpointing which cases to pursue, by following these actions.

Practitioners in the field take the risk-based approach to regulatory compliance as an article of faith. Talked about at events and printed in journals, the industry focuses mostly on strategies that can be folded into a firm's policies, procedures and operations.

Lost in the details of how to do this is why do it at all. Why take a risk-based approach, anyway? Re-examining this question can lead to changes in what elements are made risk-based, and how a risk-based approach is carried out. The alternative is a one-size-fits-all approach, assuming all customers, business lines, and firms have the same level of risk.

Better alignment

The reason seems simple: Compliance professionals take a risk-based approach to identify suspicious parties and behaviour according to perceived risk. Like all operational overhead costs, the cost of compliance operations is always subject to optimization exercises.

But the percent of relationships and business transactions, the cases truly needing more research and ongoing monitoring, is relatively minuscule.

The percent of cases needing more scrutiny is tiny

For example, several years ago a large European bank found even with exact matching technology for sanctions screening, matches to the listed party made up about one-tenth of one percent of those reviewed. In general, these are 10% or less of records screened. The ratio was five times worse when fuzzy matching was applied.

That makes finding efficiencies necessary, especially in a competitive environment with margins under constant pressure. Not to mention that regulatory requirements are rising, as are the

expectations of regulators on the standard of care to be applied to all aspects of compliance operations.

A European bank found matches were only one-tenth of one percent of reviews

Raising the stakes

Regulators in general are raising the bar higher and higher on compliance: they are asking for more industries to be covered, more types of transactions subjected to review and reporting, and the scope of review process to be expanded.

For example, a bank was fined for not screening the SWIFT addresses of sanctioned banks, even though the names were screened. In another case, a bank was fined for not using the date of birth in the client database to identify two drug traffickers. Broadly speaking, larger institutions must meet higher standards, then those standards are pushed down-market.

Can a better conclusion be drawn from analyzing the cost of compliance?

Reframing risk

For other legal violations, financial criminals need three things: means, motive and opportunity. While a motive for monetary gain could be given to any counterparty, the same cannot be said for opportunity or means. Those of limited means or limited opportunity are statistically less likely to be involved in major financial crimes.

A risk-based approach can be redefined, then, so those less likely to be involved in financial crime are treated with a standard of care suited to their lower chances, when conducting initial and ongoing due diligence and in monitoring their activity.

Due diligence and monitoring requirements for lower-risk relationships, though reduced, are

still used to identify indicators of potential crime, as for higher-risk candidates. These can also alert a firm to the prospect that the initial evaluation of the client may be suspect.

A different standard of care should be applied to those with limited means and opportunity

It's important to recognize the focus on "financial crimes of significance". While morally satisfying to try to identify petty crimes, this attention is misguided. Operationally, as the sums diminish in unusual activity, it is more likely the activity is merely unusual, not criminal.

New gauge

Take, for example, cash deposits made by someone with a second job, or by someone building a business while still employed. More important from a regulatory point of view, potential laundering of petty crime does not have the same adverse societal impact as a large money laundering scheme.

Money laundering is not a crime because it is wrong or bad. It is criminal because it weakens the balance sheets of financial institutions, crowds out legitimate businesses from unfair competition, and limits the ability of government to guide the direction of the national economy.

Five actions to assess low risk profiles

How do you identify the lower means and opportunity that should be subjected to different treatment?

Verify that a person or organization is who they say they are according to:

- their identity, using official documents, such as passports or articles of incorporation
- their financial assets, using bank references, regulatory filings of income and balance sheet information, a pay stub, or individual tax returns
- the nature of their employment or business, through documentary evidence, such as employment verification letters and pay statements for individuals, company marketing materials, counterparty references from customers and business partners, and income statements
- their history of financial crime, by reading news articles of past involvement
- the likelihood of committing bribery or corruption, by identifying politically-exposed people and companies owned or controlled by the government

While not getting information requested from a counterparty should always be treated as a red flag, it may not always be a fatal omission in a risk-based programme. For example, a lack of personal identification in some countries is not uncommon. It can be largely ignored if financial assets are nominal.

The art of the risk-based approach is evident, even at this stage. Is there a limit to how far back to search for negative news? Should the lookback period depend on the total amount expected to transit the account in a typical month? Are all Politically Exposed Persons (PEPs), and their relatives and close associates automatically high-risk? Or does the nature of their position

and their business relationship have any sway?

94% of bribes were made to executives of state-owned companies, heads of state, government ministers, and defense officials, OECD Foreign Bribery report shows

It is important to remember that 94% of all bribes, were made to executives of state-owned companies, heads of state, government ministers and defense officials, according to The Foreign Bribery Report (2014) by the Organization for Economic Cooperation and Development (OECD).

This might permit a firm not to treat other classes of officials in the highest risk category. At the same time, a former spouse or child attending college out of town could merit less initial oversight.

"Initially" is the operative word with all things risk-based, to be fair...

Updates add value

While transaction monitoring generates alerts which may trigger a re-evaluation of Know Your Customer (KYC) data from a client, the data require periodic refreshing, even in the absence of unusual behavior.

These updates serve two purposes. First, the nature of someone's circumstances may have changed enough to warrant re-classification in a risk-based programme. A different level of transaction monitoring would be applied, even if no red flags crop up. Second, updated KYC information can lead to a new understanding of what is and is not unusual activity.

This correction to what is normal may mean transaction patterns that seemed unusual under the old model no longer do, or vice versa. Better operational efficiency, and less chance a potential financial crime evades detection are the result of these two updates.

This translates into a risk-based approach in two ways. First, the time between KYC data refreshes can be varied based on the perceived risk. Second, since the number and nature of transaction monitoring alerts can be varied based on the relationship risk, that implies an event-based re-evaluation of KYC assumptions is similarly risk-based, as it will happen less often for lower-risk accounts.

Know Your Customer data refreshes are key

What is more, these two modes of KYC update can be intertwined. For example, if a low-risk account can be identified as generating low-risk behavior, as opposed to expected medium-risk behavior, then that transaction profile could be used to lengthen the scheduled KYC data refresh cycle.

50 shades of risk

This analysis makes two major assumptions about regulatory requirements: less significant, or petty crimes are not the focus of regulatory expectations, and PEPs are not inherently high-risk. Even if these assumptions are false, a risk-based approach can be used on which the statistical basis these suggestions were founded. Simply put, one need not apply the same standards of care to all elements of focus.

The level of matching required for petty crimes could be stricter than for major crimes. To be worthy of review, crimes below a certain amount of revenue would have to happen in the past three years to be worthy of review, while those above that threshold might require a five-

or seven-year lookback. A spelling mismatch for petty crime might be disqualifying, while a mismatch on the city of residence would trigger a flag on the perpetrator of a major fraud.

A higher standard would be required for the names of PEPs from job categories or relationship types less likely to be involved in financial crimes to be considered matches. For example, a person whose name and country matched that of a defense official might be stopped for review, even with major misspellings, while the ex-spouse of a provincial legislator who has been out of office for two years might require matches of an exact name plus a date of birth.

Regulator buy-in

A risk-based approach to KYC and anti-money laundering (AML) is only as good as the ability to get the agreement of the regulator. It is a bit like looking at the approach from both ends of a telescope. At one end, it looks like a company is trying to do less, making them look small and petty. Through the other end, the AML programme appears impressive, focusing the most effort on the instances most likely to be criminal and have an impact on the local and national economy.

One's choice of lens may determine whether or not the regulator asks why the programme was designed that way, what is not being properly surveilled – and who is responsible.

Basel IV/Will new rules help or harm the market for trade finance?

By Félix Prévost and Krishnan Ramadurai

Félix Prévost is Senior Manager and Krishnan Ramadurai is Global Head, Capital Management, Global Trade and Receivables Finance, HSBC.

A decade since the onset of the global financial crisis, when overleveraged banks tipped the world into the deepest recession since the Great Depression, the Basel Committee on Banking Supervision (BCBS), an international regulatory forum that includes central bank supervisors, has revised standards to the Basel III accord on bank capital requirements.

These standards are a powerful policy tool for reining in leveraged lending. Referred to as Basel IV by market participants, the new requirements, published last December, go into effect in January 2022. Analysts and investors expect banks to report the impact from these new rules much sooner.

The reform aims to reduce variations in risk-weighted assets (RWA) between the standardised (SA) and internal ratings-based (IRB) approaches that banks use.

The wider ambition is twofold: to reduce banks' incentive to minimise risk weights by aggressively modelling under advanced IRB, and to level the playing field across banks and jurisdictions.

Trade finance will be affected by these new requirements in four areas:

Credit RWAs

The new SA aims to be more granular and risk-sensitive

in two ways: a more detailed differentiation between risk factors for unrated exposures to banks and corporates, and for rated exposures in jurisdictions with credit ratings. Banks must also carry out more due diligence on all counterparties, including on credit ratings agencies.

The credit conversion factors (CCF) for off-balance sheet commitments will still reflect the low claim rates identified by the ICC Trade Register. Banks modelling the CCF for off-balance sheet commitments, such as letters of credit, may not continue this practice, which could increase the exposure-at-default (EAD) of trade finance products under IRB.

What is more, by introducing a 10% conversion factor for unconditionally cancellable commitments, up from a 0% floor, banks may no longer be willing to provide higher credit limits outright, because of the additional costs to them for unused credit limits.

Basel IV reduces the scope of advanced IRB models to small- and medium-sized corporates, defined as consolidated revenues under EUR500 million. This introduces a higher probability-of-default (PD) floor of 0.05%, up from 0.03%. The senior unsecured Foundation loss-given-default (LGD) has been lowered to 40% from 45%.

Banks may no longer offer higher credit limits outright

The reform recognises the short-term, self-liquidating nature of many trade finance assets by providing a maturity (M) floor waiver to some trade finance products: M is floored at one-year in RWA calculations for most lending products. A lower M on trade finance products, such as letters of credit, (which are typically valid for about 120 days), results in

a lower RWA compared to a similar maturity short-term non-trade finance loan.

Good news for trade finance, good news for SMEs

Basel IV's regulatory capital treatment for Credit RWAs should boost the provision of trade finance to SMEs. It should also help narrow the US\$1.5 trillion gap in unmet trade finance demand by SMEs.

The reforms also simplify the Operational Risk Framework by replacing the four current approaches with a single standardised approach where the capital charge is a function of bank size and operational losses incurred over the last ten years.

Up to the task

The new approach should better reflect the scale of misconduct, mis-selling, money laundering and sanctions penalties after the global financial crisis.

The impact will be greatest on large banks with a record of past operational failures. It will reward smaller and well-governed competitors, by giving them an opportunity to compete on capital and pricing.

New Backstops

A leverage ratio buffer will give more control over the buildup of excessive leverage by Global Systemically Important Banks (G-SIB).

The ratio is a simple measure that compares a bank's capital measure against its exposure measure un-weighted by risk. It is a backstop to the absolute leverage a bank can achieve. The new ratio will be set at 50% of each G-SIB's risk-based capital buffer.

Impact of the change opens up the trade finance market for smaller players to capture market share from large, established banks.

A new capital output floor

means bank calculations of RWAs generated by internal models cannot in aggregate fall below 72.5% of the risk-weighted assets computed by the standardised approaches. This limits the benefit a bank can gain from using internal models to 27.5%.

This will likely increase capital requirements, and reduce the incentive to develop internal models. The floor will be phased in over five years starting at 50% in 2022.

Ripple effects

While it is hard to gauge the impact of Basel IV on industry and banks, it is clear banks must make hard decisions since the reforms are challenging, complex, and at times contradictory.

The capital output floor could reduce the incentive to move portfolios to the IRB approach. The floor effectively reduces the benefit of the IRB approach.

Combined with SA changes and the limitations and constraints on IRB options and approaches, IRB use may fall. Lenders in locations where regulators have restrained the use of IRB models, often in emerging markets, will also benefit.

Which of these ratios or norms is the binding constraint for banks? In the US, it is clear the annual stress tests determine the dividends paid and the level of capital ratio maintained. As a result, logic dictates the binding constraint will be the stress test combined with the leverage ratio – which is a prime driver for the regulators to take prompt corrective action (PCA) rather than the regulatory reported ratios.

Basel IV will boost competition

Will banks run their businesses and pricing models using the stress test as the reference point, or the reported regulatory ratios? Banks

with the leverage ratio as the binding constraint must reconcile this with the regulatory ratios and the stress test.

The process is even more complex for big groups with subsidiaries. Global banks will need to report capital ratios under the IRB approach and the SA, since the SA will set the capital output floor, while simultaneously meeting the norms set out by the annual stress tests and meeting the non-risk-based leverage ratio.

It is worth noting trade finance maintains its off-balance sheet conversion factor advantage in the leverage ratio calculation, which for this measure at least makes it relatively more attractive compared to other lending.

The off-balance sheet treatment under SA, IRB and leverage ratio, and the maturity floor waiver under IRB should encourage banks to continue underwriting trade finance products. This is especially true for SMEs, which remain in the scope of advanced IRB modelling.

By levelling the playing field and rebalancing the relative value of assets, Basel IV could boost competition from smaller domestic banks, non-bank lenders and investors, through direct competition with banks in the primary market or by participation in distributed assets from banks that lend to finance trade.

To close the SME trade finance gap, traders and bankers alike must embrace a more diverse lending base.

Regulating business/ The two pillars of ethical regulation

By Christopher Hodges and Ruth Steinholtz

Christopher Hodges is Professor of Justice Systems at Oxford University. Ruth Steinholtz is Founder and Principal of AretéWork LLP. They co-authored Ethical Business Practice and Regulation. A Behavioural and Values-Based Approach to Compliance and Enforcement (2017).

Two of the world's experts on ethical regulation spell out the state of play in curbing corporate malfeasance and offer a new way forward.

In Transforming Culture in Financial Services (2018), the UK's Financial Conduct Authority (FCA) said: "Despite record fines, increasing investigations and an expanding compliance industry, misconduct remains. Why? What have we not learned?"

The Authority found that even with severe penalties for drunk driving, 11% of road deaths in the UK are still caused by drinking.

Despite decades of massive fines and damages, especially in the US, the number of corporate scandals is not shrinking: the Enron and WorldCom accounting scandals, expenses fudging by parliamentarians, the Madoff investment scandal, the BAE Systems and Siemens bribery scandals, the foreign bribery scandals of Rolls Royce and Brazilian construction company Odebrecht, doping by cyclists and Russian athletes, corruption of FIFA officials, sexual exploitation, Facebook's use of data, and cricket ball tampering. The list goes on.

Clearly imposing penalties has failed to change behaviour.

Should companies be selling mortgages that people will never be able to repay, or insurance products

that people do not need, or installing devices to beat emissions tests? Should executives be paying a fair level of tax in countries where their earnings are high, or pay themselves huge salaries compared with average staff pay or local wages?

So how does one stop these same mistakes from happening, over and over again?

A single thread

All the major reports on root causes of the 2008 financial crisis found one key to successful regulatory compliance: corporate culture. How an organisation makes decisions and carries out its activities affects what it achieves.

