

2017

# RETHINKING TRADE & FINANCE

AN ICC PRIVATE SECTOR  
DEVELOPMENT PERSPECTIVE

State of the Market:  
Trade, Finance and Development >

Trade and Supply Chain Finance:  
Survey Findings and Market Trends >

Policy, Advocacy and Inclusiveness:  
Shaping the Global Architecture for trade >

Rethinking Trade and Finance:  
Digitisation and the State of FinTech >



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- Alexander Malaket (OPUS)

and comprised of

- Dominic Broom (BNY Mellon),
- Mark Evans (ANZ),
- Dave Meynell (TradeLC Advisory),
- Dan Taylor (DLTAYLOR Consulting) and
- Jun Xu (Bank of China),

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# In this report

## REFERENCE INFORMATION

Acknowledgements >	1
Table of Figures >	6
Acronyms >	9
Forewords >	11

## RECAP AND SELECTED HIGHLIGHTS

16

## STATE OF THE MARKET: TRADE, FINANCE AND DEVELOPMENT

ICC Advocacy at a watershed moment in global business >	38
Global Economic Outlook >	40
Recent trends in correspondent banking relationships >	46
Evolving trade flows and trade corridors, reconfiguration of global supply chains and sourcing patterns >	52

## TRADE AND SUPPLY CHAIN FINANCE: SURVEY FINDINGS AND MARKET TRENDS

ICC Global Survey on Trade Finance and Supply Chain Finance 2017: results and analysis >	66
SWIFT trade finance traffic - 2016 statistics >	88
Analysis of global trade finance gaps >	102
Preparing our industry for the future - How training tomorrow's experts can reinvigorate trade finance today >	110
Update on Global Supply Chain Finance Forum >	114
Supply Chain Finance: corporate perspectives >	118
Market trends in Supply Chain Finance - Receivables Financing >	126
Export finance market trends >	138
Export Credit insurance market trends >	148



## POLICY, ADVOCACY AND INCLUSIVENESS: SHAPING THE GLOBAL ARCHITECTURE FOR TRADE

Foreign direct investment – pulling it out of a rut >	158
Making trade work for all >	164
Impact of MDB trade facilitation programmes, regional insights >	168
Selected elements of international advocacy: trade, finance and development >	190
Sustainable trade and the role of the banking industry >	194
SME competitiveness: thinking strategically about regional integration and regional value chains >	198
Access to Trade Finance for SMEs and first time clients of banks in Africa – from the perspective of financial institutions >	204
Protectionism in the 21st century and trade barriers faced by firms >	208
Legal and regulatory issues adversely affecting banks in Trade and Supply Chain Finance – can non-bank entrants benefit from their less regulated environment to make an impact on the market? >	214
Challenges of global trade in an environment of increasing regulatory controls >	218

## RETHINKING TRADE AND FINANCE: DIGITISATION AND THE STATE OF FINTECH

Digitalisation in trade finance: accelerating the journey >	222
The digitisation of trade >	226
Disruptions in the supply chain and Blockchain >	230
Accelerating the role of FinTechs in trade banks >	234
Digital transformation and supply chain evolution >	238
Data is the new oil in B2B banking >	240
Roundtable discussion: digitisation of trade finance – the state of play and the road ahead >	245
Closing remarks >	254

# Table of figures

1: Contributions to GDP growth	41
2: Risks to global growth projections	41
3: Growth by country group	42
4: Slowdown in merchandise trade	43
5: Correspondent payments (gross and index values, respectively)	48
6: Value and number of active correspondents, 2012-2015 gains and losses, in %	49
7: Change in cost of remittances by recipient countries (2012-2016 Q3)	50
8: Historical global trade flows	52
9: Global trade flows showed sustained growth across regions from 2009 to 2014, where it peaked at USD 18.1 trillion in value	55
10: Global trade flows contracted from 2014 to 2016, with global trade falling back to USD 15.8 trillion in 2016	55
11: Forecast trade flows based on BCG Trade Finance Model	56
12: Global trade flows expected to grow from 2016 to 2020, reaching USD 18.7 trillion	57
13: Forecast trade finance revenues based on BCG Trade Finance Model	57
14: Decomposition of growth in trade finance revenues based on BCG Trade Finance model	58
15: Expected loss of trade finance and other asset classes, 2008-2015	59
16: Digital transformation in trade represents an estimated USD 2.5-6 billion savings opportunities (up to 35% over 3 to 5 years)	60
17: Digitisation of internal operations can be accomplished via OCR and forming 'digital ringfence' around operations	61
18: Location of survey participating banks	67
20: Number of employees involved in trade finance operations	68
19: Trade finance operations structure	68
21: Growth of traditional trade finance business	70
22: Aspect most likely to adversely impact business in the short-term	71
24: Most important area of development and strategic focus for the trade finance industry over the next 12 months	72
23: Evolution of trade finance revenues in 2016	72
25: Area of greatest potential for growth and evolution in the financing of international trade	74
26: Configuration of global trade finance operations	75
27: Position of SCF in banks at this time	76
28: Customers' use of third-party platforms in 2016	76
29: Potential for digital channels to impact trade finance sales	77
30: Views on progress related to trade finance digitisation	77
31: Where truly commercialised industrialised digital trade flows are expected to first occur	78
32: In which industries truly commercialised industrialised digital trade flows are expected to first occur	80
33: How many years until 60% or more of all trade flow processes will be digitised	80
34: Industry sectors receiving most trade finance	81
35: Single biggest challenge facing trade finance operations units today	83
36: Performance in terms of operational risk and error rates compared to last year	83
37: Client segment as highest priority to the bank	84
38: Service most often requested by clients in 2016	86
39: Trends in refusal rates, claims, discrepancies, court injunctions during 2016	87



40: SWIFT trade traffic worldwide	89
41: Volume of MT 700s, 2009-2016	89
43: MT 700s sent, 2011-2016	90
42: Import Traffic	90
44: Top 5 importing countries	91
45: Top 5 importers with the highest growth	91
46: Top 5 importers with the largest decrease	91
48: MT 700 received, 2011-2016	92
47: Export Traffic	92
49: Top 5 exporting countries	93
50: Top 5 exporters with highest growth	93
51: Top 5 exporters with largest decrease	93
54: Volume of L/Cs sent by regions	94
52: Volume of L/Cs	94
53: Amount of the L/Cs (converted to USD)	94
55: Average value of L/Cs sent by regions (converted to USD)	95
56: Volume of L/Cs received by regions	95
57: Average value of L/Cs received by regions (converted to USD)	95
58: Confirmation of letters of credit by volume, 2016	96
60: Volume of L/Cs received by availability combination, 2016	96
62: Percent distribution of L/Cs by tenor, 2016	96
61: Percent distribution of L/Cs received by availability combination, 2016	97
59: Confirmation of Letters of Credit, by region, 2016	97
63: Volume of L/Cs received by tenor per region, 2016	98
64: Breakdown of proposed trade finance transactions by region (% of global value of transactions)	103
65: Proposed trade finance transactions that were approved/rejected, by type	104
66: Breakdown of proposed trade finance transactions by type	104
67: Is there a shortage in servicing the trade finance needs of the global market?	105
68: Change in trade credit lines compared to 2015 by client type	105
69: Proposed trade finance transactions that were approved/ rejected, by region	106
70: Reason for rejecting trade finance transactions	107
71: Potential barriers to servicing trade finance needs	107
72: Ways in which financial technology will impact banks' abilities to do more transactions	108
74: Extent to which MDBs and ECAs help in fulfilling demand for trade finance in different regions	108
73: Most significant benefit of greater integration and harmonisation of rules, standards, regulations and policies in trade finance	108
75: Technical competency and capacity in trade sales	111
76: Methods to address the capacity and skills shortage	111
77: Using 'Standard definitions for techniques of Supply Chain Finance'	114
78: Most used techniques in supply chain finance	115
79: Average value of trade finance transactions, % of respondents	127
80: Number of trade finance transactions done per year (% respondents)	128
81: Global regions with biggest expansions and declines in demand for trade finance products, percentage, total sample	128

# Table of figures (cont.)

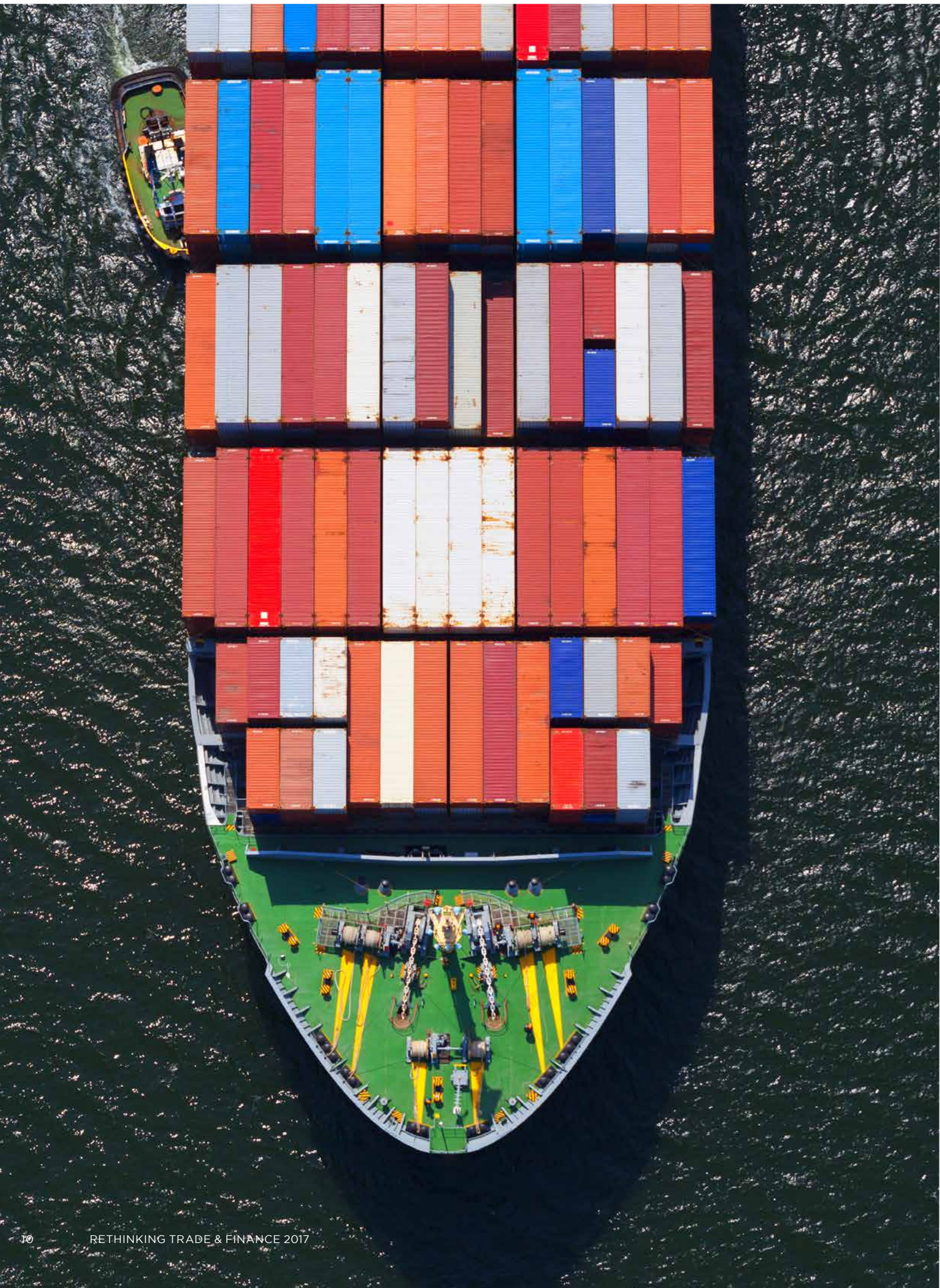
82: Preferred method for selling or distributing risk, percentage, whole sample	129
83: FCI 2016 global factoring statistics and market share by region	132
84: Global factoring volume, 1996-2016	134
85: FCI members share by product	134
86: Total factoring volume, 2010-2016	135
87: FCI's share of world international cross-border factoring	136
88: How has pricing in export finance changed over the last year?	139
89: Do you expect pricing to go up or down in the next 12 months?	139
90: What is the key driver of pricing in the market at the moment?	139
91: Is Basel III being priced into your export finance deals?	139
92: Are ECAs doing enough to support SMEs today?	140
93: How have bank fees in export finance changed over the past year?	140
94: In how many export finance deals were you involved in 2016?	141
95: How does that compare with 2015?	141
96: What do you see as being the most prohibitive factors to doing export finance business in new markets?	142
97: What were your top sectors for export finance?	143
99: Consideration of the export finance product offering in its totality	144
98: What were your top three borrower countries in 2016?	144
100: What do you think will happen to the export finance market in 2017?	146
101: Berne Union new business & world exports, 2006 - 2016	149
102: Berne Union new business private & public, 2006-2016	149
103: Berne Union global claims paid, 2005 - 2016	150
104: Private Members' ST loss ratio claims paid and premium income	151
105: Average pricing by reporting line for private members of the Berne Union	151
106: Claims by region and reporting committee, all Berne Union members, 2008-2016	152
107: FDI inflows, global and by group of economies, 2005-2016, and projections, 2017-2018	159
108: FDI inflows, top 20 host economies, 2015 and 2016	160
109: Estimated medium term impact on GDP of alternative trade policy scenarios	165
110: Factory Americas, Asia and Europe	199
111: Competitiveness score by region and firm size	200
112: Frequency of legally enforceable provisions in trade agreements	201
113: Composition of the trade finance portfolio of banks in Africa	204
114: Default rate on banks' trade finance activities across customer groups	205
115: Default rate on banks' trade finance activities across customer groups by region	206
116: Reasons banks reject clients' trade finance requests	206
117: Protectionist vs. liberalising measures - number of measures introduced since 2008 and still in force by end of each year	210
118: Problems Swedish firms face outside the EU	212
119: Future considerations for digital trade and supply chain finance	228
120: Focus on emerging technologies <sup>16</sup>	230



# Acronyms

<b>AI</b>	Artificial Intelligence	<b>MSME</b>	Micro, Small- and Medium-sized Enterprises
<b>ADB</b>	Asian Development Bank	<b>NAFTA</b>	North American Free Trade Agreement
<b>AfDB</b>	African Development Bank	<b>NPL</b>	Non-Performing Loan
<b>AML</b>	Anti-Money Laundering	<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>BPO</b>	Bank Payment Obligation	<b>OIC</b>	Organization of the Islamic Cooperation
<b>CIS</b>	Commonwealth of Independent States	<b>PRI</b>	Political Risk Insurance
<b>EBRD</b>	European Bank for Reconstruction and Development	<b>SADC</b>	Southern African Development Community
<b>ECA</b>	Export Credit Agency	<b>SCF(P)</b>	Supply Chain Finance (Program)
<b>EU</b>	European Union	<b>SDGs</b>	Sustainable Development Goals
<b>FCI</b>	Factors Chain International	<b>SEME</b>	Southern and Eastern Mediterranean
<b>FDI</b>	Foreign Direct Investment	<b>SITA</b>	Supporting Indian Trade and Investment for Africa
<b>GBP</b>	Great British Pound	<b>ST</b>	Short Term
<b>GDP</b>	Gross Domestic Product	<b>SWIFT</b>	Society for Worldwide Interbank Financial Telecommunication
<b>GRIF</b>	General Rules of International Factoring	<b>TFA</b>	Trade Facilitation Agreement
<b>GVCs</b>	Global Value Chains	<b>TF</b>	Trade Finance
<b>IDB</b>	Inter-American Development Bank	<b>TFFP</b>	Trade Finance Facilitation Program
<b>IFC</b>	International Finance Corporation	<b>TFP</b>	Trade Facilitation Programme
<b>IFG</b>	International Factors Group	<b>TFTA</b>	Tripartite Free Trade Agreement
<b>IIC</b>	Inter-American Investment Corporation	<b>TISI</b>	Trade and Investment Support Institution
<b>IMF</b>	International Monetary Fund	<b>TPP</b>	Trans-Pacific Partnership
<b>IoT</b>	Internet of Things	<b>TXF</b>	Trade & Export Finance
<b>ITA</b>	Information Technology Agreement	<b>UN</b>	United Nations
<b>ITC</b>	International Trade Centre	<b>UNCTAD</b>	United Nations Conference on Trade and Development
<b>ITFA</b>	International Trade & Forfeiting Association	<b>(e)URC</b>	(Electronic) URC Uniform Rules for Collections
<b>ITFC</b>	International Islamic Trade Finance Corporation	<b>(e)URF</b>	(Electronic) Uniform Rules for Forfeiting
<b>KYC</b>	Know Your Customer	<b>URR</b>	Uniform Rules for Bank-to-Bank Reimbursements
<b>L/C</b>	Letter of Credit	<b>US Ex-Im</b>	Export-Import Bank of the United States
<b>LAC</b>	Latin America and the Caribbean	<b>WTO</b>	World Trade Organization
<b>MDB</b>	Multilateral Development Bank		
<b>MENA</b>	Middle East and North Africa		
<b>MLT</b>	Medium and Long Term		







# Foreword



**The ICC Banking Commission has undergone a busy period of development and evolution, including a strengthening of our governance processes, a renewal of our Advisory Board and Executive Committee, and an articulation of a multi-year strategic plan.**

At the same time, our work in 2017 has continued to enhance the quality of the wide range of work products we develop and publish in support of international trade, trade financing and economic inclusiveness.

The importance of drawing clear linkages between economic value, trade and trade-related financing is especially acute under current circumstances. The need to champion trade, and ensure access to adequate levels of financing is perhaps more critical than it has been since the peak of the global crisis.

Like trade, the business of financing international commerce combines traditional and long-established mechanisms like documentary letters of credit, together with evolving, high-growth propositions in the financing of cross-border supply chains.

The 2017 edition of the “Rethinking Trade and Finance” report seeks to take a clear forward-looking perspective on international commerce and on trade financing, and aims to provide insight and analysis that will help our readers to formulate strategy and to make decisions that will advance the evolution of global trade.

Our partnership with the Asian Development Bank continues again this year, as we seek to understand the scope and nature of the Trade Finance Gap. The level of unmet demand for trade finance has been estimated at over USD 1.6 trillion annually, at a time when banks continue to face capacity constraints in responding to this unmet demand, and Financial Technology (FinTech) firms are actively looking to apply innovative solutions to trade financing. The United Nations (UN) also underscores the importance of ensuring adequate and cost-effective trade financing for small businesses and has also committed to carry out an official review of the Trade Finance Gap and its underlying causes.

The 2017 edition of the “Rethinking Trade and Finance” report highlights certain notable developments in international trade and in the financing of cross-border commerce:

- The ICC Banking Commission has devised strategic direction based upon three core pillars – Rulemaking & Standards, Advocacy and Inclusiveness. The “Rethinking Trade and Finance” survey links directly to major elements of the Banking Commission strategy and related priorities for work, serving both as an input for the activities of the team, and as a basis for the advocacy work we engage in around the world.
- The importance of the work of the International Chamber of Commerce, and of the ICC Banking Commission, is magnified under current international circumstances. Whether we refer to the ICC’s engagement through our global network of Chamber members, our National Committees and our various Policy Commissions, or whether we highlight specific initiatives, current market conditions demand continuing, active engagement by the ICC on a variety of topics.
- The ICC reaches the highest levels in advocacy and policy, from engagement through the G20 CEO Advisory Group, to the recent achievement of UN Observer Status. At the same time, the Banking Commission leads in highly specialised advocacy work around capital adequacy, Anti-Money Laundering (AML) and other regulatory aspects linked to international banking.

The 2017 edition of the annual “Rethinking Trade and Finance” report is a reflection of the scope of engagement of the ICC, the reach of our partnerships and alliances, and our intentions and aspirations related to impact around trade, finance and inclusiveness.

Sincerely,

**Daniel Schmand**  
Chair, ICC Banking Commission





# Foreword



## The 2017 edition of the ICC's and the ICC Banking Commission's flagship "Rethinking Trade and Finance" report and survey comes at a transformational moment in the history of trade and the global economic system.

The report has its roots at the peak of the global financial crisis, and has since earned its place as a leading publication on the subject of trade, finance and economic inclusiveness.

I take this opportunity to extend our appreciation to Mr. Vincent O'Brien, immediate past Chair of the Market Intelligence activities of the Banking Commission – including the conception, oversight and publication of this report. Vincent has long served the ICC and the Banking Commission, to the great benefit of our colleagues, stakeholders and clients, and continues to do so as a member of the Executive Committee, and as a member of the leadership team developing our Regional Banking Commission in MENA among other activities.

It is a privilege to be asked to continue the work undertaken by Vincent and the team on this annual publication, to continue to work closely with past and future partners and contributors to this unique report. It is particularly motivating to take on this responsibility at a moment when we must clearly, compellingly and unequivocally advocate for the benefits of international commerce.

The International Chamber of Commerce and the ICC Banking Commission must champion trade, articulate its benefits in economic value-creation, international development and improved standards of living around the globe. The importance of thoughtful international engagement must be more clearly brought into focus, and within that, the value of international trade, and the enabling role of trade finance merit specific attention.

It is in those latter areas that the Banking Commission and the "Rethinking Trade and Finance" report will continue to focus. We will continue to strengthen our survey, data collection and analytical methodology, and refine the nature of our content to ensure we provide valuable, forward-looking market insight.

Let us be clear: the current architecture of the global economic system, including the framework for global trade, is imperfect. More can and should be done to ensure broader inclusiveness, fairer distribution of wealth and benefits and more equitable sharing of positive impacts from trade and international engagement.

That said, trade has clearly generated net benefits for the world, and remains one of relatively few undertakings that can generate positive global impact

through effective policy measures and private sector business initiatives.

The path to improvement and progress is through more, enhanced value-creating trade, not through isolationism, protectionism or blatant, short-sighted self-interest. Arguing in favour of international commerce on the basis of economic theories that describe trade in terms of absolute versus comparative advantages may be academically robust, but it fails to connect with reality "on the ground".

In concrete terms, trade generates macro-level benefits at national and regional levels, as well as specific benefits for companies of all sizes that pursue opportunities in international trade through communities anchored in global supply chains.

The 2017 edition of the Rethinking Trade and Finance report continues a strong tradition of quality analysis, global collaboration and effective advocacy in support of trade financing, international commerce and international development. Trade will remain an important element of the human experience, but its pursuit and execution faces transformational forces, from politics and policy to technology, regulation and the reconfiguration of trade flows and global supply chains.

We hope you will find great value in the pages that follow, and invite your comments and feedback, so that we can continue to improve our efforts to Rethink Trade and Finance every year. Our thanks to the members of the new Editorial Board for materially enhancing the quality of the final product:

- Dominic Broom, Global Head of Trade Business Development, BNY Mellon
- Mark Evans, Managing Director, Transaction Banking at ANZ
- David Meynell, Managing Director, TradeLC Advisory
- Dan Taylor, Principal, DLTAYLOR Consulting
- Jun Xu, Deputy General Manager, Global Trade Services Dept., Jiangsu Br., Bank of China

With very best wishes,

**Alexander R. Malaket** CITP, CTFP  
Deputy Head of the Executive Committee  
Chair ICC Banking Commission Market Intelligence







# Recap and Selected Highlights

I. REFERENCE INFORMATION

II. RECAP AND SELECTED HIGHLIGHTS

III. STATE OF THE MARKET

IV. TRADE AND SUPPLY CHAIN FINANCE

V. POLICY, ADVOCACY AND INCLUSIVENESS

VI. RETHINKING TRADE AND FINANCE

# Recap and Selected Highlights

**Trade is emphatically a commercial activity, whether it takes place bilaterally between one importer and one exporter, or in the context of complex global supply chains. Likewise, whether it evolves in a multilateral policy and trade agreements context, or in an environment marked by a series of bilateral trade agreements and regional or national levels.**

Trade is also, however, such a far-reaching commercial activity with a history that links closely to the story of human evolution, that it is a uniquely powerful lever of public and international policy, with the potential to materially impact economic conditions, standards of living and degrees of economic inclusiveness around the globe.

Trade rarely takes place safely and successfully without some form of enabling trade financing, broadly defined to cover traditional mechanisms, Supply Chain Finance, as well as a range of proven risk mitigation techniques.

Trade, then, is a potential prescription to a range of economic and social ills, some even argue an important contributor to international security in its ability to counter the risk of war and enable economic engagement among parties that disagree politically. It is, at the same time, imperfect, sometimes unjust, and thus a popular target along with the notion of “globalisation”, to bring to life legitimate disenchantment with the current global economic architecture.

Since the peak of the global financial crisis (GFC), certain linkages have been brought sharply into focus, that have long existed but been largely underappreciated.

Nearly a billion people have been lifted out of “extreme poverty” according to The Economist and few would dispute that trade has played a part in this first of many steps yet to be taken.

The GFC illustrated to world leaders, business executives and academics, a reality that has long been known by practitioners: trade cannot safely take place without some form of trade financing – an esoteric activity in which we include traditional mechanisms like Documentary Letters of Credit and fast-growing

techniques and structures in Supply Chain Finance, together with some form of risk mitigation, which can be provided through private sector sources, export credit agencies or multilateral development banks, among other sources.

If we link these assertions, trade financing drives trade activity, which contributes directly to international development, poverty reduction and economic inclusion – all despite inherent imperfections and inequity that persist in the system, just as they tend to be in evidence in many human endeavours.

The strategic direction of the ICC Banking Commission has been shaped and devised with these dynamics in mind, and thus, the 2017 edition of one of our flagship publications, likewise, follows this approach, putting trade financing in its wider context, and looking explicitly at some of the major linkages that shape the trade, financing and inclusiveness discourse today.

The following pages draw from the full text of the report to provide a snapshot of selected key findings.

Notably, we have added an editorial commentary following each major contribution, with the objective of provoking thought at the strategic level and at the operational/tactical level, with some observations relevant to individual institutions and some proposed at the industry level.



## References

The Economist, The world's next great leap forward. Towards the end of poverty, June 2013:

<http://www.economist.com/news/leaders/21578665-nearly-1-billion-people-have-been-taken-out-extreme-poverty-20-years-world-should-aim>



The Banking Commission team certainly appreciates that time is at a premium for all our readers and community members, and so have provided options and formatting in the report that allow for quick access to key data points and insights. It is our hope nonetheless that the carefully crafted and authored content from our valued contributors will make this report a practical publication that will be referenced multiple times by our readers, both for its strategic content and for the more granular quantitative and operationally relevant elements of the document.

## Selected Observations and Highlights

The ICC Report Rethinking Trade and Finance 2017 has been organised around four broad thematic areas:

- State of the Market: Trade, Finance and Development
- Trade and Supply Chain Finance: Survey Findings and Key Trends
- Policy, Advocacy and Inclusiveness: Shaping the Global Architecture for Trade
- Rethinking Trade and Finance: Digitisation and the State of FinTech

It is clear that the global context in which trade takes place, and in which policy is shaped and decided, risk analysed and financing extended, has changed materially if not drastically in the past several years. Trade growth struggles to regain its place as outpacing global GDP growth (and therefore clearly driving economic prosperity), “populism” has surged in parts of the world, and trade is countered by voices pushing isolation, self-interest and protectionism. This is in part because anti-trade and anti-globalisation players managed to seize and control the narrative in a way that resonated with people in various parts of the world.

The following pages can usefully be read with these realities in mind.

It is equally true however, that trade has existed since the first intrepid soul crossed tribal and cultural boundaries to seek opportunity in exchange, since explorers and sailors braved the risk of falling off the edge of the earth, or created the original Silk Road, and it will continue long after the current crop of global leaders have been forgotten. Even with transformational developments on the physical level of global supply chains, it is equally likely that some form of financing will be required to enable and sustain that trade, and it may well be that some form of a Letter of Credit will still support some portion of international commerce.

It is this latter view, the one anchored in the reality that trade does benefit the world, that it is a powerful tool of peace and inclusiveness with much untapped potential and that it impacts billions of people and trillions worth of life-changing economic activity, that the following pages find their best context.

It is imperative that leaders and influencers in the business of financing international commerce internalise the importance of taking a wider view, balancing commercial imperatives with vision around our collective impact in and responsibility toward the global communities we serve.

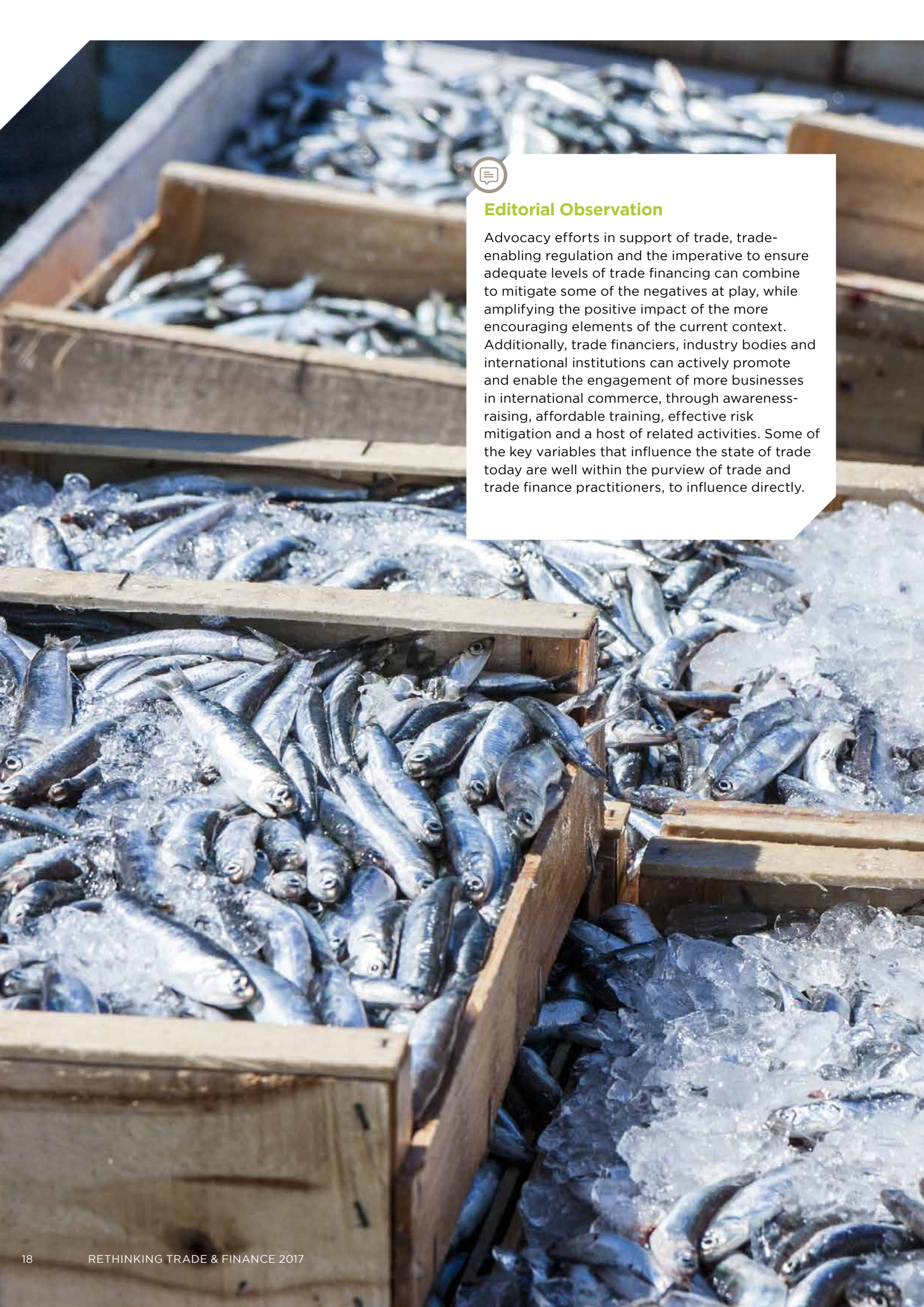
## State of the Market: Trade, Finance and Development

At the highest level, numerous trends and developments shape the evolution of the global economic and trade architecture, including the substantial and growing level of unmet demand for trade financing – often referred to as the oil in the engine of international commerce. Latest survey results and analysis by the Asian Development Bank point to a gap in global trade finance in the range of USD 1.6 trillion annually – much of it in developing markets, particularly developing Asia.

The trade finance gap is further concerning because it is increasingly clear that banks will be unable to materially close this gap, and that there is a misalignment in the availability of funds and liquidity, at least as viewed through a lens that seeks to identify the greatest need. The global economic system has largely recuperated pre-crisis levels of liquidity; however, it is disproportionately available to multinationals and large corporates – the top end of the market – and consistently absent in the micro, small and medium-sized enterprise (MSME) segment.

Daniel Schmand, Chair of the ICC Banking Commission, reminds us of the persistency and urgency related to the trade finance gap, noting that banks continue to be challenged by capacity constraints in aspiring to mitigate the gap and support greater levels of trade. Financial Technology (FinTech) companies, many in startup phase, have identified significant opportunities in the financing of international trade, and have the potential to play an important role in progressing a collective effort to narrow, then close, the global trade finance gap. Daniel observes that the Banking Commission’s latest strategic direction has been set on the basis of three core pillars, which together cut across traditional areas of Commission activity, expand into the broader context where we can achieve material further impact, and encompass the latest, potentially transformational developments in the industry. The pillars of our strategy, developed





### Editorial Observation

Advocacy efforts in support of trade, trade-enabling regulation and the imperative to ensure adequate levels of trade financing can combine to mitigate some of the negatives at play, while amplifying the positive impact of the more encouraging elements of the current context. Additionally, trade financiers, industry bodies and international institutions can actively promote and enable the engagement of more businesses in international commerce, through awareness-raising, affordable training, effective risk mitigation and a host of related activities. Some of the key variables that influence the state of trade today are well within the purview of trade and trade finance practitioners, to influence directly.



in close consultation with senior leaders in the Banking Commission Advisory Board and Executive Committee, as well as senior members of the Commission Secretariat in Paris, are:

- Rulemaking and Standards
- Advocacy
- Inclusiveness

The ICC “Rethinking Trade and Finance 2017” report reflects this strategic direction and illustrates compellingly how certain critical linkages combine to shape the state of trade and trade financing today.

Alexander Malaket, Deputy Head of the Executive Committee and newly appointed Chair of the Market Intelligence function argues that this edition of the report comes to market at a transformational moment in the history of trade, noting the critical importance of thoughtful international engagement, with specific continued focus on the importance of trade financing as an indispensable enabler of trade and economic value-creation.

#### ICC advocacy at watershed moment

John Danilovich, Secretary General of the International Chamber of Commerce, highlights the many decades of advocacy of the ICC and the world-leading rulemaking and industry practice/standards-setting of the Banking Commission, noting the historical achievement of the ICC in attaining official observer status at the United Nations. Calling on the private sector to more effectively communicate the benefits of free, open and rules-based trade, John further calls on political leaders to devise policies aimed at improving the equitable distribution of the benefits of trade, suggesting that the various signs of discontent evident today around trade and globalisation be interpreted as a signal to do better for more people.

#### Global economic outlook

In considering the state of the global economy, the World Bank notes preliminary signs of growth and directionally positive signs, but cautions us to the risk of excessive optimism built on fragile foundations. Commodity-importing developing countries in East and South Asia contribute to the positive side of the equation, whilst downside risk related to low productivity and policy uncertainty in key markets add to the negative side of the equation.

Though it is suggested that the fragmentation of production via local and regional supply chains may have reached a peak, and therefore, similarly for related trade flows, the World Bank notes that numerous developing and emerging markets still have potential to contribute to trade growth by reaching higher into global value chains.

Protectionist rhetoric coupled with trade-restrictive initiatives in key G20 economies are having a dampening effect on expectations of trade-driven growth, as is a slowdown in import-based economic activity globally.

#### Correspondent banking relationships

Just as the critical role of trade finance in enabling trade and contributing directly to the creation of economic value has remained largely underappreciated, so too, the importance of the longstanding global network of correspondent banking relationships has operated “under the radar” among a small community of international bankers and trade financiers.

Regulatory requirements around banks’ level of knowledge about counterparties with which they interact and conduct business, including correspondent banks, have been such that costs of maintaining a basic correspondent relationship had risen from perhaps €15,000 to €75,000 per relationship, driven largely by compliance costs.

At the same time, the reputational risk associated with non-compliance by a partner bank, and the financial exposure that might arise, combined to drive a global consolidation of correspondent relationships, with some institutions reducing their networks by hundreds, even several thousand partner institutions – predictably, those based in developing and emerging markets – as part of a broader move to “de-risk” by exiting markets, bank and client relationships.

The International Monetary Fund, in its contribution to this year’s report, and in prior work of the Fund as well as remarks by Managing Director Lagarde has succeeded in bringing attention to this key issue and its importance to trade, trade finance and financial inclusion.

The issue of de-risking, and the unintended adverse impact of regulation on access to the global financial system, is an area where our earlier call to action is directly relevant. Industry associations have worked together with international institutions to articulate the issue and to propose policy-based courses of action aimed at maintaining robust regulatory requirements whilst ensuring access to trade, cross border payments and other critical services, through healthy correspondent networks around the world.



#### References

C. Lagarde, Relations in Banking – Making it Work for Everyone. July 2016: <https://www.imf.org/en/News/Articles/2016/07/15/13/45/SP071816-Relations-in-Banking-Making-It-Work-For-Everyone>

The IMF notes that the number of active correspondents globally has declined by about 5% between 2011 and 2015, while the number of relationships (a good proxy for transaction volumes) increased by 30%. While economic activity has not been materially affected to date, the Fund does note that pressure on correspondent banking relationships has compounded economic fragility in some markets and may impact long term growth. The importance of remittance flows in international development has been increasingly recognised, and is one area where de-risking has had adverse effects, and an area where policy initiatives are needed to ensure adequate access and to reduce the risks related to the use of grey-market services as an alternative.

### Evolution in trade and trade finance flows

The Boston Consulting Group (BCG) rounds out our State of the Market section with numerous insights from the firm's growing trade-related practice. BCG highlights the evolution of trade flows and the shift East of the geopolitical center of trade, estimating that trade flows will grow at an annual rate of about 4.3% to reach nearly USD 19 trillion by 2020. The axes of trade growth identified by BCG include inter-regional trade in APAC, between Asia and Europe and within Europe.

The firm's proprietary models predict that trade finance revenue growth will outpace projections on trade growth by almost half a percentage point to grow at 4.7% annually, from USD 36 billion last year to USD 44 billion in 2020, based on growth projected in markets where trade is conducted to a significant degree on the basis of traditional trade finance



### Editorial Observation

Much will be said about the potential adverse impacts of Brexit, of protectionist rhetoric and of coming developments around the Trans-Pacific Partnership and NAFTA and of the protectionist tone and policies of the Trump administration. These developments will doubtless have their impact, and it may not be the most obvious of the consequences that raise concerns at this moment.

TPP partners are looking for ways to advance without US participation; Canada and Mexico are looking at alternatives, including closer engagement at the sub-national level, where trade actually has its impact, and those favouring a multilateral approach to global evolution, look to CETA and other approaches as models for the future. The ASEAN region, home to significant levels of economic growth, remains a strong voice in support of trade and multilateralism, and while the UK looks to re-ignite relationships through the Commonwealth as one way forward, EU leaders have become more resolute in their support of the vision that was the European Union.

China has taken decisive steps to fill a leadership gap in international affairs, both economically through the massive Belt and Road Initiative (B&R) which builds directly upon earlier initiatives like the internationalisation of the RMB, the creation of the Asian Infrastructure Investment Bank and the BRICS Bank.

The ratification of the Trade Facilitation Agreement, a major victory for supporters of trade and multilateralism, the ratification of CETA by the

EU and Canada as one of the most advanced and comprehensive trade agreements to date, and the increased focus on trade finance in a variety of business and policy circles combine well to support a multilateral, rules-based trade and economic system. China's Belt and Road initiative to recreate and broaden the Silk Road, may be the largest such initiative in a generation, with potential to drive economic value through infrastructure investment, trade and the ecosystems that will evolve around the eventual New Silk Road. All of this will require financing and risk mitigation, across the spectrum from short-term trade finance to long-term project finance.

Taking a forward view, it is not unreasonable to posit an outcome to the current difficult dynamics, that will lead in the end to a much more robust, equitable and sustainable form of inclusive multilateralism.

Such an outcome demands that the leaders in each of the core components of the global economic, investment and trade architecture take proactive steps to shape the outcome they envision, and not presuppose the final result. This is true for senior leaders in trade financing, just as it is in other areas, and one area where concrete action can and should be undertaken, is in the development of creative ways to deploy financing to SMEs and micro-enterprises around the world. Traditional banking channels are not conducive to solutions at scale, but trade financiers can nonetheless be part of the solution.



mechanisms. Taking a forward view, BCG advocates in favour of greater automation in trade finance, coupled with the development of alliances and partnerships aimed at delivering value and new propositions to the market, including higher levels of digitisation. The use of intelligent automation and technology, notes the firm, can enhance the financials linked to trade finance, while concurrently enhancing the ability of trade banks to meet regulatory and compliance requirements.

## Trade and Supply Chain Finance: Survey Findings and Key Trends

### ICC Global Survey on Trade Finance findings

This year's edition of the industry's most comprehensive survey on trade finance trends gathered 255 responses from banks located in 98 countries. "Survey fatigue" may have contributed in part to lowering the number of responses received in the current edition. This is not good news for the survey or for the report, but it is outstanding news for the business of financing trade, since this reflects a growing and increasingly broadly-based interest in the subject matter.

The geographic breakdown of participating banks remains quite consistent year over year, though a couple of developments this year are worth highlighting. The significantly higher participation of banks in Asia in this edition (28%) compared to 2016 (18%) is positive and enforces the representativeness and alignment of this trade finance study with the reality that supply chains are often anchored in Asia, with large numbers of suppliers based in the region. By contrast, very notable in this edition is the proportionately lower participation of banks from North America (4.9% compared to 12% in 2016).

The largest share of participating banks corresponds to those with operations presence in a number of countries, but in one geographic region, which we will refer to as regional banks (57.6%), followed by global banks with operation centres worldwide (28.6%), and smaller single country banks comprising almost 10% of the pool of respondents. More than a third of the respondents are banks with a small number of employees involved in trade finance, reporting that 50 people or less contribute to the delivery of trade finance. 40% of respondents employ between 50 and 300 dedicated trade finance professionals and 20% employ over 300 people globally for trade finance solutions.