But unless dysfunctional corporate culture is dealt with, the seeds have already been planted for the next crisis.

Execs say their corporate culture is inadequate

Although corporate culture and integrity are widely talked about, several polls show that while senior leaders believe culture is important, many do not believe theirs is adequate. What is more, many

regulators do not act with ethical culture top of mind.

Building an effective ethical culture is not just about corporate social responsibility (CSR), governance or sustainability. It is about tempering the single-minded pursuit of shareholder value with achieving the objectives of all stakeholders. It is about fairness and doing the right thing, which allows employees to sleep soundly and people with integrity with the willingness to work for an organisation.

Firms of endearment

A growing body of evidence shows companies that adopt a holistically ethical approach are very successful and sustainable. No surprises here. Staff devote all their energy to their work and perform well. Suppliers are motivated to support and are willing to put in a good word.

An analysis of 57 US and 15 non-US companies found those that adopt a comprehensive approach to meet the needs of all stakeholders had far better financial results than the S&P average over 15 years, which appeared in the book, Firms of Endearment: How world-class companies profit from passion and purpose.

An earnings spinner

More recently, a McKinsey study in 2017 of 600 firms showed those that focused on the long term had an average profit 81% higher than companies chasing short-term profit.

Whole Foods pioneered conscious capitalism, which emphasises the integration and interdependence of stakeholders. Whole Foods and its stakeholders have grown and prospered, even if the market has not always rewarded the company, perhaps due to its long-term focus.

TSB Bank was established in 2013 to reset the relationship between banks and society by putting customers and communities before short-term profit. It scrapped all sales targets, sales-linked rewards and access to comparative sales data at branch and area director level. Instead, TSB rewards staff purely on customer service, and assesses performance by skills, attitudes and behaviours instead of outputs. The Bank says this is why customers are opening 1,000 new accounts every day.

A growing body of evidence shows ethical behaviour is profitable

It's the barrel, not the apples inside

What is more, the relationship between ethical culture and conduct rests on a solid base of science.

The idea of the bad apple has been replaced by the apple barrel in a range of recently-published books: *The Honest Truth about Dishonesty*, *Thinking Fast and Slow*, and *Nudge*.

These ideas can be applied to compliance and regulation. We define Ethical Business Practice (EBP) as a holistic approach to doing the right thing in all companies' activities.

This definition goes beyond a code of ethics or a Board directive to be ethical, to create an ingrained

culture of ethics. In short, ethics is everyone's responsibility.

In Ethical Business Practice, a company identifies core ethical values and other elements of a cultural and leadership framework, and values-oriented ethics and compliance.

Firms measure and manage their internal culture with tools that range from the simple to the sophisticated, such as the Barrett Cultural Values Assessment.

Ethical Business Practice builds up cultural capital and consistent evidence of trustworthiness. These both lower transaction costs and risk, creating more value. Ethical Business Regulation is an example of the value of cultural capital, where building up trust can be a mitigating factor in the event of misconduct.

A new model of regulation

Businesses demonstrating trustworthiness deserve a supportive response from regulators, not a punitive response. This can take the form of an engaged relationship, in which activities and risks are regularly discussed proactively. This is what is meant by Ethical Business Regulation (EBR).

EBP and EBR improve compliance for many reasons, notably the ability to identify problems early and sort them out. There is no need for huge fines or class actions, based on outdated theories that these deter wrongdoing.

Stiff sanctions and intense scrutiny can then be reserved for real criminals. The way to shape future behaviour of businesses and people is to encourage and support, not beat them up. Improvement should be nurtured, people trying to do the right thing should not be alienated. The actions of regulators can support or inadvertently repress good behaviour.

Examples of EBP and EBR exist in many sectors, such as international civil aviation safety (based on a

universal open or no blame culture), water pricing in Scotland, food safety in the UK, and workplace safety in Canada and Finland.

In the next stage, a regulator needs to adopt a comprehensive ethical approach, as a new string to its bow. Opportunities abound in data protection compliance, Internet self-regulation, and combining regulation with anti-money laundering and cybersecurity in financial services. The Australian Securities and Investments Commission recently signaled its intention to move to EBR for banking regulation.

Adopting EBP and EBR can transform business and regulation. But these two horses of business and regulation need to drink from the same trough. In so doing, they can achieve outstanding compliance and stellar economic growth.



Background information

Ethical Business Practice

A holistic commitment to an aligned culture

Employees can:

- do the right thing, based on ethical values
- recognise ethical dilemma and skillfully resolve it
- be open and honest: speak up and learn from mistakes

Ethical Business Regulation

A relationship between a business and a regulator

- the business produces evidence of its ongoing commitment to Ethical Business Practice
- the regulator recognises and encourages that commitment

5



TRANSFORMATION

Setting the scene/Daniel Schmand, Chair, ICC Banking Commission

A call to action for collaboration addressed at the trade finance industry, as it sits on the cusp of a digital revolution.

The growth experienced and further anticipated by banks in terms of value of trade finance and supply chain finance processed needs to be sustainable.

Page 129-130 >

The future of digital

Making the move to digital has never been more pressing, as the industry looks for ways to become more efficient and productive amid pressure on margins from competition and compliance. The trade finance industry faces special challenges, from finding a way for many different actors in the supply chain to coordinate, to the blizzard of paperwork involved in trade finance transactions. But there is a way forward. ▼

Digital trade/

Plotting the path to transformation

Early indications show the trade finance industry could make big savings in time and staffing today, through methods such as Robotic Process Automation, and blockchain is fast moving into a commercially viable proposition. But the hurdles to an all-digital strategy may be more political than technical.

Page 131-138 >

Digitising trade/

Kicking it into higher gear

What needs to change in practice, rule-making, advocacy and financial inclusion to usher in the digital era. **Page 139-142 >**

Conflicts in laws/

Time to get your clauses in order

Why banks need to take a hard look at their policies and procedures – and exposure and tread carefully in using electronic contracts.

Page 143-144 >

Digital forfailing/Making distributed ledger tech a reality

To make DLT happen requires several legal issues to be sorted, while blockchain promissory notes could attract new investors.

Page 145-146 >

Sustainability

One of the major risks to growth in global trade are sustainability risks to global supply chains. Voluntary sustainability standards are an important part of the solution. Regulations and shifts in demands for transactions linked to environmental impacts are propelling banks to provide sustainable trade finance. ▼

Voluntary Sustainability Standards/ Schemes are spreading

Consumers from Brazil to Belgium are getting savvier about the carbon footprint of the products they buy, a big reason for the growth in voluntary sustainability standards. But several problems need to be solved on the use of VSS's. **Page 147-150 >**

ICC's work on sustainable trade finance/ Blueprint in the making

A new ICC working group on sustainable finance started in 2016 is looking into standards, a due diligence tool, and ways to spread best practices. **Page 151-154 >**

Setting the scene/Making trade finance digitalisation happen

By Daniel Schmand

Daniel Schmand, Chairman of the ICC Banking Commission and Global Head of Trade Finance, Deutsche Bank

While protectionism and talk of trade wars have dominated the headlines, this Global Survey reveals that the outlook for global trade is actually positive. Almost two-thirds of respondents do note an increase in the value of traditional trade finance provided in 2017, while nearly half have seen a jump in supply chain finance.



However, this growth needs to be sustainable. This means digitalising trade finance and logistics documentation and automating handling from farm to fork, from factory to warehouse. While we all know the benefits: increased transparency, time and cost savings; reduced errors; and reduced compliance and operational risk; it seems to very difficult to make digitalisation business as usual.

We have seen major breakthroughs in the form of various blockchain pilots, but we can, and should, expect more. Only 12% of respondents to the Survey have successfully implemented technology and are witnessing the benefits. Almost half are struggling to do so – whether this be due to legacy systems, regulatory restrictions or cultural barriers. Worryingly, 37% don't have technology implementation on the agenda at all.

Individual digitalisation initiatives rather than those linking up with the wider industry, create problematic digital “islands”. This has its roots in the multi-faceted nature of trade transactions, which span multiple countries – each with

their own legislation – and parties, ranging from exporters, importers and banks, to insurance companies and port authorities.

It is the role of the ICC Banking Commission, therefore, to support the creation an ecosystem based on the necessary standards so that emerging technologies can connect all its stakeholders.

Set the standards

I'm pleased to say this work has begun in earnest, with the formation of our Digitalisation Working Group in June 2017.

A key focus will be the adaptation of rules and regulations to ensure they are “e-compliant” – allowing banks to accept data rather than documents. We will also look into the development of minimum standards for the digital connectivity of service providers – particularly across legal, liability, information security and technology firms. We believe that this will not only help foster innovation, but also drive uptake.

Of course, new operating models based on new technology also bring legal challenges. How do the rights of third parties differ under

paper and electronic bills of lading? How can blockchain effectively comply with data protection regulation? These are just some of the issues being examined by legal experts.

While the trade finance industry is making good progress on coming together to tackle these challenges, not much can happen without the support of regulators and governments. It is here that the ICC Banking Commission has a significant role to play, not only from an advocacy perspective, but also in terms of engaging in constructive dialogue with these bodies and organisations such as the WTO and UN. It is no coincidence that national digital strategies in a number of Asian economies have coincided with them taking the lead in technological innovation.

We sit on the cusp of a digital revolution. The payments industry has taken the leap in response to platform competition from providers such as WeChat and Amazon – just look at the progress made by the SWIFT global payments initiative. Trade finance cannot afford to be left behind.



12%

of survey respondents
successfully implemented
digital solutions for trade
finance due diligence

37%

don't have implementation
on the agenda



Digital trade/ Plotting the path to transformation

By Sukand Ramachandran, Jarryd Porter, Ravi Hanspal, Teck Hsien Ho, Ankit Mathur
Sukand Ramachandran is a Partner and Managing Director of Boston Consulting Group, Jarryd Porter is a Project Leader at BCG, Ravi Hanspal is a Project Leader at BCG, Teck Hsien Ho is a Consultant at BCG, Ankit Mathur is Lead Knowledge Analyst at BCG.

Early indications show the trade finance industry could make big savings in time and staffing today, through methods such as Robotic Process Automation, and blockchain is quickly turning into a commercially viable proposition. But the hurdles to an all-digital strategy may be more political than technical.

Short-term gains

Banks and industry bodies are evolving the digital backbone of trade finance operations. In the short term, efforts are mostly focused on boosting efficiency and lowering costs. Industry veterans in conversations with BCG said methods such as Robotic Process Automation (RPA) and machine learning (ML) have matured enough to encourage the digitisation of trade finance processes, and support the automation of compliance processes, such as sanctions screening.

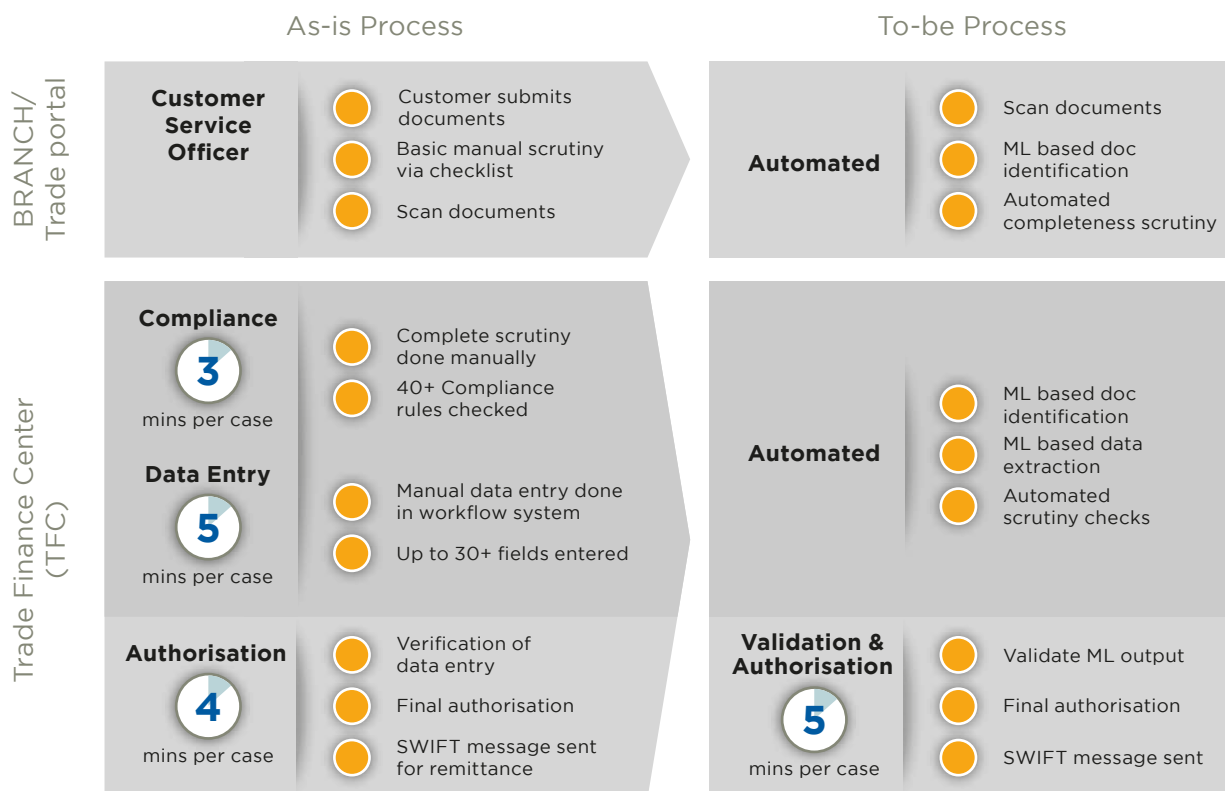
Saving time and staffing

One example is Intelligent OCR, which scans non-standardised documents, recognises the text, and digitises the contents into data automatically without human input. Automated template solutions – document templates with integrated automation features that increase the efficiency of document creation – will also be used more in trade finance documentation.

Recent examples of RPA and ML include the partnership of a technology startup and an Asian

trade bank to automate trade finance processes such as L/C issuance, which reduced previously end-to-end human involvement to final validation and authorisation, cutting processing times by 60%, and reducing full-time employee headcount needed for data entry and scrutiny by 70%.

Robotic Process Automation, Machine Learning in Trade Finance Processes



A project automating L/Cs slashed processing times by 60%

Longer-term, digital could transform the way trade finance is conducted. One possible application is distributed ledger technologies, or blockchain, to replace a lot of paper documentation and manual reconciliation, tracking, and verification of transactions. This switch would boost trade transparency, prevent duplication and excess documentation, and boost compliance.

Digital ledger tech would boost transparency

Recently major trade banks have launched or plan to launch blockchain-based technologies for commercial use. In the past,

these projects were mostly pilots or proofs-of-concept. Recent initiatives signal potential commercial maturity. Banks aim to focus more on building flexibility into their infrastructure as new technologies become more commercially viable.

Saving billions

Both short-term efforts and long-term innovations are necessary to unlock huge cost savings for trade banks. BCG estimates an integrated digital solution incorporating intelligent automation, collaborative digitisation, and future technology solutions would save global trade banks between US\$2.5 billion and US\$6.0 billion in cost savings on a cost base of US\$12 billion to US\$16 billion.

Boosting revenue

A full digital transformation may also boost revenues 10%. For example, digitising operations may allow banks to more effectively

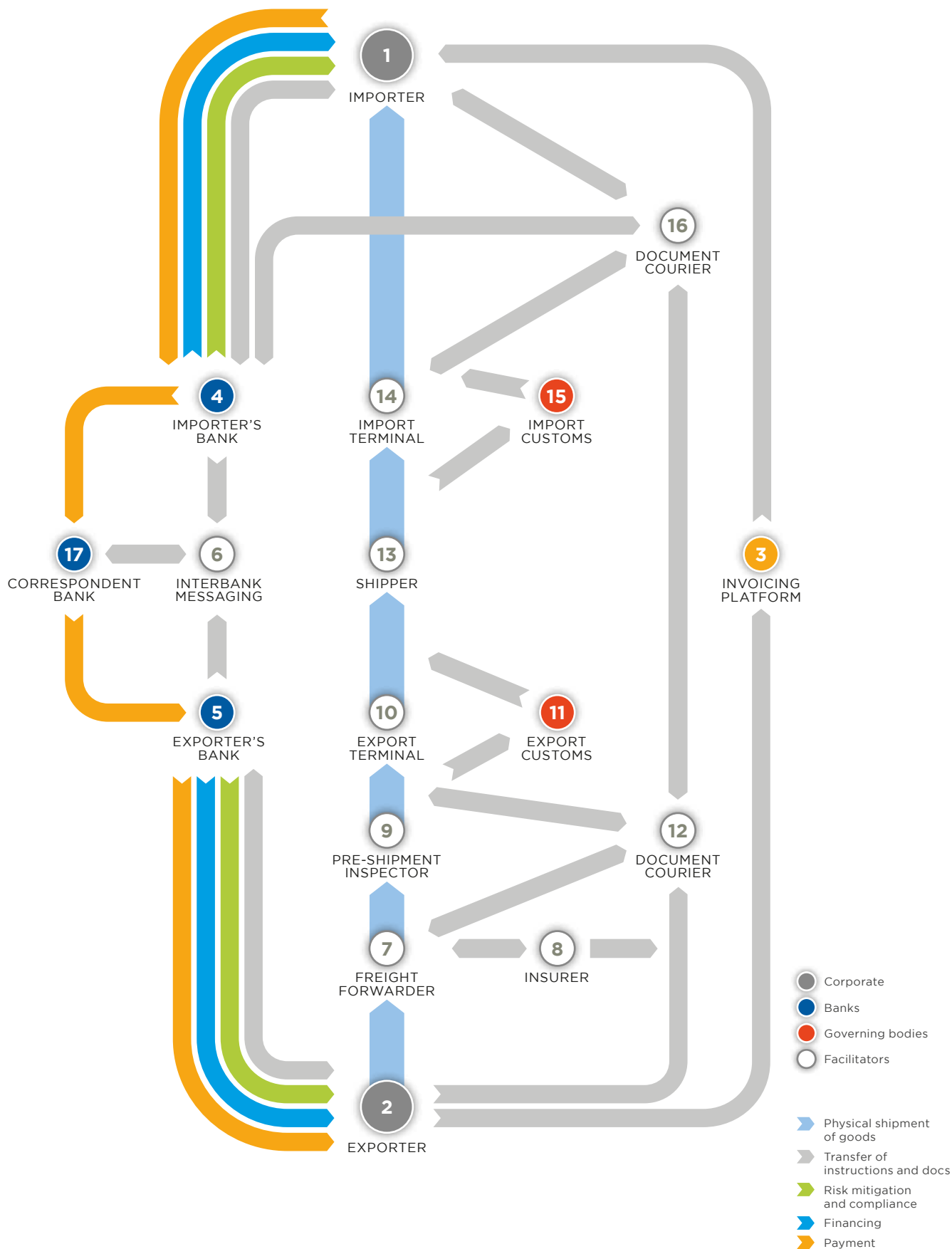
cross-sell using front-end platforms, but the main benefit is cost savings.

Industry 4.0 will unleash reams of data

The current trade model is a complex flow of goods, information, documentation, and capital among a wide range of players. So it is not surprising that many links in the process could be disrupted by technology. The table on page 134 shows potential digital disruptors.

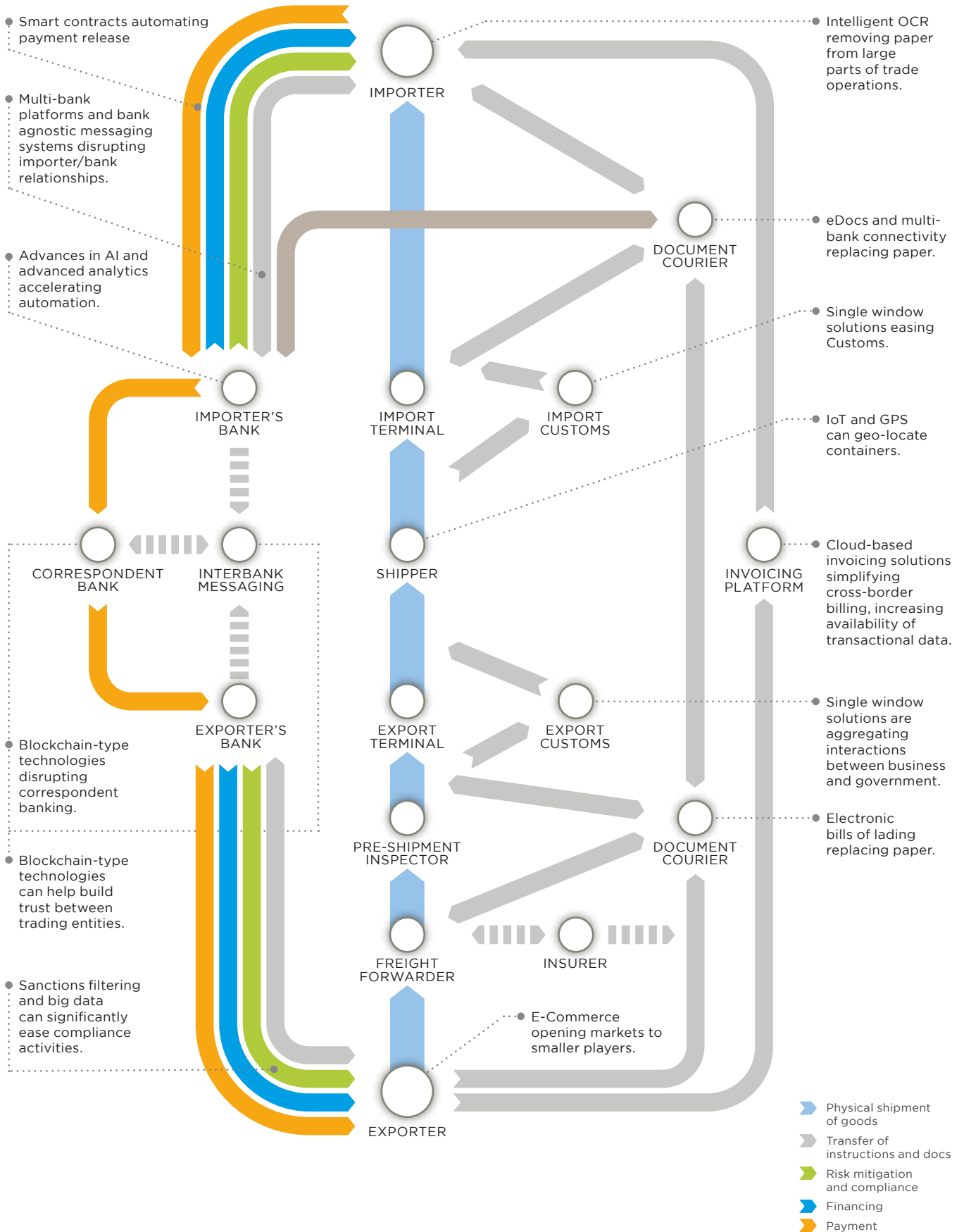
One major potential disruptor is the emergence of Industry 4.0, especially the increased adoption of the Internet of Things ("IoT") and the integration of 3D printing in global supply chains. 3D-printing may upend physical supply chains and reduce the role of trade finance in global supply chains and trade transactions.

Trade and trade finance actors



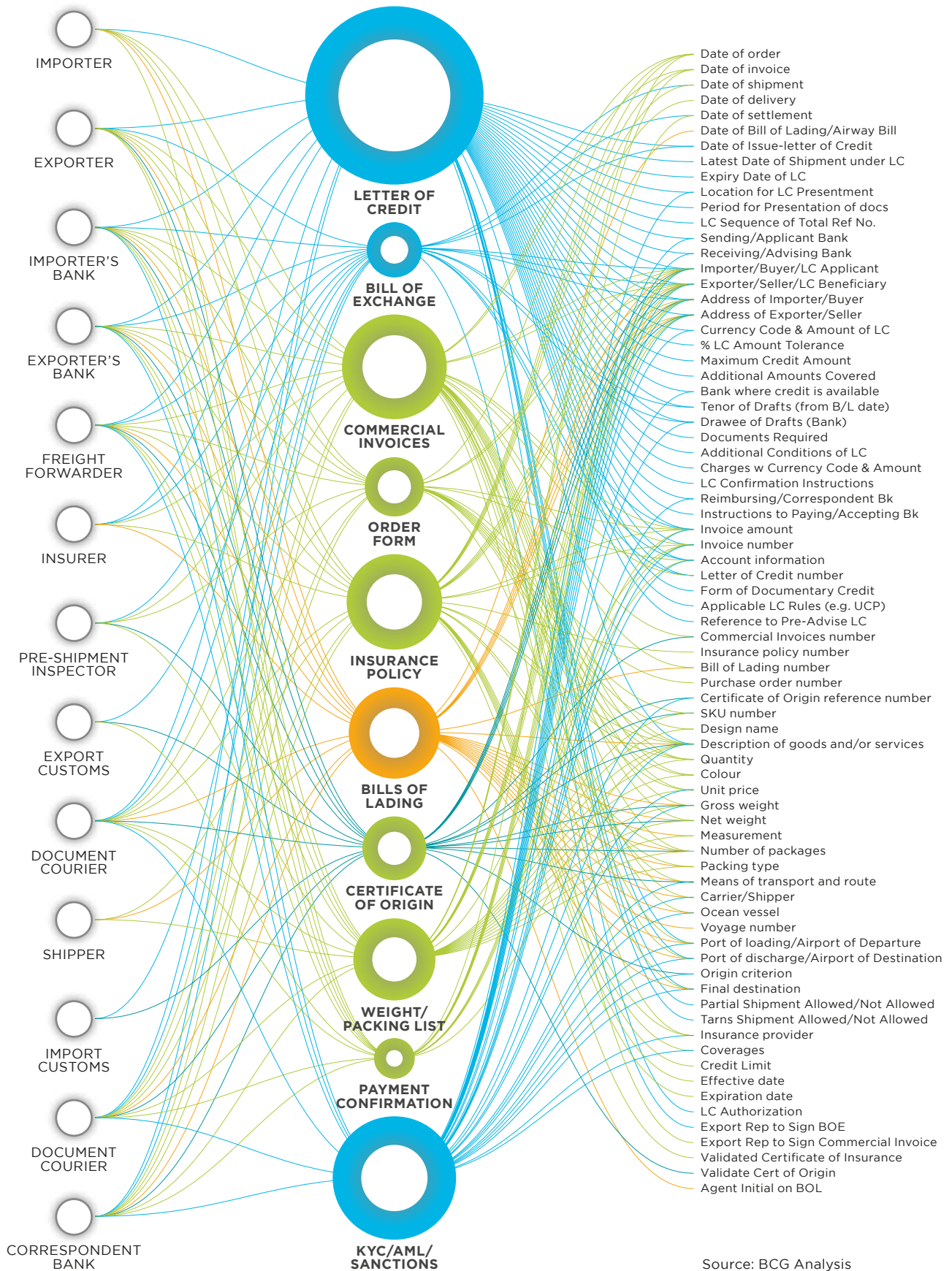
Source: BCG

Digital disruptors to trade and trade finance



Sources: Press reports, BCG

Players create about 5,000 data field interactions



Source: BCG Analysis

3D printing may reduce the role of trade finance in supply chains

IoT could advance better end-to-end tracking of trade transactions in real time, and reduce the risk of delivery or payment. It could also encourage the shift to open account transactions, as lower delivery risk mitigates the need for documentary trade for risk management. IoT use will increase the volume of data. If not handled well, this rise in data intensity may hamper the digitisation process.

All trade parties, from importers and exporters to banks, customs and logistics institutions, interact and collectively create a huge amount of data during the transaction, which varies by product. L/Cs are the most complex

product: the end-to-end journey involves more than 20 players and more than 100 pages across 10 to 20 documents, many duplicated and transmitted multiple times. The interactions between these players and documents produce about 5,000 data field interactions, created from the interactions between two or more players.

Only 1% adds value

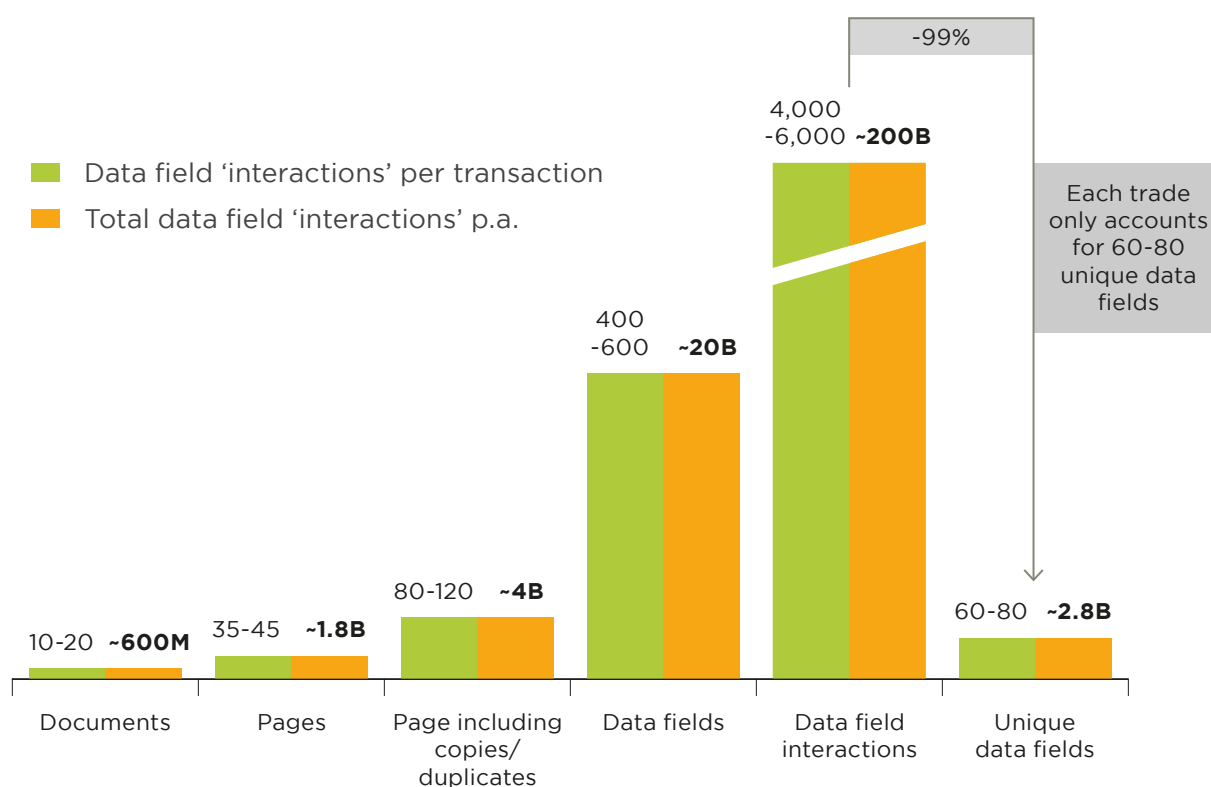
Most of these interactions are duplicates of existing data and are not scrutinised or are sometimes ignored. The share of this redundant data rises during the trade journey. In total only about 1% of data field interactions add value. Globally this is an estimated 200 billion data field interactions supporting trade finance. Industry 4.0 and increased IoT use will exponentially pile on to this volume of data.