Overall, the demographics of survey respondents appear to adequately reflect the characteristics of the trade banking market in particular, and thus survey responses can appropriately be seen to reflect

market views and can be extrapolated in order to inform strategic and operational decisions related to international trade and trade financing.

The survey, in combination with this report, has been designed to provide wide-ranging context and analysis, consideration of policy and advocacy activities linked to trade and finance, as well as specific commentary on the transformational developments in financial technology digitisation of trade and the role of non-banks in financing international commerce.

The post-crisis environment reflects a consolidation and reduction in cross-border activity, including trade finance, by numerous banks around the world and this, coupled with on-going efforts to digitise trade-related documentation, and automate some of the operational activity and decision-making, combines to result in a significant level of centralisation and concentration of trade operations capability.

Traditional trade finance remains important and relevant despite the long-anticipated disappearance of the Documentary Letter of Credit. While there was some evidence of a return to traditional mechanisms at the peak of the global financial crisis, nearly 80% of survey respondents express the view that traditional trade finance will exhibit little or no growth, or decline outright year-on-year going forward. Whether these developments will occur in an environment of positive trade growth, allowing traditional mechanisms to remain important to about 10% of global merchandise trade, as has been the case, remains to be seen.

While the trend to trade on open account terms is now well established, financing techniques and mechanisms aimed at facilitating these trade flows remain, taken holistically, on a path to development even though they encompass very mature techniques like factoring and forfaiting. In light of this, the domain expertise and "lessons learnt" in the context of traditional trade finance can prove highly valuable to the development of Supply Chain Finance (SCF). Relatedly, the well-established relationship value and cross-sell opportunities that flow from traditional trade finance argue further in support of an extended lifespan for this dimension of the trade financing business. 68% of survey respondents have identified SCF and technology as areas with the highest potential for growth in the context of trade financing, but that growth will quite likely maintain some roots in the traditional trade finance space.

Nearly 44% of respondents identify priorities linked to digitisation and technology, including FinTech and the development of – or adherence to – fast-emerging platform propositions, as priority areas of strategic focus.

Survey findings related to the pace of digitisation of trade activity are striking, in that 50% of respondents see high levels of digitisation achieved in less than a decade but an almost equal portion of survey participants expect the evolution to take from 10-25 years. Even interpreting that data point optimistically, a significant group within the pool of survey respondents expect that 60% digitisation of trade processes will take at least ten years to achieve.

While holding those disparate views, survey respondents are surprisingly consistent in their perspectives about the competitive/disruptive impact of FinTechs on traditional providers of trade finance. Survey results suggest that FinTechs and their competitive offering is not seen as a threat to banks' positions as providers of trade finance, with only 1.4% of respondents identifying this as a key concern. This may be reinforced by a widely-shared view that many high-potential FinTechs lack the required domain expertise to translate a good idea into a sustainable business, and that some form of collaborative dynamic will necessarily evolve.

The latter view seems to have been prescient, as recent industry dialogue, even among leading FinTechs, has shifted from competitive language and value propositions, to dialogue which envisions collaboration with incumbent providers, and looks to complementarity of propositions and competencies as a way forward.

It is worth noting that the provision of traditional trade finance has been relatively mature and static as a business proposition, certainly in terms of any truly disruptive or transformational developments. Prior to about 2005, when the threat of disintermediation resulting from the shift to open account trade drove banks to consider "defensive innovation" as a strategy, most change had been incremental. This latest survey and report come to market following an unprecedented period of change in the industry, with more to come as the physical supply chain is increasingly transformed through robotics, enhanced logistics, 3-D printing, drone-based delivery and numerous other, truly disruptive developments.

Two thirds of survey respondents report that topline revenues for their business have increased or remained unchanged, a very positive sign in the context of anaemic trade growth, low to zero-interest environments and the very high costs of meeting necessary but sometimes overly stringent regulatory and compliance requirements. This finding is also notable in an environment where capital adequacy requirements have made trade finance business more expensive and have translated directly into balance

sheet constraints on the business, which compound constraints related to risk appetite.

Notably, over 68% of responses identify compliance and regulatory requirements as areas of significant concern, whilst a surprisingly low 11% pointed to capital constraints in the same manner. Part of this result may stem from the cyclical nature of trade finance in terms of balance sheet capacity. That is, all else being equal and the Basel Committee's work being taken as a given – a position which some market participants adopt – trade financiers alternate between focusing on origination and distribution, with the industry clearly in origination mode for some time now.

Cost control is a perennial area of focus for all types of operational units within banks and even across industry sectors, thus its ranking is predictably highest, and similarly, with a core focus on operational efficiency, throughput, productivity and process efficiency, it is to be expected that some focus would be put on technology as an ongoing challenge.



### Editorial Observation

While the 2017 edition of this report does not address questions of pricing specifically, it is worth noting that the trade finance business has a well-established practice and history of allowing high-value services and solutions to either be (under-) priced into a product fee, or to become commoditised in the competitive arena, in part because pricing is presented on a cost-plus, transaction basis. It has rarely been presented as a matter of standard practice, in terms of the value delivered to clients by providers of trade financing solutions.

As the industry develops new propositions in SCF and aims to provide a holistic set of solutions across complex global supply chain ecosystems, and in light of the increasing recognition of the critical importance of trade financing in the enablement of trade, the time may be ideal for the start of a value-driven discussion around the price of trade financing and SCF.

Such an approach is about more than assuring adequate, value-based returns, it is about ensuring the long-term viability and sustainability of the trade financing business, and all the trade and economic benefits which arise directly from trade finance and SCF.





I. REFERENCE INFORMATION

II. RECAP AND SELECTED HIGHLIGHTS

III. STATE OF THE MARKET

IV. TRADE AND SUPPLY CHAIN FINANCE

V. POLICY, ADVOCACY AND INCLUSIVENESS

VI. RE THINKING TRADE AND FINANCE



Operations management practice in banking and in trade finance in particular has evolved materially over the past several years, with detailed management dashboards and reporting capabilities aimed at tracking processing times against client service level agreements, throughput and other typical operational Key Performance Indicators. At the same time, increasingly stringent regulatory oversight and issues of reputational risk are combining to prompt trade finance units to track operational risk.

The increasing application of technology with direct impact on transaction processing, for example, automated document preparation services, have reduced rates of discrepancy and non-compliance of documents presented for payment by exporters, and have as a direct outcome, reduced operational risk.

### SWIFT trade finance traffic

The ICC Survey and accompanying report is highly enriched every year through the contributions of numerous partners with a unique view on one or more “slices” of the full picture related to trade and trade financing. SWIFT, whose network provides the global channel through which trade-related instruments, communications and settlements are transmitted to the farthest corners of the world, provides just such a view.

SWIFT traffic covers the vast majority of trade finance executed on the basis of traditional instruments like Documentary Credits and Documentary Collections, as well as derivative mechanisms such as Acceptances and various forms of financing under these instruments.

Most trade today is conducted on open account terms, and therefore enabled through techniques of Supply Chain Finance, however, the data related to flows enabled through traditional trade finance - probably about 10% or about USD 1.5 trillion in annual merchandise trade, remains important.

Documentary Credit (L/C) and Documentary Collection traffic has shown a largely flat to downward trendline for numerous years, and the latest numbers from SWIFT confirms this trend for the 2017 report. Likewise, APAC retains its position as the major user of SWIFT messages and traditional trade finance products, with Iran notably showing the highest year-on-year growth in import L/C usage and Vietnam taking first position as the market receiving the largest volume of export L/C traffic.

The situation in Iran is directly linked to developments on the geopolitical front, whilst the latter reflects the evolution of trade corridors and the role of parts of Asia ex-China as the emerging nexus of global production and therefore export.

- In 2016, SWIFT trade finance message volumes have shown a decrease of 4.72% (slightly less than last year's decrease of 4.99%). This trend is underlined by the decrease in category 7 messages by 3.62% and by 8.64% in category 4 messages.
- Asia-Pacific continues to register far greater volumes of MT 700 with a 73% share for imports and a 77% share for export of the world traffic in 2016.
- Countries that imported the most using L/Cs transmitted through the SWIFT network are: South Korea, Bangladesh, China, India, and Hong Kong.
- Countries that exported the most on the basis of export L/Cs received through SWIFT are: China, Hong Kong, India, Singapore, and Japan.
- Iran shows the highest annual increase in import L/C traffic compared to 2016, with an increase of over 70% while Vietnam shows the highest annual increase in export-related message volumes which is 7% respectively.
- Algeria shows the highest annual decrease in import L/C traffic 26% while Japan shows the highest annual decrease in export messaging, at more than 13%.
- The average value of an L/C (MT 700 only, amount converted to USD) in 2015 was USD 350,000 whilst in 2016, it increased to USD 463,000.

### Gaps in trade finance provision

As with the insights provided by SWIFT, the ICC collaboration with the Asian Development Bank, which also extends to our other flagship report on trade finance default and loss data, has been invaluable, and the source of very constructive advocacy efforts around ensuring adequate levels of trade financing globally.

There is broad agreement about the reality of unmet demand in trade financing. 61% of survey respondents perceive that there is more demand for, than supply of, trade finance around the world. 45% of global demand for trade finance originates in Europe, China and advanced Asia; developing Asia faces challenging market conditions, experiencing a rejection rate of about 15% against 8% in China and advanced Asia.

Notably, a significant portion of survey respondents report an expectation that appropriate leveraging of FinTech has the potential to enable banks to save money, and by extension, to expand the availability of trade finance and at least partially close a persistent global gap in the financing of trade activity.



The trade finance gap estimated at USD 1.6 trillion represents untapped potential in trade, unrealised economic value and lost opportunity in terms of development impact and economic inclusiveness.

Capacity issues among providers, insufficient levels of collateral and numerous other issues, including incomplete financial literacy among SMEs combine to contribute to rejection rates, meaning refused finance, thus contributing to the trade financing gap. Balance sheet constraints and limitations around risk appetite also influence the ability of incumbent providers to address demand for trade-related financing. Numerous initiatives are underway, as a direct result of ADB research (as well as similar analysis by the IFC and others) to raise awareness about the gap, to influence policy and to raise engagement around mitigating, perhaps ultimately closing the global trade finance gap.

#### Trade finance professional development outlook

One reality related to the business of financing trade, which may indirectly contribute to the trade financing gap, is an ongoing consolidation among providers of traditional trade finance, coupled with the maturing demographic of trade finance specialists worldwide. Limitations around technical capacity and professional competencies can translate directly to unmet demand due to limitations at the transactional level.

The International Chamber of Commerce has established the ICC Academy based in Singapore, the initial focus of which was to deploy professional development solutions aimed at trade finance, including two levels of professional certification.

In addition to content developed by practitioners with a desire to balance solid theory with practical application and professional relevance, the Academy has produced a series of accompanying webinars, and is creating a robust, energetic global community of practitioners aimed at supporting our delegates and students.

The Academy complements the work of numerous industry bodies and training organisations, as well as the training and technical assistance efforts of various multilateral institutions. The creation of material levels of additional professional capacity in trade finance will directly contribute to increased capacity to underwrite trade finance business, and will address a critical generational gap in competencies around the financing of international commerce.

#### Standard Supply Chain Finance terminology

The ICC is a key partner in the global network of industry bodies, training entities and advocacy organisations around international trade and trade-

related financing. This is reflected in the request to the Banking Commission to lead /facilitate a multi-association initiative to draft a set of standard definitions for techniques of supply chain finance.

The drafting process and related output was described by a long-serving member of the Banking Commission as “having set a new standard” for this type of initiative, initially a collaboration between the ICC, BAFT, FCI, IFG (the latter two now merged), ITFA and EBA.

The collective group, referred to as the Global Supply Chain Finance Forum agreed post-publication of the Standard Definitions for Techniques of Supply Chain Finance, that BAFT would take the lead on market adoption. Anecdotal evidence quickly pointed to significant market interest, and subsequent interactions, including at the annual BAFT trade conference in Chicago in 2016, where the Standard Definitions figured prominently in a day-long SCF Bootcamp. Delegates noted that the document was proving valuable in internal discussions with risk specialists, credit departments, product units and other stakeholders.

BAFT notes in the update provided, that over 78% of survey respondents reported having incorporated all or part of the Definitions in their business. The definitions are a first step in establishing a common global understanding and reference points; BAFT and the GSCFF partners see this as a first step to some level of international standardisation, followed by data collection for purposes of advocacy, and likely a rulemaking exercise similar to the highly successful ICC rules that guide the use of traditional trade finance products around the world.

#### Corporates’ perspective on SCF

Bank of China and Australia and New Zealand Banking Group (ANZ) provide a view of current corporate perspectives on SCF, illustrating in their respective contributions, that there is a wide spectrum of views, of engagement and of understanding about SCF in the market, even in a region where many global supply chains are anchored.

In China, it is reported that large corporate and mid-cap companies put significant emphasis on SCF and see material potential in developing SCF propositions and programs, understanding the importance of broad internal involvement, and in some cases, treating SCF as a highly strategic element of their approach. The SME segment, in contrast, exhibit limited knowledge about SCF techniques and practice. It was noted that some public policy attention has been directed to SCF in the last year, and that there is clear opportunity to raise awareness of the Standard Definitions in China.



## Editorial Observation

Factoring is a long-established technique in financing, historically leveraged by SMEs and other businesses in need of financing and prepared to pay a premium to access the variations available through this industry. Significant effort has been invested to advance market perceptions about the nature of factoring and about businesses that avail themselves of the services of factors, both domestically and on a cross-border basis. As a major component of Supply Chain Finance, factoring is both established and at the leading edge of finance in international commerce, and it will be critical in the coming years, for collaborative initiatives to build upon and extend beyond the work of the GSCFF to include advocacy, data collection and analysis and other areas that can help advance the evolution of trade financing and cross-border factoring in particular, both in support of SMEs and as a contribution to the reduction of the global trade finance gap.

ANZ reports that there is growing interest in SCF, perhaps particularly Payables Finance as a means of enhancing working capital across the supply chains of large buyers, however, notes that perceptions remain in the market, that certain SCF techniques may be seen to reflect supplier weakness and are viewed as solutions of last resort. Such perceptions have been observed in various markets as the SCF proposition evolved from a new offering to a more mature set of solutions in those markets, thus a path to advance SCF in Australia and New Zealand can be discerned from the experience of other regions of the globe. Large buyers report a widely favourable view of SCF and have company-wide support for program deployments.

### Supply Chain Finance techniques

Complementing the update provided by BAFT, the International Trade and Forfeiting Association (ITFA), another of our GSCFF partners, provides a view from its segment of the market. The Association reports seeing growth and potential in SCF, even in the context of modest trade growth. ITFA members view forfeiting as a “beacon” in the midst of recent negative news, reporting for example, that the forfeiting market in China stands at about USD 30 billion, and that robust business is being undertaken globally, with significant involvement from non-bank providers. ITFA

survey respondents report average deal size in the range of USD 5 million, with 60% of responding banks completing at least 300 transactions in a year.

The report then turns to an update from another GSCFF partner, Factors’ Chain International (FCI). The organisation reports that factoring activity has doubled in size since the peak of the global crisis in 2009, but that year-on-year growth is currently modest when taken globally. With reduced volumes of activity in China, cross-border factoring activity has recorded its first year-on-year decline since the peak of the global crisis, whilst European markets, among the most mature globally, show growth in the range of 2.5%.

While the Middle East experienced a decline of 7%, Africa showed strong growth, reporting an increase of 9% in business versus last year. Asia, the new centre of gravity for trade in many respects, nonetheless reports a material decline of 15% in factoring activity, with the impact of the slowdown in China reflected in this number.

Despite a reduction in volume reported this year, international factoring represents in relative terms, the largest percentage of overall factoring activity in two decades, driven to a significant degree by the global shift to open account trade, and the prominent role of factoring as a technique in this space, particularly for SMEs.

### Export finance outlook

Continuing in our effort to provide a perspective directly from the market, with attendant relevance, we partner with TXF for the now annual survey on trends in export finance, which this year reflects the views of about 100 senior practitioners around the world, including those based at leading banks, export credit agencies, and major corporates.

Power and infrastructure project led the field over the past year as particularly active sectors, figuring in the top 3 sectors for 18% and 14% of respondents respectively. These are followed by oil and gas upstream and downstream (8%) and renewable energy (7%). Growth patterns vary significantly across regions, but a significant portion of survey respondents (47%) report the view that more could be done to support SMEs in the context of export finance.

While providers appear positive and enthusiastic about growth initiatives and moves into new markets, survey respondents noted common concerns around legal complexities in entering new markets. The relationship value of export finance is widely acknowledged, with 90% of survey respondents



### Editorial Observation

Export finance is a critical part of the financing of international commerce, often involving complex transactions with longer tenors, strategically critical trade flows and risk profiles that frequently require recourse to export credit insurance, guarantees or financing support. From an advocacy perspective, the ICC and others in the market note the critical role of ECAs in assuring access to trade and export financing in some of the most challenging markets on the globe, and in times of crisis when, as seen during the GFC, private sector providers were unable to respond to market conditions on their own.

The mandates and operating models of ECAs vary significantly, as does the domestic and international political context in which they operate – hence the recent challenges faced by US Exim on largely political and ideological grounds, while other jurisdictions embrace the role of ECA support in enabling export trade flows. The issue of a relatively equitable global environment around ECA activity is both perennial and fundamental, and at this time even extends to regulatory debates about the appropriate capital treatment of ECA-backed trade financing.

noting that the provision of export finance solutions helps secure additional business from clients.

In this context, the market reports an overall reduction in pricing over the past year, which almost 60% of survey respondents attribute to competition. The TXF-ICC survey also explores key expectations and priorities for banks and ECAs, with some issues relevant to other areas of trade financing, like regulatory and compliance, being noted with some prominence. Issues perhaps a little more specific to the export finance space, such as complex, non-standard documentation, and the issue of variances in ECAs models and value propositions materially in the survey results.

#### Export credit insurance outlook

The Berne Union provides a view on the state of the export credit market, as one of two leading industry

bodies and the one perhaps slightly more focused on the ECA/public sector side of the market but with members from both communities and thus able to provide a holistic view of the market. The headline from the Berne Union contribution is one that speaks of a robust and healthy industry, though members report a reduction in premium income in the range of 15% between 2011 and 2015. Payments against claims are reported to have decreased year-on-year, with about 16% of total claims paid in Brazil. Average loss ratios remain stable at the industry level at a manageable 30%. Berne Union members, like much of the trade financing industry, identify protectionist developments in the global economic environment as an area of significant concern, and similarly, regulatory treatment of trade finance, both from a capital perspective and from a compliance point of view, impacts the business of ECAs and Berne Union members.



### Editorial Observation

As noted earlier and in various parts of this year's report, the role and importance of ECAs has been widely acknowledged following the global financial crisis, and it is incumbent upon industry leaders to ensure that this message is clearly and consistently communicated through advocacy efforts, well-targeted messaging and joint efforts by numerous industry bodies and associations. ECAs have been at the forefront of social responsibility and sustainability, certainly in part as a result of past adverse impacts of certain financings. Public policy combined with reputational considerations have

motivated ECAs to lead in requiring environmental and social impact assessments in advance of approving financing, with the Equator Principles serving as a valuable reference for the rest of the industry around standards, sustainability and responsible financing. A feature of the ECA market that is notable and bears monitoring, is the evolution of ECA business and presence beyond the traditional European market, particularly in certain high-growth, non-OECD markets where trade – and the support of ECAs – is considered strategically critical to long term growth.







## Policy, Advocacy and Inclusiveness: Shaping the Global Architecture for Trade

Following a review of the market from various perspectives the report then shifts attention to the Policy, Advocacy and Inclusiveness-related content.

### Foreign direct investment

UNCTAD leads off with a review of the state of foreign direct investment – a topic which historically would have been considered distinct from trade, but linked to it, in the classical debate of whether trade follows investment, or investment follows trade.

More recent thinking, taking a holistic perspective across the architecture of the global system, looks at trade, investment flow, outsourcing and offshoring plus complex supply chain-related ecosystems, as part of the same complex equation. One version of this argument and framework was frequently articulated by Stephen Poloz, previously CEO at Export Development Canada and currently Governor of the Bank of Canada. Under such a framework, FDI flows and analysis becomes directly relevant to an understanding of trade, and thus trade financing and the areas of development and inclusiveness that we are linking together.

FDI flows declined by 2% globally, with developing Asia – the anchor for many global supply chains – showing a marked 15% reduction in flows, Latin America and the Caribbean are impacted by a loss of 14% of investment activity year on year, with economies in transition a bright spot on the state of global FDI, showing an increase in flows of 81%.

According to UNCTAD, investment flows underpin about 80% of international trade activity through the channels of global value chains.

### Making trade work for all

The OECD follows with a contribution that argues firmly and clearly in favour of trade, but does so on the basis of a candid recognition of the legitimacy of certain populist concerns about inequity and the need for a fact-based dialogue on the benefits of trade. The OECD presents several specific recommendations around the imperative of having the global economic system work more equitably and to the benefit of more people, looking at a range of areas for action and policy focus, from systemic aspects that unintentionally limit the ability of MSMEs to engage internationally, to issues around global coordination and collaboration around regulatory requirements, corruption and related considerations that impact the global trade architecture and economic system, with particular focus on inclusiveness.

From the perspective of the ICC, as the leading global voice of business, and that of the Banking Commission as leaders in the arena of trade financing, the message of the OECD is both aligned with our own views and is a critical one to communicate, effectively, to the wider international community. While no trade practitioner will claim perfection in the current architecture for trade, the explicit acknowledgment of the imperfections and inequalities is, at this stage and in the current geopolitical context, an important step in advancing the dialogue.

### Trade facilitation programs from multilateral institutions

Just as the role of ECAs is recognised and understood to be key to assuring adequate levels of trade finance, and thereby underpinning trade, the multilateral development banks likewise play a critical role, particularly in developing markets and often in relation to enabling SME engagement.

Several of the multilaterals have trade finance and supply chain finance programs, some in operation since the late 1990's, that have been very robust and have enabled access to billions in trade-related financing, with, thus far, zero losses incurred. IFC alone, with a global mandate, reports having supported USD 19 billion in emerging markets trade; other multilaterals tend to be more regionally focused – the ADB, for example, reports a 24% increase, year-on-year, in the amount of trade activity supported, reaching over USD 3 billion and positively impacting about 1,500 SMEs in the region. A review of the major IFI trade finance programs is included in this section, which can inform trade financiers, not only about the breadth of programs and geographic coverage available, but also specific characteristics and areas of focus of certain programs.



## References

S. Poloz, Financial intermediation under the new trade paradigm: EDC and integrative trade, 2012: <http://www.edc.ca/EN/Knowledge-Centre/Economic-Analysis-and-Research/Documents/financial-intermediation-new-trade-paradigm-edc-integrative-trade.pdf>

### Trade finance advocacy

The subsequent section speaks to the specific efforts and successes of the ICC and the ICC Banking Commission, around raising the visibility of and awareness about trade financing and supply chain finance. The advocacy and awareness-raising efforts reach the highest levels of international leadership and top-level fora, including through the newly achieved UN Observer Status, and through the annual B20/G20 cycles.

### Sustainable trade finance

Relatedly, the section which follows speaks to the work of the ICC Banking Commission around sustainability, including consideration of sustainable trade issues, but specifically around sustainability in trade financing and SCF. Deliberations in this context include consideration of risk issues, mitigation options and even potentially, financial incentives to drive sustainable behaviours in trade and in the financing of trade flows.

### SME competitiveness

In addition to increasing focus on the broader context in which trade financing operates, and on the importance of inclusiveness, all stakeholders agree on the economic importance of SMEs globally, and on persistent challenges reported by those same SMEs in accessing financing to enable growth. This challenge extends specifically to trade-related financing, as

illustrated through the ADB trade finance gap analysis. Certain techniques of supply chain finance, specifically Payables Finance, offer significant promise in mitigating this issue.

The Geneva-based International Trade Center puts specific focus on SMEs in the context of regional value chains, noting that these regional ecosystems may prove easier for SMEs to access than the much-discussed global value chains or GVCs. Several reasons for this are noted, including the idea that global supply chains and value chains can, due to their complexity, involve a significant role for aggregators, effectively keeping an SME supplier at some distance from the export market and ultimate buyer. The ITC contribution also highlights an observed difference in impact between trade agreements that are “deep”, versus those that are less encompassing, and detailed.

Just as traditional providers partner with multilateral development institutions and, based on the support and risk guarantees of those institutions, establish trade-related transactions with local banks in developing economies, so too, can the ITC with its core focus on SMEs, benefit from the support of traditional financial sector actors to increase the efficacy of SME engagement in accessing finance and trade financing and thereby, their likelihood of success as exporters in international markets.

### Access to trade finance in Africa

The African Development Bank makes a further contribution to the SME-oriented discourse in this year’s report, by sharing findings from their survey of SMEs across 49 countries in Africa. Given the high growth exhibited by parts of the continent, and the young demographic in many of the countries in Africa, together with the urgent need to take growth-promoting policy and business decisions, this contribution encompasses several of the recurring issues in the 2017 report. The findings of the AfDB survey are timely and very relevant to the discussion around global trade, evolving corridors and the broadening base of international supply chains, including the importance of the so-called “last mile” of suppliers in those regional and global supply chains and value chains.

With SMEs accounting for over 80% of private sector employment across Africa, the under-servicing of the SME segment in the region is particularly concerning and the consequences acute, thus in urgent need of rectification.

SMEs exhibit a 14% default rate in Africa, a level that is materially higher than the default rate observed in global trade finance portfolios, which typically remain below 1% and often are a fraction of that;



### Editorial Observation

The work of the ITC, as a joint entity of the UN and the WTO, is unique and differentiated in the market, clearly having a development focus and equally clearly aimed at SMEs in those markets – many, the very suppliers or potential suppliers upon which both regional and global value chains rely. The contrast of this clear, mandate-driven focus on MSMEs against the very limited practical engagement of traditional financial sector firms is both notable and understandable; it also clearly argues for decisive movement by private sector providers (particularly banks) beyond rhetoric about the importance of SMEs to concrete, if non-traditional action in support of those same SMEs. The evolution and increasing adoption of certain techniques of Supply Chain Finance represents one such concrete step forward, but in the case of Payables Finance in particular, this is on the back of the credit capacity of large buyer clients.



survey analysts conclude that SME creditworthiness is thus linked directly to the limited availability of trade finance for the very important segment of economic activity and job creation. The other frequently cited rationale for limitations in credit facilities extended to SMEs, including trade financing, relates to the absence of what is considered adequate levels of collateral., with 30% of survey respondents identifying this issue, versus 36% pointing to high default rates.

The AfDB concludes with a call to action to international institutions in building capacity and technical competencies among local African banks and institutions, in support of SME access to finance and access to trade-related financing. That call to action can and should extend explicitly to international banks and private sector players in finance and trade financing in particular, through complementary capacity-creating initiatives.

### Trade barriers globally and in Sweden

We then shift back to a more macro view, with the contribution of the Swedish National Board of Trade which highlights a view that governments around the world, taken together, are introducing on net, more barriers to trade than they are removing. While these may largely be non-tariff barriers, their effect on trade is nonetheless chilling. Of particular concern to the Trade Board are the adverse impacts of subsidies, localisation requirements and other impediments to trade that can be observed in the context of public procurement practices – supply chains which, it is worth noting as an editorial comment, are often cited as opportunities for SMEs, but are often riddled with requirements that are prohibitive for SMEs to even attempt to pursue. Customs procedures, technical and product adaptation requirements and other similar issues, several in the well-explored regulatory and compliance space, are highlighted as areas of concern, even in trade with the EU, where the removal of such barriers is at the core of the vision for the political, economic and trade partnership that is the European Union.

This section of the report concludes with two perspectives on regulation and the regulatory issues and context around trade and trade financing.

### Trade finance regulatory framework

Sullivan & Worcester provide a view on the potential benefits to non-bank providers of trade finance and SCF, of having a nascent and far less stringent or mature regulatory framework to deal with than incumbent banks active in the financing of international trade. The contribution observes that regulatory authorities, even as they contemplate revisions to Basel III, have done little to encourage

banks to remain engaged or to engage in the provision of trade financing, including SCF – that there is no attempt to create a sense of risk-aligned “comfort” for banks active in the finance of cross-border commerce.

From a lack of clarity around the types of assets that can be used in risk mitigation, to changes in Basel IV to the risk-weighted asset framework which will impose restrictions on the ability of banks to use an internal model for calculating regulatory capital, the firm argues that current regulatory expectations are not particularly conducive to bank involvement in trade finance.

The entry of non-banks and the rise of “shadow banking” is highlighted and linked to current regulatory requirements, expectations and gaps, however, Sullivan and Worcester note that non-bank financial institutions are indeed subject to regulation, including national regulations as well as those related to sanctions. They do not however, face the same level of regulatory expectation as banks in the areas of risk asset regulation and capital adequacy, and do have greater flexibility in client onboarding and in the structuring of facilities – with the end result being that non-bank financial institutions may be well positioned to bring significant additional capacity to bear in closing the global trade finance gap.

### A risk-based approach to regulation and compliance

A contribution by Thomson Reuters brings into sharp focus, the significant financial and resource cost incurred by banks in an increasingly complex and stringent regulatory environment, with respondents to a Thomson Reuters survey in 2016 noting that they spend an average of USD 60 million each on KYC-related procedures alone. Relatedly, and despite significant energy invested in considering this aspect of relationship management, and various initiatives looking at the application of technology in this respect, it takes an average of 24 days to onboard a new corporate or commercial client.

The Thomson Reuters discussion points to the adoption of a risk-based approach to regulation and compliance, which the Banking Commission is fully supportive of in the context of trade financing in particular, however, rightly points out that efforts to interpret overarching regulatory frameworks and guidelines by regional and national regulators are contributing to a lack of alignment or consistency globally. This is particularly problematic for global financial institutions – still the major providers of trade finance if we exclude intra-firm trade credit – given they deal in multiple jurisdictions, and may be fully compliant in one context but run badly afoul of regulators in another.



## Editorial Observation

The ICC and the Banking Commission recognise and support the critical need to ensure the robustness, sustainability and stability of the global financial system, and thus appreciate the need for robust and effective regulation.

Where advocacy efforts have been focused however, is in promoting risk-aligned regulatory frameworks and expectations, with effective mitigation of unintended adverse consequences on the conduct of necessary, legitimate commercial activity. Regulatory initiatives that prompt excessive de-risking, or reduce the appetite of banks to engage in cross-border business, including the provision of correspondent banking services or solutions in the financing of trade are not in the best interests of the international community, and are particularly harmful to developing economies and SMEs.

In this respect, while it may feel correct to divorce regulatory oversight and standards from commercial considerations, the reality is that many of the world's leading global banks and financial institutions are commercially oriented, and obligated to deliver shareholder value, thus

the impact of regulation is considered from both a reputational risk perspective, and from a commercial perspective, as Thomson Reuters points out, with an eye to cost/benefit analysis.

A comprehensive and candid, fact-based dialogue between regulatory authorities and regulated entities is necessary and will ultimately support the development of risk-aligned regulation and the conduct of value-creating business.

The call for a balanced dialogue on regulation is articulated specifically in an article authored for TXF, titled "Rethinking Trade Finance Regulation" which the ICC concluded was a constructive addition to deliberations on the topic.



## References

A. Malaket, K. Ramadurai, Rethinking Trade Finance Regulation, August 2016. Available for TXF subscribers: <http://www.txfnews.com/News/Article/5707/Rethinking-trade-finance-regulation>



## Digitisation and the State of FinTech

The final section of the 2017 report takes a distinctly forward-looking view in addressing technology and digitisation – two forces poised to fundamentally disrupt and transform trade, trade banking and trade financing, including high-growth SCF, and including accessibility of financing in developing economies and among SMEs.

### Digitalise trade finance

The ICC Banking Commission recently launched a Working Group on Digitalisation, with a specific focus on the financing of international trade, and a mission to “accelerate the journey” in light of advancing capabilities and increasingly urgent market expectations in this sphere. An introduction to the work of the Group notes that developing economies have been quick to adopt and progress digitisation initiatives, much like they were quickly engaged in mobile payments relative to other parts of the world. The ability to advance to deployments based on the most current technical architectures and technologies is one enabler of this reality, and the urgency of facilitating access to domestic and international hubs of economic activity, like supply chains, further motivates this fast adoption.

The Banking Commission contribution notes that individual market players or institutions may be effective at digitisation of their own internal practices and processes, but that one challenge quickly taking shape, is the creation of a series of disconnected “digital islands” of activity, bridged by legacy paper and process-intensive activity. The contribution calls on the trade finance industry globally, to take concrete steps to facilitate and accelerate digitisation, noting that industry leaders can do so through greater collaboration and the development of standards and rules aimed at reducing uncertainty around emerging practices.

The Editorial Comment which follows this section makes mention of the ICC’s new collaboration with the Global Legal Entity Identifier Foundation (GLEIF) - a G20-mandated entity that will have important positive impact across various aspects of trade and trade financing, and will prominently in Banking Commission initiatives going forward.

### Digitalise trade finance

Misys continues the discussion, noting in their contribution that doing nothing on digitisation of trade finance is no longer an option. Misys considers the notion of a “digital bank” and looks to this idea as it might impact a trade finance business, observing that one leading trade bank estimated potential

annual savings of USD 50 million in undertaking material digitisation of its trade business.

The elimination of paper from trade finance transaction processing could reduce throughput time by two hours per transaction, and the judicious application of technology to compliance-related processes and procedures could conservatively reduce compliance costs by 30% or more in the trade banking business. In line with evolving areas of focus at the ICC Banking Commission, Misys notes explicitly the material positive impact that can be created on sustainability, in a comprehensive shift from paper to digital transaction processing. This latter consideration is given significant profile and visibility by Misys and the Financial Times through the World Trade Symposium ([www.worldtradesymposium.com](http://www.worldtradesymposium.com)), on the Board of which the ICC and the Banking Commission are well represented.

### Blockchain and supply chain disruptions

PwC then provides an overview of Blockchain with an attempt to explain an expansive and diverse technology with a potential to disrupt supply chains, particularly given the belief that trade finance and supply chain management are areas ripe for innovation. A recap of already familiar observations for some of our readers, this contribution is valuable to a wide range of practitioners, regardless of any assumed familiarity with the topic, particularly given the recency of the field, the rate of new development, and relative shortage of documented production case studies. One of the key observations in this respect from PwC is that 77% of respondents to their survey expect blockchain to be in production systems or processes as soon as 2020.

### FinTechs in trade banks

A contribution by Simmons & Simmons hones in on the interplay between banks and FinTechs, linking these emerging relationships and alliances to the digitisation discussion and noting that collaboratively developed solutions could reduce the cost of paper-based trade financing by up to 15%.

The firm shares highlights of its Hyperfinance Survey, covering over 200 financial institutions and encompassing the view of many of the world’s leading trade banks. It is notable that only 7% of survey respondents see themselves as being at the leading edge of innovation, and that 59% see themselves on par with, or lagging their peers in this respect.

Strikingly, 80% of respondents report that the deployment of digitally driven products and solutions have demonstrably contributed to revenue growth. The assertion is that while there is a clear motivation





## Editorial Observation

The capabilities of technology and the receptiveness of the market are now firmly in alignment in terms of the ability to and the demand for digital trade and digital trade financing. Market acceptance of dematerialised documentation, legal recognition of the enforceability of non-paper based communication, transfers of title, or representations of commercial or financial obligation are all critical. They converge today with advanced optical character recognition, sophisticated artificial intelligence, data-based matching and decisioning and other technical capabilities, to open up an entirely new world of digitalised global commerce.

While it can be argued that progress should have come sooner, the reality today is that the transformations in the physical and the financial

supply chains have been irrevocably set in motion, and that trade financiers will have no option but to respond appropriately, or be left behind.

At the ICC and the Banking Commission, we, together with key partners across the global system of trade and across the architecture of the international economy, will work to lead the way in supporting, enabling and advocating for these positively transformational developments. Fundamentally, trade will continue, and financing (as well as risk mitigation) will remain an enabling requirement for trade, whether business is conducted through existing channels, or whether it shifts materially to online platforms or some other form of interaction. The core mission remains the same, even if the modalities and the nature of the enabling transactions is fundamentally transformed.

and desire to pursue development and launch of digital propositions, few financial institutions possess the competencies necessary to execute against these ambitions. Survey respondents point to collaboration (55%), FinTech partnership (48%) and acquisition are seen as the three primary paths to innovation, with respondents expressing limited enthusiasm for the acquisition option, and voicing reservations around cultural alignment between banks and FinTechs in the partnership scenario.

The firm points to cybersecurity concerns, IP issues and regulatory risk, but concludes by proposing six specific steps to foster and enable innovation:

1. Escape the 'Four Walls';
2. Adapt the on-boarding process;
3. Get pragmatic about IP;
4. Centralise a digital innovation strategy;
5. Know your partners;
6. Pick the right investment model

### Physical and financial supply chain evolution

The digitisation challenge and opportunity extends beyond trade financing and SCF, and encompasses trade as a whole, including a wide range of activities in global supply chains, as well as mission-critical processes in logistics, customs clearance and other market access related considerations.

GT Nexus contributes a unique perspective on the breadth of the issues to be considered, as a company that possesses expertise in both the physical and financial supply chains. In a recent survey conducted by GT Nexus and Capgemini, it was noted that 75% of supply chain executives consider digital transformation to be important to their business, this from a respondent group of 330 executives across 20 countries.

Survey respondents expressed only limited satisfaction with progress to date, pointing to the need to receive, manage and mine massive amounts of data that reside in complex global supply chains. Enhanced understanding of supply chain-based data flows is highlighted as a direct path to enhanced commercial agility and responsiveness

### Data: the new oil in B2B banking

In a related thesis, the title of which subsequently appeared on the cover of a major UK-based publication, German FinTech TraxPay posits that data is the new oil in B2B banking. Perhaps even more fundamentally, TraxPay suggests that a degree of market power combined with something akin to complacency has created an "innovation gap" in banking, that FinTechs are anxious to target.

Contrasting competitive postures and collaborative models, this contribution to the digitisation dialogue suggests that the latter approach offers significant potential. Market players whose proposition is to

facilitate data mining and analytics through artificial intelligence, while leaving intact the customer/bank relationship dynamic, will bring net new value to the market and will be successful in advancing innovation.

### Interview on the progress in digitisation

The report also features a conversation with some of the leading trade finance figures, from a roundtable held during the ICC Banking Commission meeting in Jakarta, in April 2017, and moderated by Vincent O'Brien. The discussion is constructed around one of the main themes of this year's report: digitisation of trade finance, with key concepts for implementation stemming from the conversation: collaboration, connectivity, innovation, accessibility, consensus, transparency, standardisation, simplification.

### Closing remarks

The report rounds up with a call for cooperation in enhancing the market intelligence capability of the trade finance industry, by combining insights, resources and networks to access more efficiently data and information from trade finance providers worldwide, in order to even better assess current developments and foresee market changes.



### Editorial Observation

The foregoing section aims to provide a view of selected findings, observations and highlights in what we hope you will find to be a high-value, comprehensive and world-class report on the state of trade and the state of trade financing and SCF, at a moment in history where staunch, thoughtful and compelling arguments need to be made, in support of rules-based, multilateral and open trade.

We encourage you to review the rest of the report to pick up on the detail and nuances of the many contributions that make this, we hope, a powerful strategic reference and a source of practical insight and observations to guide.

We also invite you to engage with us in vigorously championing trade, multilateralism, international engagement and the critical role of trade financing and SCF in enabling the creation of trillions in economic value. This even as we work together to improve a global system that can, and should, undeniably be more equitable and more inclusive in all respects.









# State of the Market: Trade, Finance and Development

**ICC Advocacy at a watershed moment in  
global business >**

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**Global economic outlook >**

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**Recent trends in correspondent banking  
relationships >**

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**Evolving trade flows and trade corridors,  
reconfiguration of global supply chains and  
sourcing patterns >**

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# ICC advocacy at a watershed moment in global business

INTERNATIONAL CHAMBER OF COMMERCE

**Business today faces an environment with both unprecedented challenges and tremendous opportunities. The challenges come in part from a generalised and deep-seated feeling of dissatisfaction—with government, with markets, with the media—and of disenfranchisement as many feel locked out of growing economies.**

**Author**

John Danilovich, Secretary General, International Chamber of Commerce

The opportunities reside in the central truth that trade-led growth has been, and remains, a key engine of economic and social progress.

Our current situation calls for a twofold response from business. First, private sector voices must redouble their efforts in explaining the pivotal importance of an open and rules-based international trading system. Trade matters not just for the giants of industry but also for SMEs, and for consumers around the world. This must be effectively communicated so that policymakers do not repeat the damaging protectionist blunders of the past.

At the same time, we must recognise that the wave of popular discontent we are seeing is not merely the result of a communications problem but signals the need for domestic policies that do a better job at redistributing the undeniable benefits of globalisation.

Business operates in a wider societal context where shareholders and the public increasingly expect companies to both attain financial success and contribute to broader social goals. The omnipresence of phrases such as corporate social responsibility, global citizenship, and sustainable business practices is a testament to this expectation.

Since its founding, ICC has recognised the natural link between world trade and international security, with ICC's founders even referred to as 'merchants of peace'. This core tradition was recently reflected in the United Nation's (UN) landmark decision to confer Observer Status on ICC—the first time ever that a business organisation has been granted such an honour. UN Observer Status comes at a time when the voice of global business is needed more than ever to affirm the importance of global cooperation.

**Trade-led growth has been, and remains, a key engine for economic and social progress**

**UN Observer Status comes at a time when the voice of global business is needed more than ever to affirm the importance of global cooperation**

Through our policy commissions, ICC has an unrivalled pool of global business expertise across areas that will be key for future growth and sustainable development, from digital technologies to taxation. UN Observer Status will allow ICC to share this much-needed expertise with leaders around the world on a new level as we advocate for a more holistic approach to managing the global economic system. The global issues we now face are greater than any one country or organisation and ICC recognises that all stakeholders will have to look beyond their self-interest to find solutions that will benefit all.

People, communities and nations have traded since the dawn of human existence, and will continue to trade well past current debates and deliberations. And while many criticisms of trade remain widely distorted, few deny that steps must be taken to make our international trading system more inclusive. Many such steps are already being discussed at the highest levels of government and throughout global institutions.