Scrutinizing these interactions reveals only about 60 to 80 unique data fields, such as dates, amounts, and reference numbers. Collaboration and coordination among all parties could reduce data intensity to just these unique data fields, boosting the efficiency and ease of processing trade transactions. This data convergence would also make compliance and regulatory processes more accurate and efficient.

Blockchain as potential solution

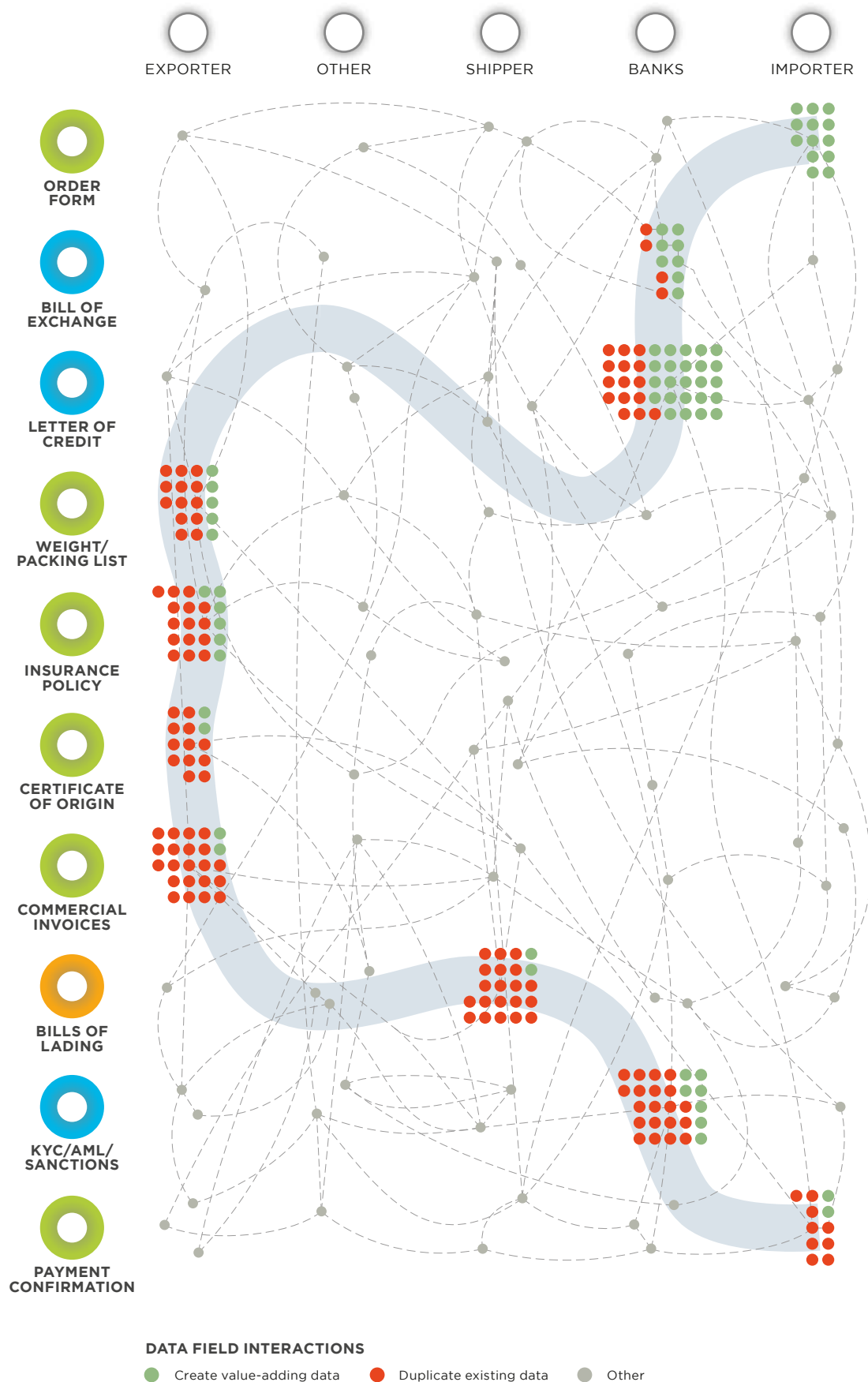
Blockchain-enabled smart contracts are a possible solution: authorised trade parties can create and securely access data fields digitally. These contracts could automate shipment tracking, payments execution, and delivery verification. The blockchain backbone could also increase

Approximately 200 billion data field interactions support the Trade Finance ecosystem



Source: BCG

Trade information fabric results in 60 to 80 unique data fields



Source: BCG Analysis

security and transparency, ease of audit and information sharing, and reduce waiting and processing times.

The challenges may be more political than technical. A wide range of parties involved in trade are at varying stages of digital maturity. Those at an early stage may struggle to adopt and take part in digital solutions, such as blockchain. The large number of parties makes it hard to come up with a quick and widespread solution.

Going digital could save US\$6 billion on costs of US\$16 billion

Common standards

To shepherd the process forward and better manage data intensity, the first step is to develop and agree on a framework of industry standards for building technology solutions. The framework must be workable for all players and not favour the interests of the few. Given the range of players involved, convening a conference of stakeholders and establishing the framework could take time.

An alternative would be for one party, such as a global trading platform or a leading industry body, to forge ahead with an acceptable framework and gain enough traction and participants to build up scale. The party would then leverage this scale and network effect to become the industry standard. Standards supported by competitors and imitators could create some confusion in the interim, but this competition would build a dominant set of standards faster than getting a framework that all parties agree to.

Another would be for participants to evolve towards common standards, adopting or building compatibility with existing major frameworks when developing new solutions. In this way, the industry

can get to a common standard without spending a lot of time agreeing on a unified standard.

Another step is to make sure players understand the underlying information fabric and make the right judgments on what data elements add value. This allows players to agree on new internal processes that better support a digital model for trade.

Players could involve SMEs, providing scale and building widespread acceptance of the agreed-upon digital standards. Cost-savings from digital efforts in trade finance should be reflected in prices and create demand. Reducing data intensity would also cut costs for managing and processing data, further accelerating the appeal for SMEs.

To face the rapid pace of technological progress, and pressures from competitors to provide better and cheaper services, trade banks must have a strong and well-planned digital strategy.

The downside to digital: a huge increase in data

A priority for all

A comprehensive digital transformation of trade will not be successful until all major links in the value chain collaborate. Corporates, for example, should team up with banks and one another to identify the best way to digitise trade processes and eliminate paper and manual processes. Third parties, such as shipping companies and insurers, should also collaborate with corporates and banks to make sure they do not hold up the digital transformation.

Banks should also collaborate with technology startups and fintech companies to build complementary capabilities, boosting their service while lowering cost-to-serve. These partnerships should get data from the entire value chain and

improve their ability to make credit decisions on clients. This would also allow trade banks to serve SMEs more affordably and compete against the commercial platforms well-placed to provide SCF and other non-documentary trade finance to SMEs.

Regulators and governance bodies also represent some of the largest challenges to a complete digital transformation. Their primary focus is on the regulatory compliance of trade participants instead of making trade transactions simpler.

To support innovation, these bodies could use digital technology to boost trade security, compliance, and the rule of law. Close collaboration globally of these bodies would speed the transformation.

The road ahead to incorporating digital technology in trade may be long and hard, but the payoff in cost savings, security, and smoother trade processes more than justifies the effort.

Digitising trade/ Kicking it into higher gear

By Michael Vrontamitis, Alexander Goulandris, Michael F Quinn, Dave Meynell, Bhriguraj Singh, Sean Edwards

Michael Vrontamitis is Head of Trade, Europe and Americas at Standard Chartered Bank and ICC Digitalisation Working Group co-chair; Alexander Goulandris is Co-founder and CEO of essDocs and ICC Digitalisation Working Group co-chair; Michael F Quinn is Managing Director of Global Trade and Loan Products at JP Morgan and ICC Digitalisation Working Group Head of Sub-Stream: BPO; Dave Meynell is owner of TradeLC Advisory and ICC Digitalisation Working Group Head of Stream: e-compatibility; Bhriguraj Singh is Global Head of Documentary Trade, Product Management, Trade and Receivables Finance at HSBC and ICC Digitalisation Working Group Head of Stream: Minimum Standards; Sean Edwards is Chairman of IFTA and ICC Digitalisation Working Group Head of Stream: Acceptance.

“Going digital is good for trade and good for the wider economy”

Banks today are faced with compressed margins from labour-intensive paper-based processes, higher due diligence costs from stricter compliance and regulatory requirements, and pressures to shorten process turnaround times and simplify risk mitigation. The need for digital innovation has never been greater.

A mountain of paper to scale

The benefits of digitalisation to trade finance are widely acknowledged. An estimated four billion pages of documents circulate in documentary trade. Digitalisation can reduce the manual and error-prone processes for document and compliance checking.

Four billion documents in documentary trade are in circulation

A full audit trail that shows a document's chain of custody over its lifecycle can detect risk and fraud ahead of time and access to

data can make regulatory and client reporting requirements easier.

Technology contributes most to future GDP

The broader effects of digitalisation on facilitating trade and as a result on boosting economic growth are also clear. Progress from technology will have the greatest impact on GDP levels by 2035, accounting for an extra 20% of GDP in Brazil and in China an extra 55%, according to the World Trade Organization (WTO).

By leveraging data to make credit decisions faster and more efficiently, digitalisation can also shorten supply chains, expedite faster knowledge transfer across trading nations, bring together new trading partners, and prompt new trade flows.

Aiding trade

Digitalisation will help boost trade in three main ways: by digitising paper documents, replicating existing business practices in digital format, and experimenting with new technologies, products and processes.

The challenge is that no standard method exists embracing such a range of initiatives.

Moving beyond paper-based processes is by no means easy. It requires simultaneous change by multiple counterparties. A basic shipment from east Africa to Europe can undergo more than 200 interactions comprising nearly 30 parties, including shippers, forwarders, ocean carriers, ports and custom authorities, before banks, insurers, and export credit agencies get involved, according to global transport and logistics company Maersk.

So it comes as no surprise that trade finance lags behind retail banking and payments processing in the race to go digital.

Digital infrastructure first

To speed up and smooth the banking industry's path to digitalisation, ICC's Banking Commission last year set up a working group on digitalisation in trade finance. Based on the commission's three strategic pillars – rule making, advocacy and financial inclusion – the new group is creating a framework for the digitalisation of trade finance so that all ICC rules are e-compliant and reflect evolving market practice.

The working group is also developing minimum standards for digital connectivity, and looking at the legal issues related to the three main areas of the trade finance industry's development.

In documentary trade finance, underpinned by traditional letters of credit (LCs), banks are improving processing efficiency, reducing costs, and strengthening security by digitising paper documents.

New platforms

In the past year, banks have launched initiatives for the electronic presentation of documents. Danske Bank announced it was partnering with essDocs, a platform to digitise and automate trade operations, finance and logistics so its corporate customers can use electronic presentation under eUCP LCs and eDocumentary Collections. In March, Evergreen Line, a large Taiwanese shipping company, said it is partnering with Bolero, a provider of electronic bills of lading (eBoL). But while these two key players have offered electronic BoLs for years, uptake has been slow.

At the same time, while electronic LCs (eLoC) have been available for some time, despite a few landmark transactions industry-wide use has been limited. While the reasons vary, it is worth noting each electronic system represents only a small slice of the overall trade cycle

and is not a wholesale replacement of the entire trade finance system.

Solution on the shelf

Products such as the Bank Payment Obligation (BPO) – championed by SWIFT and the ICC Banking Commission are helping facilitate and speed up trade by providing trading parties and intermediary banks with digital data at each stage of the transaction and shipping cycle.

BPO is a hybrid between LCs and open account. It provides payment assurance on the automatic exchange and matching of digital trade data without paper documents for a transaction. The advantage is the BPO already has a set of rules in place published by ICC. It is the only open network solution on the market.

But use has been slow: only 13% of Global Survey respondents say their bank uses the BPO. Corporate use is low, largely because banks have not promoted it.

Landmark transactions continue, though. In 2016, Commerzbank processed the first live BPO transaction between Germany and China, the first export BPO financed in favour of the supplier between Germany and Turkey, and the first BPOs in the UK, together with UniCredit. Commerzbank also pioneered the instrument in Austria last year, and in Belgium and Greece this year.

Supply chain finance (SCF) platforms are also popular as economic volatility and longer supply chains from globalisation test corporate financial sustainability. While five or six banks dominate SCF, corporates can choose from alternative SCF providers that use techniques beyond traditional payables finance.

Last year, FCI (formerly Factors Chain International) said it is partnering with Demica, a specialist provider of working capital

solutions, on a new SCF platform, FCIreverse. FCI will ramp up its network of 400 banks and factoring firms to fund client suppliers anywhere in the world.

The hottest trend

Expanding 20% per year, payable finance is one of the fastest-growing areas of trade finance. A total of 43% of Global Survey respondents said supply chain finance is a priority area of development and strategic focus in the next year.

Power to transform

The biggest development in the last year is probably the growth in distributed ledger technology (DLT) and blockchain applications. These trade by recording transactions in sequential blocks, creating data that all parties in the supply chain share, with real-time updates. What is more, banks can eliminate the risk of fraud by cross-referencing the payment of invoices against a blockchain-based central registry.

This has prompted bank-led consortiums to experiment with trade-related, digital ledger technologies, including we.trade to make domestic and cross-border commerce easier for SMEs. The Marco Polo initiative is another – working to develop cutting-edge trade finance solutions using a robust suite of APIs and technological tools.