Alongside macro policies to alleviate any negative effects of global economic integration on workers, we must also build understanding on how trade works so that more can take advantage of the enormous opportunities it offers. ICC's launch of the Singapore-based ICC Academy, which focuses on professionalising the business of trade finance, has quickly evolved to encompass training, development and certification in other areas of the ICC's work. Much like ICC's advocacy activities, the Academy's development of high-quality programmes—backed by a vibrant international community of practitioners and students—reflects a commitment to the wider context in which business operates.

Whether through ICC's standard-setting activities, our global services or advocacy for issues like access to trade finance, ICC aspires to work with a view to the responsibilities that business has to the communities in which we operate and thrive.

Achieving UN Observer Status is a powerful next step in the evolution of ICC's mission and the clearest indication yet that business must take an active role in determining how we collectively face the challenges and opportunities of an ever more connected global economy.





# Global economic outlook

THE WORLD BANK

## Authors

Jakob Engel and Jose Guilherme Reis, Global Trade and Competition Unit of the World Bank Group's Trade and Competitiveness Global Practice

## Global economic prospects

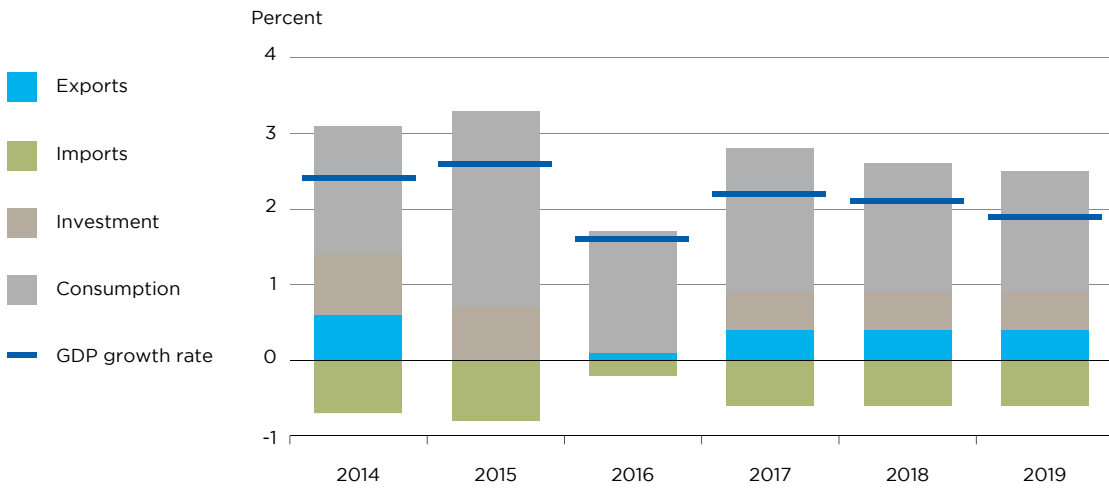
Eight years after the global financial crisis, the global economic outlook is slightly more positive, with the recovery that gained pace in late 2016 generally expected to continue throughout 2017. According to the most recent (April 2017) IMF “World Economic Outlook”, global growth is projected to rise from 3.1% in 2016 to 3.5% in 2017 and 3.6% in 2018. This is both an upgrade on the previous IMF projection from October 2016 and more optimistic than the World Bank’s January 2017 “Global Economic Prospects”, which estimated global growth at 2.7% for 2017. However, policy uncertainty remains a significant source of downside risks.

The causes for a more optimistic outlook can be attributed both to a post-election boost in market confidence in the United States and the hope that an easing of fiscal policy may reinforce existing cyclical momentum. Nevertheless, growth remains primarily driven by consumption (see Figure 1), which tends to lead to weaker recoveries due to the potential for build-ups of imbalances, and in turn reduced growth over the medium to long run.

The much-discussed productivity slow-down of recent years appears to continue unabated, with growth in labour productivity in both advanced and emerging economies remaining far behind the average for 1990-2008. As such, downside risks remain substantial (see Figure 2) due to both continued policy uncertainties in many advanced economies and some emerging economies as well as around the pace of interest rate hikes in the US, rising protectionist tendencies, geopolitical tensions and the potential for self-reinforcing feedback loops between sluggish demand, low inflation, weak balance sheets and slow productivity growth.

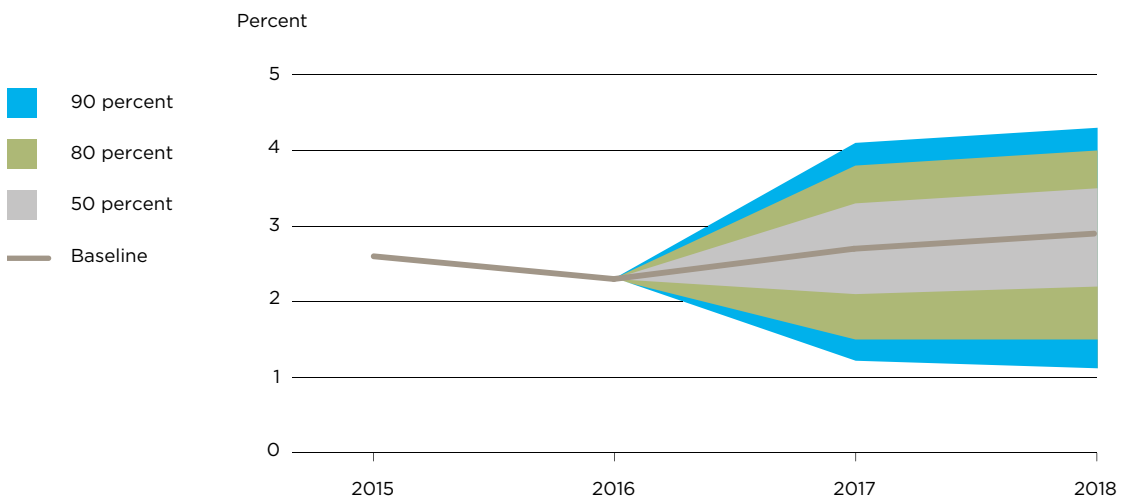
**Despite improvement, downside risks remain substantial due to continued policy uncertainties**

**Figure 1: Contributions to GDP growth**



Source: World Bank

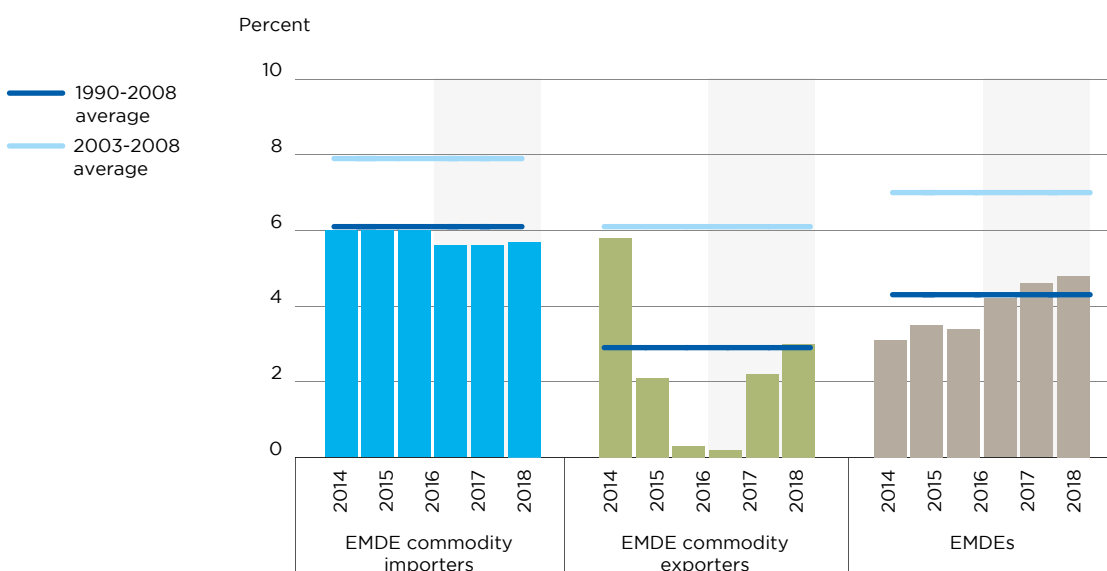
**Figure 2: Risks to global growth projections**



Source: World Bank

Despite weak investment and productivity growth, emerging and developing economies are expected to recover from the difficulties faced in 2015 and 2016, with much of this driven by stable and high growth in commodity-importing developing countries (see Figure 3). Particularly commodity-importing economies in East Asia and South Asia are more likely to experience robust growth, with South Asia remaining the fastest growing region in the world throughout each quarter of 2015 and 2016. Recent projections revised growth prospects in Latin America and the Middle East downwards due to the need for continued adjustment to the decline in their terms of trade in recent years, oil production cuts, and idiosyncratic factors. Both sub-Saharan Africa and the Latin America and Caribbean region experienced stagnant and at times negative growth throughout most of 2016.

**Figure 3: Growth by country group**



Source: World Bank 2017

### Financial stability and credit conditions

One consistent source of optimism in this context is the continued improvement of global financial stability following years of broadly accommodative monetary and fiscal conditions. Most analysts have a positive outlook for asset prices and equity markets with risk premia and indicators of volatility declining. Longer-term interest rates have risen, helping to boost earnings of banks and insurance companies. Emerging economies have increased their resilience through lower corporate leverage and reduced external vulnerabilities.



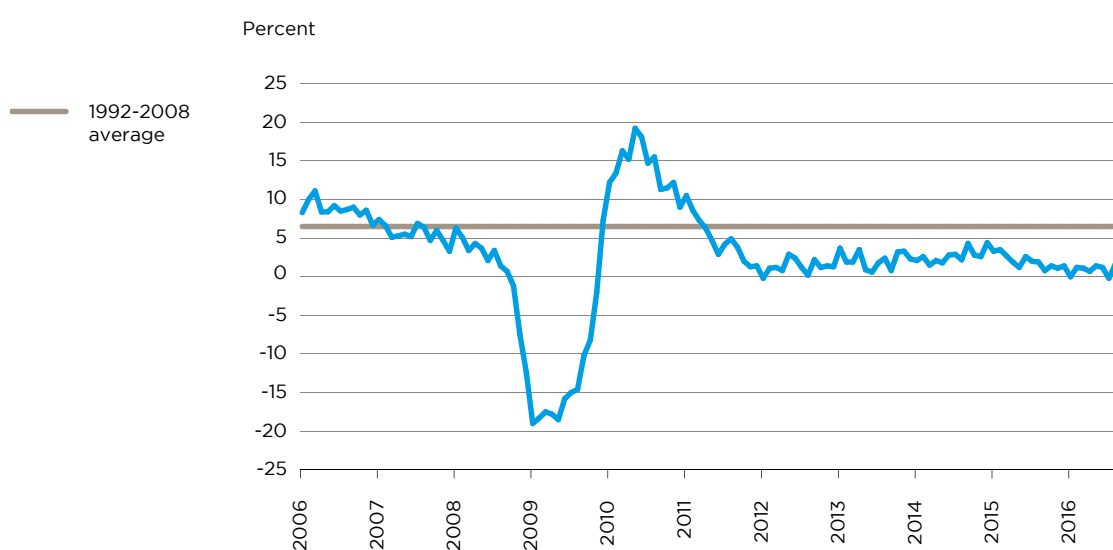
## The rollback of financial regulations could undermine recent gains in stability

However, as for much else, this optimistic view rests on policymakers finding the right balance between policies that encourage risk-taking and boost output and investment, while also avoiding financial stability risks and exacerbating domestic and global imbalances. Risks from increased leverage and deteriorating credit quality in the US, structural challenges in banking and high debt in the Eurozone, and continued vulnerability to shocks in many emerging economies demonstrate that the current optimistic climate rests on fragile foundations. Particularly the rollback of financial regulations could undermine recent gains in stability; the most recent IMF Global Financial Stability Report (April 2017) argues that “while regulation is never costless, neither is its removal. ... Decisions to opt out of mutually established regulations in an uncoordinated or unilateral manner could result in financial fragmentation and could threaten to reignite a race to the bottom in regulatory standards.”

### Global trade and trade restrictions

While a recovery in trade volumes is expected for 2017 and 2018, global trade growth in 2016 was the weakest since the global financial crisis, with goods trade stagnant for most of the year. This was driven by cyclical inventory drawdown across advanced economies and contracting imports in China and major commodity exporters. The continued low-inflation environment has further exacerbated this trend, prompting firms to defer capital goods investments (and in turn depress imports). Analyses attribute the trade slowdown to changes in the composition of economic activity away from import-intensive investment, a slowing pace of trade liberalization and global value chain growth, and an uptick in trade protectionism. Slow investment growth has contributed to declining capital formation and in turn trade in capital goods. Services trade proved more resilient in large part as it is less sensitive to changes in credit and trade finance conditions.

Figure 4: Slowdown in merchandise trade



Source: World Bank 2017

Furthermore, the boom in trade driven by the fragmentation of production through global and regional value chains may have reached its apex, resulting in a lower income elasticity of trade than observed during the past two decades, a trend that started prior to the financial crisis but has since accelerated. This is particularly pronounced in the US and Japan as well as through Chinese firms' move away from specialising primarily in processing and assembly trade, and towards domestic production of intermediate inputs. However, many emerging and developing economies still have substantial untapped potential to move up value chains towards more complex and higher value-added products.

New trade restrictions reached a post-crisis high in 2016 and the ever-rising stock of restrictive measures together with previously mentioned concerns about a further resurgence of protectionism could lead to substantial welfare losses and a far more tepid recovery than current projections suggest. This could be exacerbated by the potential for retaliatory trade restrictions and even the undoing of existing trade agreements, though currently the trend towards an ever-greater number of increasingly deeper regional and bilateral trade agreements continues relatively unabated.

In 2016, G20 countries took more trade-restrictive measures than trade-facilitating ones, with a gradual shift away from subsidies and safeguard measures, towards more opaque distortive measures such as localisation requirements, export incentives, and other trade finance measures. The share of G20 imports affected by trade-restrictive measures put in place since the global financial crisis continues to rise gradually. Of the 2,978 trade-restrictive measures recorded for WTO Members since 2008, only 740 had been removed by mid-October 2016. By far the most common trade-restrictive measures implemented during the most recent WTO monitoring period are import tariffs, followed by import customs procedures, and export measures. In this period, there has been a notable decline in the number of anti-dumping measures imposed. These most commonly targeted China, with 69 of 81 initiations targeting steel products.

While tariffs have declined considerably since the late 1980s, there has been little further progress since the financial crisis and non-tariff measures remain pervasive in goods trade. Moreover, given the growing size of services and its potential contribution to productivity growth, trade restrictions in this area are particularly concerning. According to the OECD Services Trade Restrictiveness Index, restrictions are particularly high in air transport, legal services and accounting services, while distribution, sound recording and logistics tend to be the most liberalised.

### **Special thematic focus: addressing displacement and adjustment**

In the context of the current resurgence of protectionism, there has been growing interest in better understanding and addressing the root causes of growing frustration with globalisation and greater integration. There is an ever-growing body of literature that trade openness has an important role to play in promoting growth and prosperity, including for the poorest in society. However, the distributive impact from trade integration can be uneven. This is addressed in great depth in a recent joint IMF-World Bank-WTO report Making Trade an Engine of Growth for All.



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Generally, trade openness is associated with higher levels of employment. However, an unusual period of sharply increased import competition beginning around 2000, negatively impacted certain regional labour markets in some developed economies. As emerging economies, most notably China, rapidly integrated into manufacturing value chains, areas most exposed to competition from Chinese manufactures saw significant and persistent losses in jobs and earnings that heavily impacted low-skilled workers. Research has shown that when reallocation of workers is costly, negative impacts on communities in affected areas can be substantial, long-lasting and express themselves in unpredictable ways over long time periods if not addressed properly.

Trade and trade-related policies as well as domestic policies to address trade-related adjustments have an important role to play here. While a further opening of global markets paired with strong trade rules can help promote economic stability and growth, trade-related adjustment policies such as easing worker mobility across firms, programs to facilitate reemployment and improve skills, and wage insurance programs are important complements to this. Similarly, social safety nets programs like unemployment insurance can provide workers with a necessary cushion while giving them time and space to retool. Finally, measures to support competitiveness and address productivity growth are essential to help displaced workers find new opportunities.



### Editorial Comment: selected strategic and tactical implications

#### Strategic implications

Market conditions reflect some signs of coming recovery in trade growth rates, with Asia remaining an anchor for global supply chains, and South Asia continuing to exhibit the fastest growth rates in the world, with commodity trade flows in the region being materially important. In addition to prevailing and developing economic conditions, policy considerations are identified as key to the achievement of a sustainable recovery. High-potential areas of commercial activity with links to economic value creation and growth, such as services sector trade, are attracting the attention of trade financiers, yet it is observed that the sector has been more resilient than other areas precisely because it is less susceptible to shifts in credit conditions and, possibly, changes in trade finance conditions.

Strategically, these observations suggest an opportunity in ensuring market coverage in high-growth regions linked to the evolution of supply chains and trade corridors. The continuing and cyclically recurring importance of commodity trade flows is reinforced, and the potential in

pursuing opportunities in new sectors like services sector trade activity is brought into focus. The importance of policymaking and policy-related decisions is highlighted as an important pillar in shaping economic recovery. Thoughtful and targeted advocacy around the importance of trade, the critical role of trade finance and the linkages to wider economic value creation and inclusiveness must be part of industry strategy, and arguably also part of the strategic efforts of individual institutions.

#### Tactical considerations

Trade finance banks committed to remaining engaged under current conditions will benefit from assuring accessibility to adequate levels of credit capacity and risk appetite in markets critical to economic recovery, as well as effective solutions in support of trade in new high-growth sectors. Value propositions linked to economic inclusiveness can have commercial value as well as material positive reputational impacts. Trade finance banks seeking to position in this manner may benefit from assuring capacity to deliver comprehensive solutions in SCF.





# Recent trends in correspondent banking relationships

THE INTERNATIONAL MONETARY FUND

**This article summarises the main findings from the IMF’s recent Board paper on correspondent banking relationships, “Recent Trends in Correspondent Banking Relationships—Further Considerations”.**

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## Context

The potential adverse impacts of the withdrawal of correspondent banking relationships (CBRs) on the macro-economy and financial sector have received significant attention among policymakers.<sup>1</sup> International organisations such as the World Bank, the Financial Stability Board (FSB), Bank for International Settlements (BIS) and the IMF have been working to assess and address this issue.<sup>2</sup> The FSB outlined a four-point action plan to assess and address the decline in correspondent banking, which was presented to the G20 in November 2015.<sup>3</sup> Efforts have been made by public and private stakeholders to facilitate international dialogue to help develop coordinated policy responses and support industry initiatives to address this issue.

Correspondent banking plays a key role in global trade and economic activity, enabling domestic and cross-border payments, including remittances, and supports international trade and cross-border financial activity. Correspondent banking is a bilateral arrangement, often involving a reciprocal cross-border relationship in multiple currencies. A correspondent banking arrangement involves one bank (the correspondent) providing a deposit account or other liability accounts, and related services, to another bank (the respondent). CBRs also support payment solutions performed by other financial institutions, including money transfer operators (MTOs), which are the main intermediators of remittances flows. Given their central role in the provision of domestic and cross-border payments, the withdrawal of CBRs could undermine economic growth through affecting international trade and cross-border financial activity.

**The pressure on CBRs has increased financial fragilities in some economies**





1

The phenomenon was first documented using surveys carried out by the World Bank, the IMF with the Union of Arab Banks (UAB), and the Association of Supervisors of Banks of the Americas (ASBA). Results from these surveys indicated that smaller jurisdictions in Africa, the Caribbean, Central Asia, and Europe have been most affected. <http://documents.worldbank.org/curated/en/534371468197058296/Fact-finding-summary-from-de-risking-surveys>; <http://www.asbaweb.org/E-News/enews-44/Docs/banksup/O2banksup.pdf>

2

The Governors of the BIS Economic Consultative Committee (ECC) mandated the Committee on Payments and Market Infrastructures (CPMI) to produce a technical report on CBRs describing current trends and analysing potential measures to alleviate some of the concerns and cost issues related to correspondent banking. (BIS CPMI, 2016, Correspondent Banking, [www.bis.org/cpmi/publ/d147.pdf](http://www.bis.org/cpmi/publ/d147.pdf)). IMF staff produced a staff discussion note highlighting the key issues, evidence to date, and outlining the role for policy action (Erbenová, Michaela, Yan Liu, Nadim Kyriakos-Saad, Alejandro López-Mejía, Giancarlo Gasha, Emmanuel Mathias, Mohamed Norat, Francisca Fernando, and Yasmin Almeida, 2016, 'The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action,' Staff Discussion Note (SDN/16/06), Washington: International Monetary Fund, available at: <https://www.imf.org/external/pubs/ft/sdn/2016/sdn1606.pdf>)

3

The FSB action plan on actions to assess and address the decline in correspondent banking included to: further examine of the dimensions of the decline and implications for financial inclusion and financial stability; clarify regulatory expectations, including more guidance by the Financial Action Task Force (FATF); support domestic capacity-building in jurisdictions that are home to affected respondent banks; and strengthen tools for due diligence by correspondent banks. <http://www.fsb.org/2015/11/report-to-the-g20-on-actions-taken-to-assess-and-address-the-decline-in-correspondent-banking/>

Factors leading to global banks' withdrawal of CBRs are multiple, interrelated, and vary case-by-case. In general, decisions to terminate CBRs, reflect correspondent banks' assessment of the profitability and overall risk of the relationships. Banks decisions to terminate CBRs often relates to the correspondent bank's lack of confidence in the respondent bank's capacity to effectively manage risk, as well as profitability considerations or a combination of these two elements. Recent changes in the regulatory and enforcement landscape have contributed to this phenomenon, notably with respect to more rigorous prudential requirements, economic and trade sanctions, anti-money laundering and combating the financing of terrorism (AML/CFT) and tax transparency standards.

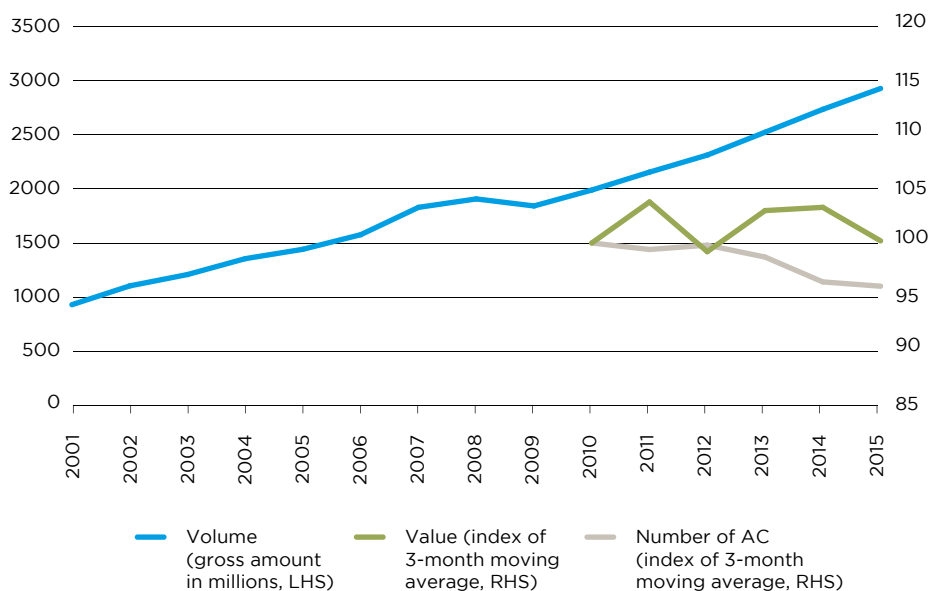
Recent analysis of trends in CBR withdrawal suggests that economic activity has been largely unaffected so far even in the countries where CBR withdrawal has been the most significant. The macroeconomic impacts of CBR withdrawal to date have been less severe than initial indications based on survey data (World Bank (2015)). So far, cross-border payments have remained stable and economic activity has been largely unaffected, despite a recent moderate decrease in the number of CBRs. Countries' ability to put in place alternative arrangements largely explains why economic activity has been largely unaffected even in the countries where CBR withdrawal has been the most significant. Many CBRs have been maintained (albeit at a higher cost) or alternative arrangements have been put in place, including through the increasing use of nested CBRs, when the CBR is used not only by a respondent bank's customers, but also by other banks and financial institutions to process the payment flows of their clients.

However, the pressure on CBRs has increased financial fragilities in some economies, which could undermine affected countries' long-run growth and financial inclusion prospects. Some of the alternative arrangements (e.g., increase use of nested CBRs, or concentration of activities into one CBR) may not address the underlying drivers of CBR withdrawal and thus are potentially providing a respite only in the short term. Due to consolidation within the industry, CBRs have also become more concentrated, meaning that the same value of transactions is conducted via fewer CBR corridors. This has made the CBR network more vulnerable to shocks. The search for low-cost alternatives for money transfers could result in migration of activities outside of the regulatory perimeter, thereby increasing financial instability and AML/CFT risks. Finally, financial access could also be restricted if banks had to close their business lines due to the lack of alternative arrangements or due to higher costs of maintaining CBRs (e.g., due to AML/CFT compliance requirements).

### Recent trends in CBR

From a global perspective, analysis by the Committee on Payments and Market Infrastructures (CPMI) shows that the loss in CBRs has been limited.<sup>4</sup> Aggregated data from the SWIFT database, covering both capital and current account transactions indicates that the number of active correspondents (AI) has declined by 5% between 2011 and 2015 (Figure 5). In the same period, the value of transfers via CBRs remained broadly stable. On the other hand, the volume of CBRs, which indicate the number of transactions, grew by almost 30% over the same period. While price and composition effects can distort these figures, the overall magnitude of changes does not indicate major loss in CBRs at the global level.

**Figure 5: Correspondent payments (gross and index values, respectively)**



Index data reflect end-December values (with 2010, the first available data point, as base year). Volume reflects number of sent and received transactions. Value reflects nominal values converted to US dollars using daily exchange rates.  
Source: SWIFT Annual Review, CPMI Correspondent Banking 2016.

Countries facing civil unrest or conflicts, under adverse economic conditions and small states have been more strongly affected by the withdrawal of CBRs. Based on SWIFT data, declines in the number of active correspondents and the value of transfers via CBRs have been the most significant in countries facing civil unrest or conflicts (Republic of Yemen, Syria, Ukraine), advanced economies that underwent an economic crisis (Cyprus, Greece), and small fragile states in the Caribbean, Pacific or Africa (Figure 6). This suggests that in many circumstances CBR losses are a consequence of broader political and post-GFC macroeconomic conditions.

Although the impact on remittance and trade flows<sup>5</sup> remains limited, pressure on CBRs may have contributed to an increase in the cost of remittances. In 1 out of 5 countries remittances amount to close to 10% of GDP, which implies that remittances represent a potentially strong transmission channel from CBR losses to the macro-economy. Based on the World Bank Remittances Prices Worldwide database, the downward trend in the cost of remittances, which has been observed since 2011, came to a temporary halt in 2015 (Figure 7). The increase in remittance costs has been stronger in jurisdictions where CBR losses were more severe, including countries in the Pacific (Samoa, Vanuatu), East Asia (China, Vietnam), Central America (El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama), South Europe (Turkey), and the Middle East (Egypt, Jordan). The correlation with the total value of remittances flows, however, was limited as alternative channels for remittances remained available.

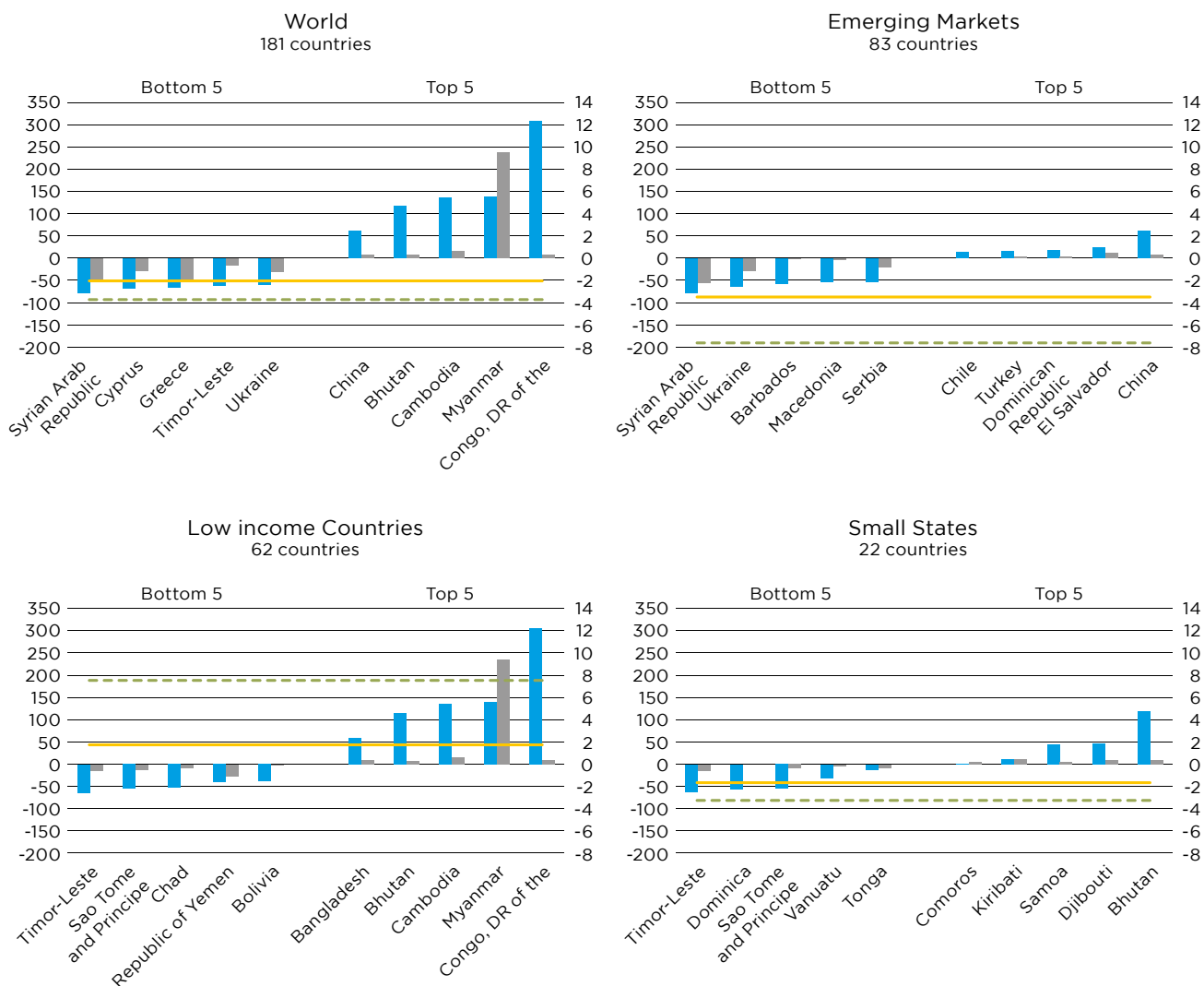


4

Hard data on CBR activities is scarce and thus the analysis used three major sources of information. SWIFT data, which contains the exchange of transfer messages, including payment information and settlement instruction, is a superior data source. The aggregate SWIFT data cover single customer payments and general financial institution transfer (remittances and trade financing) and provide information on the number of active correspondents, the total value of transfers and the number of transfers (volume). An additional source of information used was the World Bank Remittances Prices Worldwide database, which combined with the SWIFT and remittances flows data helped to investigate the pass-through of CBR pressures to remittances costs and flows. Given the lack of hard evidence, the analysis also looked at information gathered by IMF country teams.



**Figure 6: Value and number of active correspondents, 2012-2015 gains and losses, in %**



Source: IMF (2017) based on SWIFT data

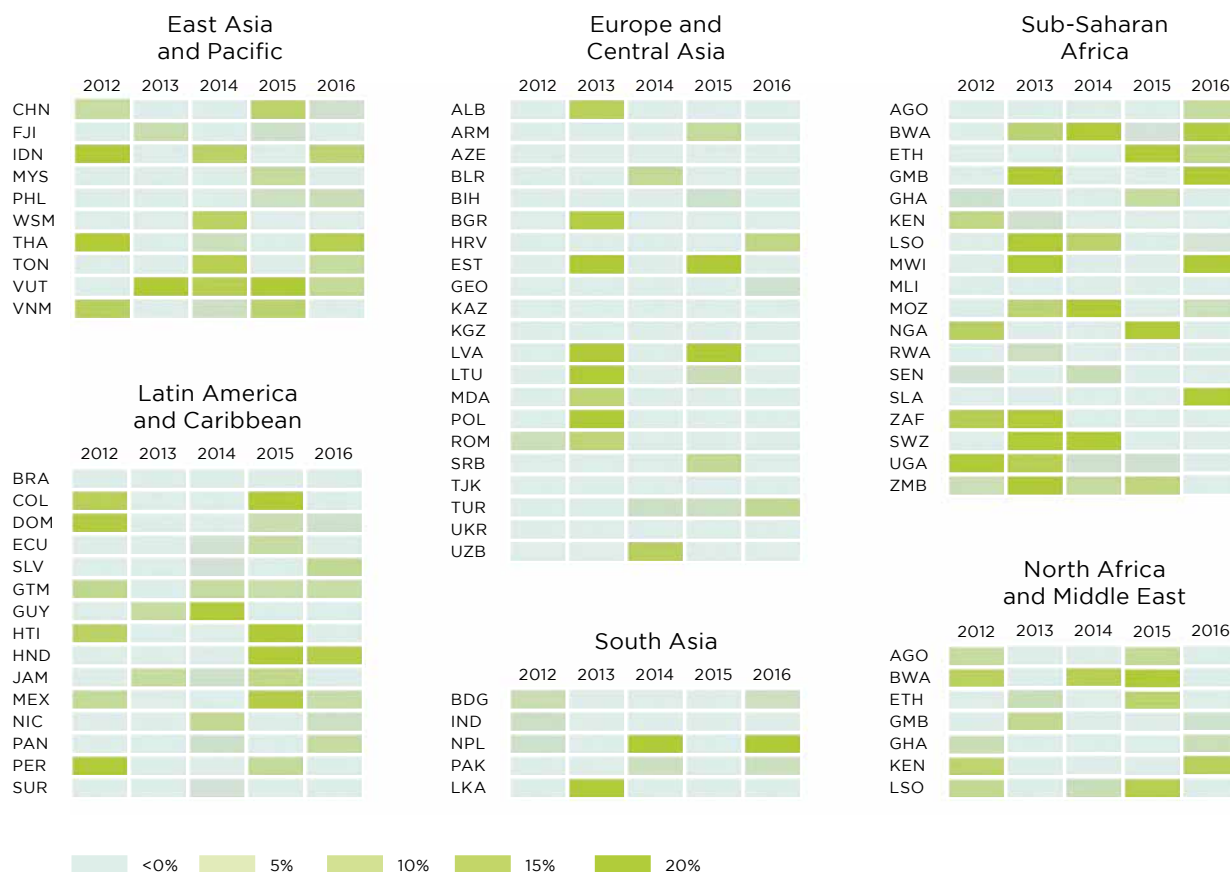


5

Empirical evidence regarding the impact of CBR withdrawal on trade financing is limited. Trade financing requires extensive information provisioning by both seller and buyer, and thus, the costs of due diligence by banks is less cumbersome and less costly. Thus, CBR withdrawal might have less impact on this specific service line. See IMF (2017).

The impact on the cost of remittances has been moderate to date and appears to have been temporary. In 2015, when the rise in costs was the strongest, only 5% of all countries in the sample experienced an increase in costs of more than USD 2 on a USD 100 transfer. At the same time, in most cases, the initial increase in fees did not last and was followed by a period of decline, offsetting the initial adverse impact on remittances. The fact that remittances costs resumed their downward trend observed before 2014 might reflect the importance of continued financial innovation in determining the evolution of transfer costs.

**Figure 7: Change in cost of remittances by recipient countries (2012–2016 Q3)**



Source: IMF (2017).

Note: Calculations based on World Bank Remittance Prices Worldwide database. Costs of transfer of USD 200, in less than an hour. Fixed sample composition. Weighted across source countries using bilateral remittance values. Country sample restricted by availability in the combined database (CPMI 2016, World Bank Remittances Prices Worldwide, World Bank Migration and Remittances Database) used in the analysis.

IMF staff's assessments indicate that CBR pressures have so far had a direct impact on only a limited number of countries' financial systems. The withdrawal of CBRs was discussed with 49 member countries between 2015 and 2016, where this issue was deemed macro-critical or where the discussion was agreed with the countries. The coverage of CBR issues across Article IV consultations highlights similar regional pockets of CBR withdrawal as identified in the surveys, namely in the Caribbean, the small islands of the Pacific, the Middle East and North Africa (MENA) region, Central Asia, and Africa. In these cases, staff found that CBR withdrawal has had a moderate or no significant impact on the financial system in 23 countries, and an adverse impact in 4 countries (Belize, Iran, Liberia, and Sudan). No country team quantified a macroeconomic impact, but several stressed the need for careful monitoring as a more significant loss of CBRs could have negative implications for the economy in the future.



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## Going forward

Addressing the withdrawal of CBRs will take time and would require strengthened, coordinated and collective action on the part of public and private stakeholders. Given that the economic impacts from pressure on CBRs are not imminent in most cases, policy measures in most countries should be preventive and focus on medium to long term solutions. The first port of call for all countries concerned with the withdrawal of CBRs includes measures to enhance respondent banks' capacity to manage risks, improve communication between correspondent and respondent banks, strengthen and effectively implement regulatory and supervisory frameworks in line with international standards, particularly for AML/CFT, and remove impediments to information sharing. Other initiatives to address the underlying drivers of CBR withdrawal, particularly those related to correspondent banks' profitability and risk assessment concerns, should be considered, though they tend to have more limited impact. In the event of a complete loss of CBRs by all commercial banks in a country, the public sector should also consider the feasibility of temporary mechanisms, including public-backed vehicles, to provide payment clearing services.



## Editorial Comment: selected strategic and tactical implications

### Strategic implications

Correspondent banking networks have been indispensable in facilitating global commercial and financial activity, from large value financial settlements to low value, but critically important remittances, for many years. As with many bilateral networks, they require continued maintenance, both in terms of infrastructure and counterparty risk management. The current risk-reward equation has fundamentally put into question the viability of traditional correspondent networks, with the cost of maintaining even a basic relationship reportedly increased by 500% or more. Adverse financial and reputational consequences arising from compliance failures by correspondents are difficult to measure, and could be catastrophic.

The current make-up of many of these networks, even following material global consolidation, is probably unsustainable over the longer term; but technology, particularly in the form of advanced robotics, coupled with regulatory initiatives such as the Global Legal Entity Identifier, have the potential to enhance and transform them. Global correspondent banks will provide the necessary investment, given conducive regulatory regimes.

Financial institutions seeking to remain active in trade and trade financing, or to significantly grow cross-border business, will benefit from a strategic review of existing correspondent relationships, disciplined focus on reciprocity and ongoing advocacy about the importance of correspondent networks in trade.

### Tactical considerations

Rising regulatory and compliance costs, coupled with the need to meet growing demand for correspondent services in developing economies is widening the fault lines running through traditional correspondent banking services. Hence the increased urgency in finding a way to bridge these conflicting pressures. A dialogue between current service providers (principally global banks), technology companies and regulators, is of the essence.

Such a dialogue, based on mutually informed perspectives and objective data, ought to be guided by the observations and insights articulated by IMF Managing Director Christine Lagarde in June of 2016, in remarks delivered to the US Fed, and immediately endorsed by the ICC and the ICC Banking Commission.





# Evolving trade flows and trade corridors, reconfiguration of global supply chains and sourcing patterns

THE BOSTON CONSULTING GROUP

## Authors

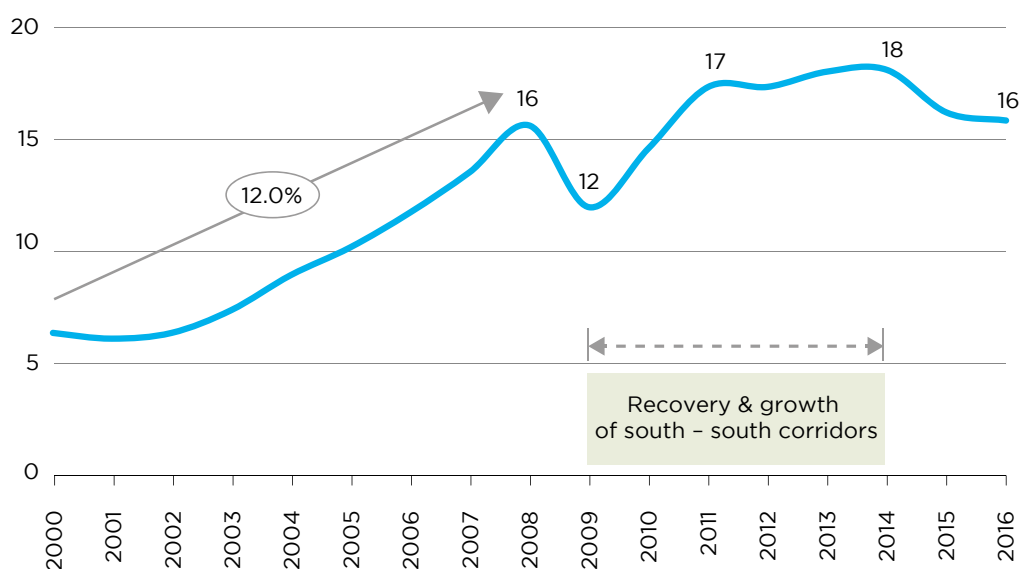
Sukand Ramachandran, Partner and Managing Director, Jarryd Porter, Project Leader, Ravi Hanspal, Consultant Kayne Harwood, Senior Associate, BCG

### Executive summary:

- Trade's geo-political centre is shifting east, with China, the EU and Japan stepping up as the US changes tack
- The BCG Trade Finance Model predicts a positive outlook for trade flows and Trade Finance revenues
- Trade Finance is an attractive, low-risk asset, but compliance costs and risk are growing
- Trade Finance practitioners are innovating to reduce costs and create profit growth
- Innovations such as the Internet of Things (IoT) and 3D printing will have disruptive consequences for Trade Finance

**Figure 8: Historical global trade flows**

Trade in USD trillion



Source: BCG Trade Finance Model 2016, UN Comtrade

## Trade's geo-political centre is shifting east, with China, the EU and Japan stepping up as the US changes tack

Trade flows saw considerable growth in the early and mid-2000s rising from USD 6.3 trillion to USD 15.6 trillion between 2000 and 2008. However, following the Global Financial Crisis (GFC), such growth has not yet returned. Moderate growth between 2011 and 2014 saw trade flows hit a new high of USD 18.1 trillion. This trend reversed and trade flows contracted to USD 15.8T by 2016, back to near pre-crisis levels. This contraction was driven mainly by commodity prices as volumes remained relatively steady. Potential challenges to growth in the next few years include slower growth in world GDP and a slowdown in, or even retreat from, globalisation.