Recently Maersk and IBM unveiled a blockchain-based venture to digitise the supply chain from end-to-end. These are a few initiatives that will likely be commercialised in 2018.

Governments also need to be more aware of the need to digitalise trade finance. Last year, the defacto central banks of Hong Kong and Singapore said they are linking up their trade finance platforms under development with blockchain technology. Called the Global Trade Connectivity Network (GTCN), the vision is to build an information highway based on DLT between the two, to make cross-border trade

and financing cheaper, safer and more efficient.

Digital ledger tech could transform trade finance

Initiatives underpinned by DLT and open-source as a result could transform the trade finance industry by furthering industry-wide standardisation, collaboration and consensus.

But DLT solutions may pose new risks in cyber-security and data security. Although banks now understand the cyber-security risk to core platforms, payments and FX businesses, they must apply these lessons to trade finance.

Applying these emerging technologies to trade finance at any scale is a long-term endeavour. In the meantime, the BPO today offers banks a digital process for settlement, risk mitigation and financing and a comprehensive digital foundation to transition to DLT.

For the BPO to work, the Uniform Rules for Bank Payment Obligations (URBPO), SWIFT's Trade Services Utility (TSU), and ISO data standards must be modified.

For this reason, last year the Banking Commission's Executive Committee set up a BPO sub-stream on emerging technologies. The work will examine if the BPO can be a transitional framework, how to modify and revise the BPO rulebook to directly include buyers and sellers, and how these changes would affect the requirements of governing standards.

These revisions could take up to two years. The sub-stream is also looking to boost the industry's use of the BPO.

Uniformity counts

Guidelines are the biggest missing link in the industry's move to digital, which will hasten learning, help practitioners analyse platform risks, and understand the effects of digitalisation.

Clearly defined rules will also accelerate the spread of knowledge, make it easier for banks and corporates to connect to digital platforms, and make sure all service providers are working to the same criteria. ICC's Banking Commission, given its long-established track record in producing universally-accepted rules and guidelines to help facilitate the free flow of trade, is uniquely placed to help set these rules.

In the last year, the working group's stream on minimum standards has been laying the groundwork for an initial set of minimum standards for the digital connectivity of participants in a trade ecosystem. This year conversations are being held with banks to get a clearer picture of what is required. The e-compatibility stream, which evaluates ICC rules for e-compliance, is updating some e-rules by the fourth quarter.

An organisation needs to take up digital roles as notary and standards setter and enforcer

The transition to digital is not possible without changes to laws and regulations. To create a clear framework, the working group's acceptance stream is conducting an interim legal survey to understand the rights of third parties under paper versus electronic presentation of documents, to be finished by the second quarter. The working group is also promoting adoption of UNCITRAL e-commerce legislation with several partners, including the G20, WTO, IFC.

Attention also need to be paid to the digital trade finance ecosystem. An organisation needs to take on roles such as a digital notary, custodian, standards setter and enforcer, perhaps an independent institution which raises issues of funding and governance.

The working group has laid the groundwork so that existing rules are ready for a digital environment, and taken steps to give guidance to industry.

Technology is not enough

New technology alone cannot bring about digitalisation in trade finance. While banks are good at building digital platforms, many operate in digital silos or proprietary islands which stymies the free flow of information. Encouraging greater collaboration through rule-making, advocacy and engagement is crucial.

Since trade often relies on a dense network of counterparties, it is important to look beyond digitalising pockets of transaction flows. A practical view on integration and creating a legal and regulatory framework for all with a set of minimum standards and clearly defined rules is vital for interoperability.

With lots of digitalisation projects underway, the industry is in a better position than a year ago. But the process remains huge, complex and costly.

Network effects

The digitisation of trade finance is essentially about building a network, which requires all participants to continuously cooperate. Collaboration between banks and fintechs will speed up the journey to digital in a new way. Blockchain-based platform Batavia, a collaboration of UBS, Commerzbank, Bank of Montreal, CaixaBank, Erste Group and IBM will provide trade finance for transactions all modes of transport. We.trade, a collaboration among

Deutsche Bank, HSBC, KBC, Natixis, Société Générale and UniCredit with IBM, targets SMEs.

But the broader strategy should be how to merge these pockets into a larger trade ecosystem. Ideally, data would seamlessly move from one digital island to another, while buyers, sellers, banks and logistic companies could rely on data, and information flowing through the supply chain would be speedier than the flow of goods.

Platform developers must be mindful of open standards and future interoperability. The full benefits of digitalisation can only be realised if a few trade corridors go fully digital, such as the Hong Kong-to-Rotterdam corridor.

Digitalisation, although largely initiated by banks and technology companies, must prove its worth to the entire trade cycle. Many trade finance banks, for instance, are still not multi-bank capable. To communicate digitally with banks, a corporate needs e-banking software, which is unsustainable in the long run.

Digitalisation is fundamentally not only about aligning the industry with one of the biggest trends in history. It is also about meeting customer and compliance requirements down to the level of SMEs.

The focus should also be using this new technology to improve the efficiency of real transactions, and driving home the benefits of digitalisation.



Background information

Connecting from end to end in real time

Enterprise software firm R3 started the Marco Polo initiative in 2017 with Technology firm TX acting as the vendor. BNP Paribas, Commerzbank, ING and Standard Chartered collaborated.

After a successful six-month proof of concept, the blockchain-based platform, which provides end-to-end, real-time connectivity between trade participants while getting rid of data silos, the project is being piloted, and aims to onboard up to two dozen banks by the end of the year.

R3 is also running the DLT-based Voltron platform to connect importers and exporters. In the long term, the two initiatives will be merged into a larger system of trade products.



Find more online

We.Trade

we.trade manages, tracks and protects trade transactions between European SMEs. Using DLT and smart contracts, the open platform's shareholders include Nordea, Santander, Deutsche Bank, HSBC, Rabobank, Société Générale and UniCredit. New member banks will be onboarded to standardise, collaborate and achieve consensus. Commercialisation is expected in the second quarter.

Conflicts in laws/ Time to get your clauses in order

By **Angelia Chia**

Angelia Chia is a Partner at Mayer Brown

Why banks need to take a hard look at their policies and procedures – and exposure and tread carefully in using electronic contracts.

Traditional Trade

A recent court decision marks a fundamental shift in how the governing law is determined for letters of credit (LCs) which will have a major impact on trade finance contracts globally, and for legal and credit risk assessments. As a result, trade finance practitioners need to revisit the potential risks and how to address them in drafting these contracts.

In *Taurus Petroleum Ltd v State Oil Marketing Company of the Ministry of Oil Iraq*¹, the UK Supreme Court, the country's highest civil court, recently decided on two LCs issued by the London branch of Credit Agricole subject to UCP600.

The jurisdictions were:

Baghdad, Iraq - the seat of arbitration and where there was a promise to pay the Central Bank of Iraq

New York - where payment was to be made into the Iraq oil proceeds account at the Federal Reserve Bank

London - where the London branch of a French bank issued the LCs is located and where parties wanted enforcement to take place

France - where the head office of the bank issuing the LCs was located.

In unanimously overruling the Court of Appeal decision in *Power Curber International Ltd. v. National Bank of Kuwait*, the UK Supreme Court decided that debts arising from payments under LCs will follow the general position in English law: the law governing the debt will be where the debtor's residence is located. Following the *Taurus* case, the governing law is London, where the branch of the French bank is located, instead of the place

of payment following the *Power Curber* case, which would have been New York.

These two clauses were added so the court had to decide if it changed who was the beneficiary:

“A Provided all terms and conditions of this letter of credit are complied with, proceeds of this letter of credit will be irrevocably paid in to your account with Federal Reserve Bank New York, with reference to “Iraq Oil Proceeds Account”.

These instructions will be followed irrespective of any conflicting instructions contained in the seller's commercial invoice or any transmitted letter.

“B We hereby engage with the beneficiary and Central Bank of Iraq that documents drawn under and in compliance with the terms of this credit will be duly

honoured upon presentation as specified to credit CBI A/c with Federal Reserve Bank New York."

The court had to interpret whether these clauses changed the beneficiary of the LC from the State Oil Marketing Company (SOMO) to the Republic of Iraq, as the proceeds were to be paid to the Iraq Oil Proceeds Account, not to SOMO. The court decided these clauses did not change the position under the LC. SOMO stayed the beneficiary.

Takeaways for practitioners

The Taurus Petroleum case is a significant decision and a stark reminder for LC practitioners to consider conflicts of laws.

While principal contractual terms between parties are typically agreed as embodied in the relevant ICC rules, these rules still have to be implemented in many jurisdictions, and parties are free to amend the terms and rules. As such, all relevant considerations under the applicable laws will have bearing on how the terms are interpreted.

Banks generally resist adding clauses on the choice of governing law and where and how to resolve disputes because there are difficulties when dealing with so many jurisdictions and getting all parties to agree. Banks must be aware of these risks.

Hong Kong and Singapore will in all likelihood be persuaded by the Taurus decision. So it is possible three of the world's financial hubs will follow this change in legal position.

As such, when banks take into account country risk to assess pricing and exposures, they should consider whether to review policies, procedures and systems. They need to determine which country to take into account, whether it is the place of payment, following the Curber case, or the place of debtor's residence, following the Taurus case. Given the impact on banks and their large portfolios in LC transactions from this change in

legal position, banks should decide if their policies and procedures need to be updated.

LC issuers must have a robust process to make sure clauses added to the LC are consistent and do not create operational risks and unintended consequences.

Open account and supply chain finance

Supply chain finance techniques for open account typically involve a loan product or an assignment of accounts receivables, in all its complexity for cross-border transactions. These techniques sometimes include negotiable instruments, such as bills of exchange, electronic platforms and guarantees, and other security arrangements that add an extra layer of legal inquiry.

In 2016, ICC together with other trade industry bodies published the Standard Definitions for Techniques of Supply Chain Finance, a guide on terms and techniques. This was a good first step in coalescing loose definitions in a complex field. Understanding the nature of the products, such as asset purchases versus loans, is important from many perspectives, even though the economic outcome is essentially the same.

For receivables purchases, at least two contracts and relevant governing laws must be considered, in assigning or transferring receivables and related rights, by way of ownership. What is more, buyers or sellers typically try to avoid booking a loan, which introduces accounting issues. This is on top of the financial industry's need to achieve the right standards of ownership and control over accounts receivables and cash proceeds.

For negotiable instruments such as bills of exchange (financial instruments created by statute in one jurisdiction) their form, negotiation, acceptance and need for noting and protesting in other jurisdictions give rise to conflicts of

law considerations. This is to ensure the instrument is still enforceable against the relevant parties.

To keep up with the on-going development in respect of negotiable instruments, the United Nations Committee of International Trade Law (UNCITRAL) promulgated the Model law on Transferable Records and this is a work of noteworthy effort.

Electronic platforms raise new questions on the enforcement of electronic contracts, and the capacity and authority of a party that attaches an electronic signature and its probative value in an enforcement action. UNCITRAL's promulgation of the *Model law on Electronic Commerce laws*³ and *Model laws on Electronic Signatures*⁴ is important. But these model laws have not been adopted consistently across the globe, and many countries have not adopted electronic commerce legislation.

E-takeaways

Trade and trade finance are entering a new and exciting digital age. But the watchword is caution. While industry bodies try to keep pace with industry developments, laws in jurisdictions are developing at a feverish pace. Practitioners must conduct the right amount of due diligence in this increasingly integrated and complex world.



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Digital forfaiting/Making distributed ledger tech a reality

By Sean Edwards

Sean Edwards is Chairman of ITFA.

Forfaiting may help solve the problems getting in the way of commercialising distributed ledger technology (DLT). This is especially true for receivables finance. DLT could also ramp up the market for forfaiting, estimated at about US\$35 billion, not to mention if some of the value of receivables discounting was reallocated to forfaiting.

Negotiable instruments on blockchain?

To get there, several legal issues must be resolved. For promissory notes, which offer the most potential, most legislative definitions of these instruments require writing and signature. The English Bills of Exchange Act 1883 states there must be “an unconditional promise in writing... signed by the maker...”.

Digital promissory notes offer the most potential

Electronic writing and signing are therefore critical to create promissory notes in digital form. Most advanced economies allow

this, either according to common law in many countries, as for writing on stones and sea shells, or because of specific laws.

Recent changes include:

- an English law change in 2015 allows electronic presentation of promissory notes and bills of exchange
- eIDAS (electronic IDentification, Authentication and trust Services), an EU regulation and standards for electronic identification, and trust services for electronic transactions in the EU single market

eIDAS shows the desire is there to integrate the highest standards of cyber-security in e-commerce, by giving special status to qualified

electronic signatures. But legal issues remain, such as the ability to deliver negotiable instruments, in a very specific legal sense. Work is going on to resolve these issues.

Real digital assets

Given the right legal framework is in place, promissory notes could be created that are true digital assets (or state objects, as the Corda blockchain platform defines them). This is different from a functional equivalent or substitute, and it is a powerful construct as it has inherent value.

It is a type of ‘private money’ without the complexity and controversy of cryptocurrencies. It can exist on any digital network, or be free of that network, even

though a digital network has many advantages. What is more, digital assets are technically easy to create, as R3, TradelX and Wave have shown.

Promissory notes come without the complexity and controversy of cryptocurrencies

A new dog with old tricks

Many proposed blockchain applications for trade have focused on matching or tracking invoices, purchase orders and shipping data. There has been less focus on creating powerful and robust payment obligations. A digital promissory note has the benefits of a paper promissory note, without the mostly practical and logistical drawbacks of paper.

What is more, blockchain promissory notes will satisfy the needs of an important potential partner, non-bank financial investors (NBFIs). These instruments can be assigned some of the characteristics of quoted Eurobonds, which these investors are comfortable with. NBFIs would also like their simple legal structure and tradability.

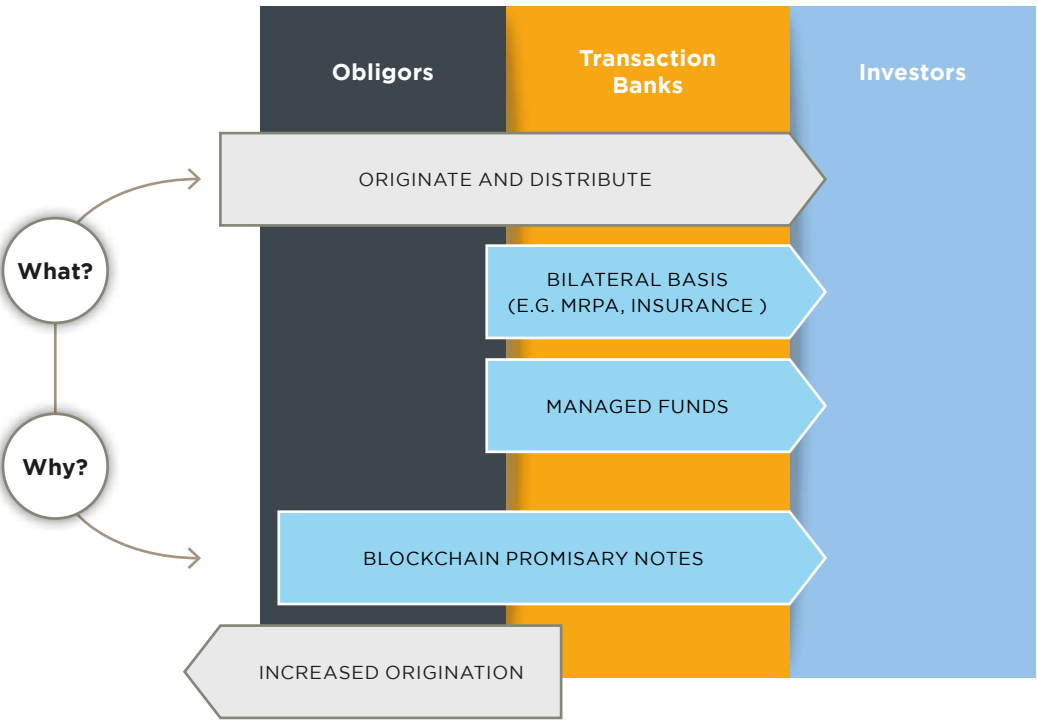
Lack of a suitable operating infrastructure is one of the biggest obstacles that prevents NBFIs from investing more in trade finance.

Blockchain minimizes performance risk during credit analysis

Assigning ISINs and fitting self-contained instruments into the right operational environment, which is

being developed, are crucial for NBFIs. Blockchain promissory notes simplify all this, while minimizing performance risk during the process of credit analysis.

DLT is some of the best technology that could unite and meet the expectations of the many actors in trade finance. Digitised traditional forfaiting instruments would deepen and broaden the market for trade finance as well as boost demand and supply.



Source: Casterman Advisory April 2018

Voluntary Sustainability Standards/Schemes are spreading

By Mathieu Lamolle, Sandra Cabrera and Regina Taimasova

Mathieu Lamolle is a Senior Advisor – Sustainability Standards & Value Chains at International Trade Center; Sandra Cabrera and Regina Taimasova are Advisors – Sustainability Standards & Value Chains at ITC.

Consumers from Brazil to Belgium are getting savvier about sustainability issues related to the products they buy, a big reason for the growth in voluntary sustainability standards. But several problems need to be solved on the use of VSS's.

Voluntary sustainability standards (VSS)¹, the market-driven tools to control for sustainability-related risks in the supply chain, have really caught on since they were first introduced way back in the 1960s. Of recent, there has a ferment of new ways to measure sustainability and hold suppliers accountable, driven by a rising sustainability consciousness of consumers that is rapidly spreading across the globe.

In the early days, VSS mainly covered agricultural products and organic production. Fast forward

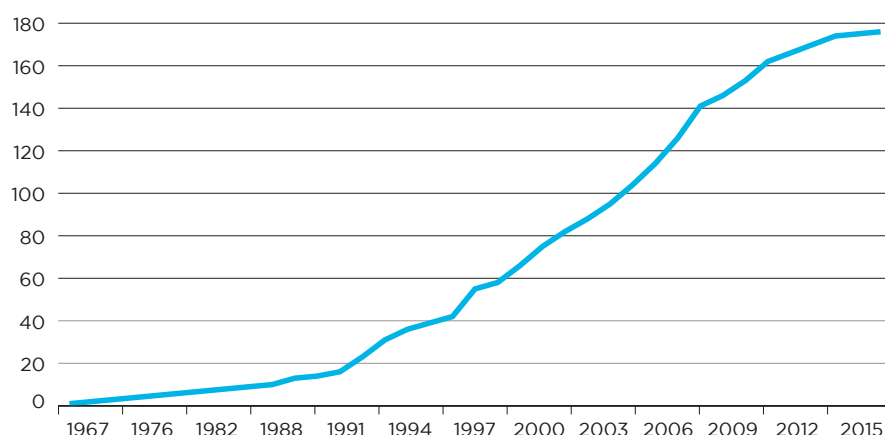
to today, and these systems cover a whole host of sustainability issues: from fair and ethical trade to climate change adaptation, from textiles and tourism to forestry and mining.

Voluntary sustainability standards now cover a wide range of issues and sectors

The rising number of sustainability standards tracks developments in the global sustainability agenda. The United Nations Conference on Environment and Development in Rio de Janeiro in 1992, and adoption of Kyoto Protocol on reducing greenhouse gas (GHG) emissions by the states in 1997, effectively triggered the setup of VSS, among other world forums and international bodies set up since to address climate change and sustainable development.

Voluntary standards pick up pace in the early 'oughts

Cumulative number of initiatives



Source: International Trade Centre and European University Institute (2016). Social and Environmental Standards: Contributing to More Sustainable Value Chains. ITC, Geneva.

There are five other reasons behind the rise in VSS standards:

- growing concerns about the environmental and the social impact of production processes
- globalization of trade, as products are sourced from all over the world, risks and demand for traceability
- concentration in the food industry: as processors and retailers seize more market power, they impose more technical requirements for the products they source, including on product quality and sustainability of production processes
- greater consumer demand for sustainably-produced products
- more competition, which drives businesses to impose stricter sourcing requirements, including sustainability standards

Production volumes compliant with VSS have risen in tandem. For example, the Better Cotton Initiative's certified cotton lint volume rose to 2,086,000 metric tons in 2015 from 35,000 metric tons in 2010 while the land area went to 2,217,000 hectares in 2015 from 65,000 hectares in 2010. Fairtrade's certified land area rose to 2.5 million

hectares in 2015 from 1.4 million hectares in 2011, growth of 179%.²

But despite this rapid growth, the market for certified products is still tiny: less than 1% of global agricultural areas.³

Experts criticise the growth in the number of voluntary sustainability standards, saying sometimes it raises production costs, if a supplier to several buyers has to comply with several standards.

The problem is made worse when the supplier bears the costs of certification, as is mostly the case. This is a major problem for small- and medium-sized enterprises and smallholders who often lack enough funds to cover the costs of certification.

Too much of a good thing?

Multiple standards also leads to confusion among consumers, who sometimes cannot distinguish between sustainability labels and cannot understand product claims and sustainability impact. As a result, consumer trust is undermined.

Several trends have emerged in the creation of VSS, which provide insight on how sustainability standards will evolve in the future.

VSS is taking hold in developing countries

Heading south

While VSS first emerged in developed countries, developing countries are now setting up their own schemes. Brazil, South Africa, India and Kenya have the highest number of VSS headquartered in the developing world, ITC and European University Institute (EUI) research shows.



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VSS is taking hold in developing countries for three reasons:

- concerns over sustainability, as local producers develop their own standards
- cost effectiveness of local systems, including local assurance mechanisms for assessing compliance
- ownership of the sustainability agenda, including translating international schemes to suit local issues

In China, for example, authorities are developing national VSS instead of helping develop international standards. China's standards substitute for major international standards. The Chinese Social Compliance Management System CSC9000T is a national response to the Fair Labour Association (FLA), Social Accountability International (SAI) and the Ethical Trading Initiative (ETI).

For now however, demand for VSS-certified products is still much higher in developed countries, as consumers in developed countries are more aware and demand sustainably-made products.

But awareness is rising among consumers in the developing world. A Nielsen survey conducted in 2014 showed that 63% of respondents in Latin America were willing to pay more for products and services from companies with a positive social and environmental impact, up from 13% in 2011. In the Asia-Pacific region the figure was 64% in 2014, 9% up from 2011.

From raw materials to services

Product scope of VSS is also shifting - to services. In the 90s, VSS dealt with commodities, such as coffee, cocoa, and tea. While commodities is still the largest group of sustainably-certified products, VSS-certified services are gaining a market niche. These services include catering, cleaning, administration, financial and insurance services,

water supply and sewage, real estate, transportation and storage.

Tourism is the largest VSS-certified service sector: Travelife, a sustainability standard for tourism, for instance already certifies more than 1,300 hotel members worldwide.

Hardwiring VSS

Using VSS mechanisms, more governments are embedding their sustainability commitments in legislation, and private companies are embedding their commitments into corporate strategies. For instance, Unilever developed its own Sustainable Agriculture Code (Unilever SAC) to make sure its suppliers comply with the minimum sustainability requirements set by Unilever. By 2020, Unilever aims to source all of its agricultural raw materials sustainably. Mars, on the other hand, relies on external standards such as Rainforest Alliance, UTZ, Fairtrade, and Roundtable on Sustainable Palm Oil (RSPO) to source product ingredients. The company aims to source all of its cocoa from certified sources by 2020.

Governments are recognising more and more the value of working with VSSs as a mechanism to meet their sustainability commitments. Depending on rules, governments may not explicitly refer to specific VSS, but in procurement guidelines they reference the underlying criteria of VSS or create lists of VSS meeting these criteria.

Alternative audits

Some entities substitute traditional models of audit and assurance with alternative models that go beyond a certification system. Traditional assurance models are usually based on independent, third-party audits, and have proved to be efficient at assuring compliance against the VSS.

New assurance models are emerging

But due to the high costs, questionable integrity of auditors and audit duplication, other assurance models are emerging. Self-declaration is a first step towards recognized compliance. New concepts are coming to the fore for shared responsibility and accountability in the supply chains, in which business partners divide up responsibility, and do not rely exclusively on external assurance providers to make sure sustainability requirements are covered in their supply chains.

Companies and standard-setting organizations are collaborating in joint efforts to boost sustainable production in the supply chain. They get together to set common codes and IT solutions, that allow them to assess suppliers and manage supply chain information on supplier compliance to sustainability standards or frameworks.

Pooling resources

For instance, Nestlé, Unilever and Danone set up the Sustainable Agriculture Initiative (SAI) Platform in 2002 to share knowledge and best practices for developing and carrying out of sustainable agricultural practices at a precompetitive level. Today the Platform membership counts more than 90 members. Developed by its members, suppliers, farmers and external stakeholders, the Farm Sustainability Assessment (FSA) is a common framework of leading food and drink companies that use SAI Platform to source sustainably-produced agricultural materials.



Background information

Setting local standards: Indonesia's palm oil

Indonesia's Sustainable Palm Oil (ISPO) is a public standard developed by Indonesia's Ministry of Agriculture to deal with issues like deforestation, the protection of High Conservation Value Areas (HCVs), and child and forced labour.

It is an alternative to the Roundtable on Sustainable Palm Oil standard (RSPO), the world's largest voluntary certification

scheme for sustainable palm oil, accounting for 18.5% of palm oil area worldwide.

ISPO was set up to retain ownership of sustainability issues in palm oil cultivation and that depend on public policies, such as land, and registering and training farmer farmers. These policies are not fully handled at the mill and plantation levels in the RSPO standard.

ICC's work on sustainable trade finance/ Blueprint in the making

By Ruediger Geis and Harriette Resnick

Ruediger Geis is Head of Product Management Trade at Commerzbank; Harriette Resnick is former Managing Director and Associate General Counsel at JPMorgan Chase supporting its Global Trade business and co-chair of the ICC Banking Commission's Sustainable Trade Finance working group.

A new ICC working group on sustainable finance started in 2016 is looking into standards, a due diligence tool, and ways to spread best practices.

How do we safeguard the planet, its inhabitants, and global economic growth? There is no easy answer, but sustainable trade can help. What is needed are responsible companies that conserve the Earth's natural resources and protect the environment from climate change; ethical supply chains that guarantee fair labour conditions and human rights for workers; and resilient business models that sustain employment and prosperity well into an uncertain future.

As the lynchpin of the real economy, the banking sector can play a critical role by providing sustainable trade finance.

Outside forces

Several forces are steering the trade finance industry in a more sustainable direction.

The first force is regulation. More local, national and international authorities recognise the need to combat and adapt to the impact of climate change, support the Paris Agreement, and realise the UN's Sustainable Development Goals.

The Financial Stability Board's Task Force on Climate-Related Financial Disclosures highlights the need for business to be transparent about material risks from climate change.¹ The European Commission's high-level expert group on sustainable finance is outlining a blueprint for a financial system that makes sustainability considerations part of decision-making.²

Government restrictions on the import of conflict minerals, illegally harvested timber and the use of forced labour or child labour and related disclosure requirements add to the need for greater transparency on how goods are financed and produced.^{4, 5, 6, 7}

With transaction banks increasingly under the microscope, regulations will probably get tougher, and penalties bigger for non-compliance.

The second force is credit and reputational risk. No bank wants its image tarnished, or to risk greater losses, due to the unsustainable practices of a customer or a company in its supply chain. The reputational risk department at Commerzbank, for example, on average checks more than 5,000 transactions, loans and relationships a year against strict social, environmental, and governance (ESG) criteria.

These risks go well beyond bad publicity. As regulation and social advocacy grow, so does the threat of protests or litigation. Bank customers failing to manage these risks are vulnerable to regulatory fines, liability for damages, or losses.

As regulation and advocacy grow, so does the threat of protests or litigation

There are numerous recent examples of business losses related to illegal deforestation. For example, a U.S. lumber company, which was fined and had its assets seized because of logging in the habitats of endangered species in Russia. An Indonesian palm oil producer is no longer an eligible supplier to major importers after being suspended by the Roundtable on Sustainable Palm Oil, a certification authority. A cocoa plantation company with activities in Latin America had its operations halted, trading



Background information

Sustainable trade finance defined

The ICC Banking Commission defines this as “finance which supports goods or services produced in a manner that minimises adverse environmental or social impacts or risks, or that promotes environmental protection or social benefit.”

In its 2015 Charter for Sustainable Development, the ICC set forth guidelines to achieve sustainable development in a business context, described as “a process whereby companies seek to manage their financial, societal (including governance) and environmental risks, obligations and opportunities.” This is commonly referred to as a triple bottom line approach where business connects to healthy and balanced economic, societal and environmental systems. In order to do so businesses must be aware of

the principles of sustainable development such as outlined in this Charter, and consider their impacts on the environment in which they operate.”³ The Charter recognizes the importance of implementing this approach with distributors, service providers, and other relevant partners, and collaborating with all actors in the value chain to achieve responsible behavior across the entire product or service life cycle. Applying this approach to the context of traditional trade and supply chain finance products, our working group has defined “Sustainable Trade” as “the business and activities of buying and selling commodities, goods and services that meet environmental, social and economic criteria capable of benefitting all actors involved and minimizing adverse impact while fostering sustainable global development.”

suspended, and debt and equity delisted. It is now insolvent.⁸

The third force is the market. Consumers are more aware of and concerned about the environmental and social footprint of the products they buy. They have the power to vote with their wallets. Corporates are reacting by committing to sourcing sustainably-produced goods, and requiring verification from certification schemes that screen for environmental and social impacts.

The impact of these combined forces is evident. Since 2011, the amount of global soy produced that is verified by the Round Table on Responsible Soy has grown five-fold. In the same period, the land supporting sustainably cultivated bananas expanded three-fold; and certified sustainable cotton production has grown almost nine-fold over the past decade, according to the Better Cotton Initiative.