### The US changes tack

Trade flows involving the US recovered steadily post-GFC from trade flows of USD 2.4 trillion in 2009 to USD 3.7 trillion in 2014, then contracted to USD 3.4 trillion in 2016.

The US has pulled away from its role as the global champion of liberal trade policy and multilateral trade deals to focus on bilateral trade deals that, it believes, will provide fairer terms. It has pulled out of the Trans-Pacific Partnership (TPP), but has not withdrawn from trade dialogue in the Asia Pacific all together – a US delegation attended China's recent Belt and Road Initiative summit. While the US may succeed in negotiating pro-US bilateral agreements, it is also offering other major markets, notably China, the EU and Japan, an opportunity to step up as a champion of globalisation and capture the next wave of growth.

### Asia is taking centre stage

Trade flows involving the Asia Pacific continued to grow strongly post-GFC from USD 7.1 trillion in 2009 to USD 11.9 trillion in 2014, and contracted to USD 10.6 trillion in 2016.

China is investing heavily in promoting trade growth. Its ambitious B&R strategy could boost China's growth and provide an answer to the uncertain and slower global trade environment. However, B&R faces some challenges; from lack of commercial imperatives behind projects, to investment in traditionally unstable trade routes, to stalled projects and discussions. Foreign direct investment in B&R initiative countries fell 2% in 2016, and early evidence from 2017 suggests the slowdown is continuing. The withdrawal of the US from the TPP has also increased the importance of the Regional Comprehensive Economic Partnership (RCEP), of which China is the largest participating economy by far.

Growth of trade involving China is also a good sign for documentary trade products. The Chinese government tends to favour documentary to open account trade as it is easier to track actual imports and exports and detect capital flight.

Japan, Australia and New Zealand are leading efforts to salvage a TPP without the US. However, the loss of access to the US market – a major benefit under the deal – may prompt other parties to reconsider their positions. Japan's TPP push signals that China is not the only Eastern power that can counterbalance the US's turn inwards, and that large economies have alternatives to unfavourable bilateral agreements with the US. Japan also recently concluded the 18th round of free trade talks with the EU.



### Belt and Road Initiative

Belt and Road Initiative (B&R) is China's overarching trade strategy to link Europe and Asia, as well as Africa and Oceania, via two routes – one overland and one maritime. With investments in B&R countries expected to reach USD 1.6 trillion, it is arguably the largest overseas investment drive by a single country. It aims to provide next wave of growth to China and connected economies via robust trade infrastructure that opens new supply routes and changes the transportation economics of supply chains. The B&R strategy refers to:

- The Silk Road Economic Belt (covering countries situated along the historical Silk Road), and
- The Maritime Silk Road (focused on trade in the South China Sea, South Pacific Ocean and Indian Ocean),

but the term is often used to include the China-Pakistan Economic Corridor and the Bangladesh, China, India, Myanmar Economic Corridor as well.

### **The EU has potential, but is preoccupied with internal issues**

Trade flows involving the EU were slower to recover post-GFC, growing from USD 8.8 trillion in 2009 to USD 11.6 trillion in 2014, before falling to USD 10.2 trillion in 2016.

The EU is the world's largest trading block, but it has been noticeably quiet on the trade policy front. Internal pressures may be taking precedence: Greece, Spain and Italy; Brexit; immigration challenges. One positive development is the European Parliament passing the Comprehensive Economic and Trade Agreement (CETA) with Canada in February 2017; although the agreement still needs to be approved by EU national parliaments.

### **The BCG Trade Finance Model predicts a positive outlook for trade flows and trade finance revenues**

To understand how these geo-political trends are playing out in practical terms, we applied BCG's Trade Flows and Trade Finance Revenue Pools Model (BCG Trade Finance Model). The outlook is positive, with a return to growth in 2017.

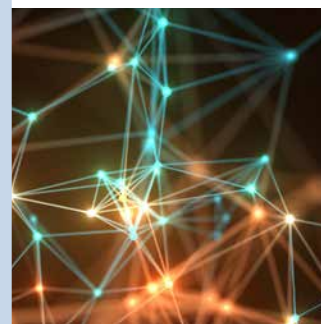
#### **The BCG Trade Finance Model predicts trade flows will grow at around 4.3% per year, from USD 15.8 trillion in 2016 to USD 18.7 trillion in 2020**

The BCG Trade Finance Model's base scenario predicts trade flows will grow 4.3% per year to pass the 2014 peak of USD 18 trillion in 2020. The rate of increase in trade flows will be highest in the southern trade corridors, with corridors between Africa and Latin America (10.4%), Africa and the Asia Pacific (9.0%), Asia Pacific and the Middle East (8.5%) and the Middle East and Latin America (8.1%) adding USD 503 billion. However, the core drivers of overall growth will be inter-regional trade within the Asia Pacific (adding USD 697 billion) and within Europe (adding USD 435 billion), and trade between the Asia Pacific and Europe (adding USD 320 billion).

The BCG Trade Finance Model's bull scenario predicts growth of 6.1% per year to USD 20.0 trillion in 2020. The bull scenario assumes higher world GDP growth, a swift recovery in commodity prices, an engaged US, a version of the TPP (ex-US), and Britain trading on EEA member terms.

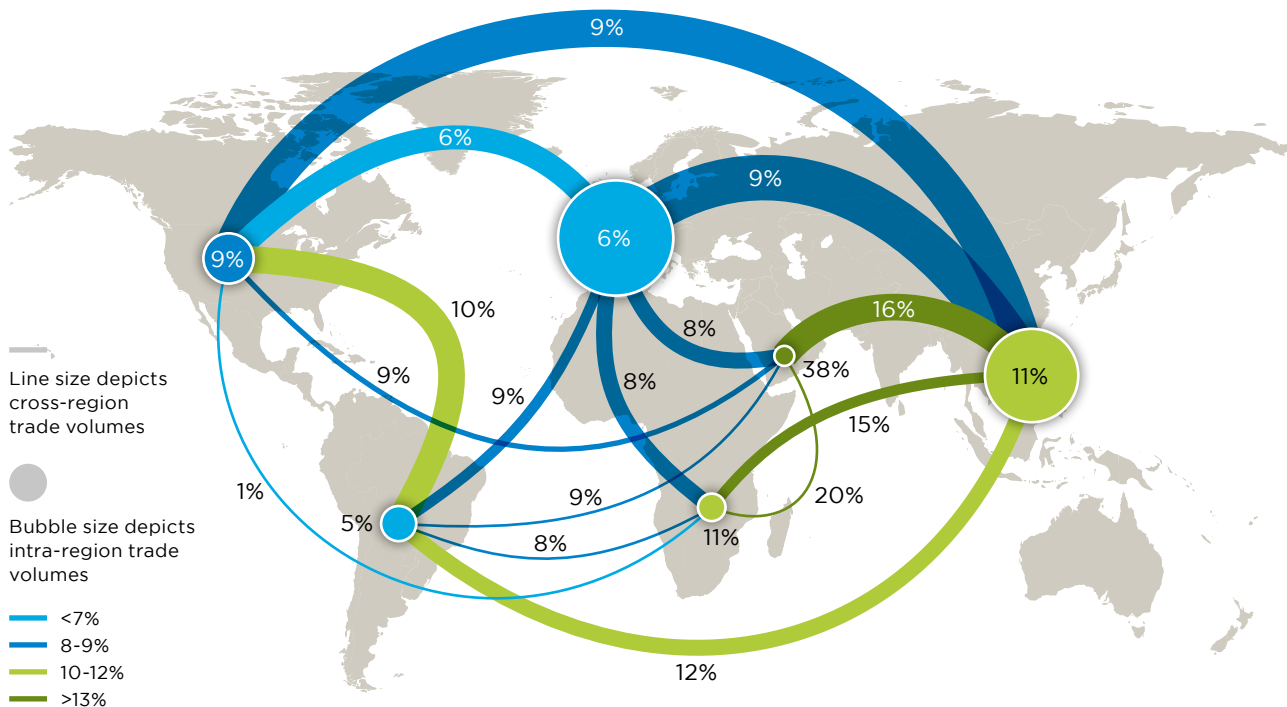
The BCG Trade Finance Model's bear scenario predicts a return to growth of 2.4% per year to USD 17.3 trillion in 2020. The bear scenario accounts for lower world GDP growth, continuing depressed commodity prices, increasing nationalism and protectionism in major economies, and UK trade on WTO terms post-Brexit.

**The BCG Trade Finance Model predicts trade flows will grow at around 4.3% per year**



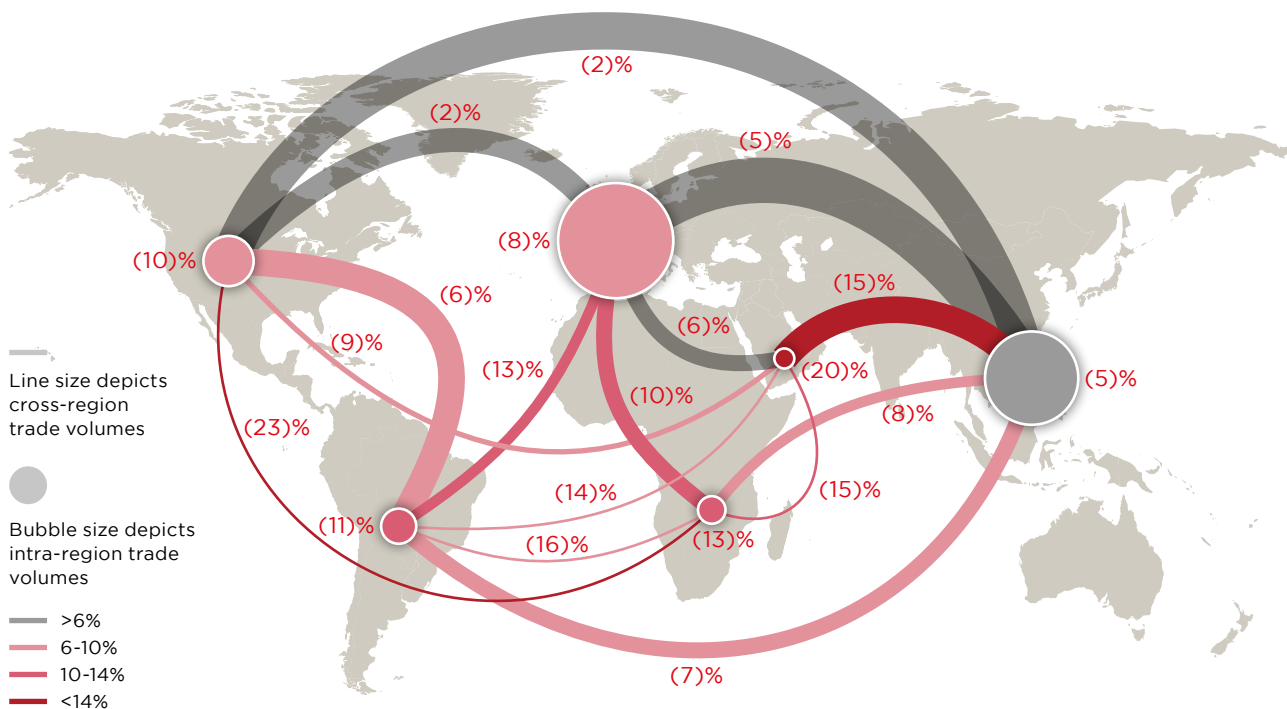


**Figure 9: Global trade flows showed sustained growth across regions from 2009 to 2014, where it peaked at USD 18.1 trillion in value**



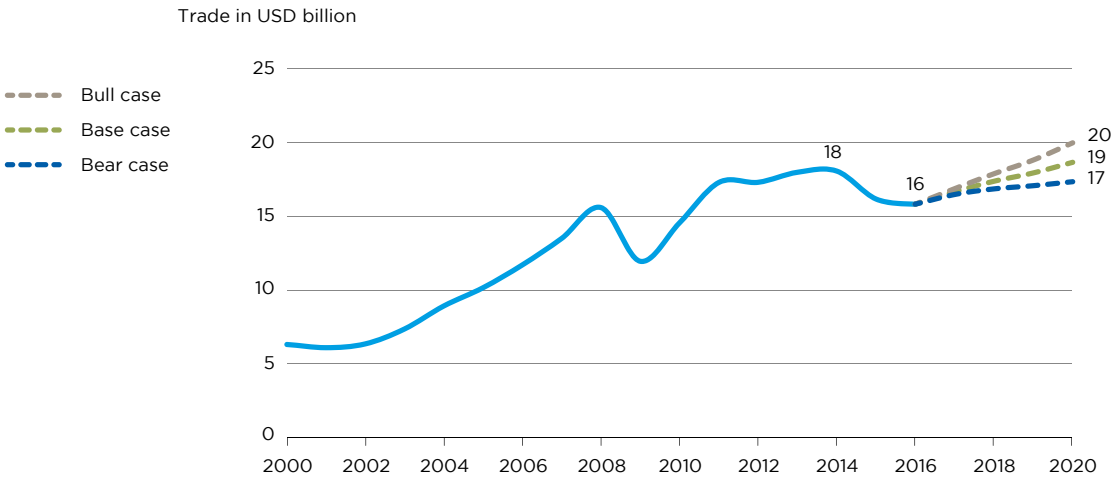
Line/Bubble colour represents 2009-14 CAGR / Source: BCG Trade Finance Model 2016 / Note: Forecasts are at constant FX rates

**Figure 10: Global trade flows contracted from 2014 to 2016, with global trade falling back to USD 15.8 trillion in 2016**



Line/Bubble colour represents 2014-16 CAGR / Source: BCG Trade Finance Model 2016 / Note: Forecasts are at constant FX rates

**Figure 11: Forecast trade flows based on BGC Trade Finance Model**



Source: BCG Trade Finance Model 2016

**The BCG Trade Finance Model predicts Trade Finance revenues outpace flows, growing around 4.7% per year, from USD 36 billion in 2016 to USD 44 billion in 2020, due to growth in higher documentary trade markets (Figure 14)**

Between 2014 and 2016, revenues from trade finance fell from USD 41 billion to USD 36 billion as trade flows contracted and product mix shifted from traditional documentary trade finance products (e.g., Letters of Credit) into simpler, cheaper open account transactions. Increased legal certainty, the ease of international communication, and more information on counterparties are driving increased confidence in non-documentary trade. Prices of trade finance products remained broadly stable, although with some evidence that banks are passing on some compliance-related costs to customers through slight upward pricing adjustments.

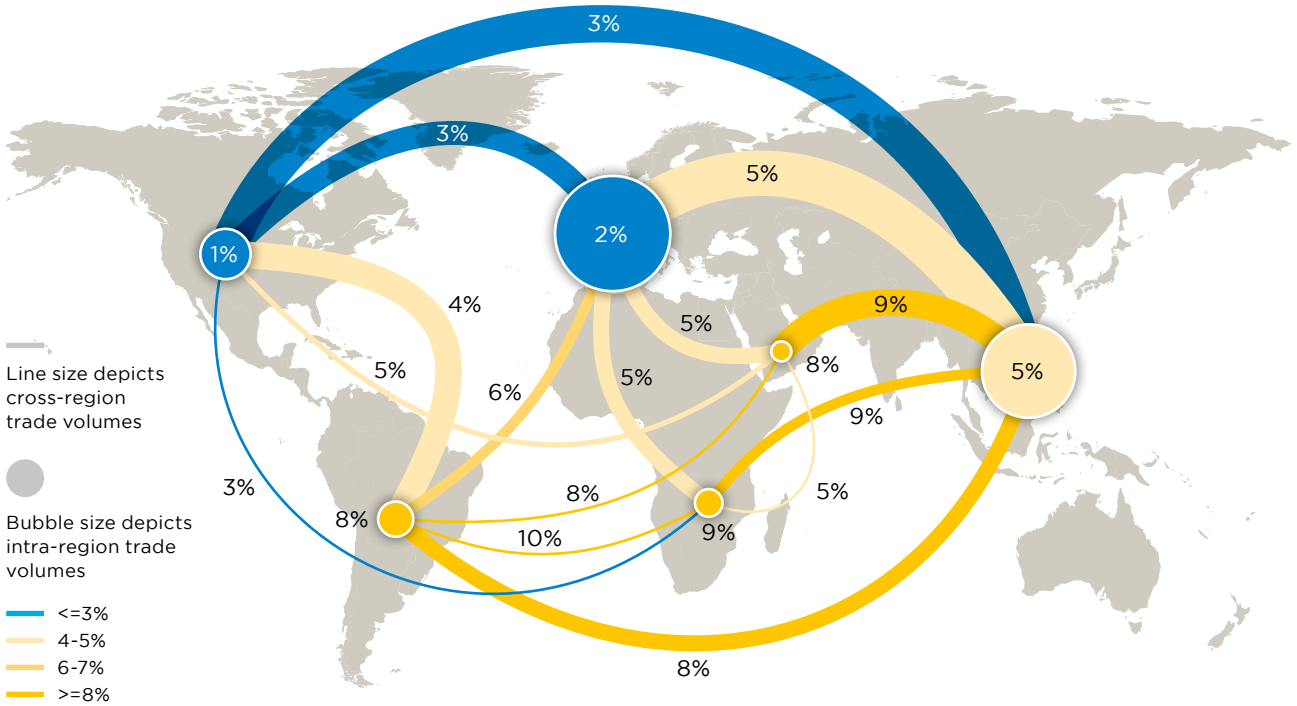
Again, the future looks brighter, with a return to growth. The BCG Trade Finance Model's base scenario predicts growth in trade finance will slightly outpace growth in trade flows and reach USD 44 billion in 2020. While documentary trade as a percentage of trade flows is assumed to fall slightly, strong growth is occurring in trade flows in the Asia Pacific, Middle East and Eastern Europe, where documentary trade is higher and providing an offsetting effect.

The BCG Trade Finance Model's bull scenario predicts trade finance revenues will grow at 6.0%, on par with trade flow forecasts, to USD 46 billion in 2020. In this scenario, trade risk declines, along with usage of documentary trade products.

The BCG Trade Finance Model's bear scenario predicts growth in trade finance revenues of 3.4% per year to USD 42 billion in 2020. In this scenario, risk in trade remains high and heavy documentary trade markets provide a greater share of growth, halting the historical decline in documentary trade usage which has contracted 4% per year.

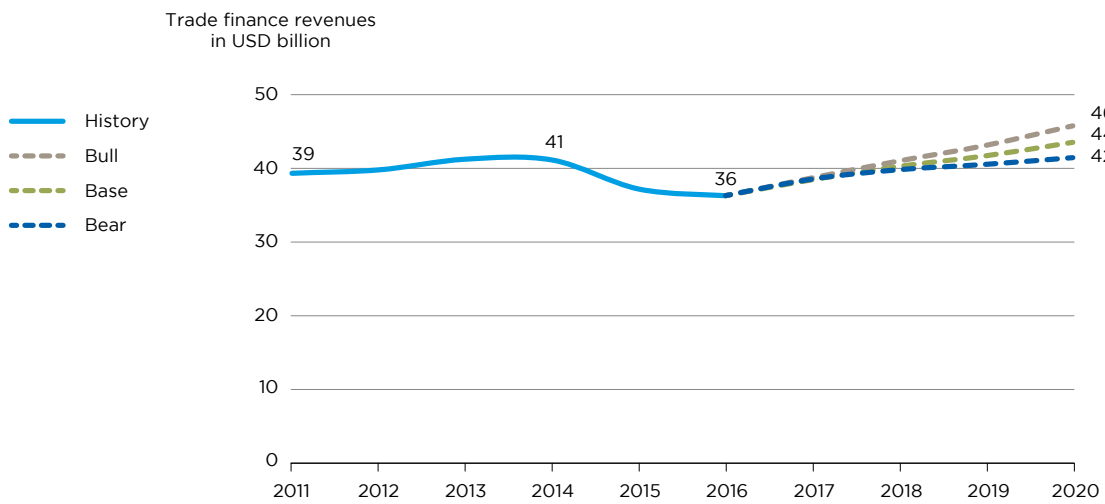
**4.7%**  
 Predicted growth of trade finance revenues according to the BCG Trade Finance Model

**Figure 12: Global trade flows expected to grow from 2016 to 2020, reaching USD 18.7 trillion**



Line/Bubble colour represents 2016-20 CAGR / Source: BCG Trade Finance Model 2016 / Note: Forecasts are at constant FX rates

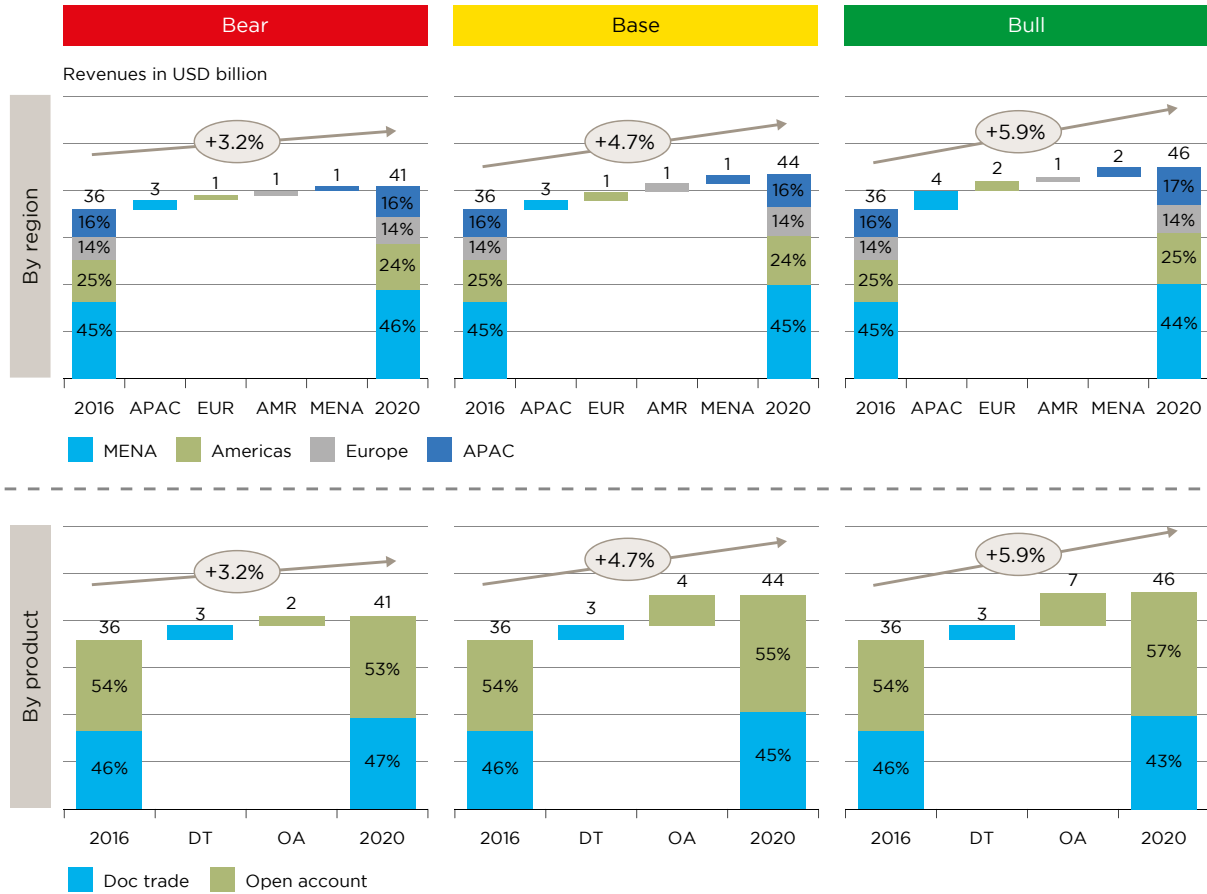
**Figure 13: Forecast trade finance revenues based on BCG Trade Finance Model**



Source: BCG Trade Finance Model 2016



**Figure 14: Decomposition of growth in trade finance revenues based on BCG Trade Finance model**



Source: BCG Trade Finance Model 2016



### BCG's Trade Flows and Trade Finance Revenue Pools Model (BCG Trade Finance Model)

BCG's proprietary Trade Finance Model predicts the value of future trade flows, trends in pricing and impact of key regulations. To do this, it uses the following inputs:

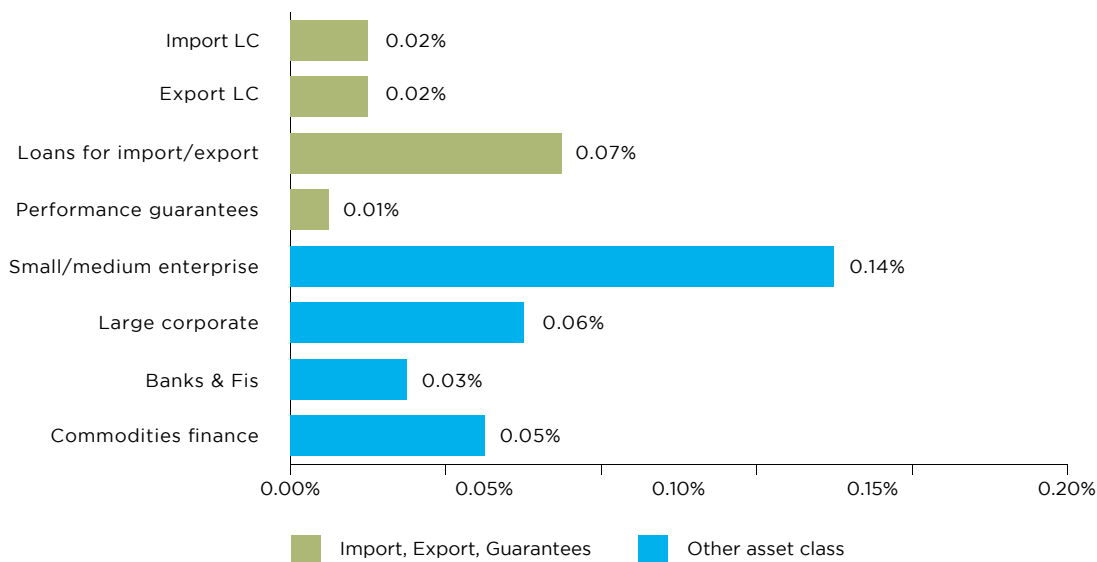
- Macro-economic factors (e.g., GDP growth and commodity prices)
- Summarised inputs for a set of businesses (specific MTs) from SWIFT
- Insights from industry experts
- Insights from BCG senior advisors and experts on trade finance
- Trade flow data from UN Comtrade

- Inputs from various central bank and government sources, and
- Triangulation with public sources

The model predicts trade flows in individual trade corridors, split into over 50 sub-commodities and goods. It also provides bull, base and bear scenarios using different assumptions on general macroeconomic conditions, commodity prices, and specific macroeconomic and political shocks.

Trade finance revenue pools are predicted by combining trade flows with product share and pricing factors across five major trade finance products: Letters of Credit, Documentary Collections, Performance Guarantees, Facilitated Open Account, and Commodity Structured Trade Finance.

**Figure 15: Expected loss of trade finance and other asset classes, 2008-2015**



Source: ICC Trade Register, 2016

### Trade finance is an attractive, low-risk asset class but compliance costs and risk are growing

#### Credit risk of trade finance products remains low

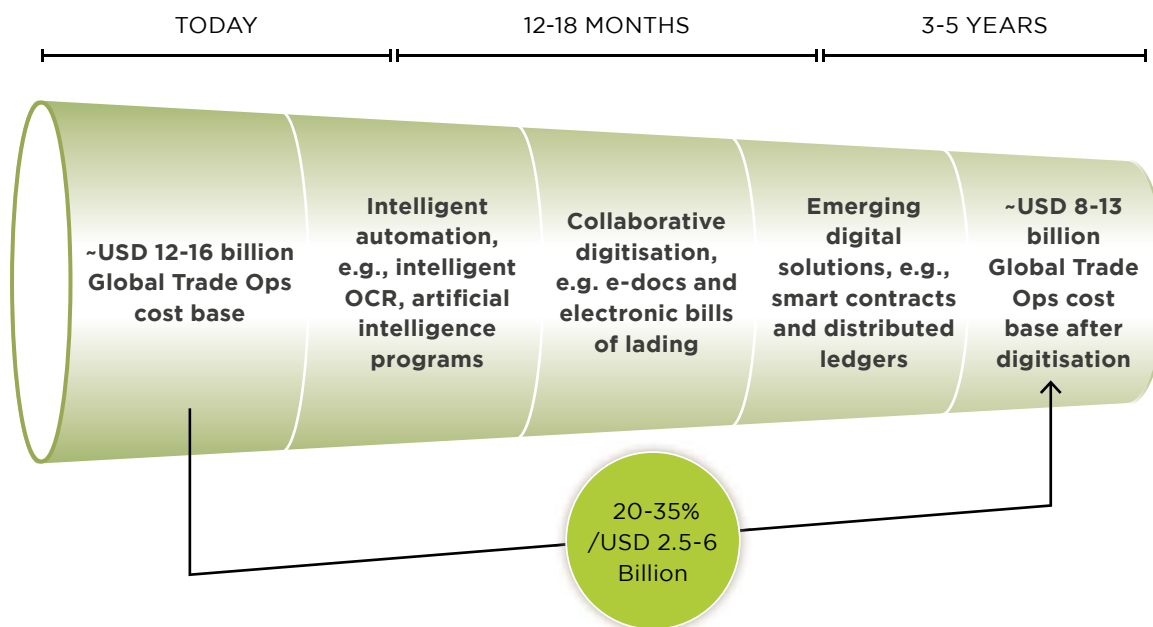
The ICC’s Trade Register Report provides a global view of the credit risk profiles of Trade and Export Finance transactions. The 2016 Register confirmed that the risk profile of Trade Finance assets is favourable to comparable asset classes, such as corporate and SME lending. Trade Finance products present banks with short average maturities, little credit risk, and low default and loss rates. These characteristics have been recognised by major risk underwriters in the insurance industry that are actively adding liquidity to trade financing. Major trade banks have shifted to ‘originate & distribute’ models to improve overall financial return metrics for the banks.

While short-term trade finance products showed a slight uptick in defaults from 2013-15, default rates remained low across all products and regions.

#### Trade finance compliance costs risks are growing

Regulation of cross-border transactions continues to increase, along with a lack of cross-market regulatory harmonisation. This drives increasing compliance costs and risks in trade finance as banks adapt to comply with a growing and changing set of regulations covering sanctions, trade embargoes and anti-money laundering, which can result in material fines if breached.

**Figure 16: Digital transformation in trade represents an estimated USD 2.5-6 billion savings opportunities (up to 35% over 3 to 5 years)**



Source: BCG analysis

### Trade finance practitioners are innovating to reduce costs and create profit growth

Trade finance practitioners report that the margin pressures described above, and customer demand, are directing them to focus on efficiency and embrace new digital technologies such as artificial intelligence, smart contracts and other blockchain-based solutions. BCG analysis shows an opportunity for industry-wide cost reductions of USD 2.5-6 billion over three to five years. A two-pronged approach is required; automating today's paper-based processes, while investing in collaborative solutions that digitise information exchange and transactions. Banks also need to innovate to grow by using advanced analytics and big data to better understand supply chains and unlock network value.

#### Banks are using Intelligent Optical Character Recognition (OCR) to create a digital ringfence and automate paper based processes

To date, two challenges have prevented increased automation. Firstly, fragmentation and variation in tech adoption has stymied coordinated digital solutions so most trade finance transactions remain paper based. Secondly, constant evolution of the compliance behaviours that automated systems need to detect.

Advances in artificial intelligence (AI) have helped overcome these obstacles to some extent. Intelligent OCR can quickly and accurately digitise incoming paper documents, allowing banks to create a digital



#### Intelligent Optical Character Recognition

Intelligent OCR can scan unstructured documents, recognise text and input values into back-end fields. The technology can read printed and handwritten text with a high degree of speed and accuracy, and match text to specific fields by learning document types based on visual layout and textual characteristics. Typically, only around 25% of raw documentation is relevant, which means OCR can deliver significant efficiencies in data sorting and entry.



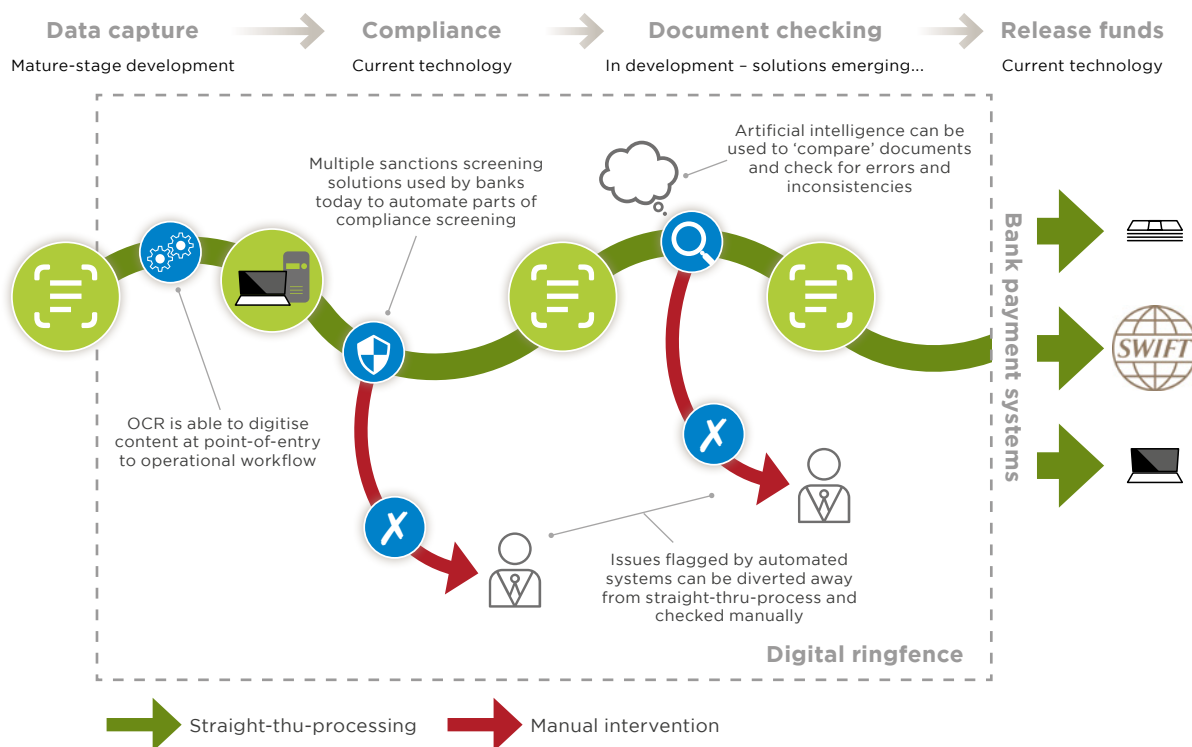
ringence (collaborative e-document solutions also provide an answer when adopted by both banks and customers, although take-up has been slow). AI programs can mimic a human's ability to learn from experience, adapt and make decisions in changing conditions, and raise an alert when they confront something unfamiliar, rather than take the wrong action.

Intelligent automation can also help banks to reduce compliance risks. Firstly AI solutions have demonstrated that they are faster, more consistent, and more accurate than humans at detecting compliance risks. Secondly, reducing the cost base of this previously labour intensive process may allow banks to bring high-value compliance processes back onshore for better quality and oversight.

**Banks are participating in collaborative blockchain and smart contract pilots to automate Trade Finance information exchange and transactions**

Information on any trade finance transaction is currently spread across the files and information technology systems of multiple parties, which is inefficient and risks inconsistencies. Distributed ledger technologies (e.g., blockchain) have the potential to enable the exchange of reliable trade information in a digital form. Smart contracts underpinned by distributed ledger technology can automate the execution of payments when pre-defined conditions are met.

**Figure 17: Digitisation of internal operations can be accomplished via OCR and forming 'digital ringence' around operations**



Source: BCG analysis

Major trade finance banks are investing in distributed ledger and smart contract solutions, and some have already trialled them. Challenges for any solution include collaboration across a fragmented industry, security concerns, infrastructure compatibility, and regional variation in regulations.

### **Banks are using big data and advanced analytics to understand customer supply chains and capture a larger share of network value**

Banks already have a lot of data on their customers and the value chains in which they operate. Yet, they can learn a lot more from this data to give them an edge in sales and pricing. For example, customer data can be used to better understand transaction risks and the propensity of players in the value chain to need their products. This data can also help banks to reduce compliance risks by detecting irregularities in supply chains.

Much of the data held by banks, or accessible to them, is dispersed and unstructured. Banks will need to invest in big data and advanced analytic solutions to unlock the value of this data and reveal opportunities for growth. One solution is to co-operate with FinTechs that can provide the data. For example, a major trade finance bank is partnering with a FinTech to launch a working capital finance product on the FinTech's supply chain management platform. Using data supplied by the platform, the bank will offer products further down the supply chain, and more easily assess the credit risk of potential customers based on their supply contracts and invoices.

### **Innovations such as the Internet of Things (IoT) and 3D printing will have disruptive consequences for Trade Finance**

The exponential increase in data generated by the IoT has exciting implications for supply chain management. In future, the IoT could track trade by pallet and from door-to-door and provide real-time information to exporters and importers on the location and condition of goods. This will greatly reduce the risks involved in trade, and disrupt the value proposition of traditional Trade Finance products. Along with blockchain solutions, the data generated by IoT will reduce barriers to entry. The underserved SME sector, with a USD 1.2 trillion to USD 2.6 trillion credit gap, may be fertile ground for FinTechs.

Trade Finance practitioners should also keep an eye on the further disruptive potential of Industry 4.0. The ability to produce goods on demand and on location with 3D printers may reduce trade flows in end products. These physical trade flows will be replaced by trade in the intellectual property rights for the code-containing designs used by 3D printers. Industry 4.0 is also likely to disrupt trade flows in commodities, which will be required to supply production in more locations and in reduced volumes. When combined with the effects on commodity trade of increased local production of renewable energy, global flows of end goods and commodities could look radically different in the next 10-20 years or so.

**Investment in big data and advanced analytic solutions is needed to unlock the value of banks' data and reveal opportunities for growth**



### **Industry 4.0**

Industry 4.0 – also known as the fourth industrial revolution and industrial internet – refers to the advances in industrial productivity made possible by the connected systems enabled by nine new technologies: autonomous robots, simulation, horizontal and vertical system integration, the internet of things (IoT), cybersecurity, the cloud, additive manufacturing (e.g., 3D printing), augmented reality, and big data and analytics.

## BCG's perspective on five actions that trade finance banks can take to increase profitability and position for the future

- Position your trade finance strategy around the right trade corridors to take advantage of changes in trade activity.
- Continue to streamline your core trade finance processes by using continuous lean optimisation to reduce unit costs.
- Take advantage of progress in Intelligent OCR and AI automation to create a digital ringfence around your trade finance operations and automate labour intensive back-office processes.
- Be involved in collaborative trade finance solutions by investing in innovation and taking part in pilots (e.g., blockchain, smart contracts).
- Develop a big data and advanced analytics strategy to better understand the supply chain networks that you serve and capture a larger share of network value



### Editorial Comment: selected strategic and tactical implications

#### Strategic implications

Shifting geopolitical dynamics and starkly opposing views on a way forward through multilateral versus bilateral engagement, protectionism versus open trade and unilateral self-interest versus a more global and inclusive approach – these differing worldviews directly impact strategic priorities and direction around international commerce and trade-related financing. A related shift in political influence and global positioning, with significant shift toward China, has already begun to shift the landscape and context.

With the Trans-Pacific Partnership at risk, or at best likely to proceed without US involvement, China's B&R strategy stands out as a major initiative with potentially transformational implications and the very real prospect of reshaping trade corridors and supply chains around the world.

Trade specialists and trade finance executives have both an opportunity and an obligation to help better advocate for trade, international engagement and

the critical role of financing in enabling cross-border commerce. This is an important moment to champion international engagement as a pathway to growth and inclusiveness, and a key point at which to continue advocating for effective, appropriate and risk-aligned oversight and regulation of trade and financing activity, both under current supply chain and corridor configurations, as well as under evolving post-B&R contexts.

#### Tactical considerations

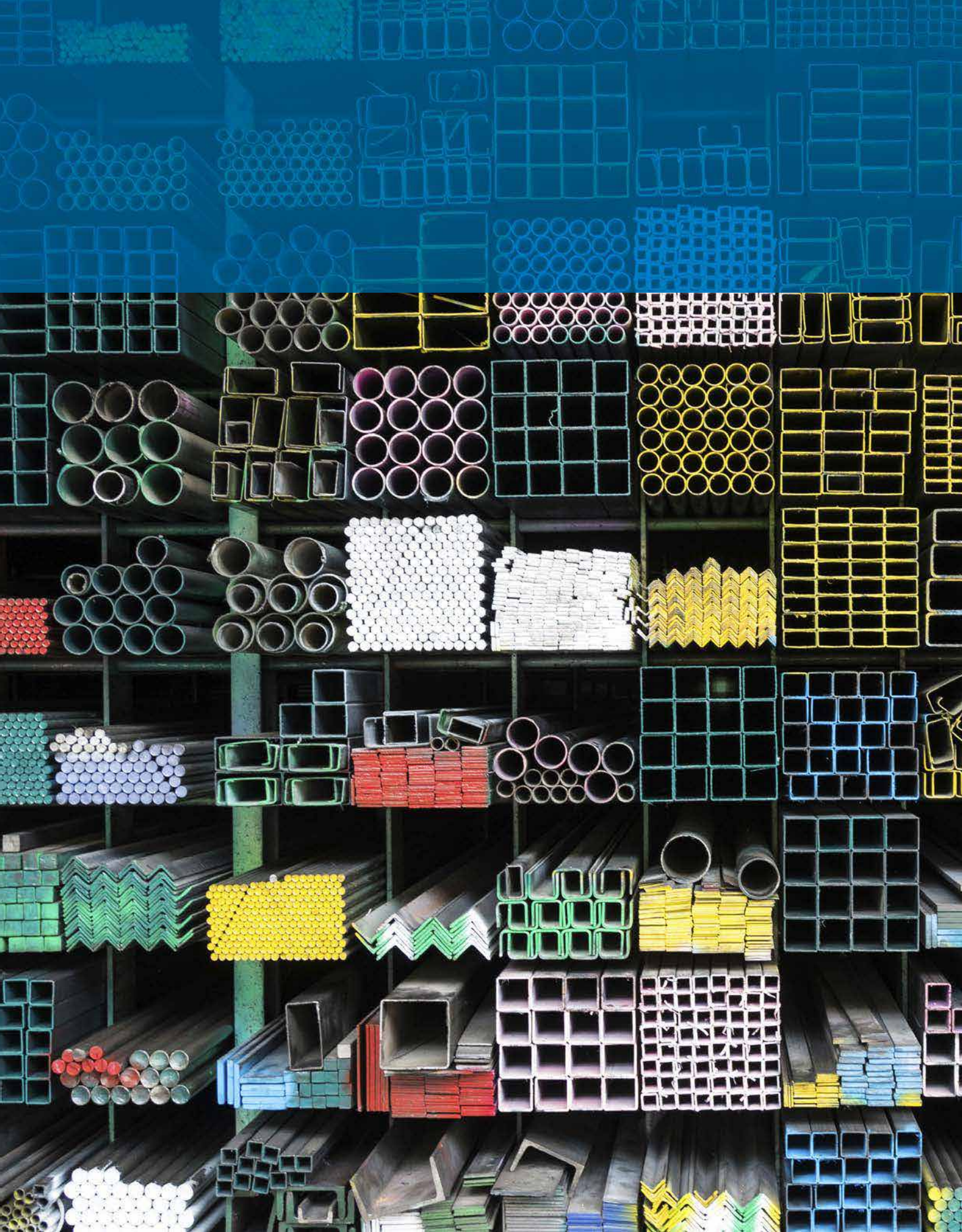
Continuing regulatory and compliance costs, coupled with the need to meet persistent levels of demand for trade finance and SCF – including aspirations to address large amounts of annual unmet demand – must create urgency in the attempts of trade bankers to assure the sustainability of their businesses and the continuing value of their financing and risk mitigation propositions.

It is clear that complacency around long-established trade finance instruments and practices, no matter how robust, is no

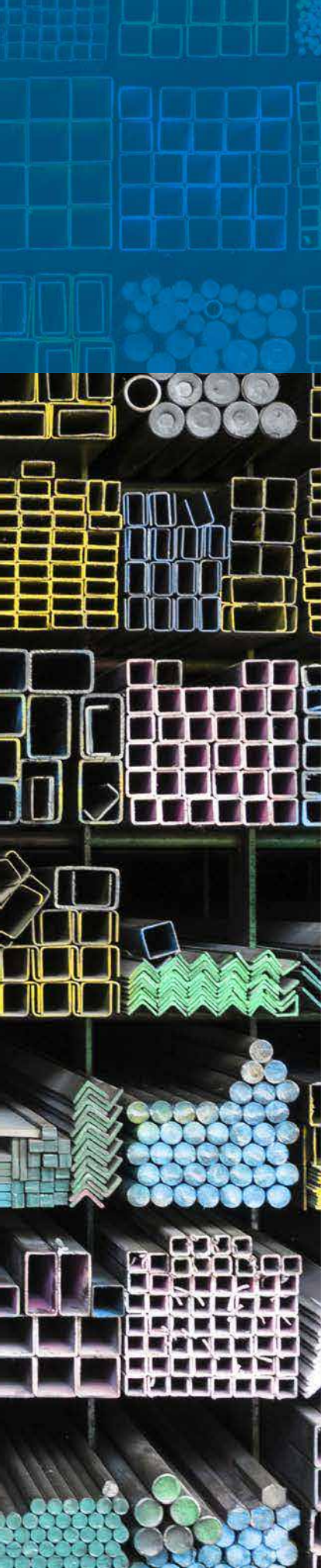
longer a viable approach and that material changes will either be conceived and deployed by practitioners on a proactive basis, or they will be demanded by end-clients, and then become a problem for industry leaders to address in crisis management mode. Creative strategic alliances, the application of effective transformational technologies and the development of comprehensive suites of solutions across complex supply chains will inevitably be part of the tactical considerations of trade finance providers over the near term.

Equally, those entrusted with running economically important trade finance businesses must look beyond cost-control to revenue generation and investment in their businesses, and must by implication become increasingly adept at championing trade finance within financial institutions whose executives often have, at best, a cursory appreciation for the nature and value of this esoteric form of financing and risk mitigation.









# Trade and Supply Chain Finance: Survey Findings and Market Trends

**Global and regional trends in trade finance and supply chain finance >**

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**SWIFT trade finance traffic statistics >**

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**Analysis of global trade finance gaps >**

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**How training tomorrow's experts can reinvigorate trade finance today >**

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**Speaking the same language: standard definitions for Supply Chain Finance >**

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**Supply Chain Finance: corporate perspectives >**

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**Forfaiting market trends >**

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**Factoring market trends >**

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**Export finance market trends >**

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**Export Credit insurance market trends >**

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# ICC Global Survey on Trade Finance and Supply Chain Finance 2017

## RESULTS AND ANALYSIS

### Survey respondents

This year's edition of the industry's most comprehensive survey on trade finance trends gathered 255 responses from banks located in 98 countries. Industry leaders and influencers were surveyed in the period from March through May 2017, on their banks' trade finance and supply chain finance business during the calendar year 2016. In the spirit of providing clear value-added to our readership, to ICC and Banking Commission members and to the international trade and trade financing community at large, respondents were asked to share their views on notable current and future developments shaping their organisation's trade finance activities, and by extension, the next generation architecture for trade and trade finance.

It is worth pointing out that this year, the questionnaire was reconfigured with the specific objective of collecting data points and insights across specific aspects of the trade finance and SCF business, in close consultation with our newly established Editorial Board.

The survey, in combination with this report, has been designed to provide wide-ranging context and analysis, consideration of policy and advocacy activities linked to trade and finance, as well as specific commentary on the transformational developments in financial technology digitisation of trade and the role of non-banks in financing international commerce.

The survey sent to respondents this year was enhanced in design and usability and specifically structured to obtain data and perspectives on key areas of trade finance and supply chain finance, including:

- Strategy
- Operations
- Sales
- Product development

Although the survey population changes every year, the geographic breakdown of participating banks remains quite consistent year over year. As such, the banks most represented are in Asia (28%) and Western Europe (25.5%). The significantly higher participation of banks in Asia in this edition (Figure 18) compared to 2016 (18%) is positive and enforces the representativeness and alignment of this trade finance study with the reality that supply chains are often anchored in Asia, with large numbers of suppliers based in the region. This also aligns with Asia's share of

**This is the industry's most comprehensive survey on trade finance**



# 98

The number of countries covered by the Global Survey

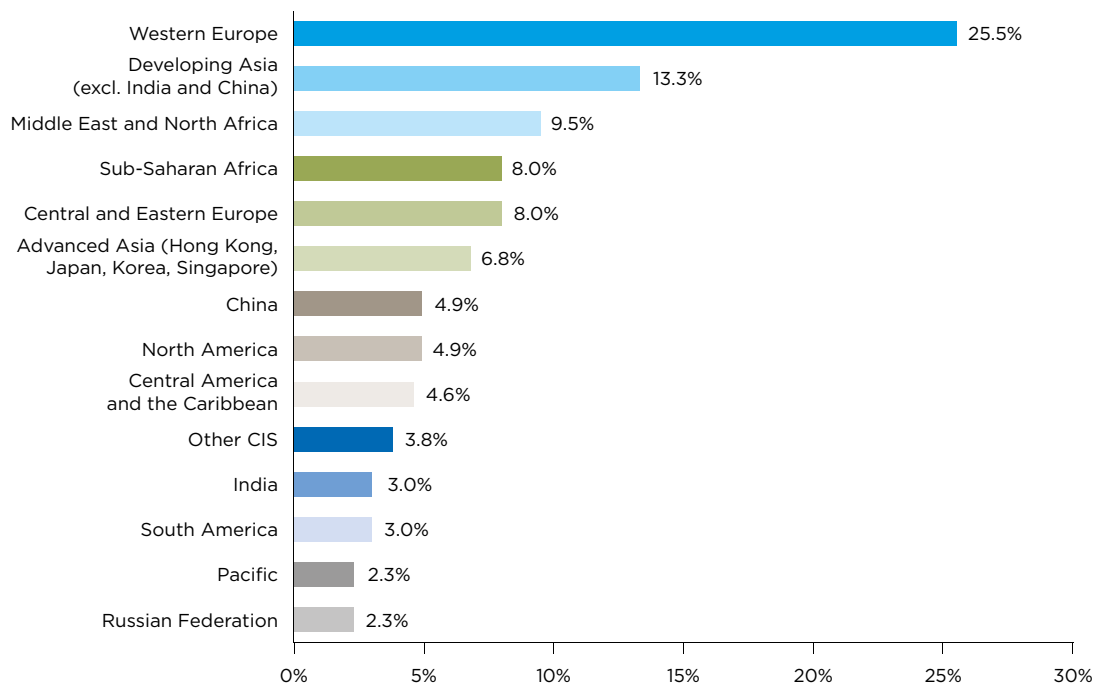
global trade and supply chain flows reflected in various trade corridor analyses and in data pools related to the region. Very notable in this edition are the proportionately lower participation of banks from North America (4.9% compared to 12% in 2016) and the higher participation of Russian banks (2.3% compared to 1.2% last year).

Rethinking Trade and Finance is a flagship publication of the ICC and of the Banking Commission, and at its inception in 2009, was a ground-breaking publication in its focus on trade and trade financing. Since then, the subject of trade finance and the fast-growing area of supply chain finance have garnered attention from numerous political, business, academic and international institution circles.

This new-found interest in trade finance and SCF as critical enablers of trade has been very positive in many respects, but is anecdotally said to contribute to a degree of “survey fatigue” among trade finance practitioners and providers in particular. This reality may have contributed in part to lowering the number of responses received in the current edition – an issue that we will be reviewing in preparation for the 2018 edition of the survey and report. Relatedly, and in an effort to bring findings to market earlier in the year, the survey was made available for a shorter period than was previously the case.

The strategic value and robustness of the data, analysis and conclusions remain clear and demonstrable, and remain in line with the standards of quality set by past editions of this report, as well as by other Banking Commission and ICC publications.

**Figure 18: Location of survey participating banks**



Source: ICC Global Survey on Trade Finance 2017



As noted earlier, the majority of survey respondents are based in Western Europe and Developing Asia, reflecting a combination of key trade corridors, buyer/supplier relationships and ecosystems, as well as the critical mass of trade finance providers operating in those regions. Important sectoral flows such as commodity trade activity links directly to both areas of the world, either as sources of commodities, or as hubs of financing and risk mitigation provision aimed at facilitating commodity trade.

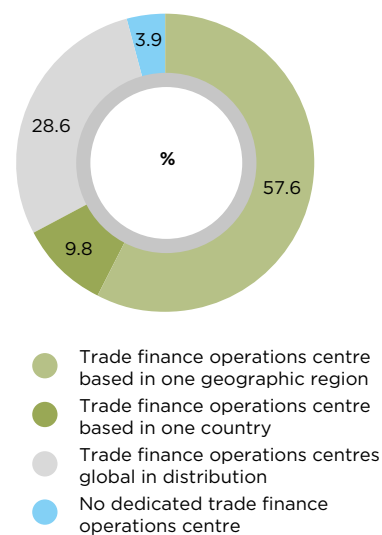
The profile of respondent banks is reflected in part through data collected around the operational characteristics of survey participants. The structure and deployment of operations units in traditional trade finance businesses (often organised under transaction banking units and covering Documentary Credits, Collections and Guarantees/Standbys) reflect the profile of participant banks.

The largest share of participating banks corresponds to those with operations presence in a number of countries, but in one geographic region, which we will refer to as regional banks (57.6%), followed by global banks with operation centres worldwide (28.6%), and smaller single country banks comprising almost 10% of the pool of respondents. Almost 4% of participating banks do not have dedicated trade finance operations centres, though they report having processed between 26 and 250 trade finance transactions in 2016 (Figure 19).

The post-crisis environment reflects a consolidation and reduction in cross-border activity, including trade finance, by numerous banks around the world and this, coupled with on-going efforts to digitise trade-related documentation, and automate some of the operational activity and decision-making, combines to result in a significant level of centralisation and concentration of trade operations capability.

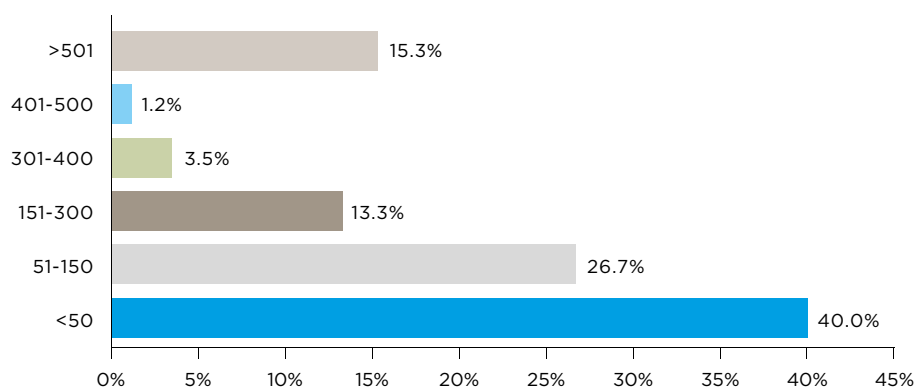
Another criterion for assessing the type of participating bank in the study was the number of employees involved in the selling, processing and delivery of trade finance products and solutions globally (Figure 20).

**Figure 19: Trade finance operations structure**



Source: ICC Global Survey on Trade Finance 2017

**Figure 20: Number of employees involved in trade finance operations**



Source: ICC Global Survey on Trade Finance 2017

More than a third of our respondents are banks with a small number of employees involved in trade finance, reporting that 50 people or less contribute to the delivery of trade finance. 40% of respondents employ between 50 and 300 dedicated trade finance professionals and 20% employ over 300 people globally for trade finance solutions.

The financing of international trade is a highly specialised form of financing, with a historically limited profile within most financial institutions, and with a limited pool of competent talent to draw from. Trade finance, particularly traditional trade finance, is a business that exhibits high rates of market share concentration among the top bank providers, thus it is unsurprising to find that just over 15% of respondents maintain operations capacity of 500 staff or more.

The cost, complexity and operational risk involved in sustaining a trade financing capability has long motivated banks for which trade is a non-core business, to outsource the operations function to larger providers with proven competencies and track records in the business. Considering this latter reality, together with the fact that trade finance is often seen as an effective entry point into desirable client relationships, it is likewise reasonable to find that 40% of respondents maintain a complement of less than 50 staff with a trade finance remit.

This distribution reflected in the 2017 survey responses aligns well with the current global reality, and thus suggests that the survey results should provide a clear window into the business of financing international commerce, starting with traditional trade finance, which still underpins about 10% of merchandise trade flows and extending into fast-evolving SCF.

### Trade finance: trends, strategy and evolution

Trade activity observed over the last several years has been anaemic, and persistent questions remain as to whether or when trade will again become a force of forward momentum in the global economic system. Analysts and practitioners are looking for leading indicators to identify the point at which trade growth will again outpace global GDP growth, and thus reclaim its place as a driver of economic growth.

Even as some hint of such developments is observed in various parts of the world, it is clear, and increasingly widely acknowledged, that trade cannot for the most part take place without trade finance or SCF. The World Trade Organization and others suggest that as much as 80% of annual global merchandise trade is enabled through some form of trade financing, including both traditional trade finance and SCF, and encompassing both financing and a range of risk mitigation solutions.

With the majority of trade now conducted on open account terms, SCF is clearly the high-growth area in financing cross-border commerce, though traditional trade finance has been shown through various analyses to remain key to USD 1.5-2 trillion in annual merchandise trade, or roughly 10% of those trade flows over a period of numerous years.

Traditional trade finance remains important and relevant despite the long-professed disappearance of the Documentary Letter of Credit. While there was some silt evidence of a return to traditional mechanisms at the peak of the global financial crisis, there remains a disparity of views in industry, about the direction in which this most mature of business practices is heading.

80%

Volume of trade enabled by trade financing

Practitioners and clients alike will affirm the continuing value brought to international commerce by the traditional mechanisms of trade finance, yet nearly 80% of survey respondents express the view that traditional trade finance will exhibit little or no growth, or decline outright year-on-year (Figure 21). Just over 21% deem that traditional trade finance will show growth, and while the survey did not explicitly differentiate between transaction volumes and the value of traditional trade finance, the views are likely consistent on both dimensions of growth.

Delving further into expectations of low to negative growth in traditional trade finance, respondents were asked to consider which factors in the current environment had the highest likelihood of adversely impacting business in the short-term (Figure 22). Perhaps predictably, over 68% of responses pointed to compliance and regulatory requirements, whilst a surprisingly low 11% pointed to capital constraints as a matter of significant concern.

Macro factors within which trade banks operate, such as protectionist tendencies in key parts of the world, market volatility and shifting trade corridors appear to be significantly less worrying to survey respondents, at least in the timeframe when the survey was executed.

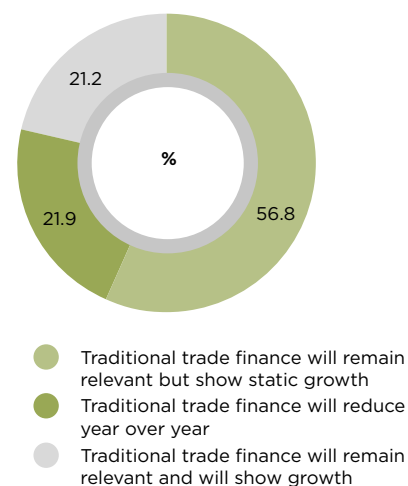
The role of FinTech firms as potential disruptors of the market has been the subject of much discussion and debate among market participants, from incumbent providers to clients, regulatory authorities to the FinTechs themselves. In the end however, only 1.4% of respondents opted to focus on competition and disruption from FinTechs as a factor that could adversely impact trade finance in the short-term.

Taken holistically, the responses to this survey question suggest that trade financiers are very focused on issues with direct impact on business, from the cost of addressing increasingly comprehensive and complex regulatory expectations, to the inevitable impact on margins and the increasingly sensitive reputational risk issues linked to failures of compliance. Contextual and strategic factors appear to be less concerning, perhaps due to the immediacy of the impact of compliance issues.

Whereas significant time and resources are spent today on advocacy and education efforts aimed at achieving something close to risk-aligned regulatory treatment of trade finance on both the compliance and capital side, efforts to counter protectionist or trade-restrictive measures are less visible at industry level. Recent developments in this area suggest both an opportunity and an imperative to engage actively in targeted advocacy on this topic, as it is likely to become more important over the next year or more.

Survey results suggest that all the talk about disruptive FinTechs and their competitive offering is not currently seen as a threat to banks' positions as providers of trade finance, with only 1.4% of respondents identifying this as a key concern. This may be symptomatic of dangerous complacency, or it may result from recent shifts in the positioning and tone of FinTechs, from one of clear competition to one that is open to exploring collaboration with established providers in the traditional financial sector. Senior trade finance executives have voiced the view that numerous FinTechs with promising propositions possess limited financial resources and do not appear commercially viable. Additionally, the inevitable regulatory scrutiny and eventual oversight will significantly

**Figure 21: Growth of traditional trade finance business**



Source: ICC Global Survey on Trade Finance 2017

**FinTechs are not currently seen as a threat to banks' positions**

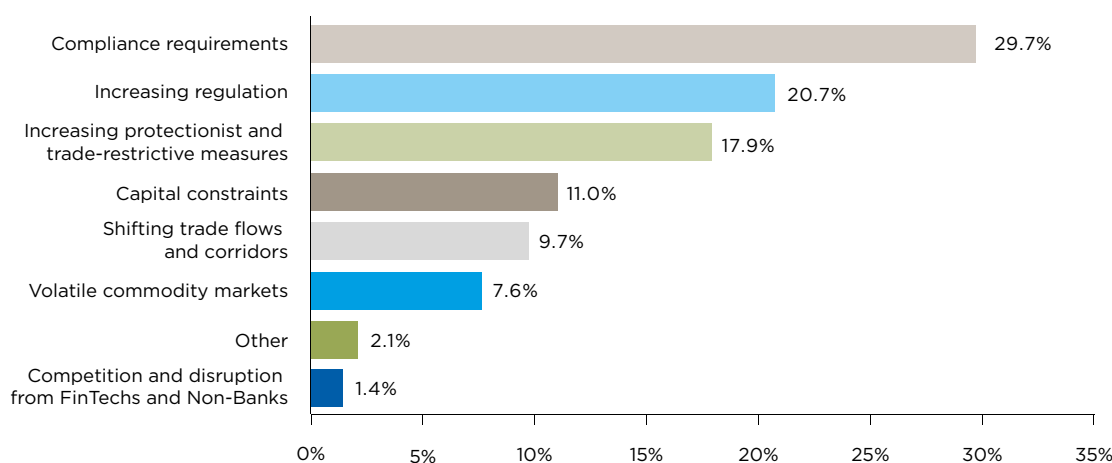




change the context of business for FinTechs, from one characterised by the presence of regulatory “sandboxes” aimed at facilitating FinTech growth, to one where regulations of a more stringent nature will be imposed.

The low focus on this dimension may also reflect the emerging reality that several of the more promising and potentially transformational FinTechs now count major financial institutions among their shareholders, thus effectively turning those FinTechs into an asset as opposed to a competitive threat.

**Figure 22: Aspect most likely to adversely impact business in the short-term**



Source: ICC Global Survey on Trade Finance 2017

While the data point is notable and interesting, it, like the previous survey question, may hint at an absence of strategic perspective on an important element of the evolving architecture for trade, risk mitigation and financing. Banks, and trade finance businesses in particular, may wish to continue to consider the disruptive nature of FinTechs and the way they conceive of, develop and deploy transformational propositions in the market, rather than taking a view that acquisition translates to neutralisation of a threat.

Two thirds of survey respondents report that topline revenues for their business have remained unchanged, or increased, with the remaining 33% indicating a reduction in revenue year-on-year (Figure 23). This is an encouraging and positive sign in light of still modest levels of trade growth and the absence of the commodity supercycle that fuelled a significant portion of global economic activity, trade and trade financing.

Globally, there are no material changes to the pricing of trade finance that would account for this finding, thus it is tempting to conclude that demand for trade finance remains relatively robust. One question to consider at the strategic level is whether this data element might be a soft “leading indicator” of upcoming trade growth, given the numerous macro-level factors that would have suggested a reduction in trade finance revenues across the board.

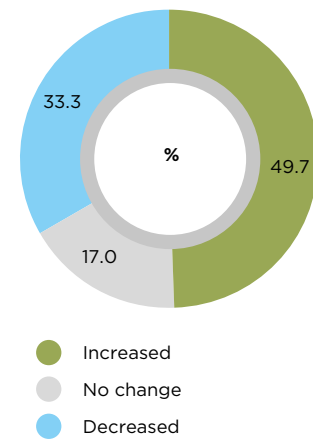
The overall positive finding on this question is all the more notable given the widely reported increasing costs related to regulatory and compliance activity, which some market commentators had suggested would drive a significant reduction in appetite for banks to engage in cross-border business, including trade finance and SCF. While we cannot comment on the impact of current market conditions on profitability, it is a clear positive to note the responses of survey participants on the state of industry revenue flows.

The now clearly global shift from trade on traditional terms to trade on open account, and the related evolution and maturing of Supply Chain Finance as a market proposition combine to lead almost 30% of survey respondents to identify SCF as the most important area for development and strategic focus in the coming 12 months (Figure 24). SCF was arguably originally “packaged” as an offering in response to a serious threat of disintermediation. The fundamental differentiation (and value) of SCF as an offering distinct from traditional trade finance is now well established, and market demand is clearly present and growing. Under such conditions, it is unremarkable to find that SCF space is now seen as a strategic priority.

The SCF business and proposition are still in development and evolution mode, with a basic common lexicon published only in early 2016 as the “Standard Definitions for Techniques of Supply Chain Finance”, the drafting of which was facilitated through the ICC Banking Commission, but which reflects the in-depth contributions of numerous global industry bodies and more than thirty senior experts and practitioners. An update on this initiative is included in this section under the section titled Update on Global Supply Chain Finance Forum.

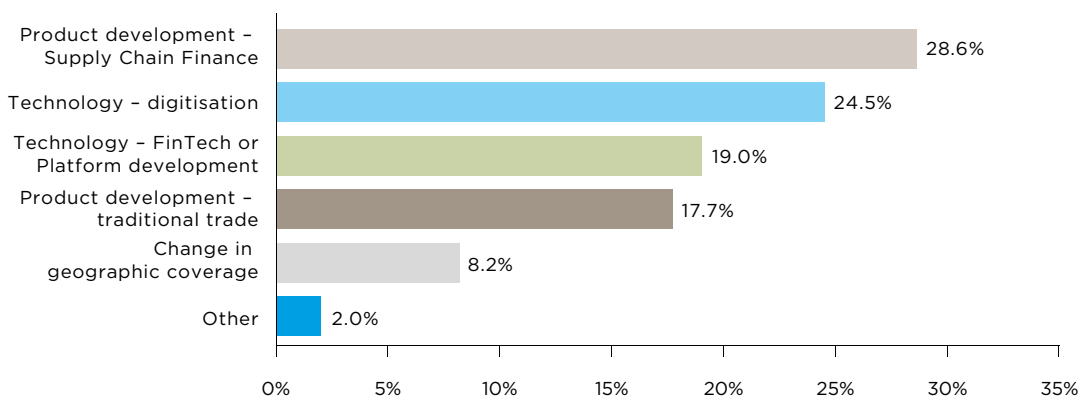
Despite its nascent status as a comprehensive, programme-like proposition which encompasses numerous financing techniques, and despite the reality that risk mitigation elements are still in development,

**Figure 23: Evolution of trade finance revenues in 2016**



Source: ICC Global Survey on Trade Finance 2017

**Figure 24: Most important area of development and strategic focus for the trade finance industry over the next 12 months**



Source: ICC Global Survey on Trade Finance 2017

## Access this publication



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



**SCF was identified as the most important area for development and strategic focus in the coming 12 months**

SCF aligns very well with an increasingly holistic view of trade, based upon the structure, global reach and functioning of global supply chains, and their complex ecosystem of commercial relationships. The priority assigned to SCF in this response is also supported by the reality that one or two techniques, perhaps payables finance and distributor finance, are showing the greatest focus by providers and uptake by clients, but work remains in developing a comprehensive offering across the supply chains, and several layers into the relationships which support the needs of anchor buyer clients.

Leading providers are focused on developing viable solutions for the provision of pre-shipment financing, where an invoice has not yet been raised or accepted for payment, and for the provision of financing support for the so-called “last mile” in complex global supply chains.

Nearly 44% of respondents identify priorities linked to digitisation and technology, including FinTech and the development of – or adherence to – fast-emerging platform propositions, as priority areas of strategic focus.

This finding reflects an understanding by trade financiers and providers of SCF, that trade itself is moving inexorably to a digitised model, whether at the transaction level, or at the level of legal and regulatory treatment of digital commerce, all of which is picking up pace around the globe, and is seen to present great opportunity for developing economies to better engage in the global economic system.

Less than 10% of respondents worry about geographic coverage, despite much attention in the last two years around the compliance-based ‘de-risking’ activity which has seen many banks exit markets, drastically reduce their portfolio of correspondent relationships and exit client relationships primarily at the commercial and SME end of the spectrum. This figure may suggest a sense that banks are providing adequate market cover to meet client needs, or might reflect a sense of fatalism about the ability of the trade business to influence market exposure decisions typically made at the level of the financial institution.

In any case, the importance of trade and economic inclusiveness could not be more clearly illustrated today, and it is an area of focus in policy circles and in the advocacy work of the ICC as well as the Banking Commission in particular. It is critical for trade financiers and providers of SCF to provide access to adequate and affordable levels of trade financing, but equally critical to ensure that this availability extends into markets most in need, which are almost by definition also those in growth mode. In the narrowest commercial sense, it is the growth, and the continuing critical mass of suppliers, in developing economies that will provide a return on investment-based motivation for banks (or other providers of trade financing) to look at these markets.

In light of the priorities identified by survey respondents, it is perhaps natural to see that SCF and technology are also selected as the areas showing the greatest potential for growth, with almost 68% of participants pointing to these two options (Figure 25).

Notable in this question is the belief by over 11% of respondents that there is a compelling opportunity in financing trade related to new sectors of commercial activity. One such area of focus has been services sector trade, a high-growth area for both advanced economies and for leading emerging markets, which reportedly represents about USD 5 trillion annually in trade activity. The desire to develop financing solutions for

new sectors of trade is timely for the industry, and will require some degree of innovative thinking, with services sector trade being an example of such a scenario.

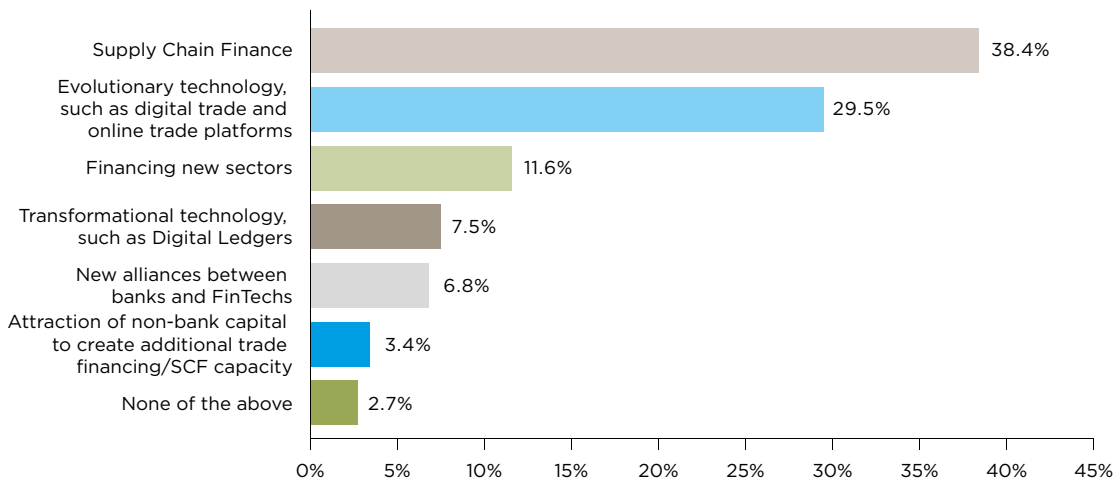
The need to finance services trade requires flexibility to fund intangible flows where no traditional asset exists to secure the financing, and where the risk of non-delivery is different in character than trade flows that have been financed for hundreds of years or longer.

Once again, a survey question related to the configuration of trade banking operations is used as a proxy to reflect the evolution of the business of financing trade, seeking to tease out the evolving linkages between operational capabilities focused on traditional trade finance, and those encompassing the ability to deliver SCF solutions to bank clients.

While this logical “split” is not entirely reflective of market realities, it remains indicative, in that almost 65% of respondents report having operational capability in traditional trade finance only, despite wide recognition that growth is clearly in SCF.

**68%**  
**Believe SCF and technology show the greatest potential for growth**

**Figure 25: Area of greatest potential for growth and evolution in the financing of international trade**



Source: ICC Global Survey on Trade Finance 2017

SCF, as it exists and is delivered today, includes significant focus on factoring and forfaiting techniques among others, with the former often carried out by affiliates of banks that are unrelated to transaction banking units or trade finance businesses. Likewise, certain techniques of SCF may reside in areas outside of trade banking, for example in asset-based lending or as a standalone receivables finance unit.

The variety of business and operational models around SCF is significant, and makes it difficult to even articulate a meaningful survey question on the matter. In this instance, year-on-year comparison is facilitated through consistency of survey structure or queries. At a far more basic

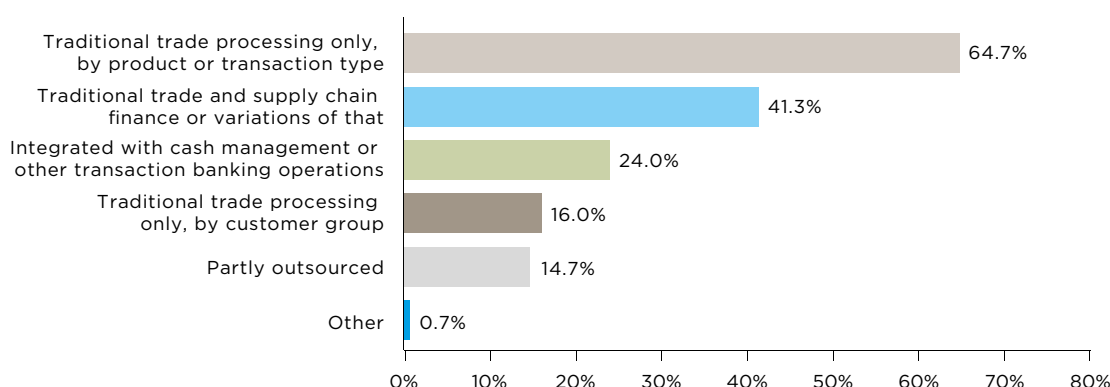


level than the distinction between traditional trade finance and SCF, it is notable that only 24% of respondents report having a meaningful level of integration with other transaction banking activities, and that less than 15% have even partially outsourced their transaction processing capabilities (Figure 26).

Findings brought into focus by this question suggest that the industry as a whole has meaningful opportunities to develop optimised operating models and best practices, and that there are likely some useful steps to be taken in reducing cost/income ratios at a time when trade banking faces numerous fundamental threats to its viability as a bank offering

Although SCF is widely seen to be an area of significant growth and opportunity, and survey participants have identified it earlier as one of the areas showing the greatest potential for growth and evolution, it is worth noting that 38% identify this as a high strategic priority expected to drive significant growth.

**Figure 26: Configuration of global trade finance operations**



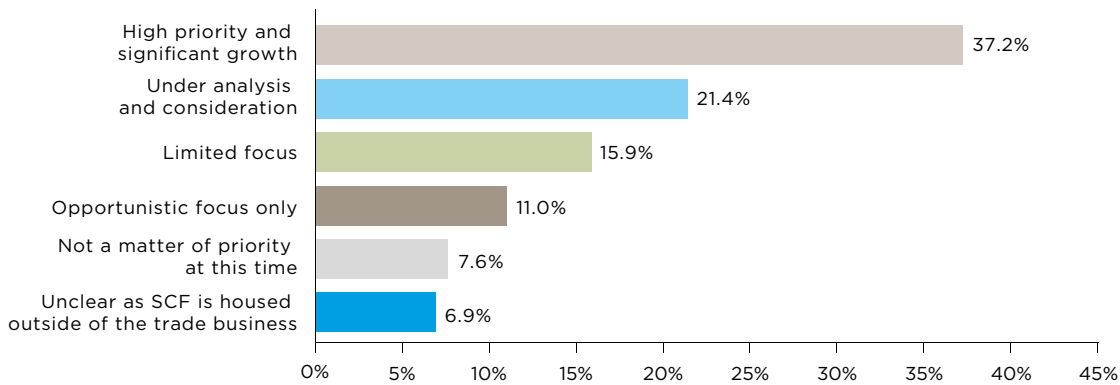
Source: ICC Global Survey on Trade Finance 2017 / Figure 26 respondents answered all applicable options

In addition to the perceptions of survey respondents about the potential of and priority assigned to SCF, another useful indicator of the growth of SCF in the marketplace involves consideration of the degree of uptake of end-clients, to third party (non-bank) platform solutions in support of the SCF-related needs (Figure 27).

Nearly half of survey respondents noted a slight to significant increase in client use of third-party SCF platforms, a finding that is consistent with anecdotal observations in the market, suggesting that interest in and uptake of these solutions is advancing steadily.

While the scope of services and solutions offered by such platforms can vary significantly, their presence in the market, at times in partnership with and complementary positioning with banks, sometimes leveraging bank balance sheet capacity and taking a more competitive posture, nonetheless represents a material evolution of the market for the financing of international commerce.

**Figure 27: Position of SCF in banks at this time**



Source: ICC Global Survey on Trade Finance 2017

In the context of increasing digitisation of trade, material market uptake of technology-enabled SCF platforms and a general acceleration of market acceptance of ecommerce and platform-based trade activity through Alibaba, DH Gate and numerous others, it is worth highlighting that over 41% of survey respondents believe that digital channels have significant to transformational potential to impact the provision of trade finance solutions to the market.

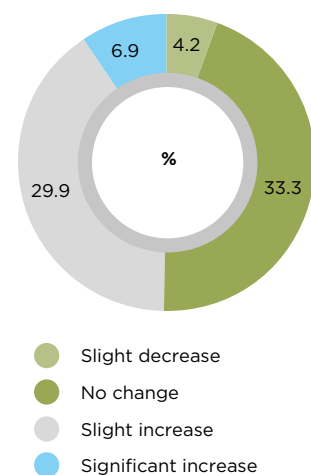
This level of optimism can also likely be linked to the attractiveness of high-growth frontier and emerging markets to trade financiers: those same markets where the leapfrogging of legacy technology allows for quick and decisive adoption of advanced business models, themselves enabled through digital channels.

Interestingly, almost 14% of respondents are either unsure of or see little potential for digital channels to impact trade finance sales. Based upon this data point, a significant portion of survey participants are unconvinced of what some of their peers see as the potentially transformational impact of certain types of technology on trade financing.

The business of international commerce is, by definition, cross-border, generally involves the conduct of business across extended distances, and thus would arguably be particularly susceptible to transformation through technology. Likewise, the provision, tracking and management of trade finance transactions in support of these flows, can reasonably be expected to align with the practices of providers' clients.

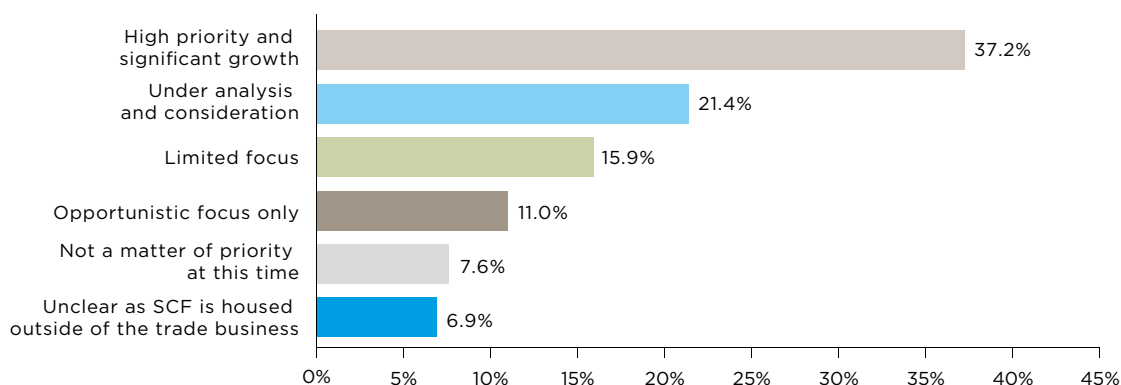
Even as thought leaders and early adopters across the industry track and anticipate with great interest, the inevitable shift to trade – and trade finance – in digitised form, the level of energy around the concept is not matched by expectations on the rate of development and acceptance of digitisation in trade financing.

**Figure 28: Customers' use of third-party platforms in 2016**



Source: ICC Global Survey on Trade Finance 2017

**Figure 29: Potential for digital channels to impact trade finance sales**

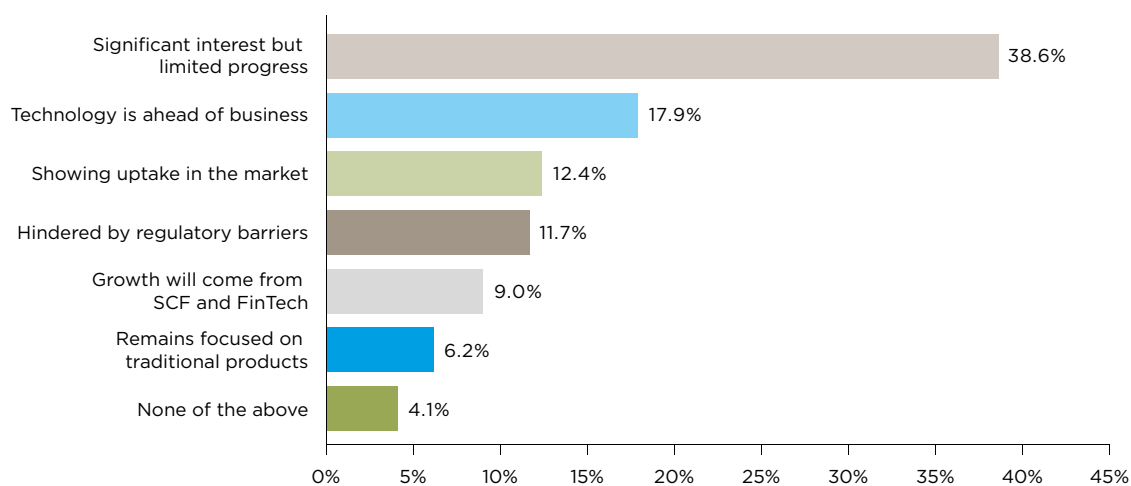


Source: ICC Global Survey on Trade Finance 2017

While 12% of respondents perceive a degree of market uptake, nearly 40% see limited progress and almost 18% report the view that technical capabilities and technology are ahead of business practice in that digital trade finance could be enabled by current technology, but the practices of financiers, risk insurers, export credit agencies and multilateral institutions have not kept pace (Figure 30).