Banks that ignore fundamental long-term shifts in demand – or finance transactions linked to impacts, such as the destruction of tropical forests, excessive use of water or pesticides, or child labour – face losing business and putting their profits at risk.

Banks that ignore adverse environmental and social impacts linked to their transactions face increased risks

Embrace the opportunities

Financial institutions that support integrating responsible practices into supply chains could do much more. They could unlock new opportunities than simply react to these trends.

For a start, banks that embrace sustainable trade and supply chain finance could reduce the market, credit and reputational risks associated with lending to customers that have not yet applied appropriate controls to their own operations and supply chains.

Banks may even benefit from new competitive advantages, as they become market leaders. This is crucial for capturing new business from corporate customers already committed to responsible production and sourcing. It is just as critical for investors and retail customers, which are more focused on the social and environmental track record of banks.

The trade finance industry will start to generate real value once banks integrate sustainability principles into business as usual. The first step is for banks to talk to their customers about whether their business raises social and environmental concerns and how they can mitigate these risks.

Call-out to collaborate

All easier said than done, but far from impossible. Industry-wide collaboration can help identify what steps banks active in trade and supply chain finance can take to go green.

The ICC Banking Commission formed a working group on sustainable trade finance in April 2016, made up of international development banks and commercial banks from across the world.

The group is organised into three streams to explore the main areas where the financial sector can build momentum for sustainable trade.

Making sense of standards

The working group's first stream looks at standards, labels and certification. Many labels and certification authorities claim to validate fair returns to farmers, labour practices that comply with

international conventions, and environmental conservation. The challenge for banks lies in assessing which of the many certification schemes have standards that effectively mitigate relevant high risks.

The group has identified the need for an integrated and automated diligence tool that leverages existing databases and analytical methods. The Global Map of Environmental and Social Risk in Agro-Commodity Production (GMAP), developed by the International Finance Corporation and the World Wildlife Fund, lets the user search to see if specific products have had harmful social and environmental impacts in the country of production.

Examples of commodities linked to high risk in many regions include soy, cotton, cocoa, coffee and palm oil. The International Trade Centre has compiled the Standards Map, detailing voluntary certification schemes that apply to certain commodities, the requirements they impose and the countries where the certification bodies operate.

By collaborating with these international organizations, the working group will design a proof of concept for a single integrated tool for bankers to easily check for social and environmental risks and assess whether a certification's requirements minimize these risks.

This information should help a bank decide whether or not to proceed with a trade transaction involving commodities produced in countries with a history of high risks.

The trade finance industry needs a roadmap for assessing sustainability

First-ever guidelines

The second stream is creating guidelines for setting best practice on analysing the social and environmental risks of trade finance. Unlike project finance, which benefits from the guidance of the Equator Principles, or the green bond market, supported by the Green Bond Principles, the trade finance industry had not developed a roadmap for assessing sustainability.

To address this need, the working group designed a questionnaire that trade banks can integrate into their customer due diligence process as a complement to existing risk management and KYC compliance procedures.

Guidelines are being developed to go with the questionnaire, which highlight other sources, indexes and databases for reviewing a customer's sustainability policies, commitments and practices. With this information, a bank can apply internal policies defining its risk appetite in relation to transactions that may pose a social, environmental, reputational, credit, market, or regulatory compliance risk.

Spreading knowledge

The third stream works on educating and training bankers on sustainable trade. Benefiting from the educational programmes developed by the international development banks represented at the ICC Banking Commission, the working group is collecting materials and training modules that promote sustainability policies and practices by banks and their customers.

This stream is also developing educational tools for trade finance professionals that highlight the potential sustainability risks associated with transactions and explain the use of the guidelines to help mitigate these risks.

Bankers can then have an informed discussion with their corporate customers about shared interests in sustainable trade finance.

It is a work in progress. Tools are needed for banks of many sizes and geographies, including in emerging markets, and to broaden the focus beyond agricultural commodities. The working group is asking banks for their feedback.

The working group will confirm the feasibility, cost and interest in using these tools. New approaches to due diligence should not be an extra burden on corporate clients, or impede deal flow. The guidelines and recommendations will be road tested to identify and solve practical challenges to implementation, and to create a process map for effectively and efficiently using these mechanisms.

New information sources will be vital to progress. Corporate sustainability reporting is improving, and technologies are emerging, such as track and trace solutions that accurately pinpoint the origin, position, and condition of goods across supply chains.

Blockchain could incentivize sustainable practices in agricultural commodities trade

Blockchain could incentivise sustainable practices in the agricultural commodity trade, by smoothing the approval of transactions based on reliable confirmation of certification and offering better financing terms to certified suppliers.

These developments may help provide all-important transparency to trade finance transactions.

The demand for sustainable trade finance will only grow. Banks have to be ready for it. With standards, effective guidelines and an awareness of the tools, banks could reap the rewards of a greener approach to facilitating commerce. Exciting times lie ahead.



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SPOTLIGHT

Neighbors with close economic ties, China and Singapore

Singapore is launching new initiatives to streamline cross-border trade and a new platform which could be a global model for distributed ledger technology.

Trade finance is rapidly changing in China, as solutions are found to help SMEs expand abroad and the One Belt One Road initiative creates huge demand for financing amid a boost in trade along the route.

SINOSURE, China's official Export Credit Agency, is building relationships with foreign banks at home, and providing finance for the Belt and Road and Going Global 2.0 strategies of expansion abroad.

Global trade in 2028/Singapore's digital trade finance journey

Regulatory and business authorities in Singapore lay out their five-point plan to respond to the needs of business for a seamless and interoperable digital strategy for trade and trade finance. [Page 157-158 >](#)

From the Field/How China finances its growing trade and globalisation

China's trade finance market has some unique features, and the country is moving forward with novel ways to fund e-commerce. [Page 159-162 >](#)

SINOSURE view/What's driving China's galloping growth in trade finance?

Amid a transformation of China's foreign trade structure, SINOSURE is providing the risk coverage as the country transitions to an innovation-led economy. [Page 163-164 >](#)

Global trade in 2028/ Singapore's digital trade finance journey

A joint-contribution by Enterprise Singapore, the Monetary Authority of Singapore and the National Trade Platform Program Office

Singapore lays out its vision for a globally connected, digitized world for trade and trade finance.

Global trade in 2028 is going to look very different. New technologies such as distributed ledgers, big data, and widespread Internet connectivity, will reshape trade patterns and processes. How is Singapore, a small, open economy at the heart of Asia, getting ready for this new world?

Asia accounted for 60% of global economic growth last year.¹ Likewise, Asia is seen accounting for about 60% of growth in global trade until 2020.² Over two thirds of major commodities are now produced, consumed and traded in Asia.³

Shifting global trade flows

This shift in global trade patterns towards Asia is prompting greater investment in trade and connectivity infrastructure. To capitalise on these growing trade flows, Singapore, as a leading trade and financial hub in Asia, sees an opportunity to digitise trade and trade finance and in so doing transform the way trade is done.

A global trading hub

Singapore has a long history of being open to trade. Today, Singapore's trade flows are more than three times its GDP. This legacy has spawned the growth of a comprehensive and integrated

trade ecosystem of finance and logistics companies. As a financial hub in Asia, Singapore's financial sector aims to connect global markets and support Asia's development, while serving the needs of the Singapore economy.

Singapore also has one of the world's busiest ports and largest transshipment hubs. PSA Singapore Terminals are connected by 200 shipping lines to 600 ports in 123 countries, with daily sailings to every major port of call. Trade connectivity in Singapore supports 34,000 local companies in wholesale trade, representing 9% of the workforce.⁴

Singapore's digital journey

Nearly 30 years ago, Singapore launched a ground-breaking initiative, TradeNet. This national single window for trade declaration integrates import, export and transshipment document processing, and allows trade and logistics companies to exchange trade data electronically.

As technology and innovation continue to transform many sectors, in 2015 Singapore launched the Smart Nation journey, identifying strategic national projects to achieve this vision. In 2016, Singapore announced it is developing the National Trade Platform (NTP) to create a one-stop trade information management system. Once completed, firms will input trade information only once, and authorise its use by logistics providers, business partners and regulatory authorities. A developer zone will be added to the platform for insights and new services, using some of the cross-industry data shared on the platform. The platform will also include a document hub for each company to store structured digital trade data, so data can be reused to cut costs and streamline processes.

Singapore also aims to create trade connectivity linkages with like-minded stakeholders internationally. In 2017, the Monetary Authority of Singapore (MAS) and the Hong Kong Monetary Authority announced they will collaborate on developing a Global Trade Connectivity Network (GTCN): an information superhighway will be built using distributed ledger technology (DLT), between Singapore's NTP and the Hong Kong Trade Finance Platform, to make cross-border trade and financing cheaper, safer and more efficient. The GTCN aims to go live in 2019, and then expand to other platforms and jurisdictions.

To encourage more fintech companies to experiment, MAS introduced grants for technology and innovation. The grants support inventions with potentially

transformative impact on the financial sector. For example, the Capital and Credit Risk Manager (CCRM) is an electronic trading platform for trade finance assets. A total of 35 users, including 30 banks, have signed on to the CCRM platform. This allowed them to list trade finance assets for distribution, creating a secondary market for trade assets and to securely manage supporting documentation. This helps create a platform for an efficient secondary market globally to attract a broader pool of investors to these instruments, and act as a catalyst for trade financing in Asia.

Five ingredients must be fulfilled for global adoption of digital trade finance.

Technology standardisation and interoperability

At a recent ICC-World Trade Organisation (ICC-WTO) Roundtable on Trade Digitalisation and Facilitation in Singapore, companies underlined the need for technology standardisation and interoperability. Several solutions exist for electronic documentation. ICC, the International Standards Organization and the WTO must each advocate for standards on data exchange, electronic documentation, and the interoperability of digital platforms.

Put in place necessary legislation

Greater consistency in legalizing digital documents would motivate banks and companies to embrace electronic documentation. DLT offers much-needed security and integrity. Governments need to coordinate and put in place legislation making digital documents legal.

Build infrastructure

Before cross-border information can take off, digital infrastructure must be in place at national level to capture trade and financial data at the source. Initiatives such as the GTCN, an important part of this evolution, can then build connectivity across jurisdictions.

Collaborate

To create an open digital ecosystem, MNCs, global banks, shipping lines, and governments with other stakeholders must collaborate, to forge a common strategic vision for their digital journeys, and see beyond the marginal commercial value in the short-term.

Include and train SMEs

SMEs make up 60% of trade finance rejections⁵, so they will benefit most from the greater productivity and access to finance that trade digitalisation provides. SMEs need the right training to navigate the digitalisation process and handle critical issues, such as cybersecurity. They need to be aware of the benefits digitalisation brings - more efficiency, and more access to markets and financing.

In the global quest for digitising trade finance, Singapore will continue to serve as a test bed for new digital trade solutions and to advocate for digital trade initiatives.



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From the Field/How China finances its growing trade and globalisation

By Vincent O'Brien and Jun XU

Vincent O'Brien is Executive Committee Member of ICC's Banking Commission; Jun XU is Deputy General Manager of the Global Trade Services Department of the Bank of China Jiangsu Branch in Nanjing, China.

China's trade finance market has some unique features, and the country is moving forward with novel ways to fund e-commerce.

On 29 January 2018, Vincent O'Brien, an Executive Committee Member of ICC's Banking Commission, sat down with Jun XU, Deputy General Manager of the Global Trade Services Department of the Bank of China Jiangsu Branch in Nanjing, China, to talk about the fast-changing landscape of trade finance, China's rapid growth in trade and internationalisation of its enterprises.

Here are edited excerpts from the interview:

O'Brien (ICC): Chinese President Xi Jinping recently called for a global economy that is more open, diverse, balanced, secure, efficient, and with higher standards. This would help not just China but the whole world, he said: We must remain committed to openness and mutual benefit for all to increase the size of the global economic pie, he said.

Sounds promising for expanding trade and in turn for trade finance professionals. Does this match what is happening on the ground in China?

Ms Xu: Yes. China is the world's largest exporter and the second-largest economy, in which trade finance continues to play a major supporting role.

Chinese President Xi Jinping has said, 'Trade is an important engine

of economic development.” The government has made many efforts supporting globalization: advancing policies and laws to facilitate trade, such as the global trade single window system of one-stop services for importers and exporters; implementing cross-border RMB policies to promote trade facilitation; developing the Belt and Road initiative; support for inclusive finance, including to boost the access of SMEs to finance; promoting supply chain finance, and formulating laws on letters of credits and independent guarantees.

But trade finance in China has seen its ups and downs. Trade practitioners are facing new challenges on profitability, KYC and compliance, and capital requirements. After two years of decline, global trade is growing again, up 14.2% in 2017 from the year before.

The economy is still growing, but not as fast as before. GDP in China was up 6.9% in 2017, due to a slowdown in the global economy. The road to a rebalanced economy is not without bumps. Like elsewhere, we are facing headwinds such as from greater regulatory challenges. Recently, we have seen an impact on trade by an escalation in trade protectionism and anti-globalization from our trading partners. Technology also poses a new challenge, but also an opportunity.

O’Brien (ICC): Bank of China was the exclusive provider of trade finance in China for some time. Can you share some background on how trade finance developed in China?

Ms Xu: From 1953 to 1993, Bank of China was the designated state foreign exchange bank handling foreign trade settlement and trade finance. Since the foreign exchange management system was reformed in 1994, focused on implementing a single foreign exchange rate system, the State Administration of Foreign Exchange has begun managing foreign exchange businesses. Commercial banks with a foreign exchange business license may engage in foreign trade and finance.

Having said that, based on data ICC China collected from member banks, trade settlement volumes are concentrated in a group of state-owned commercial banks and a few medium to large-sized shareholding commercial banks.

Estimates show the trade settlement volume of a few major trade banks cover 70% of the country’s trade in goods.

O’Brien (ICC): It can be hard to define what is a trade finance product. What trade finance products does China have?

Ms Xu: Narrowly speaking, trade settlement in China usually refers to trade payments and receipts, while trade finance covers trade-related financing products. Maybe it is different in other countries.

A survey of 62 banks in China showed the trade finance departments of 58 banks manage international remittance business and traditional products such as LCs, collections, guarantees and standbys. Broadly speaking, trade finance products include trade settlement and trade-related financing products.

In my experience working abroad it seems cross-border remittances in banks in the west are not typically included as trade settlement products.

O’Brien (ICC): How have trade payment methods changed in recent years?

Ms Xu: Before 1994, LCs dominated international trade settlement. But as China’s trade rapidly developed, cross-border remittances as a payment method increased. International remittances made up about 80% of trade settlement volume from 2015 to 2017, while during that same period LCs were about 15%, a drop from about 19% in 2014.

O’Brien (ICC): How have exports and imports evolved?

Ms Xu: For exports, inward remittances have risen about 1% a year since 2015, now comprising

about 47%, while export LCs are less than 5% on average, and export documentary collection is about 1.5%.