This reality, and this dynamic which slows evolution and stifles progress, has been seen in trade finance before. Hesitant adoption of operational outsourcing models in the early 1990's, slow reaction around the use of (customer) front-end systems, conservative reaction to document imaging-enabled "hub and spoke" models and even the slow uptake of digitised documentation are consistent with this finding.

**Figure 30: Views on progress related to trade finance digitisation**



Source: ICC Global Survey on Trade Finance 2017

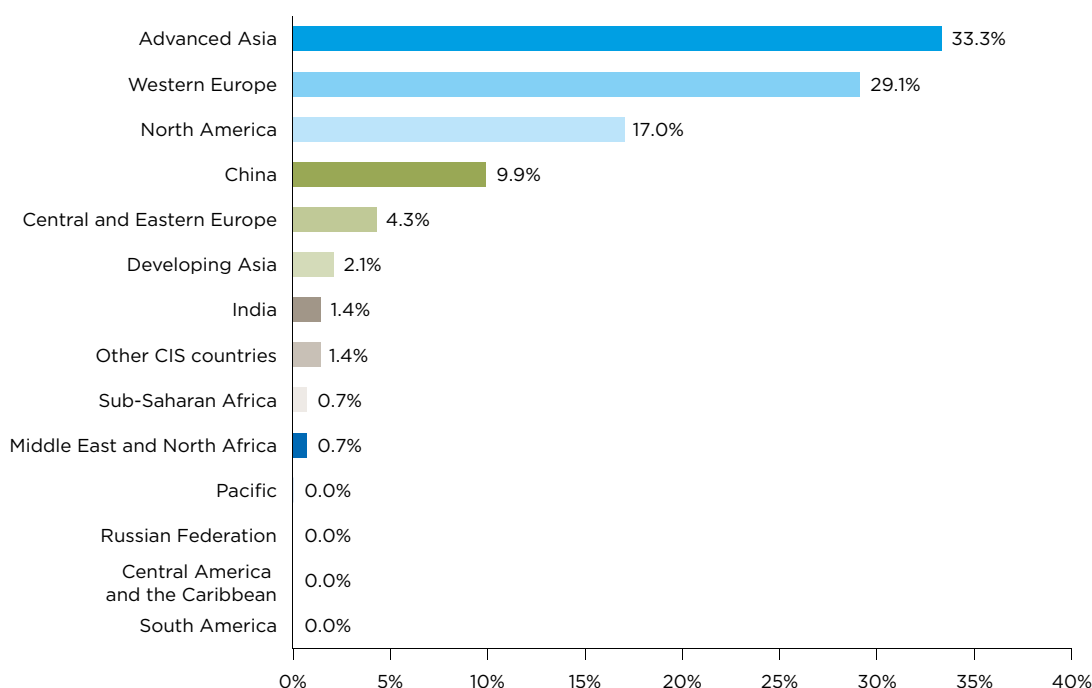
The implication of this single observation in its broader context might link directly to a frequent debate about whether trade bankers ought to follow their clients (into markets, into new technologies or into new business models) or whether they should lead the way, thereby advancing both bank and client successes. The difference today relative to twenty years ago may come down to the presence of FinTechs, and the interest that trade financing has engendered among a decidedly disruptive generation of entrepreneurs.

FinTechs in general and distributed ledger ventures in particular have identified in trade finance, a high-value, high-impact business with the potential to do significant social good, but one where antiquated practices and resourcing models are the order of the day.

If current business models and practices do not promptly evolve to catch up to the potential presented by technology today, those models will be forced to advance or will be supplanted by alternatives, with expectations of what is possible, defined increasingly outside of the narrow niche of trade finance.

Considering the question in geographic terms, respondents perceive that advanced Asia and Europe are the regions most likely to lead in terms of achieving truly digital trade flows. Over 62% of respondents combined to point to these two parts of the world as being ahead of the rest (Figure 31). China was selected by almost 10% of respondents, whereas North America, despite NAFTA and highly integrated auto sector trade, was seen to lead by a conservative 17% of survey participants.

**Figure 31: Where truly commercialised industrialised digital trade flows are expected to first occur**



Source: ICC Global Survey on Trade Finance 2017



## Advanced Asia and Western Europe are expected lead the way in digitising trade flows



Given the need for legal and regulatory standards, public policy and other contextual, but facilitating elements to set a foundation for the achievement of digital trade, adoption must extend far beyond financier and client, likely requiring a firm commitment by important stakeholders across the region that will eventually lead in this area. Commitments to ecommerce, enabling initiatives such as Single Window market access programs developed on a digital framework, are examples of factors that will enable truly digital trade in the short-term.

Specific initiatives such as the e-World Trade Platform proposed and championed by Jack Ma of Alibaba during the Chinese Presidency of the G20/B20 in 2016 are notable in their attempt to advocate for and enable in practical terms, the achievement of digital trade on a global level. Similarly, but on a transactional scale, the groundbreaking progress represented by the Bank Payment Obligation, and by the end-to-end digital trade finance transactions delivered by companies like Bolero and essDOCS, offer concrete grounds for optimism in this area.

The advent of 3D printing represents the digitisation of production and logistics, at least in part, and with such expectations now well set in the market, acceptance and accelerated uptake of digital trade is inevitable, thus the development and deployment of a suite of digital trade finance solutions must and will follow. The question that remains is whether the provision of digital trade finance and e-SCF will remain primarily the domain of incumbents, or whether new market entrants will leverage digitisation to disrupt the market and to wrest market share from today's leading providers of trade-related financing and risk mitigation solutions.

Drilling down further, respondents were asked to consider which industry sector might be most likely to first achieve full digitisation of trade, with fuels leading the way in the minds of about 17% of respondents, and telecommunications, raw materials, mining and agricultural products following in order of likelihood (Figure 32).

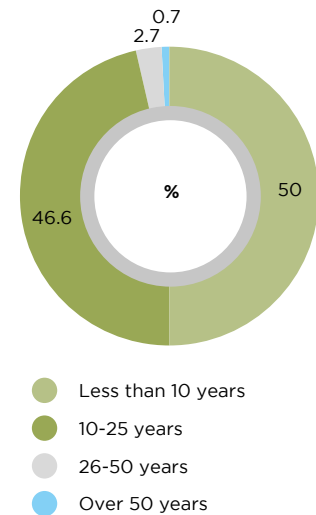
These top 3 sectors, perceived as the most likely to move to truly digital trade flows are industry sectors with strong demands for operational and cash management efficiency and characterised by large volumes of transactions. It is widely recognised that standardisation is a key requirement in enabling trade digitisation. Commodity sectors including fuels and raw materials are more mature than others in terms of such standardization, confirming the survey results in this respect. In fact, commodity customers have already pioneered in digital trade business transactions and accounted for the majority e-trade transactions including e-UCP and BPO. The telecommunications sector is also naturally in the top 3 sectors, as it relies on information technology and infrastructure, another essential aspect in trade digitisation.

Survey findings related to the pace of digitisation of trade activity are striking, in that 50% of respondents see high levels of digitisation achieved in less than a decade but an almost equal portion of survey participants expect the evolution to take from 10-25 years (Figure 33). Even interpreting that data point optimistically, a significant group within the pool of survey respondents expect that 60% digitisation of trade processes will take at least ten years to achieve.

11.6% of respondents consider that financing new sectors is a way to drive the industry forward and enable the further development of trade finance (see Fig. 25).

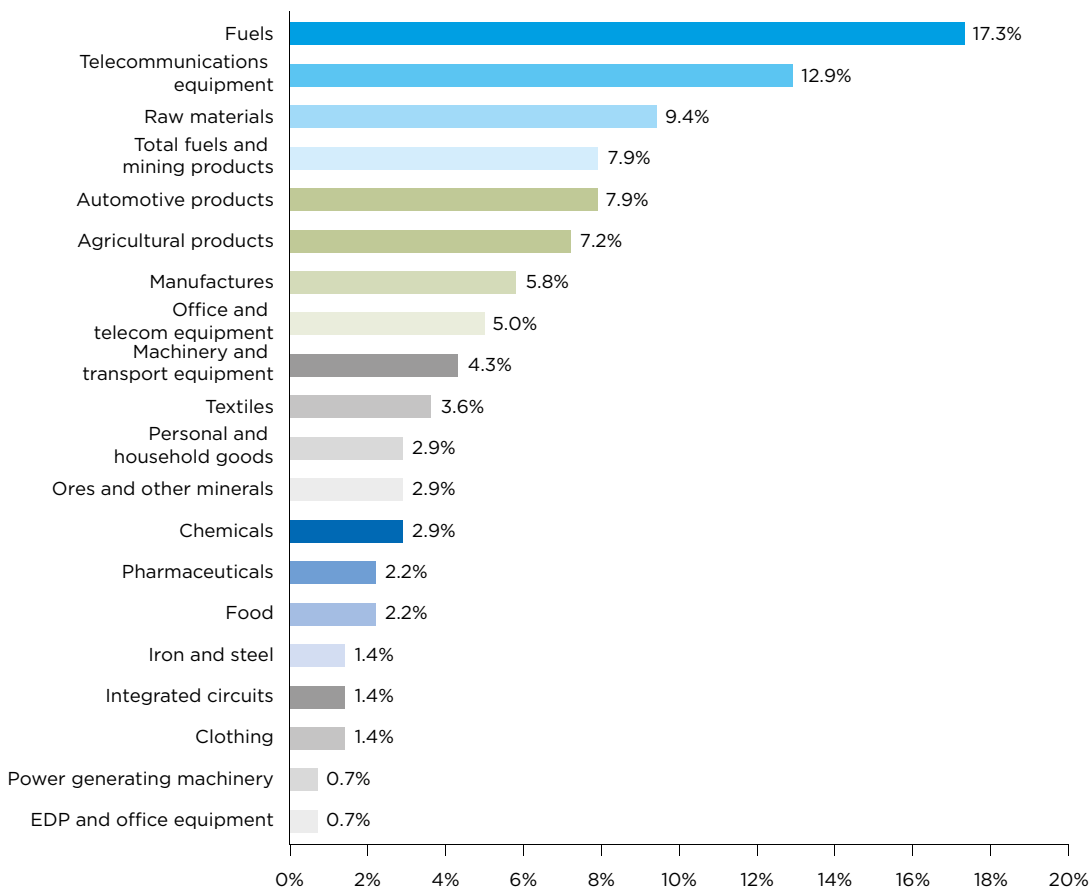
Following this observation, more insight into financing specific industry sectors is required. Survey respondents were asked to rank their most financed industry sectors and the ranking is presented below. Agricultural products sector was most frequently ranked first (16.2%), followed by total fuels and mining products with 10.6% and machinery and transport, on the same position as automotive products (9.2%). It is notable to observe that the top 5 industry sectors receiving most trade finance account for over a half of responses, 53.7%. This result, aggregated at global level, may be surprising for some readers. At individual level, trade finance provision to specific industry sectors would significantly among types of banks or geographic location. Provision of trade finance trade in this respect depends on so many factors - bank or regulatory bodies credit policies, relevance of the industry sector within the geographic area, diversity of finance channels to various industry sectors, financial status of certain industry sectors, position of the industry sector in supply chains, suitability of trade terms, country policies, etc. Some of the industry sectors have multiple channels of finance usually with

**Figure 33: How many years until 60% or more of all trade flow processes will be digitised**



Source: ICC Global Survey on Trade Finance 2017

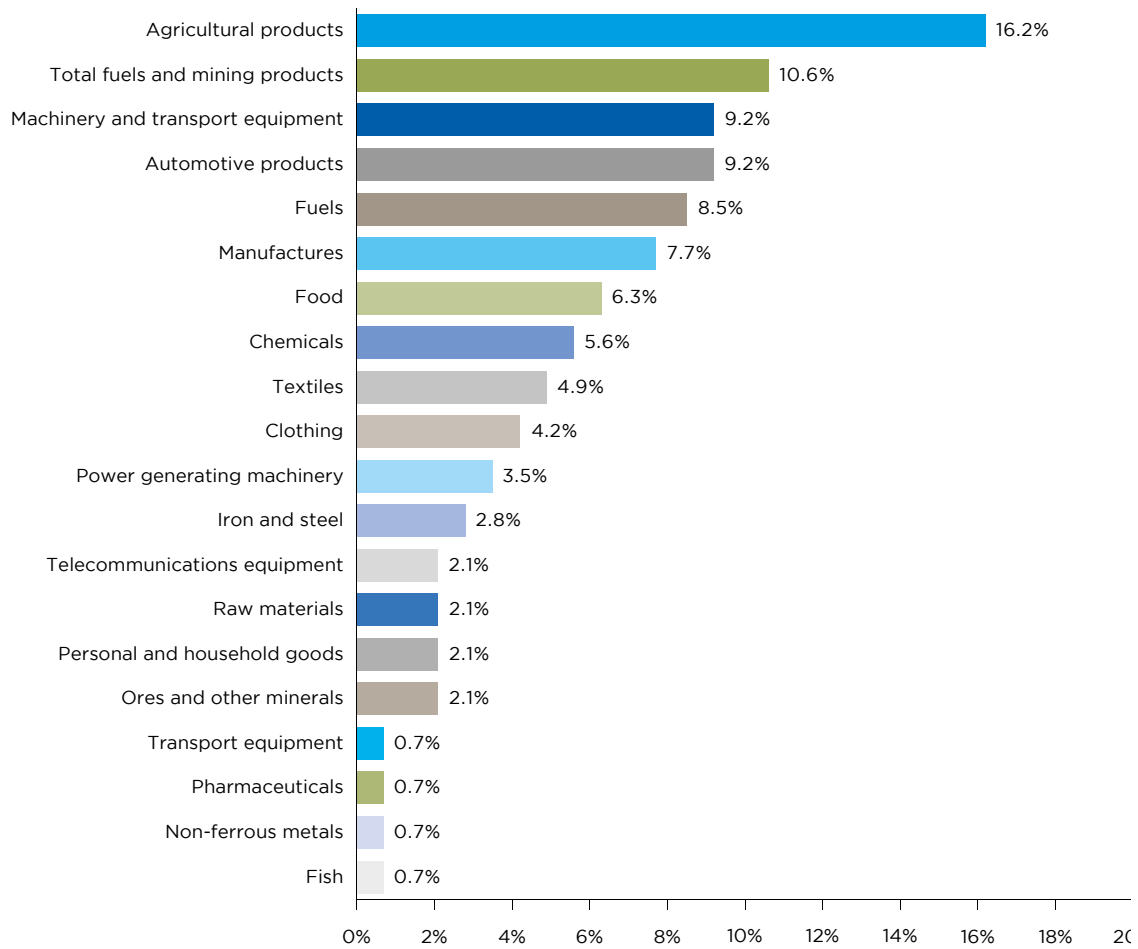
**Figure 32: In which industries truly commercialised industrialised digital trade flows are expected to first occur**



Source: ICC Global Survey on Trade Finance 2017

competitive pricing and more simplified procedures, hence trade finance may not be their priority choice of finance. Therefore, industry sectors perceived as receiving less trade finance based on survey responses, does not necessarily imply less finance provided.

**Figure 34: Industry sectors receiving most trade finance**



Source: ICC Global Survey on Trade Finance 2017

## Operations

Trade activity observed over the last several years has been anaemic, and persistent questions remain as to whether or when trade will again become a force of forward momentum in the global economic system. Analysts and practitioners are looking for leading indicators to identify the point at which trade growth will again outpace global GDP growth, and thus reclaim its place as a driver of economic growth.

Survey participants were asked to identify top current challenges faced by operations units within trade finance businesses (Figure 35). Perhaps unsurprisingly, the pressure to control costs received the greatest attention, but did so for about 23% of respondents, against a relatively close second-ranking challenge around technical competencies.

Cost control is a perennial area of focus for all types of operational units within banks and even across industry sectors, thus its ranking is predictably highest, and similarly, with a core focus on operational efficiency, throughput, productivity and process efficiency, it is to be expected that some focus would be put on technology as an ongoing challenge.

The identification of a major challenge around availability of senior-level technical expertise, identified by over 20% of respondents, is notable for several reasons. First, the inefficient, time-consuming training practices of the trade finance business, which might see a documentary specialist spend years on a single product (or even a single transaction type) is one of the root causes of this critical shortage of resources.

Secondly, in current market conditions and in consideration of the career aspirations and expectations of the current generation of new hires, the timeframes involved and the limitations around career path options linked to trade finance operations are unhelpful.

Finally, the industry-level consolidation and market exits observed during the global financial crisis, which temporarily defused the already impending resource and expertise crisis, is now past, and the redeployment of resources has largely run its course. At this moment, the demographics of those involved in trade finance related transaction processing is unsustainable and unfavourable to the long-term viability of trade operations capability.

The ICC Academy in Singapore was initially launched with a mandate related to professional development and certification in trade finance, with the explicit aim of addressing the staffing and competency crisis in the business of financing trade, including within operations units (see the contribution to this report by the ICC Academy).

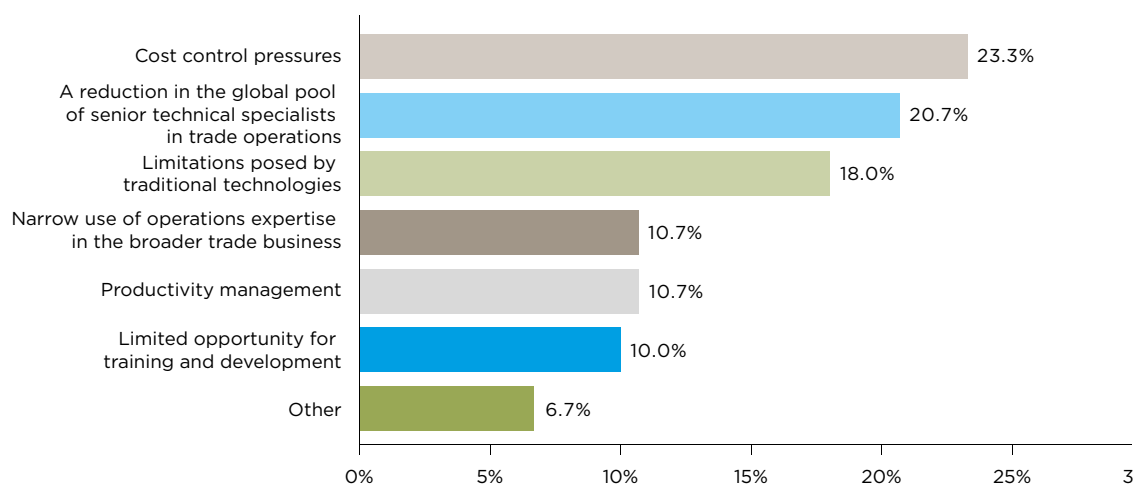
The work of the Academy, as well as the significant efforts of various multilateral development banks through their trade finance programs and related technical assistance initiatives combine well to begin to address this existential challenge to the effective financing of international trade, however, industry leaders and leading providers of trade finance and SCF must take ownership of this issue, and must invest appropriately in attracting, developing and retaining a next generation of trade financiers, including those with transactional and processing skillsets.

The pressure to control costs received the greatest attention



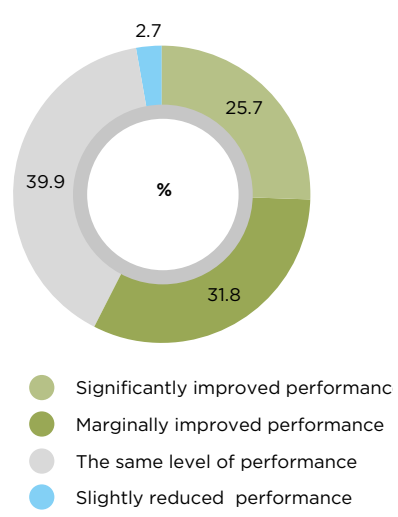


**Figure 35: Single biggest challenge facing trade finance operations units today**



Source: ICC Global Survey on Trade Finance 2017

**Figure 36: Performance in terms of operational risk and error rates compared to last year**



Source: ICC Global Survey on Trade Finance 2017

On an importantly positive note, over 57% of respondents reported marginal to significant improvement in operational performance, as relates to error rates and operational risk (Figure 36). Nearly 40% reported consistent performance year-on-year, and only 2.7% noted a slight deterioration in performance results related to these key operational factors.

While industry-wide data linked to operational risk does not currently exist, the Banking Commission is in discussions with members of the Trade Register Project, to supplement credit risk and default data collection with a parallel exercise aimed at shedding light on operational risk characteristics of global trade finance.

Operations management practice in banking and in trade finance in particular has evolved materially over the past several years, with detailed management dashboards and reporting capabilities aimed at tracking processing times against client service level agreements, throughput and other typical operational Key Performance Indicators. At the same time, increasingly stringent regulatory oversight and issues of reputational risk are combining to prompt trade finance units to track operational risk.

The increasing application of technology with direct impact on transaction processing, for example, automated document preparation services, have reduced rates of discrepancy and non-compliance of documents presented for payment by exporters, and have as a direct outcome, reduced operational risk.

With leading providers of trade finance investing in further technology aimed at increasing efficiency, and cost-effectiveness, and at reducing error rates, the results linked to this question may continue to show improvement despite persistent resourcing challenges. The use of

Optical Character Recognition or assessing the application of artificial intelligence to the document verification process, the nature and focus of operational units may face significant transformation in the next two to three years.

Despite these developments, operations executives and senior trade finance leaders ought to keep in focus the value of and continuing need for technical expertise in the mechanics of traditional trade finance products, including skills linked to managing or mitigating operational risk. One lesson arising from the global financial crisis in the trade space, was the critical need to re-integrate risk mitigation into SCF techniques aimed at addressing open account trade flows – in this context, the lessons and insights of specialists in traditional trade finance can continue to prove valuable even as a new set of value propositions is devised by the industry.

### Trade finance clients

46% of respondents identified multinational and large corporate clients as the highest priority client segment for their trade finance business, with a quarter of respondents favouring middle market clients and less than 20% identifying micro, SMEs as the highest priority (Figure 37).

This breakdown is largely consistent with the historical priorities of banks and of trade finance units, however, certain developments that may impact this perspective are worth noting.

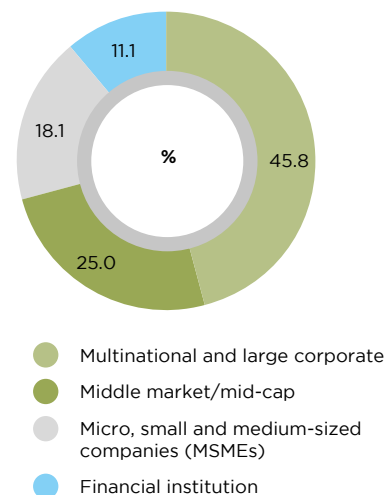
The post-crisis environment led to an unprecedented situation, where corporate clients, particularly large multinationals, were actively exiting and consolidating bank relationships and concurrently exercising market power to drive down pricing and margins. This dynamic motivated banks – and trade finance units – to focus ‘down-market’ in pursuit of client in the mid-market and SME segments, with references to a ‘mid-market sweet spot’ and the underappreciated importance of SMEs mentioned with increasing frequency.

Competition for the attention of multinational corporations (MNCs) will continue to be challenging, with relatively few global providers of trade finance able to provide comprehensive, far-reaching solutions to cross-border needs, and even collaborative propositions between banks often tested in their ability to fully meet expectations of MNC clients. Margin compression at the top end of the market will likely continue for the foreseeable future and political and social pressure on banks to better service SMEs will likewise remain a feature of the landscape.

The needs of commercial and midcap clients may merit greater analysis and understanding – accounting for the reality that the definition of a medium-sized enterprise or a midcap can vary significantly across markets and may even reach annual turnovers in the range of USD 1 billion.

Aside from political demands and pressures linked to societal expectations and reputational standing, another factor may lead providers of trade finance to reconsider this classic segmentation model, and their focus and priorities within that framework.

**Figure 37: Client segment as highest priority to the bank**



Source: ICC Global Survey on Trade Finance 2017

The shift from the historical one-buyer, one-seller view of trade, to a supply chain, ecosystem view of cross-border commerce, and considerations about the importance of strategic suppliers, and the overall health and sustainability of a supply chain, may render the discrete, segment view of trade clients irrelevant, or at least, reduce its influence in determining business development and retention priorities.

Current market conditions characterised by a mismatch in the need for and deployment of liquidity across client segments is symptomatic of a fundamental strategic decision to be taken by senior leaders in trade finance.

While limited focus is shown on financial institution clients in this response, it must be noted that correspondent banking units tend to manage financial institutions relationships and those units are often separate from trade finance groups. Additionally, compliance and reputational risk based consolidations in correspondent relationships may contribute to the ranking of this segment in the current iteration of this survey and report.

Client priorities in terms of needs and expectations, as reflected through the views of survey respondents, support certain commonly recognised and frequently repeated requirements, but also hold a couple of surprising findings.

The push for favourable (likely best understood to mean “lower”) pricing continues, reinforcing a trend of ‘commoditisation’ of trade finance, where competition among providers involves an unsustainable race to the bottom on pricing, and commensurate margin compression and cost control pressures. 30% of respondents noted a desire for favourable pricing as a matter of priority.

Traditional trade finance has been in a commoditisation downward spiral for some years, and SCF propositions – even the newest ones – are already showing signs of heading down the same path.

Challenging as it may be, particularly with banks earning large incomes perceived to be excessive, senior leaders in trade finance ought to consider redefining the dialogue around trade finance, from a price-based discussion to a value-based dialogue and pricing model.

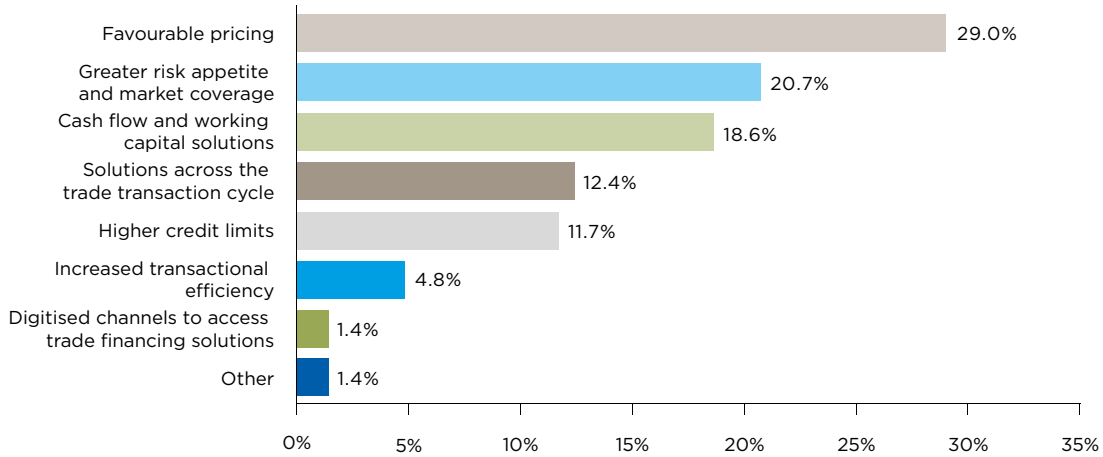
Trade finance, even the relatively stagnant traditional trade finance business, is not merely about a transfer of funds around the world (already a valuable service); it is about enabling the secure and successful conduct of trade across a wide range of political, economic and security conditions around the world.

Trade financing is about opening access to a new market with a new trading relationship, on the basis of competitively priced financing and when necessary, on a largely risk-mitigated basis.

SCF, likewise, can provide material benefits to a buyer, supplier or a significant subset of a complex global supply chain, depending on the SCF technique utilised and the scope of the program deployed. A value-based discussion with clients and their trading counterparties ought to be the norm, rather than the exception, and should lead clients to seek additional value rather than to reflexively default to requests for lower pricing.



**Figure 38: Service most often requested by clients in 2016**



Source: ICC Global Survey on Trade Finance 2017

It is notable that clients continue to request greater market coverage, and higher risk appetite from their trade financiers, even as survey respondents suggested in an earlier query, that expansion of market coverage was not a particularly high priority at the time of completion of the survey (Figure 38). Also notably, while practitioners have acknowledged transaction processing timelines that impact client cash flow and working capital, and fail to keep pace with logistics and the delivery of goods, less than 5% of respondents pointed to transactional efficiency improvement as a client priority.

Similarly, it appears that the development of digital access channels for trade financing is currently not a high priority for clients, according to survey respondents. This finding, together with the earlier observation that business practice has not kept up with technology, suggests that trade finance businesses may have a bit of time to develop access channels in advance of client demand.

As noted earlier, digitisation of trade is clearly advancing, and trade finance must likewise evolve into digital form. Accordingly, channels to access trade financing must evolve to align with broader developments in trade and trade financing.

The 2016 survey revealed that over 65% of respondents had seen no change in the refusal rate for refusal of documents on first presentation, with 15.8% seeing an increase and 18.7% a decrease (Figure 39). The 2017 figures display a positive trend in the right direction with a lower percentage of 12.3% seeing an increase and a higher percentage of 26.7% reporting a decrease. However, as seen in the recent ICC review of UCP 600, there is no doubt that greater market understanding of the instrument, and guidance on surrounding practices, could lead to an even greater improvement.

Such positivity is not entirely reflected in the issue of questionable/spurious discrepancies under documentary credit presentations with 21.9% of respondents reporting an increase in the trend as opposed to 18.5% in 2016. However, 21.3% report a decrease against 20.6% in 2016.



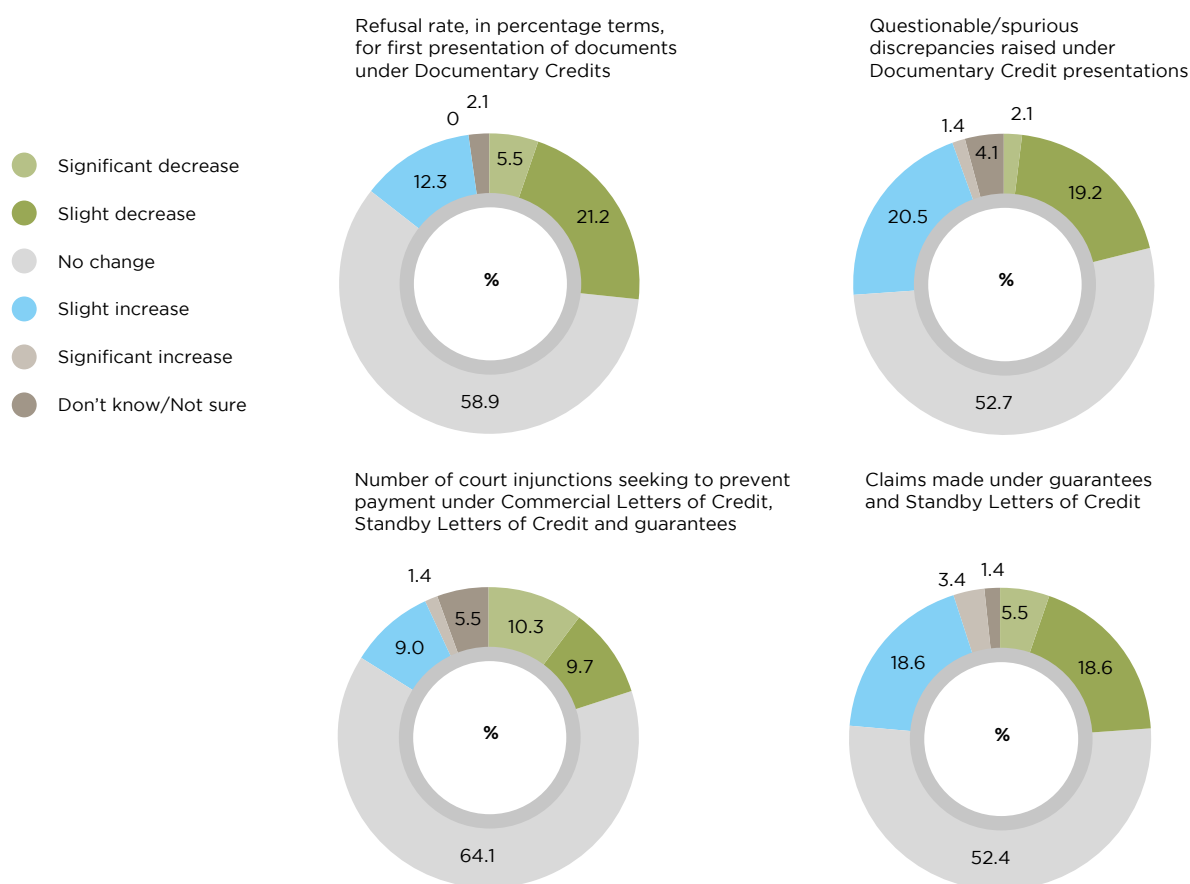


Continuing focus by the ICC, and others, in enhancing knowledge of international standard banking practice must continue apace to improve these percentages.

With regard to claims made under Guarantees and Standby LC's, 24.1% report a decrease as opposed to 21.5% in 2016. This is a positive move and is further reflected in the fact that 22% of respondents reported an increase, fairly similar to the 2016 figure of 21.5%.

The most positive trend can be seen in the number of court injunctions that have been raised in order to prevent payment under traditional trade instruments. Whilst only 8.8% reported a decrease in 2016, this has dramatically risen to 20% in 2017. Equally welcome is the fact that only 10.4% reported an increase compared to 12.9% in 2016. As stated in the 2016 report, the fundamental nature and value of bank guarantees and standby letters of credit rests in the reality that these instruments represent trusted, independent and generally ironclad undertakings to effect payment, in the event that some financial or performance obligation is not met. Therefore, the current trend in reduced court injunctions correctly reflects both the intent and the value of these instruments.

**Figure 39: Trends in refusal rates, claims, discrepancies, court injunctions during 2016**



Source: ICC Global Survey on Trade Finance 2017



# SWIFT trade finance traffic – 2016 statistics

SWIFT

## Author

Huny Garg, Head of Trade and Supply Chain, SWIFT

## Key findings

- In 2016, SWIFT trade finance message volumes have shown a decrease of 4.72% (slightly less than last year's decrease of 4.99%). This trend is underlined by the decrease in category 7 messages by 3.62% and by 8.64% in category 4 messages.
- Asia-Pacific continues to register far greater volumes of MT 700 with a 73% share for imports and a 77% share for exports of the world traffic in 2016.
- Countries that imported the most using L/Cs transmitted through SWIFT are: South Korea, Bangladesh, China, India, and Hong Kong.
- Countries that exported the most on the basis of export L/Cs received through SWIFT are: China, Hong Kong, India, Singapore, and Japan.
- Iran shows the highest annual increase in import L/C traffic compared to 2016, with an increase of over 70% while Vietnam shows the highest annual increase in export-related message volumes which is 7% respectively.
- Algeria shows the highest annual decrease in import L/C traffic 26% while Japan shows the highest annual decrease in export messaging, at more than 13%.
- The average value of an L/C (MT 700 only, amount converted to USD) in 2015 was USD 350,000 whilst in 2016, it increased to USD 463,000.



## Definitions

### Category 7 messages:

Flows for commercial and standby letters of credit and guarantees. MT 700 is in this category.

**Category 4 messages:** Flows for documentary collections, excluding the three least commonly used "cash letter" messages.

**MT 700:** 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.

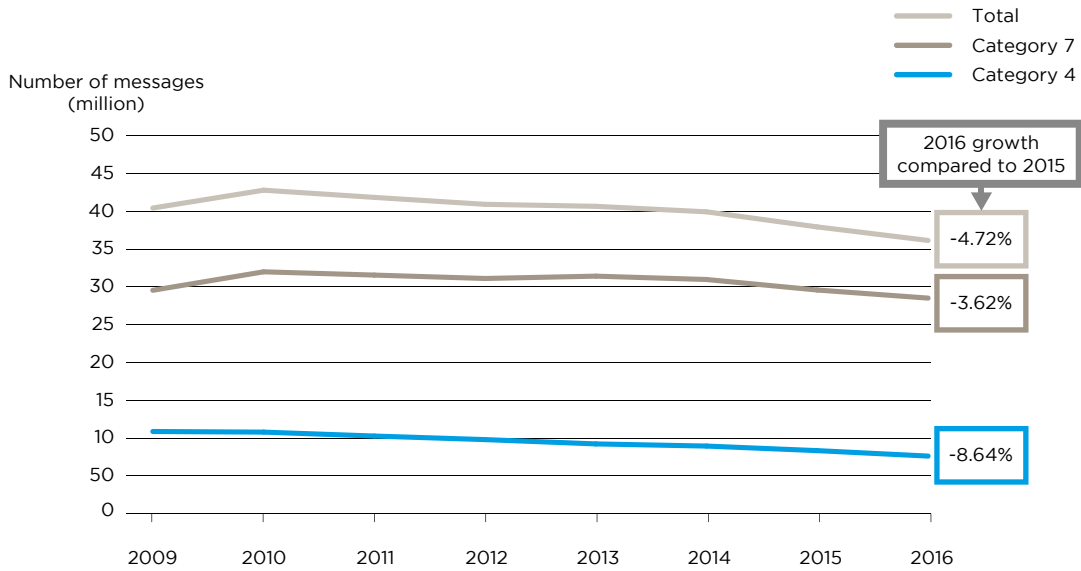
## Global trends

Before considering SWIFT trade finance volume statistics and related comments, their context should be understood. SWIFT trade finance traffic is a good indication of the overall usage trends for the Letter of Credit (L/C) product, since we assume that around 90% of the L/C transactions go via SWIFT.

## Trade finance traffic falls for the sixth year

In 2016, the SWIFT trade finance volumes show a decrease of 4.72% (lower than last year decrease of 4.99%). This trend is underlined by the decrease in category 7 (Documentary Credits and Guarantees) by 3.62% and by 8.64% in category 4 (Documentary Collections).

**Figure 40: SWIFT trade traffic worldwide**



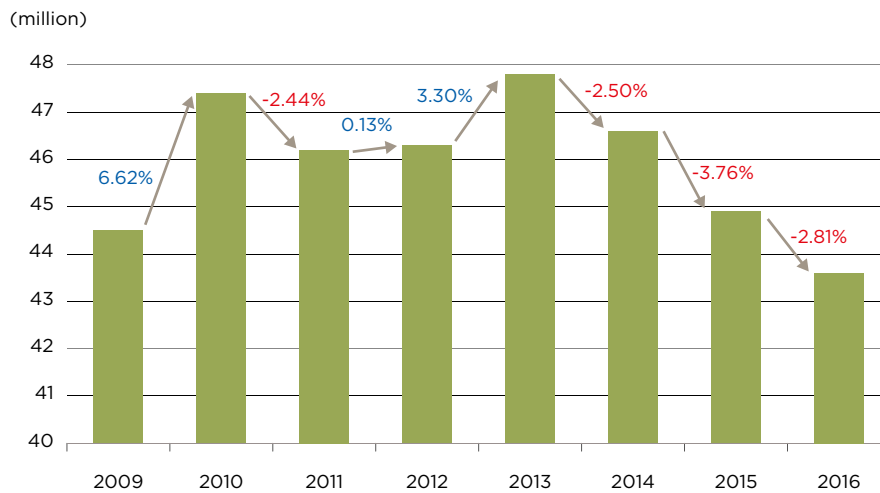
Source: SWIFT Watch

Whilst category 4 represented 27% of total trade finance traffic in 2009, this fell to 22% in 2016. since we assume that around 90% of the L/C transactions go via SWIFT.

**Volume of L/Cs on SWIFT**

In 2016, the volume of MT 700s (L/Cs or Issue of a Documentary Credit) shows the third consecutive yearly fall although the percentage decrease of 2.81% is the lowest since 2010.

**Figure 41: Volume of MT 700s, 2009-2016**



Source: SWIFT Watch

Asia-Pacific continues to register far greater volumes for sent (import) MT 700s with 73% of the world traffic in 2016. It is followed by Europe - Eurozone (7%) and Middle East (7%).

SWIFT trade finance traffic decreased in all regions in 2016 compared to 2015. The region that shows the highest annual decrease is Africa with 12.99%, followed by Central & Latin America with 8.34%.

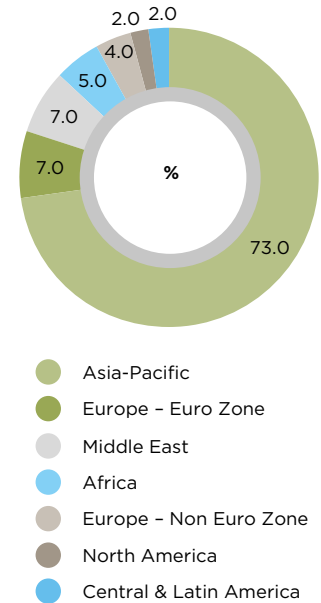
### Top importing countries

Looking at the cross-border (excluding domestic flows) volume of MT 700s sent in 2016 (import) per country, the countries that issued the most import L/Cs are shown above opposite in Figure 44.

For countries with a yearly volume higher than 10,000 MT 700s sent internationally (import), middle opposite in Figure 45 are the countries with the highest growth in 2016 compared to 2015.

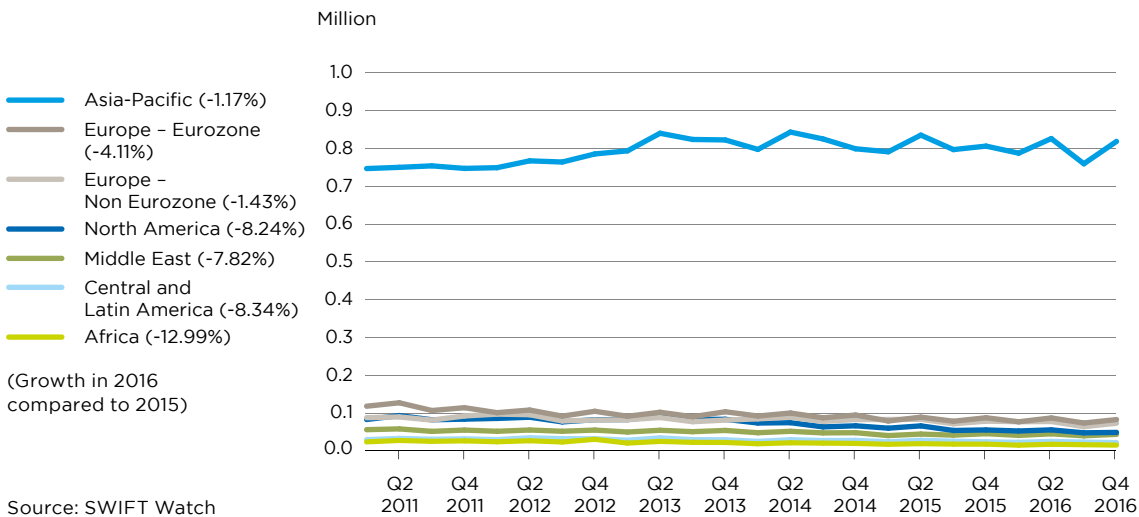
For countries with a yearly volume higher than 10,000 MT 700s sent internationally (import), bottom opposite in Figure 46 are the countries with the highest decrease in 2016 compared to 2015.

**Figure 42: Import Traffic**



Source: SWIFT Watch

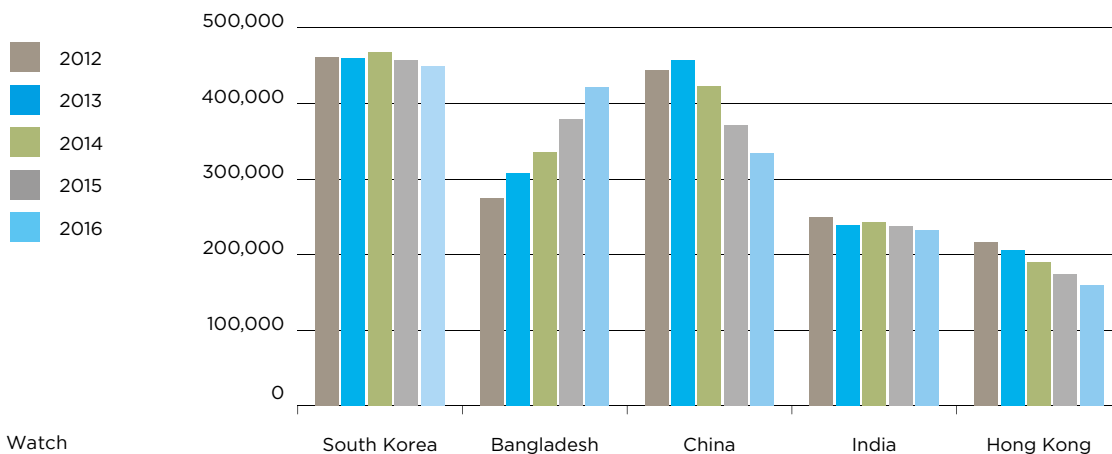
**Figure 43: MT 700s sent, 2011-2016**



Source: SWIFT Watch

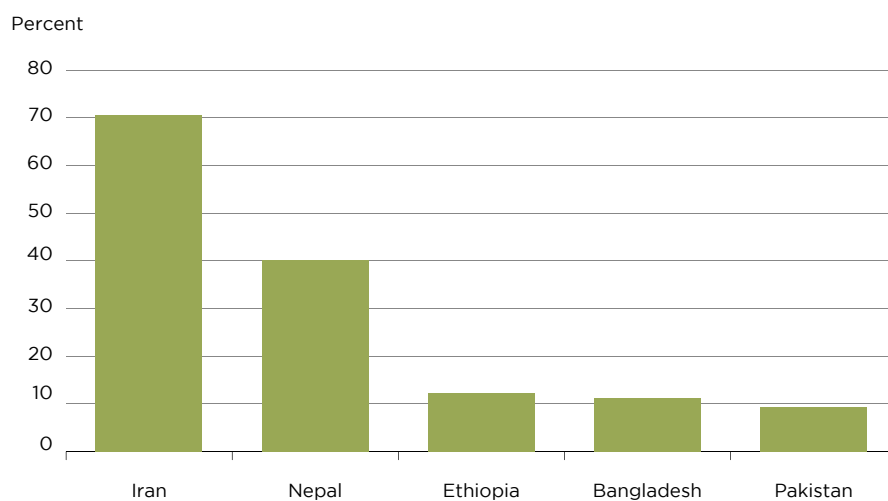


**Figure 44: Top 5 importing countries**



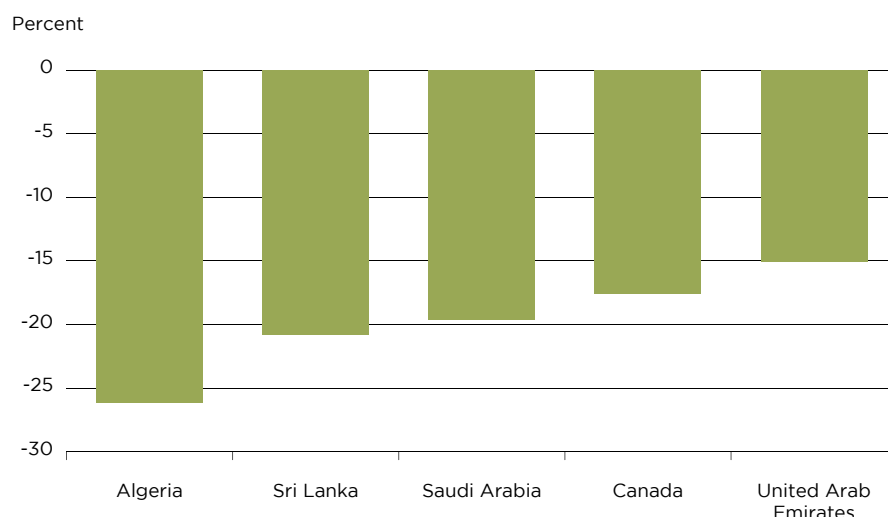
Source: SWIFT Watch

**Figure 45: Top 5 importers with the highest growth**



Source: SWIFT Watch

**Figure 46: Top 5 importers with the largest decrease**



Source: SWIFT Watch

## SWIFT regional analysis – export using L/Cs

Asia-Pacific continues to register far greater volumes for received (export) MT 700s with 77% of the world traffic in 2016. It is followed by Europe – Euro Zone (9%) and Europe – Non Euro Zone (4%).

Looking at the annual figures, there is no sign of growth in 2016 for export traffic compared to 2015. The region that shows the highest annual decrease is Central & Latin America with 9.44% in 2016 for export traffic compared to 2015, followed by Africa (-8.39%) and Europe-Euro Zone (-7.56%).

## Top exporting countries

Looking at the cross-border (excluding domestic flows) volume of MT 700s received in 2016 (export) per country, the countries that received the most export L/Cs are shown above opposite in Figure 49.

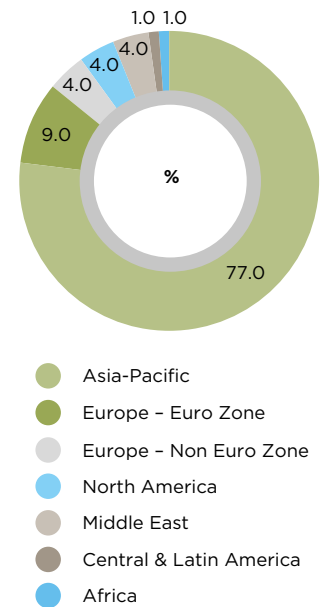
For countries with a yearly volume higher than 10,000 MT 700s received internationally (export), shown opposite middle in Figure 50 are the countries with the highest growth in 2016 compared to 2015.

For countries with a yearly volume higher than 10,000 MT 700s received internationally (export), shown opposite bottom in Figure 51 are the countries with the highest decrease in 2016 compared to 2015.

## Average value of a L/C is USD 463,000

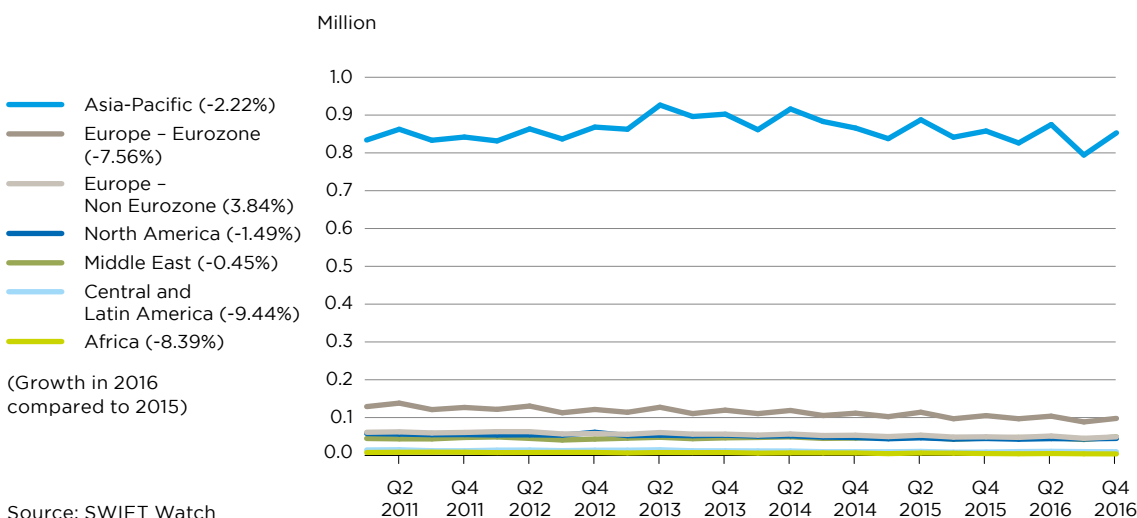
The average value of a Letter of Credit (MT 700 only, amount converted to US dollar – USD) in 2015 was USD 350,000. However, in 2016, the average value has increased substantially by 32% and reached an average value of USD 463,000.

Figure 47: Export Traffic



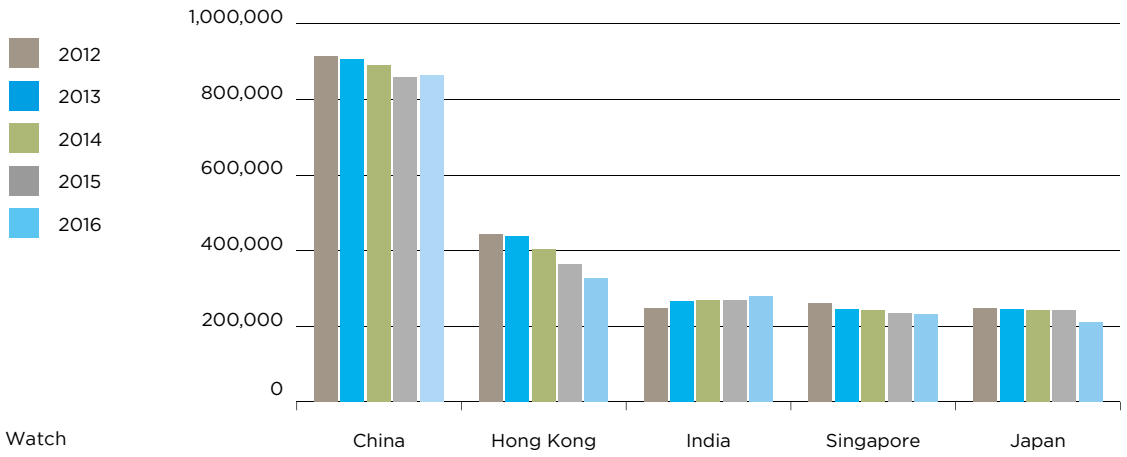
Source: SWIFT Watch

Figure 48: MT 700 received, 2011-2016



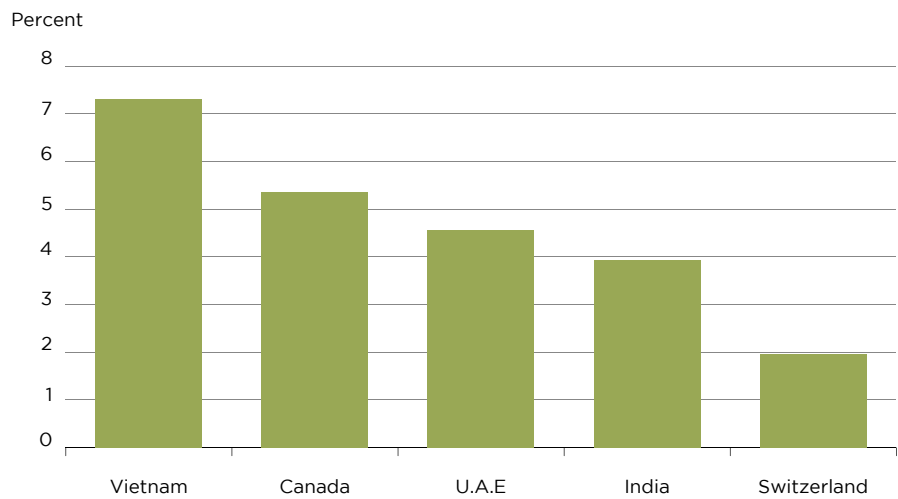
Source: SWIFT Watch

**Figure 49: Top 5 exporting countries**



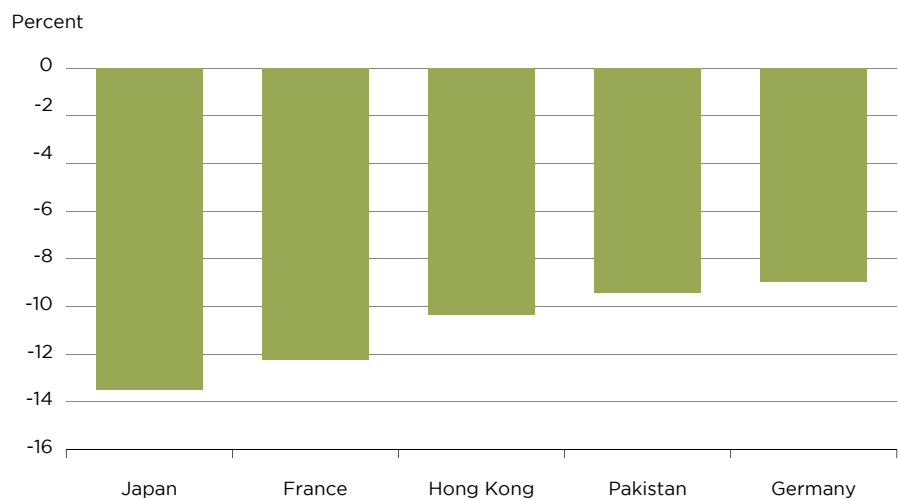
Source: SWIFT Watch

**Figure 50: Top 5 exporters with highest growth**



Source: SWIFT Watch

**Figure 51: Top 5 exporters with largest decrease**



Source: SWIFT Watch

In 2016, the USD is the currency used for 83.03% of the MT 700 messages, with the number of MT 700s being equivalent to the volume of L/Cs issued. The euro (EUR) is used for 8.94% of the L/Cs issued as measured by volume.

In 2016, the USD is the currency that represents 81.95% of the total value (converted to USD) of L/Cs issued via SWIFT. The euro represents 7.47% and Chinese Yuan or Renminbi (CNY or RMB) represents 5.12% of the total value.

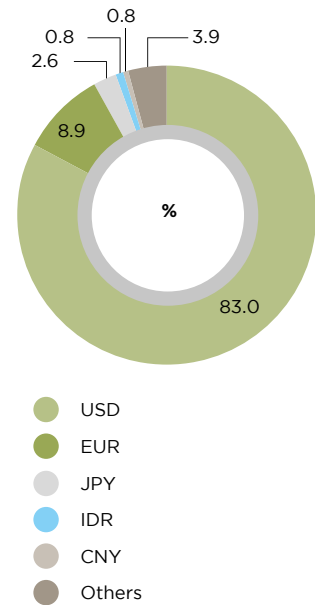
### Asia-Pacific issues most Letters of Credit for imports

The highest number of L/Cs is issued by Asia-Pacific with more than 3 million MT 700s. Most of the traffic is intra-regional. Asia-Pacific is using this instrument much more than any other regions.

### Asia-Pacific lead export L/Cs

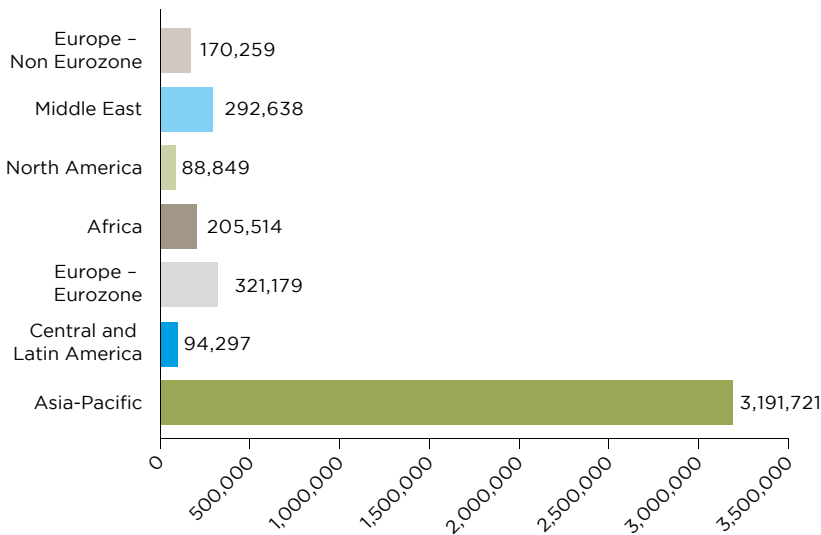
The highest number of L/Cs is received by Asia-Pacific with around 3 million MT 700s. Most of the Asia-Pacific traffic is intra-regional. Asia-Pacific is using this instrument, much more than any other region. The average value of an L/C in this region is low (USD 360,000 for exports).

Figure 52: Volume of L/Cs



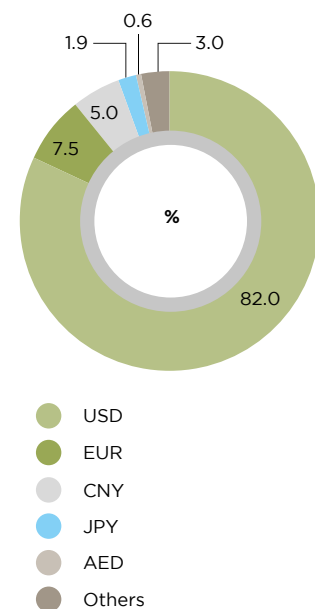
Source: SWIFT Watch

Figure 54: Volume of L/Cs sent by regions



Source: SWIFT Watch

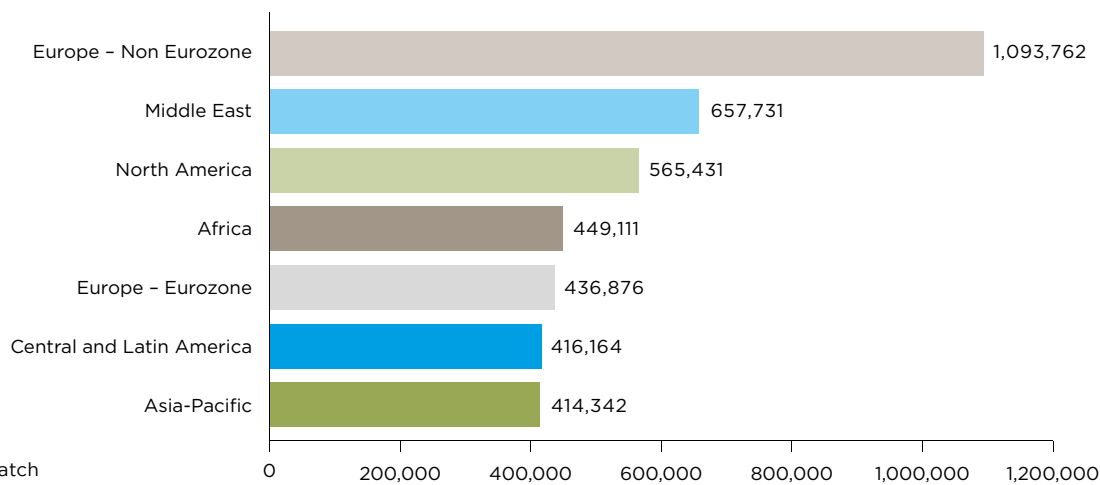
Figure 53: Amount of the L/Cs (converted to USD)



Source: SWIFT Watch

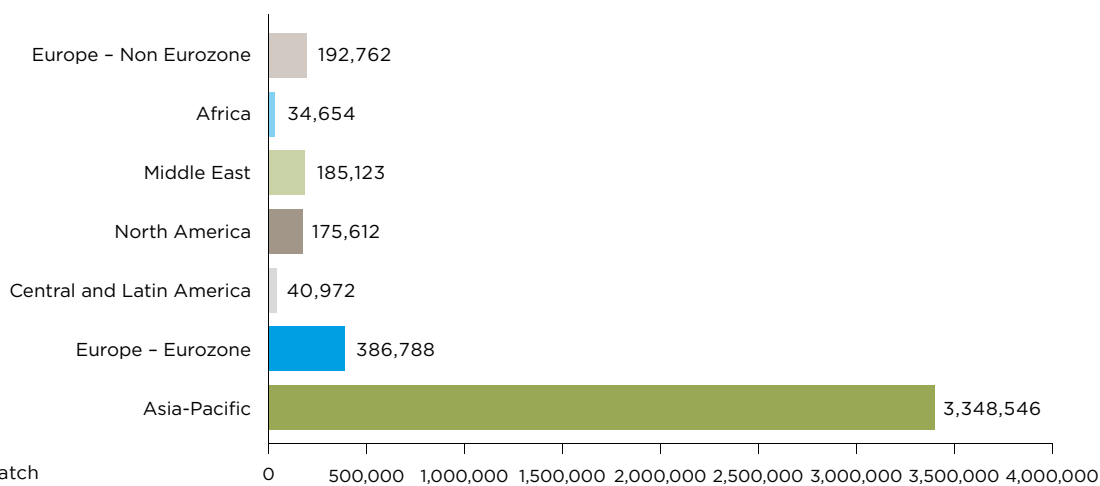


**Figure 55: Average value of L/Cs sent by regions (converted to USD)**



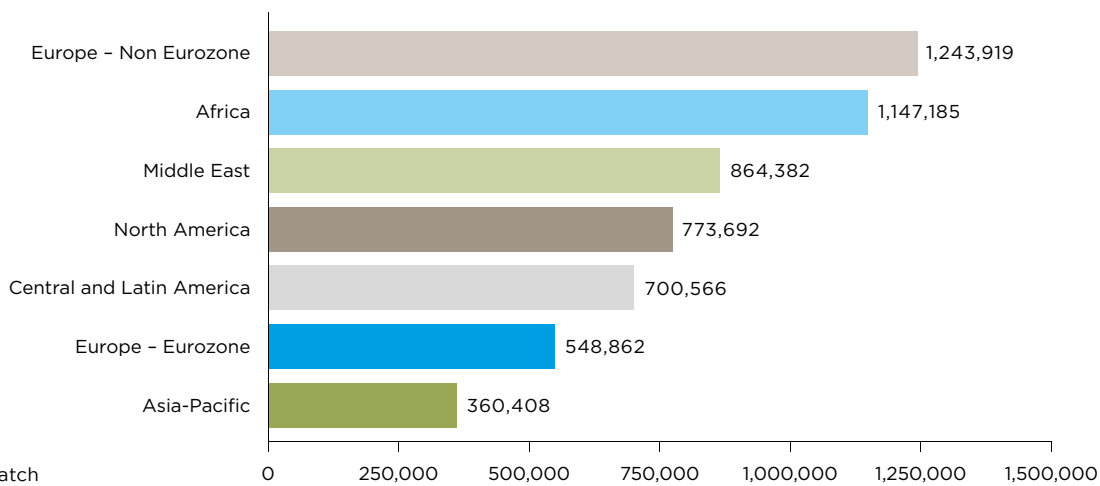
Source: SWIFT Watch

**Figure 56: Volume of L/Cs received by regions**



Source: SWIFT Watch

**Figure 57: Average value of L/Cs received by regions (converted to USD)**



Source: SWIFT Watch

### The use of confirmed L/Cs has decreased

The share of L/Cs confirmed fell by 0.4% in 2016 as opposed to 2015. L/C's issued in Africa continued to receive the highest percentage of confirmations in comparison to Asia Pacific which had the lowest

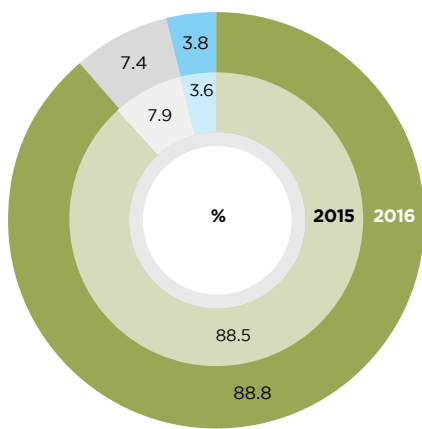
### L/Cs Available by negotiation are preferred in most regions

The majority of L/Cs are made available by negotiation, increasing the share by 0.5% in 2016 compared to 2015 (reaching 73%). Regionally, negotiation credit accounts for 78% of trade in Asia-Pacific, 80% in North America and there are high shares in all other regions but Africa.

### Average L/C tenor is about 60 days

40% of L/Cs have a tenor of between 31 and 60 days, followed by 33% being between 61 and 90 days.

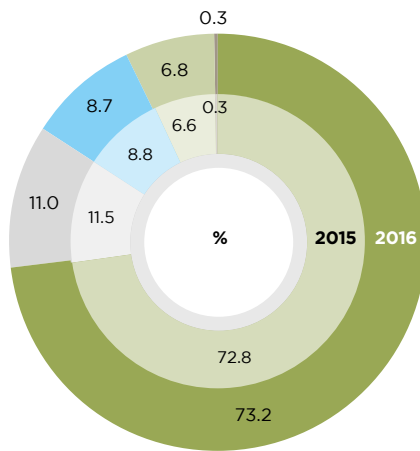
**Figure 58: Confirmation of letters of credit by volume, 2016**



- Without
- Confirm
- May add

Source: SWIFT Watch

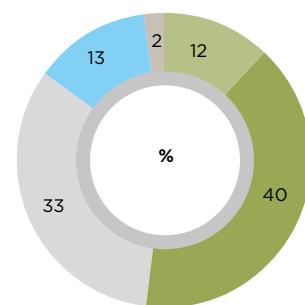
**Figure 60: Volume of L/Cs received by availability combination, 2016**



- Negotiation
- Payment
- Deferred payment
- Acceptance
- Mix payment

Source: SWIFT Watch

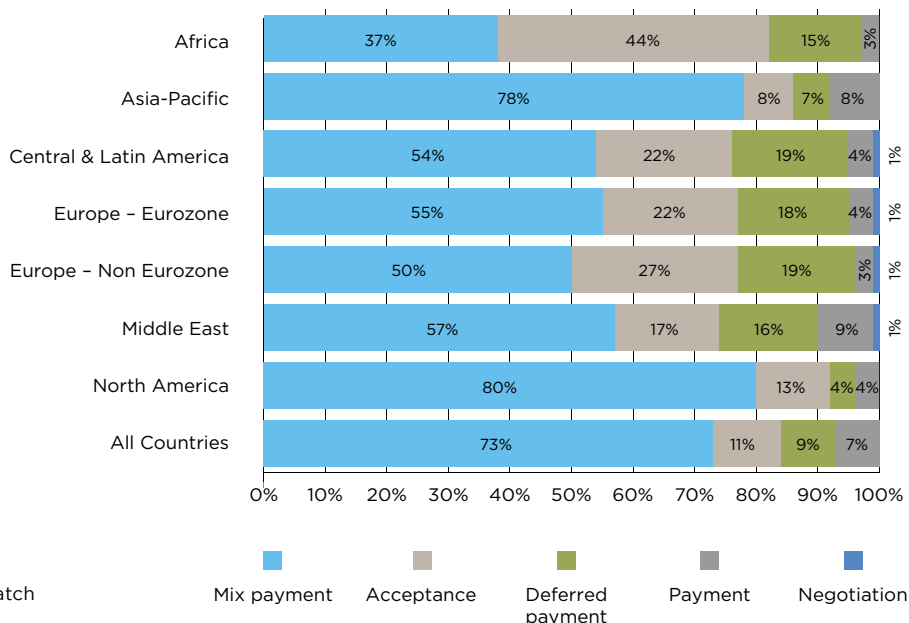
**Figure 62: Percent distribution of L/Cs by tenor, 2016**



- 0-30 days
- 31-60 days
- 61-90 days
- 91-180 days
- >180 days

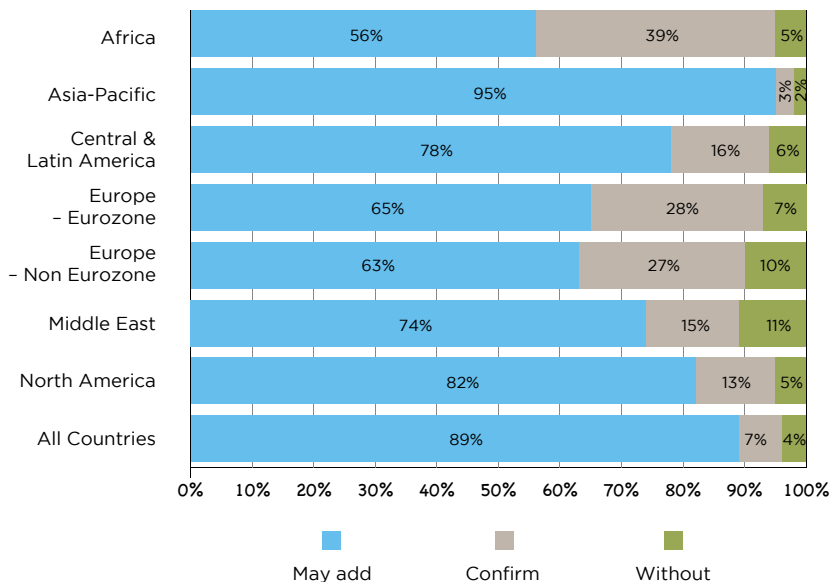
Source: SWIFT Watch

**Figure 61: Percent distribution of L/Cs received by availability combination, 2016**



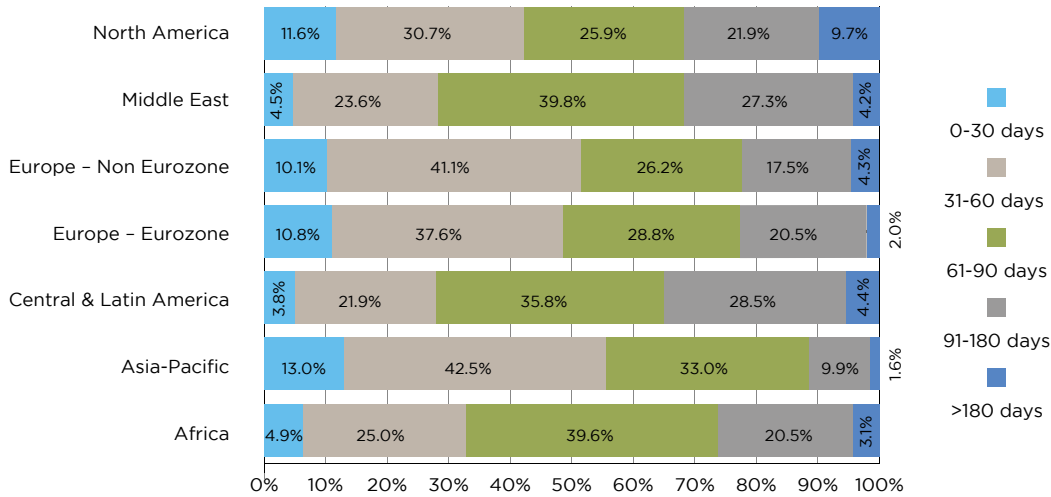
Source: SWIFT Watch

**Figure 59: Confirmation of Letters of Credit, by region, 2016**



Source: SWIFT Watch

**Figure 63: Volume of L/Cs received by tenor per region, 2016**



Source: SWIFT Watch

40% of L/Cs have a tenor of between 31 and 60 days, followed by 33% being between 61 and 90 days.



**-4.72%**

**Decline in SWIFT trade finance message volumes**



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Because financial institutions have multiple means of exchanging information about their financial transactions, SWIFT messages flows do not represent complete market or industry statistics. SWIFT disclaims all liability for any decisions based, in full or in part, on SWIFT statistics, and for their consequences





## Editorial Comment: selected strategic and tactical implications

### Strategic implications

SWIFT statistics provide a highly informative and critically important view of trade activity and of the use of particular instruments and features on a global level, and by region and market. The 2017 edition of SWIFT data overall has tended to support market observations and perceptions articulated by practitioners and commentators, and has, at the macro level, tended to tell a consistent story about the state of traditional trade finance year-on-year.

The Asia Pacific Region accounts for the highest volume of SWIFT traffic by far, about 75% of the average of import and export message traffic, and continues to account for the highest volumes of export L/C traffic specifically, reinforcing the view that the region remains a key anchor in international supply chains. The SWIFT data further reflects the very high rates of intra-Asia message traffic, again supporting the widely-held view that there is a clear gravitational pull to Asia in terms of economic critical mass and trade-based growth.

Vietnam, now clearly an emerging export economy, shows the highest annual increase in export L/C volumes, whilst Iran, as a result of a change in geopolitics and market access, reflected a 70% increase in import L/C volumes.

Africa, touted as a high-potential region for economic and trade growth, shows a notable decrease in SWIFT traffic, which may be partly the result of uptick in open account-based trade activity, and perhaps partly the result of reduced commodity trade, but merits further analysis.

Strategically, for SMEs, corporates and banks, the foregoing figures support and are in line with market analysis and expectations in terms of trade activity and key centers of cross-border commerce.

Despite a general view that global risk conditions may have worsened over all, it is notable that the rate of L/C confirmations is down year-on-year, this in contrast to separate reports of robust risk insurance activity in the trade space. This may suggest an opportunity to raise market awareness about the value and benefits of this form of risk mitigation, and may likewise imply greater opportunity to diversify risk through export credit agencies (ECA)-insured confirmed credits, and/or to create greater trade financing capacity by increasing IFI-backed confirmation of local (developing market) L/Cs.

### Tactical considerations

SWIFT data provides an objective view of trade activity using message traffic as a proxy indicator for trade flows and trade-related transactional activity. The tactical opportunity is for trade financiers, risk insurers and market stakeholders to undertake assessment of elements of direct interest to business priorities and target markets.

The flat to downward trend in the use of traditional trade finance instruments (Documentary Credits and Documentary Collections) clearly continues, but commercially interesting insights can be gleaned around the relative importance of top-ranked trade currencies (with the USD still very much dominating, thus US dollar liquidity likely to remain an issue).



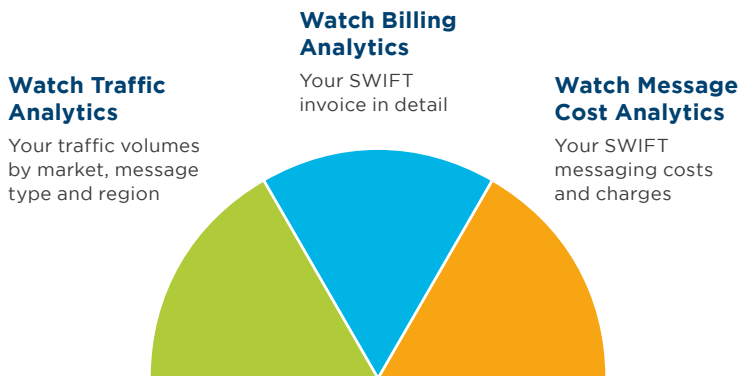
# Business intelligence

## THE SWIFT PORTFOLIO

When each business decision is crucial, business analytics, insights, BI Services and economic indicators can arm you with objective and detailed data to help you make the best decisions for your business.

### WATCH TRAFFIC

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

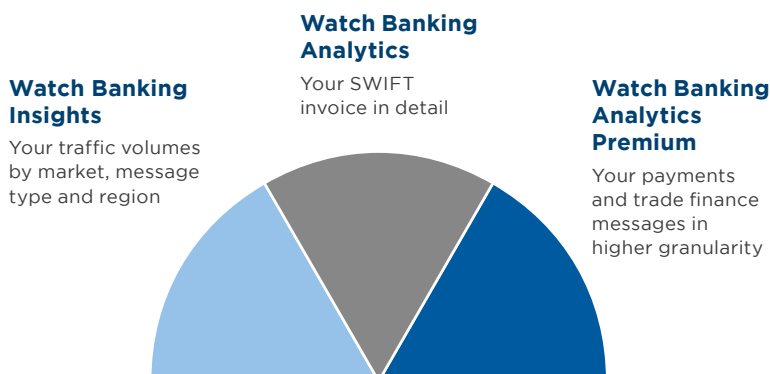


#### Features

- Market trends and analysis of traffic flows
- Drill down into messaging costs
- Efficiency and quality gains
- Comprehensive billing data

### 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.



#### Features

- Analyse your currency flows
- Identify intermediated flows
- Market intelligence and peer benchmarking
- Discover new market opportunities

## 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



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

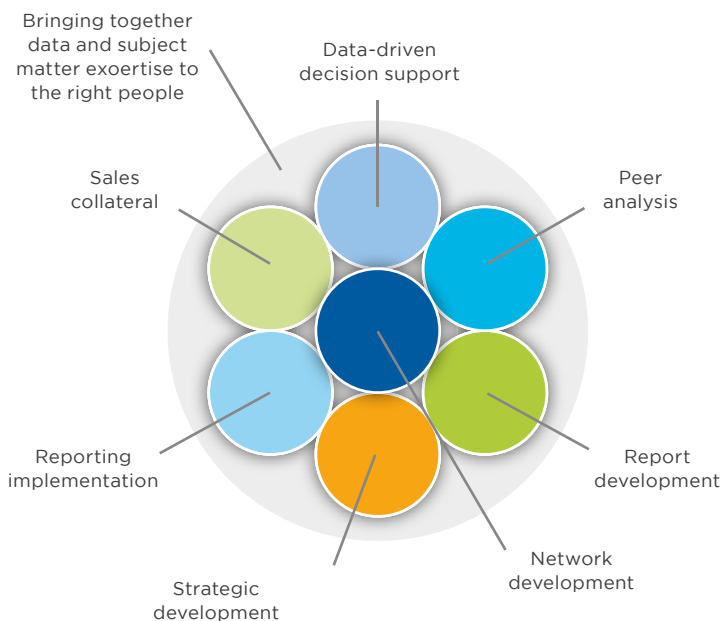


### Features

- Visual, unique data for faster decision making
- Insights in to your activity share
- Easy-to-use, interactive visual
- Market intelligence and benchmarking

## 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.



### Features

- Customised insights
- New fields and more data granularity
- Benchmarking against peers
- Direct access to subject matter experts



# Analysis of global trade finance gaps

ASIAN DEVELOPMENT BANK

## Key findings

- 61% of surveyed banks perceive that there is more demand than supply for trade finance.
- Almost half of responding banks indicate compliance with KYC and AML requirements and lack of collateral as main reasons for rejecting trade finance transactions.
- Developing Asia (excluding China and India) faces more challenging trade finance market conditions.
- Financial technology may help banks save costs and expand availability of trade finance.

### Author

Kijin Kim, Economist, ADB; Alisa Di Caprio, Research Fellow, ADBI; Steven Beck, Head of Trade Finance, ADB

Finance is critical to trade. However, access to trade finance, especially for small exporters, remains a perennial issue and measuring the gap between demand and supply of trade finance is an important challenge.

Against this backdrop, the ADB has been conducting analysis since 2013 as part of a comprehensive effort to quantify global trade finance gaps and their impact on economic growth and jobs. In collaboration with the ICC, this section aims to provide an overview of 2016 trends in bank-intermediated trade finance to gain a better understanding of market gaps, why they exist and how to address them.

A more in-depth report on gaps and their impact on growth and jobs will be released by the ADB in September subsequent to the publication of the ICC “Rethinking Trade and Finance” report.

## Demand for trade finance

Western Europe, China and Advanced Asia account for 45% of the global demand for trade finance. Within Asia, China continued to show the largest share (15%) in the global value of trade finance transactions. A group of advanced Asian countries (Hong Kong, Japan, Korea, and Singapore) follows accounting for 12% of total global demand.

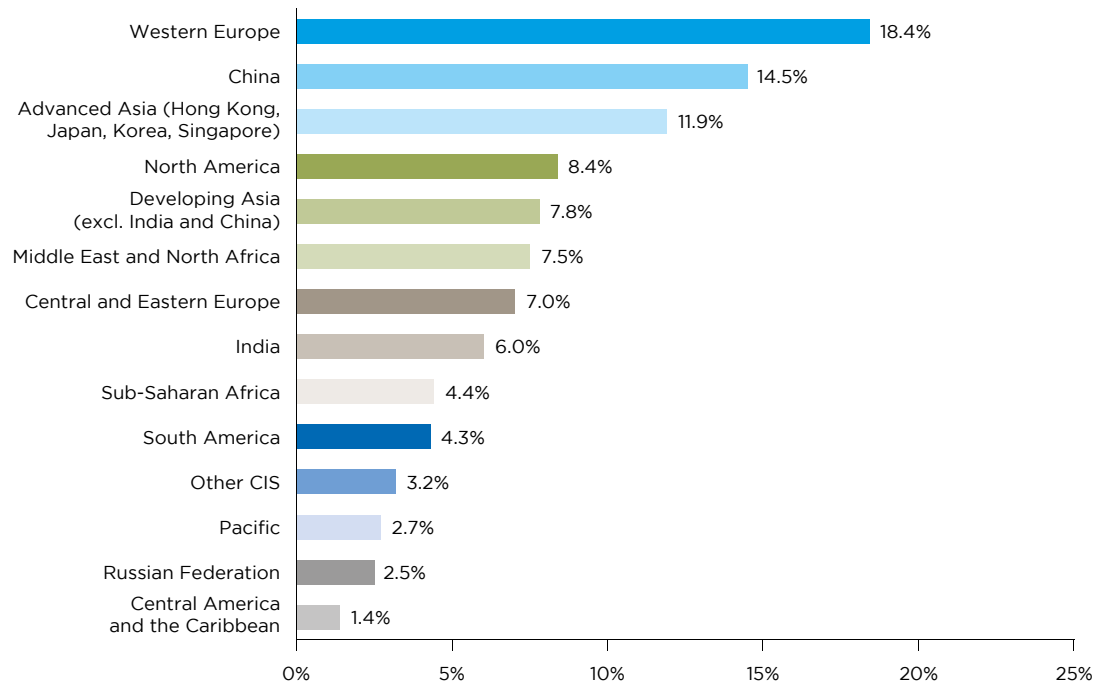
A breakdown of proposed bank intermediated trade finance transaction by type shows that commercial letters of credit (41%) is the most common way of financing trade, followed by guarantees (22%), collections (19%), supply chain finance (11%), and standby letters of credit (7%). However, the proportion of rejected out of proposed transactions shows a different pattern: the highest is supply chain finance (16%), followed by commercial letters of credit (12%), guarantees (12%), standby letters of credit (10%), and collections (5%).