For imports, the average percent of outward remittances is around 34%, almost 13% less than the inward remittance for exports. It is interesting to note the average percent of import LCs is around 11%, about 6% higher than export LCs. Import collection is about 3%, nearly 1.5% higher than export collections.

O’Brien (ICC): So if there is a move away from LCs as a trade settlement instrument with greater divergence on the export side, what is driving this change?

Ms Xu: Three reasons. First, China is one of the largest players in the global trade supply chain. This position has been facilitated by Chinese exporters extending attractive trade settlement conditions to buyers. As a result, buyers are now usually reluctant to use LCs, given their higher costs, complicated procedures, and tying up credit limits and facilities as a result.

Second, since China’s reform and opening up policy dating from 1978, major exporters have invested in building long-term relationships with trading partners abroad. LCs are no longer the main method to guard against credit risk or country risk. Export credit insurance provides an alternative for mitigating risk.

This trend is consistent with the growth of cross border remittances, which relates to open account settlement of trade transactions.

Third, LCs are no longer popular in China with large corporations due to complicated procedures, paperwork and long timelines for receiving payments.

For small- to medium-sized enterprises (SMEs), the situation is even worse. On the one hand, SMEs have little bargaining power; On the other hand, many SMEs are unfamiliar with LCs and consider them an unreliable settlement method.

O'Brien (ICC): Can you explain what you mean by 'unreliable' settlement method?

Ms Xu: Feedback from several major banks in China shows a big difference between the refusal rate under export and import LCs.

The refusal rate under export LCs is reported to be about 30% whereas under import LCs it is about 1%.

O'Brien (ICC): Can you explain why the refusal rate under import LCs is surprisingly low?

Ms Xu: For two reasons: First, since the Supreme People's Court of P.R.China introduced *The Provisions of the Supreme People's Court on Some Issues in the Adjudication of Letter of Credit Related Cases*, in 2005, issuing banks in China have been more cautious about raising discrepancies.

Second, banks in China take great care to protect their international credit status and reputation, which is why trade finance professionals in China operate at the highest professional standard.

However, almost all the banks surveyed in China found confirming banks very cautious, or dare I say picky with reported rates of refusals up to 90%. This is likely driven by fear issuing banks will reject documents.

To be frank, the data shows that this fear is unfounded. Unfortunately, this situation does little to underwrite the LC as a secure way to settle international trade, hence the unreliable settlement method stigma and sharp decline in use as a result.

O'Brien (ICC): Can you detail short-term trends in demand guarantees and standby LCs in China?

Ms Xu: In recent years international demand guarantees and standbys have risen sharply, driven by the government's opening up policies and the Belt and Road Initiative. The Belt and Road is a combination of the Silk Road Economic Belt and the 21st century Maritime Silk Road. This development initiative of the

Chinese government focuses on coordinating policies, facilitating connectivity, unimpeded trade flows, and financial integration.

Over the last four years, more than 100 countries and international organisations have supported or participated in the Belt and Road's construction.

Trade along the Belt and Road has felt the effects in trade volume and direct investment. In 2017, trade rose 17.8% and direct investment reached US\$14.4 billion.

Guarantees issued subject to URDG758 are up every year and will continue to rise, in my opinion.

Standbys are also on the upswing, and most issuance is subject to the UCP600 rules, although the shift to ISP98 (widely used on standbys) is picking up.

One major development was the 1 December 2016 decision, *The Supreme People's Court on Some Issues in the Adjudication of Independent Guarantee Related Cases*. These legal provisions have boosted the standing of international independent undertakings that support secure international trade and projects with China. The provisions also refer to ICC rules of practice.

O'Brien (ICC): Is supply chain finance (SCF) expanding in China?

Ms Xu: SCF is growing fast in the Chinese market.

Mainland China started SCF-based on the factoring model way back in 1987.

According to Factors Chain International (FCI), China has overtaken the UK as the world's largest factoring market.

Interestingly, most banks in China are unfamiliar with Standard Definitions for Techniques of Supply Chain Finance, even though SCF providers use almost all the techniques, though perhaps with different names.

Less than six months ago on 5 October 2017, the State Council

of P.R.China published *The Office of State Council's Guidance on Actively Promoting Supply Chain Innovation and Application*. This calls for promoting SCF to the real economy, and encourages commercial banks and other providers to set up technology-based SCF platforms. The objective is to provide efficient and simplified financing channels, especially for SMEs, and to promote the development of online technology-driven SCF services. With this focus and stimulus, SCF will see a significant increase and concentrated focus in China.

O'Brien (ICC): Speaking of technology, how are the Bank Payment Obligations (BPO) and ICC e-rules developing in China?

Ms Xu: BPO has not yet had a big impact in China, there have been a few transactions. Volumes are low. However, this may change if some constraints are removed, including changes in the product structure, so that URBPO rules reflect the business flow. We also need e-platforms for easy customer access and greater market acceptance.

For any set of rules to facilitate electronic trade, rules must follow and be consistent with practices as they evolve.

O'Brien (ICC): How are fintech and blockchain being applied in the Chinese market? Has either crossed over from niche technology into wider application?

Ms Xu: Bank are under competitive pressure from e-commerce companies, which are providing new channels and opportunities for corporates and SMEs. Look at the expansion of Alipay and WeChatPay in China, which are now household names for mobile payments from taxi fares to peer-to-peer transfers. Annual domestic trade of non-bank payment agencies including these two companies was about US\$16 trillion in 2016, more than double the year before, according to People's Bank of China.

Banks are adjusting their strategies, and are focusing on blockchain technology. Interesting proof of concept projects are underway in China, for instance using blockchain technology for high-volume factoring and supply chain finance.

Technology-driven finance offerings must also comply with regulation and compliance. No exceptions.

O'Brien (ICC): Can you provide an update of compliance in China?

Ms Xu: Since last year, the government has set out stringent compliance policies for financial institutions, including measures for monitoring and supervision of money laundering and financial crime. In trade finance there is a laser focus on KYC, trade background screening, trade finance products reviews and issues related to operations and dedicated advanced technology screening systems. Banks will be severely penalized for violating any regulatory requirement.

To meet regulatory requirements and internal policies, banks are facing difficulties in KYC and due diligence investigation, due to lack of resources and systems. Even with extreme care, banks are adopting different standards all over the world further complicating an already challenging situation. Unfortunately, transaction processing slows down, and delay variance can be from one or two days up to several days, or even months in extreme cases.

O'Brien (ICC): Which trade chain parties are most harmed by these measures?

Ms Xu: The consequences are felt across the board. But if pressed to identify who suffers the most, the answer can only be SMEs. SMEs are the most vulnerable customers, because they are often unable to supply the necessary information on their trading partners.

Small- to medium-sized banks also suffer ill effects, when correspondent banking



Vincent O'Brien and Jun XU

relationships are terminated due to de-risking and cost cutting.

O'Brien (ICC): On the plus side, SMEs are a boon to the growth in global trade. But as you show, SMEs face a lot of challenges. What initiatives does China have to support the internationalisation of SMEs?

Ms Xu: It's abundantly evident SMEs are an engine of economic growth in China. SMEs contribute to every share point rise in the trade finance product portfolio. At Bank of China we are sharpening our focus on the needs of SMEs, as is true for the trade finance industry in China. The valuable data from ICC Global Trade Finance Surveys helps our banks to close the trade finance gap for SMEs.

The Chinese government is addressing the difficulties SMEs face in gaining access to finance and affordable finance. To support small- and micro-enterprises, the China Banking Regulatory Commission has set targets for commercial banks to meet in lending to SMEs.

In April 2017, seven government agencies including the People's Bank of China introduced *Micro Businesses Account Receivables Finance Special Action Plan* (2017-2019). People's Bank of China has also set up the Account Receivables

Finance Platform and launched on-line account receivables finance for SMEs in cooperation with Bank of China in several provinces such as Sichuan and Jiangsu since 2017.

In the 2018 Report on the Work of the Government, Chinese Premier Li Keqiang of the State Council acknowledged these issues and set out steps to promote inclusive financing of SMEs to provide easier access to affordable finance, including trade finance.

O'Brien (ICC): It is encouraging to see SMEs contribute to the trade expansion of China.

Your insights into the emerging trends and developments in China's trade finance and payments arena has been most interesting and informative.

Ms Xu: You are most welcome.

Thank you for visiting Bank of China in Nanjing.

We look forward to welcoming you and the full ICC Banking Commission back to China for the 2019 Annual Meeting of the ICC Banking Commission to be held in Beijing.

SINOSURE view/What's driving China's galloping growth in trade finance?

By Mr. Xinshuang Guo

Mr. Xinshuang Guo is Vice President of SINOSURE and Member of ICC China Executive Board

Amid a transformation of China's foreign trade structure, SINOSURE is providing risk coverage as the country transitions to an innovation-led economy.

As China becomes an ever more powerful economic engine of global growth, it stands to reason that China's trade finance business has huge scope for further development. China's export market share grew rapidly to about 13% in 2017 from 10.4% in 2011.

It is worth noting that today China is the world's largest exporter, a place it has held since 2009. It has been the world's second-largest importer for the last nine years.

SINOSURE sees five trends driving strong growth and development of China's trade finance in the future:

The Belt and Road initiative

Since Chinese President Xi Jinping first put forth the Belt and Road Initiative in 2013, many countries and international organizations have given warm responses and supports to the initiative. The initiative is not meant as rhetoric. It represents real work that can be seen and felt to bring real benefits to countries in the region.

The proof is in the growth in trade. Total trade between China and

other Belt and Road countries from 2014 to 2016 was over US\$3 trillion. In 2017, the total volume of imports from and exports to the Belt and Road countries rose 17.8%, about 3.6 percentage points higher than average national trade growth.

This trade growth has created greater needs for financial services among the Belt and Road countries.

Trade along the Belt and Road has exceeded over US\$3 trillion

SINOSURE has made it a priority to serve and support construction of the Belt and Road by expanding the scale of its services. From 2014 to 2017, SINOSURE provided export credit insurance and overseas investment insurance to the Belt and Road regions totaling US\$455 billion, which was more than one quarter of SINOSURE's overall business. The total amount of finance granted to enterprises with SINOSURE's support was over US\$100 billion.

Banks should be aware that to make sure business develops sustainably in Belt and Road regions, country risk should be taken into account by using a range of risk management tools, including credit insurance.

The "New Normal" of China's Economy

China's foreign trade structure is undergoing transformation and upgrading as the country moves to an innovation-led economy under its new normal state. As we go further in expanding construction of the Belt and Road and International Industrial Capacity Cooperation, China's overseas engineering contract projects and complete set equipment exports, which strikes partnerships between domestic and overseas firms and develops industries and markets in other countries.

Both these initiatives represent huge development opportunities for trade finance.

Overseas engineering contracts are the main way Chinese enterprises are going global in recent years: New overseas engineering

contracts for projects signed in 2017 reached US\$265.3 billion, a 8.7% rise from the previous year.

The development, transformation and upgrading of overseas engineering contracts has not only driven exports of complete set equipment and other products, it has boosted demand for financing. SINOSURE has always provided support to overseas engineering contract projects and complete set equipment exports: the insured amounts stand at US\$24 billion in 2017, an annual growth of around 6.5%.

5 million SME customers

With about 40 million SME customers in China, 5 million in trade-related businesses, creating a large demand of trade finance.

As most SMEs lack solvency and adequate collateral and find it hard to meet the financing requirements of banks, banks are more willing to lend to multinational companies and large enterprises. As a result, the finance gap is wide for SMEs and the potential for trade finance is huge.

To help narrow the gap and provide better services, SINOSURE has launched products tailored to SMEs, especially online services, that not only improved work efficiency, but also provided new trading platforms for SMEs to explore international markets.

SMEs contributed US\$57 billion in export value in 2017. SINOSURE supported 64,000 SME customers, representing more than a quarter of SMEs exporters. SINOSURE paid total claims of nearly US\$100 million. With the support of SINOSURE, finance granted to SMEs reached US\$6.5 billion.

Attracting foreign banks

Since China joined the WTO in 2001, more foreign banks have been entering and expanding in the Chinese market. By end-2016, foreign banks from 14 countries and regions had set up 1,031 branches in mainland China.

As trade finance develops rapidly with foreign banks in China, SINOSURE has built business relationships with 79 foreign banks, one third of the total banks present in China at the end of 2017.

Last November, China announced measures to ease or lift investment restrictions on foreign companies in its financial markets. The 20% ceiling on ownership of Chinese commercial banks or asset management companies by a single foreign investor was removed; and the 25% cap on total foreign ownership of such companies was also ended. Moreover, a number of landmark measures are to be launched this year announced by Chinese President Xi Jinping at the Boao Forum for Asia Annual Conference 2018, including accelerating the opening-up of the insurance industry, easing restrictions on the establishment of foreign financial institutions in China and expanding their business scope, and opening up more areas of cooperation between Chinese and foreign financial markets. These changes should stimulate foreign banks to collaborate more.

E-commerce explodes

Information technology and financial innovation are twin drivers of trade patterns. They are revolutionizing the way people work, live and think. Cross-border e-commerce is boosting China's trade and is an engine of innovation. As elsewhere, supply chain finance, cross-border RMB business, and block chain technology are new features and trends affecting China's trade finance.

Cross-border e-commerce is developing rapidly in China, and its e-industrial trade cluster is growing ever larger. The Chinese government since 2016 has introduced policy measures to promote the healthy and orderly development of cross-border e-commerce, setting up comprehensive pilot zones for cross-border e-commerce. So far,

the State Council has approved 13 of these zones, leading to swift growth of and creative businesses.

According to China E-Business Research Centre, the trade volume of cross-border e-commerce reached 7.6 trillion yuan in 2017.

For these reasons, the institution which will lead China's trade finance market in the future will be the one that is the leader in innovative products, information technology, and risk management. SINOSURE aims to be the top contender.

Spotlight on SINOSURE

China Export and Credit Insurance Corporation (SINOSURE) is the official Export Credit Agency (ECA) and the only policy-oriented insurance company in China. Since it was founded in 2001, SINOSURE has supported US\$3.3 trillion of trade and investment, and paid more than US\$10 billion in claims to banks and enterprises.

Joining forces with more than 200 credit information providers and recovery channels across the globe, SINOSURE's transaction data covers over 7 million buyers and 110,000 banks.

SINOSURE insured and guaranteed US\$524.6 billion in 2017, an annual growth rate of 10.9% for more than 80,000 customers.

For SINOSURE, banking cooperation is critical. That cooperation takes the form of support for trade finance for enterprises through credit insurance. By the end of 2017, SINOSURE had solid relationships with 251 banks, and helped enterprises secure financing of over US\$470 billion.

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2017 PERFORMANCE HIGHLIGHTS:

Total Assets: US\$11.913 billion; **Loans and Advances:** US\$8.329 billion; **Operating Income:** US\$372 million;
Net Income: US\$220.49 million; **Ratings:** Fitch: BBB-/F3 (Negative); Moody's: Baa1/P-2 (stable); GCR: BBB+/A2.

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