**61%**

**Banks perceiving that there is more demand than supply of trade finance**



**Figure 64: Breakdown of proposed trade finance transactions by region (% of global value of transactions)**



Source: ICC Global Survey on Trade Finance 2017

## Access to trade finance for small exporters remains a perennial issue



### Trade finance availability

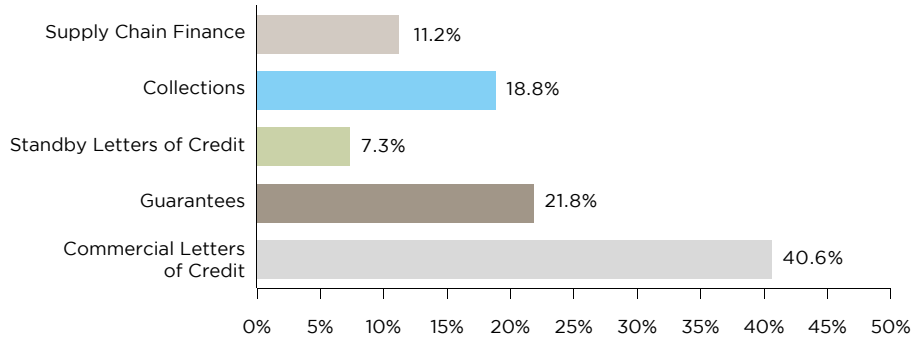
Compared to the previous year, there is little change in the perception of banks about a shortage of trade finance. 61% of survey respondents perceive that there is more demand than supply for trade finance.

A significant decrease in trade credit lines was reported more by smaller firms and smaller financial institutions (5% –7%).

The proportion of rejected trade finance proposals shows a wide range of variation by region. The highest rejection rates are reported in “other Commonwealth of Independent States (CIS)”, followed closely by the Russian Federation, the Middle East and North Africa, and sub-Saharan Africa. Western Europe, China, and Advanced Asia posted the lowest rates of rejection. This finding is mostly in line with the previous year’s survey.

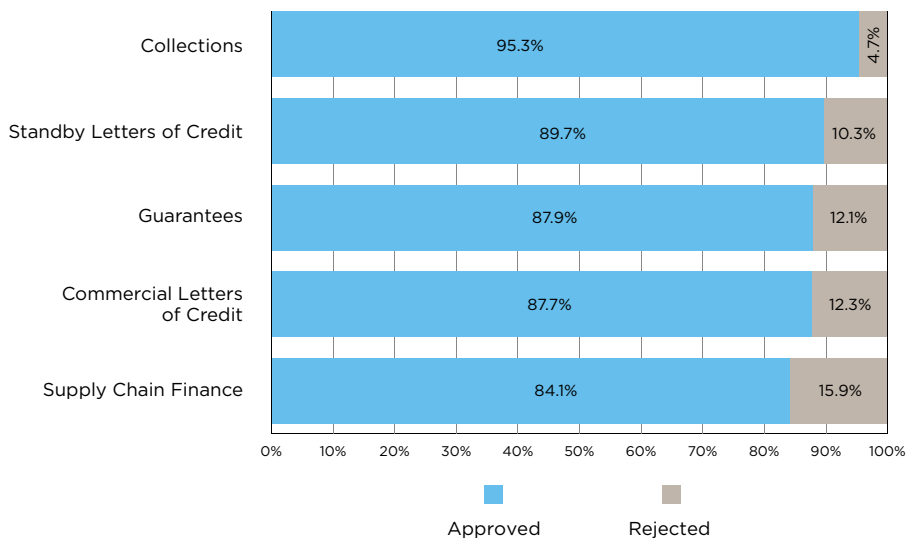
The survey results suggest that within Asia, developing Asia (excluding China and India) is faced with challenging trade finance market conditions, showing a 15% rejection rate, compared to 8% in China and advanced Asian countries. India accounts for 6% of global trade finance transactions with 11% of its proposed transactions rejected.

**Figure 65: Proposed trade finance transactions that were approved/rejected, by type**



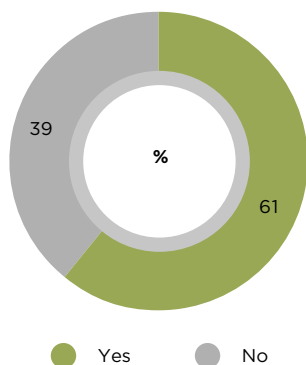
Source: ICC Global Survey on Trade Finance 2017

**Figure 66: Breakdown of proposed trade finance transactions by type**



Source: ICC Global Survey on Trade Finance 2017

**Figure 67: Is there a shortage in servicing the trade finance needs of the global market?**



Source: ICC Global Survey on Trade Finance 2017

### Challenges to trade finance and way forward

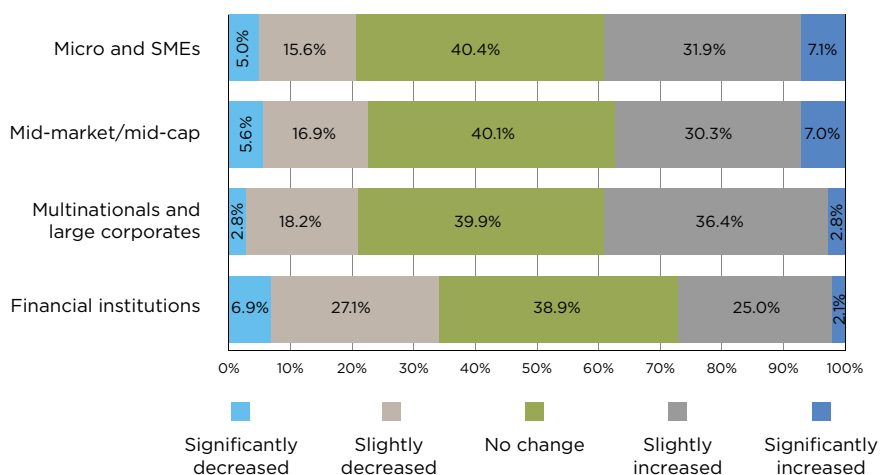
Regulatory requirements continue to be reported among the biggest hurdles in servicing global trade finance needs. Financial institutions report both anti-financial crimes regulations and Basel III regulatory requirements (80% and 71% of respondents, respectively) as major impediments to their ability to reducing trade finance gaps. Other impediments include low country ratings and low ratings of issuing banks according to 72% of respondents. 20% of respondents identified the poor quality of applications as a barrier to finance, while 15% of respondents said that bank profits are too low to accept more proposals.

To overcome these barriers and reduce market gaps, a large portion of responding banks suggest that adopting financial technology may help. The perception among 80% of respondents is that financial technology will increase efficiency and reduce the cost of complying with regulatory requirements and due diligence. Respondent banks also reported that greater integration and harmonisation of rules, standards, and regulations in trade finance would reduce market gaps and lead to more support for SMEs and higher economic growth.

### The role of multilateral development banks and export credit agencies

Globally, surveyed banks across all regions report that multilateral development banks (MDBs) and export credit agencies are helpful in fulfilling demand for trade finance. In particular, about half of the surveyed banks indicated that MDBs and ECAs would help meet the region's trade finance demand in Asia.

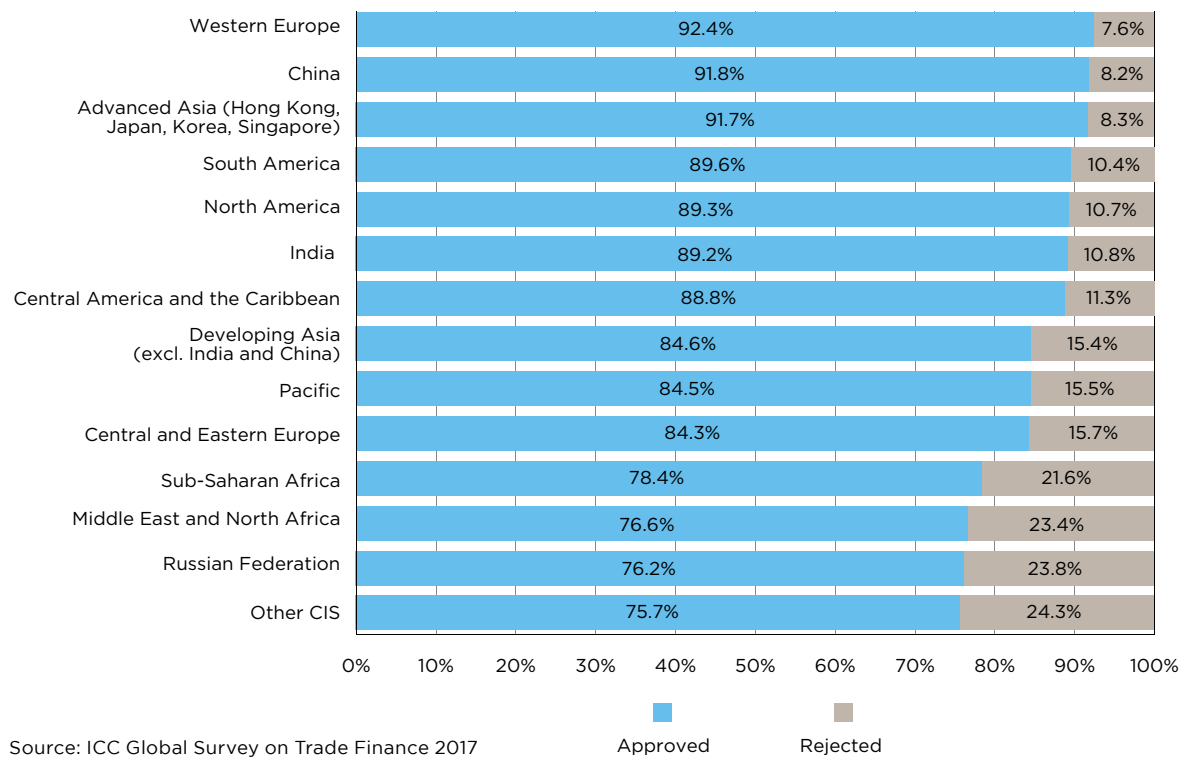
**Figure 68: Change in trade credit lines compared to 2015 by client type**



Source: ICC Global Survey on Trade Finance 2017

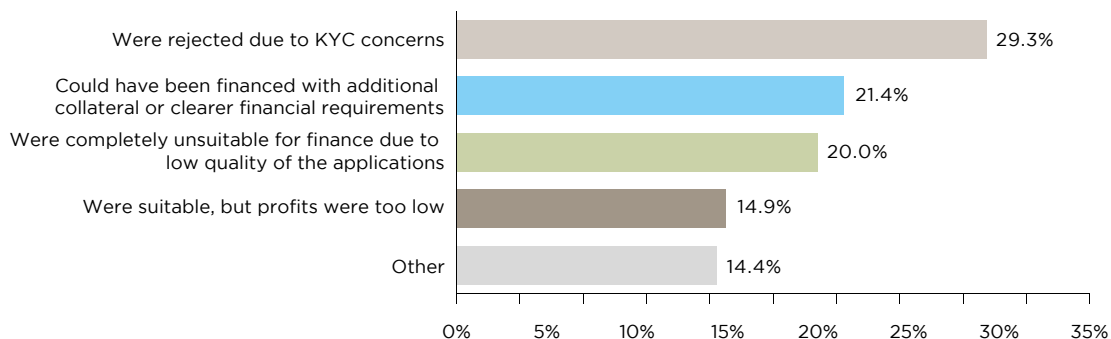
Survey responses were obtained from banks which participated in the survey voluntarily and hence the results may not be representative of the general population of bank-intermediated trade finance entities. Although the survey is conducted annually, caution must be taken in comparing results over time due to the difference in the surveyed population, as well as due to periodic refinements in data collection or analytical approach. Calculating trade finance gaps is challenging and ADB, in conjunction with other partners, strives to improve methodologies and rigor in this important area of study.

**Figure 69: Proposed trade finance transactions that were approved/ rejected, by region**



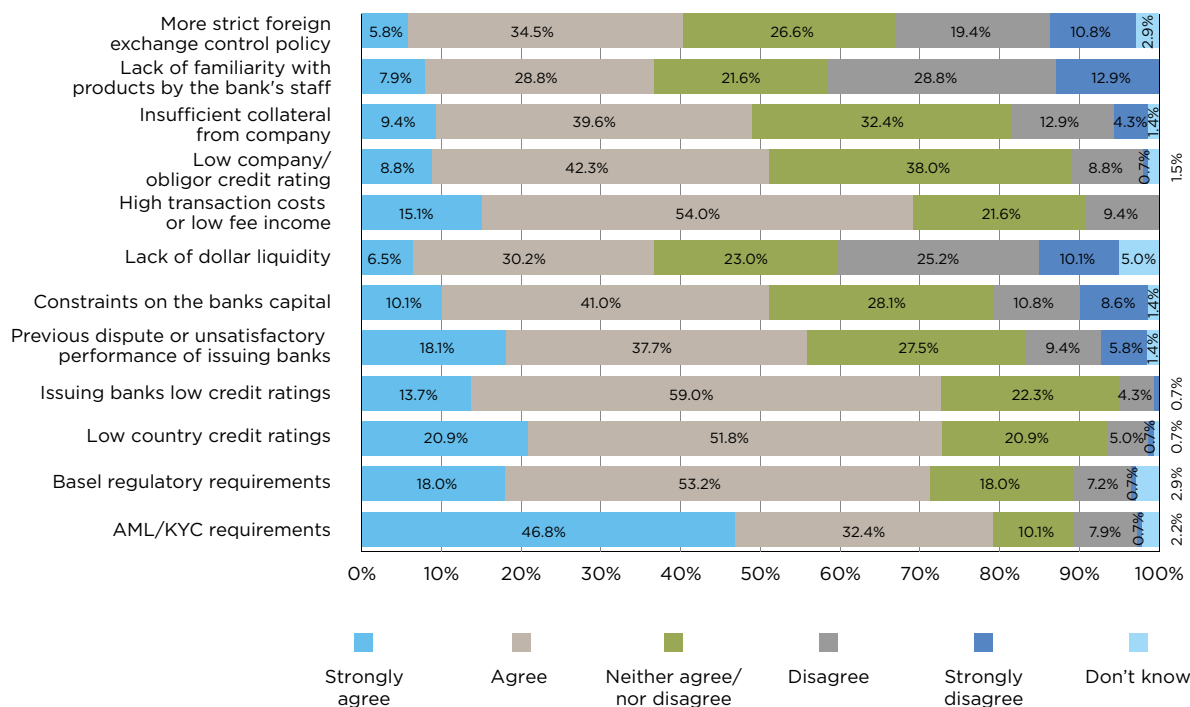


**Figure 70: Reason for rejecting trade finance transactions**



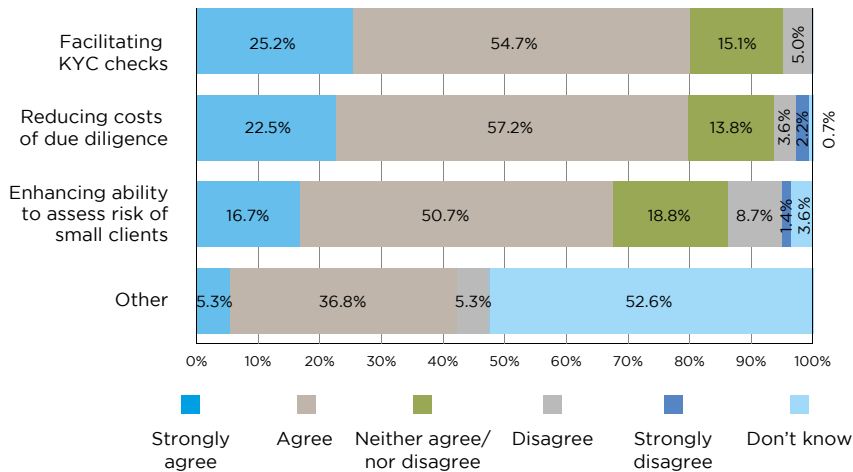
Source: ICC Global Survey on Trade Finance 2017

**Figure 71: Potential barriers to servicing trade finance needs**



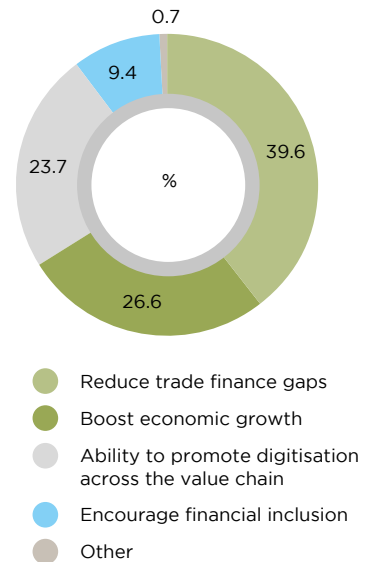
Source: ICC Global Survey on Trade Finance 2017

**Figure 72: Ways in which financial technology will impact banks' abilities to do more transactions**



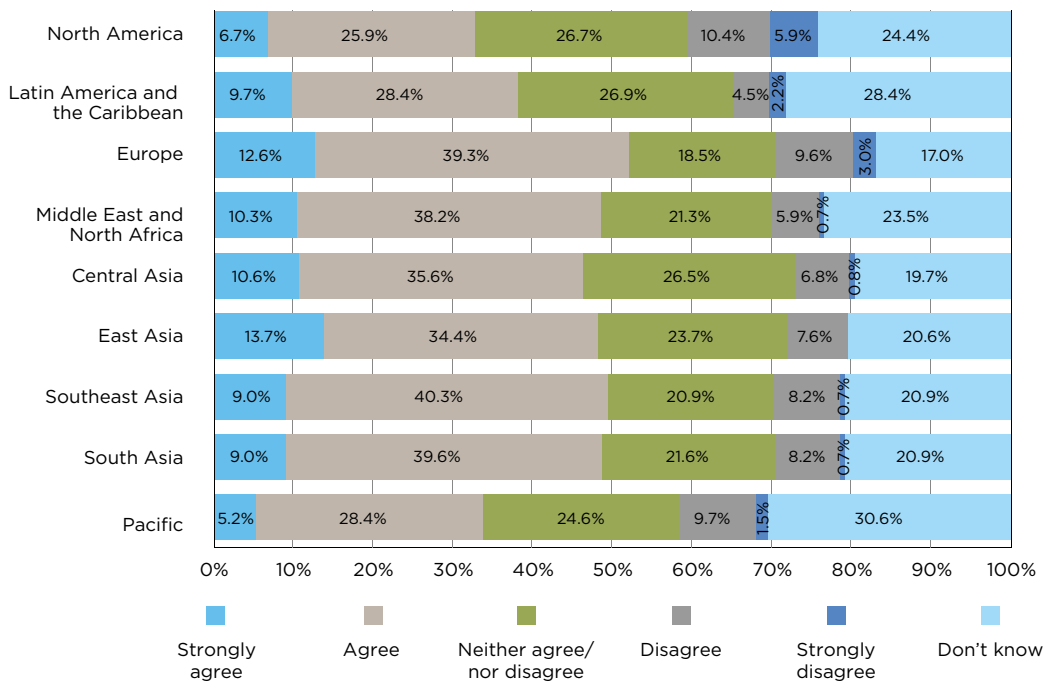
Source: ICC Global Survey on Trade Finance 2017

**Figure 73: Most significant benefit of greater integration and harmonisation of rules, standards, regulations and policies in trade finance**



Source: ICC Global Survey on Trade Finance 2017

**Figure 74: Extent to which MDBs and ECAs help in fulfilling demand for trade finance in different regions**



Source: ICC Global Survey on Trade Finance 2017



## Editorial Comment: selected strategic and tactical implications

### Strategic implications

The ADB portion of this year's survey reinforces key findings about the nature of the global trade financing sector that have been described anecdotally, and also materially advances broad understanding about a business that sustains and enables trillions of dollars in annual trade flows and related economic value-creation. ADB first quantified the now oft-quoted 'global trade finance gap', bringing into sharp focus, the significant unmet demand for trade finance around the world.

That headline aside, the elements of this portion of ADB's analysis highlight several points with strategic implications. Bank-intermediated trade finance is characterised by high rates of approvals of proposed trade financing transactions, across traditional products and supply chain finance, with up to 95% of proposed deals in certain product categories resulting in some form of financing solution. Relatedly, trade finance credit capacity seems to have remained largely at levels comparable to or higher than those reported last year, which implies that the area should present additional opportunity for financiers prepared to invest additional capacity in originating new business.

Notably, SCF remains a modest portion of the overall level of bank-intermediated trade finance, at least as reflected in the survey responses. Strategically, this suggests either a continuing misalignment between bank portfolios of trade finance activity, or ongoing disjointed organisational structures that maintain a split between traditional trade finance and the majority of SCF or open account-related trade financing.

Perhaps surprisingly, on the question of bank collaboration with export credit agencies and multilateral institutions, and the value or impact of those partners, a significant percentage of

respondents indicated not knowing about those positive impacts. Strategically, this suggests an opportunity for greater dialogue, awareness-raising and collaboration between trade banks and multilaterals (as well as ECAs). While certain specialists within banks' trade units may be very aware of these institutions and their now undeniably acknowledged roles, wider dissemination may prove helpful in creating additional opportunities for trade banks, and in developing net new capacity on a global level.

### Tactical considerations

Tactically, the ADB analysis highlights persistent perceptions about the impact of regulatory expectations both on the capital adequacy side and on the compliance side. Additionally, some specific opportunities are identified by survey respondents, around the opportunities to leverage FinTech to favourably restructure the cost/income structure of bank intermediated trade financing.

Established and credible trade finance banks ought to continue due diligence and strategic assessments related to FinTech, but should continue in parallel to undertake carefully selected proofs of concept, review alliance opportunities and seek specific, highly execution-oriented opportunities to leverage FinTech across a range of areas, individually or at the industry level, for example, in developing additional industry-level data pools around trade finance, SCF and trade-related risk mitigation activity.

These tactical elements can be broadly shared by collaborating with multilaterals through the technical assistance and capacity-building components of their various trade finance programs (most of which now specifically include an SCF component) to drive these initiatives to the financial sectors of developing economies.



# Preparing our industry for the future – How training tomorrow’s experts can reinvigorate trade finance today

ICC ACADEMY

**Today’s world is rapidly abandoning traditional classroom training methodologies and trade finance professionals are weathering a storm of regulatory, technological and structural changes.**

**Author**

Thomas G. Paris,  
Director of Production,  
ICC Academy

Before the financial crisis, trade was a powerful driver of commercial expansion with the rate of trade growth generally outperforming global GDP growth rates. Trade itself was effectively driving the world’s economy.

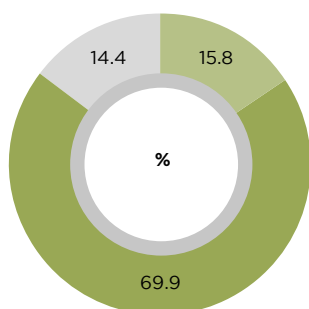
Soon after the crisis, greater attention was focused on the direct links between trade finance and economic growth when it was reported that 80-90% of global merchandise trade (valued at USD 16 trillion) was buttressed by some form of trade finance, mostly of a short-term nature.

The International Chamber of Commerce is at the forefront of a range of activities aimed at advancing the financing of international commerce, through ongoing leadership in rulemaking and standards-setting, policy and regulatory advocacy, deliberations on disruptive developments in technology and digital trade among other areas. It is in this highly dynamic and newly fast-paced context, for a business that still relies in part on mechanisms that date back hundreds of years, that the ICC Academy was established in Singapore, with an initial remit focused on trade finance and the work of the ICC Banking Commission.

The continuing professionalisation of a business that underpins trillions in annual trade activity is particularly critical as the nature of trade is redefined by evolutions like 3-D printing, advances in logistics, the entry of non-banks into the financing of cross-border commerce, and the ICC is in a unique position to respond to this clear market need, which includes an awareness-raising and education element around the nature of trade financing, for a next generation of practitioners, but increasingly, too, for a wide range of stakeholders, influencers and service providers.

**The business must evolve from a “learning by doing” approach**

**Figure 75: Technical competency and capacity in trade sales**



- Capacity and skills are more than sufficient to meet expected need
- Capacity and skills meet expected need
- Capacity and skills are insufficient to meet expected need

Source: ICC Global Survey on Trade Finance 2017

It is the increasing appreciation for the impact of trade financing on economic value-creation, international development and inclusiveness that facilitates a robust dialogue with policymakers, political leadership and a growing community of supporters – an impact long understood by practitioners, but now increasingly championed at the highest levels of international discourse.

The Asian Development Bank last year estimated a global trade finance gap of USD 1.6 trillion with over 70% of firms unfamiliar with digital finance. The most recent ICC Rethinking Trade and Finance survey also found that 61% of its respondents were signalling a global shortage in the provision of trade finance from their banks. Change is brewing on a massive scale.

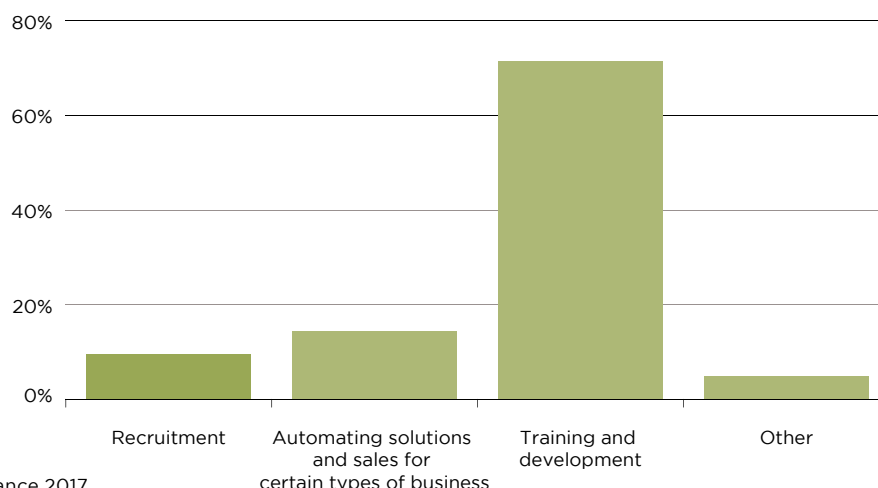
### How will professional training and education provide the boost that this industry needs?

A business with its roots firmly in “learning by doing” must evolve to a more enlightened, thoughtful and efficient model for professionalization, as much to attract skilled and committed next-generation trade financiers, as to ensure that the future of the industry is grounded in a scientifically robust competency-based framework, leveraging advanced methodologies and practices in education, training and professional development.

There is now a growing need for trade finance to evolve quickly, and for related competency development to follow the same path. With the digitisation of payment methods, nimble risk mitigation products, and a long road to a technology-enabled world paved in mobile devices – we are faced with an ever-closing window to sow seeds of innovation that will pay off later.

Interactivity and engagement has always been the key to success in the training space and our portfolio of trade finance programmes offers a structured and rhythmic approach to elucidating and assessing which

**Figure 76: Methods to address the capacity and skills shortage**



Source: ICC Global Survey on Trade Finance 2017



skills individuals need to know at distinct levels of one's career. Increasing demands for, and opportunities in, life-long learning approaches require flexibility in delivery options and channels, on-demand, global access to content, and increasingly, the support of a robust, energetic community of practitioners and interested parties at various levels on the continuum of professional development. The scope and accessibility of world-class academic content is strikingly illustrated by the growth and adoption of various global massive open online courses (MOOC) programs, many offering tremendous value at no cost, and it is in this context, that professional development and certification programs compete today for the limited bandwidth and capacity of learners, be they young graduates at the start of their careers, or senior executives facing increasing pressure to remain at the leading edge of their industry.

Just as individuals face challenges – and are provided with endless opportunity – in selecting education, training and development options, institutions and professional bodies are likewise compelled to make fundamental decisions related to the development of their human capital.

What we are accomplishing today is a fresh training ecosystem where the geographical barriers have been stripped away by creating an online community centered around professional development.

### **Why is this key?**

The trade finance industry is facing a tidal wave of new challenges and opportunities, including the need to ensure that a next generation of energised, committed practitioners is attracted to – and retained in – an industry that demonstrably impacts the world, provides personally and professionally enriching experiences, and offers a variety of career paths that can cross public sector private sector, international institution and entrepreneurial boundaries while concurrently crossing borders around the globe. To move as a unit during this transition, there needs to be a common understanding of the legacy and baseline functions of trade finance, combined with a view of the evolving path of the conduct of international commerce – and the financing and risk mitigation that enables it – or we run the risk of facing a competency crisis in the next generation.

Responding to this clear need in the market today, the ICC Academy provides the trade finance industry with 24/7 access to online modules, long-form video webinars, and thematic community discussions to groom a new generation of practitioners equipped to tackle the challenges of tomorrow in an ever-evolving market.



**30**

**courses available at  
the ICC Academy**

**90+**

**countries in the  
ICC Academy  
community**

**Monthly  
webinars  
released**



## Editorial Comment: selected strategic and tactical implications

### Strategic implications

Professionalisation, certification and systematic, structured and standardised training in trade finance is both urgent and long overdue as a matter of industry-wide strategic priority. Targeted progress has been achieved however, the adoption of a global standard, committed investment in such a profession-wide standard is still underway.

The widely acknowledged skills and competency shortage in trade financing including fast-emerging SCF, requires a coordinated global solution, one element of which revolves around professional development.

This dimension of managing a trade finance business is no longer a luxury or an option, but now a matter of strategic priority in which even scarce financial resources must be invested. Career and promotion paths must be increasingly tied to demonstrated commitment to professional development and objective certification.

### Tactical considerations

Following an unequivocal strategic commitment to professional development and certification, trade finance businesses around the world, line of business and operations executives ought to urgently implement formal training plans linked to certification, ensuring that staffing models account for necessary capacity to allow staff to complete the agreed training programs. Performance management and incentive plans must be aligned to motivate the pursuit and completion of training and certification.



# Update on Global Supply Chain Finance Forum

BAFT

**The Global Supply Chain Finance Forum (GSCFF) is the consortium formed in 2014 by BAFT, EBA, FCI, ICC, IFG and ITFA for the purpose of harmonising terminology and understanding of supply chain finance techniques.**

**Author**

Tod Burwell, President and Chief Executive Officer, BAFT



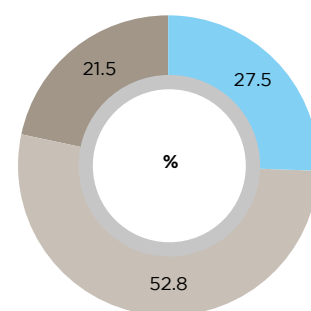
[supplychainfinanceforum.org](http://supplychainfinanceforum.org)

The Standard Definitions for Supply Chain Finance Techniques was published in early 2016, and was widely circulated and adopted by the membership of each of the contributing organisations representing a global amalgamation of more than 1,000 leading banks, factoring and forfaiting companies, technology and services providers and other industry stakeholders.

Since publishing the original document, the GSCFF has continued to drive awareness and adoption of the document. It has been shared with local banking associations, media organisations, training organisations, regulatory and government agencies, legal, accounting and other professional services firms and other important stakeholders, and GSCFF members regularly participate in training programs and panel discussions to drive awareness. Per the ICC survey, more than 74% of respondents have incorporated all or part of the definitions in their business. In May 2017, the group launched a website <http://supplychainfinanceforum.org/> to support the distribution and exchange of information pertaining to supply chain finance.

Some have raised the question, why all the fuss about definitions and terminology? Simply put, communication is the first step to understanding, which is required for collaboration. A person from Germany, Japan or the U.S. trying to negotiate a deal with someone from China, Indonesia or Brazil would have great difficulty unless they were able to reach common understanding through a common language. Standardising the basic terminology of supply chain finance should help that.

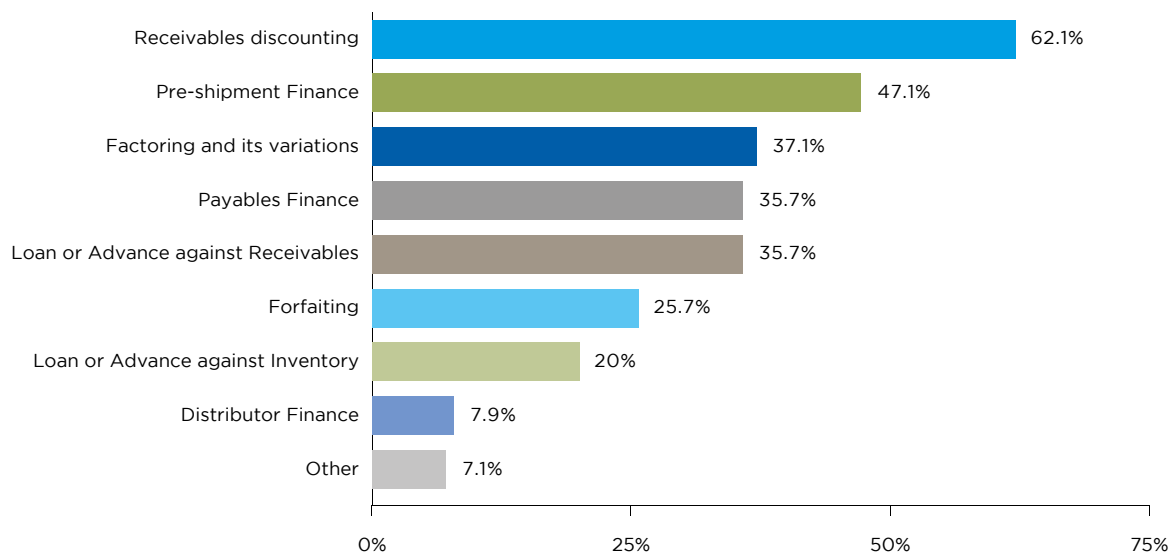
**Figure 77: Using 'Standard definitions for techniques of Supply Chain Finance'**



- My bank is not familiar with the suggested terminology to date
- My bank applies the suggested terminology widely and is applying most of this language
- My bank applies the suggested terminology partially and is using, in practice, some of the language proposed

Source: ICC Global Survey on Trade Finance 2017

**Figure 78: Most used techniques in supply chain finance**



Source: ICC Global Survey on Trade Finance 2017

The first Supply Chain Finance Boot Camp hosted by BAFT in 2016, a full-day event which included broad overviews and consideration of important industry trends, together with presentations of case studies by top practitioners, brought sharply into focus both the interest in this topic, and the degree to which the Standard Definitions have proven valuable in internal dialogue with credit, risk and compliance executives.

### SCF & SME financing

Perhaps the single most important issue inhibiting global trade and economic growth is the inability to provide liquidity to the parts of the market that most need it – small and medium-sized enterprises, often suppliers to global supply chains that happen to be located in emerging and developing economies. It is estimated that more than 90% of companies in the world are SMEs. A 2015 World Bank study indicated up to 4 out of 5 new jobs created in emerging economies come from SMEs, and SMEs account for a significant share of domestic GDP in both emerging and OECD countries. The ADB's 2016 study estimated a USD 1.6 trillion trade financing gap, with 56% of SME trade financing proposals being rejected. The World Bank study suggested that if micro and informal enterprises were included, the gap could be as high as USD 2.6 trillion. Nearly 70% of MSMEs in emerging markets lack access to credit. Supply chain finance could be one solution.

SME access to credit is a function of many inter-related things. Including:

- Capital and liquidity regulations on banks disfavour SME segment
- higher onboarding, compliance, and servicing costs as a percentage of revenue
- availability of quality data for credit assessment
- business model focus

In order to improve credit risk assessment and achieve appropriately risk-aligned capital treatment for trade finance, the industry must have both quantitative and qualitative data. Data requires standardisation. Standardisation requires clear and consistent definitions. Similarly, access to credit for SMEs can be improved by expanding the sources of lending – either directly, or through secondary investor markets. This also requires greater awareness, consistency and enforceability, starting with definitional clarity of the instruments used.

Growth of payables finance and other techniques have enabled some lenders to extend financing to the SME market, where they otherwise would not. Building a strong market awareness and adoption of supply chain finance techniques, can be a method to deliver financing to this underserved segment.

### Smart trade requires standardisation

While policy discussions in some countries are forcing a re-think about dependence on complex global supply chains versus simpler and more local or regional supply chains, the economics of supply chain efficiency are enabled by advancement in technology. But as the world increasingly embraces digitisation, the internet of things, artificial intelligence and cognitive computing, trade remains one of the last bastions of paper-based commerce. Greater digitisation can be a game changer for the intensive cost model associated with trade, as evidenced by many innovations concerning warehousing, transportation and inventory management. In order to enable this cost transformation in trade finance, greater standardisation is required.

The internet of things has made self-ordering refrigerators a practical reality. Envision a world where smart manufacturing machines order replenishment inventory based on order volumes, production and usage cycles. Taking into account delivery and cost algorithms, smart supply chain systems optimise production, sourcing, and inventory in the most cost effective manner. The logical extension of this efficiency is the incorporation of automation into financing and insurance risk models, digital event-based financing, optimising sourcing and channels of finance, the way a supply chain management system optimises landed cost. Smart trade needs smart trade finance. Smart trade finance requires standardisation.

### What's next?

The GSCFF continues to drive adoption of standardisation in definitions of supply chain finance to increase awareness and utilisation of the techniques. The industry needs organisations involved in supply chain finance to incorporate the standard definitions into their daily operations such that the industry can more broadly track data relating to supply chain finance. Better quality of data inputs will produce better quality of data assessments, market sizing, risk scoring, capital and accounting treatment, and use of the instruments. Training and education must be built using the same standard set of definitions, which can be updated as the market evolves. Transaction rules, legal frameworks and greater certainty will also bring additional investors to market with an interest to provide financing to those hard-to-reach SMEs.



### Open account transactions represent more than 80% of trade

The time has come to bring greater standardisation to the market, starting with how we define the products. We now look for the industry to enact the following:

1. Ensure the Standard Definitions for Supply Chain Finance Techniques are adopted and incorporated into your institution's daily use, training documentation, and transaction metrics.
2. Begin measuring transaction volumes and data consistent with the definitions. The ICC should eventually consider whether it is appropriate for the Trade Registry to include SCF products.
3. Documentation standards, including client agreements, should be consistent with the definitions.
4. Practices guidance and possibly rules should be considered, to add greater clarity to the behavioural underpinnings of SCF transactions.
5. Clarity on accounting treatment and regulatory treatment should be pursued as necessary



Smart trade needs smart trade finance. Smart trade finance requires standardisation



### Editorial Comment: selected strategic and tactical implications

#### Strategic implications

While differentiated language and terminology can be linked to market presence and brand, at the current stage of development of SCF, it is imperative that the basis for common and consistent understanding about SCF programs and techniques be established, maintained and further evolved. Common and consistent understanding through shared and co-owned terminology is an important first step in achieving alignment to advance, advocate for, market and evolve the SCF proposition, not only internally within banks, but with professional services firms, service providers, regulatory authorities and others.

The Standard Definitions for Techniques of Supply Chain Finance can serve as a foundational and common reference point across industry groups and associations, across legal and geographic jurisdictions and with a wide community of stakeholders interested in trade and SCF.

With eventual broad adoption of common definitions and related cross-referencing to terminology already in use today, the basis for a global set of guidelines, practices and rules similar to ICC publications like the Uniform Customs and Practice (UCP) for Documentary Credits, can be established to clear positive effect.

#### Tactical considerations

Dissemination and adoption of the standard terminology may begin at the global level through far-reaching industry bodies, but it can gain traction and have impact only once it is operationalised and ingrained into the daily operations and transactions of those providers and users of SCF techniques, and their community of service providers, commercial partners, regulators and others.



# Supply Chain Finance: Corporate perspectives

BANK OF CHINA

**In terms of SCF development, in China, while clear distinctions exist, there are also common features – according to the interviews conducted recently with companies of different sizes during which various aspects were addressed: strategic approaches, SCF policies and internal structures.**

**Author**

Jun Xu, Deputy General Manager, Global Trade Services Dept., Jiangsu Br., Bank of China

## Strategic approaches and Organisational Structures

Several companies of different sizes were interviewed and four companies were chosen as representatives for the study (see the table below). Both the large corporation and medium-sized companies interviewed pay a lot of attention to SCF and treat it as an important aspect for their development. For SMEs, the reality is significantly different. The general feedback received from SMEs reflects their lack of knowledge of SCF.

Company	Location	Size	Industry Sector
A	Shandong Province	Large	Household appliances manufacturer
B	Zhejiang Province	Medium	Kitchen appliances manufacturer
C	Zhejiang Province	Medium	Electric bicycle manufacturer
D	Jiangsu Province	Small	Textile manufacturer



The strategic approaches of Company A, with annual sales over USD 22 billion, is to improve the service environment of SCF, construct the management system for the industry chain, build a clear main line of the industry chain, support SMEs developments and sufficiently display its management strengths.

## Both large and medium-sized companies see SCF as an important aspect for their development



In order to achieve the above, Company A has made an organisational structure reform by setting up a SCF department and Distributor Finance department. Both departments are responsible for providing comprehensive internet-based financial solutions by studying the corporation's industry chain, identifying the particular risks of the industry SCF, and designing tailor-made, standard and personalised financial products.

Company A also assigns the SCF policies advocacy responsibilities to its finance company. Those are mainly to satisfy the financing demands of suppliers and distributors across the supply chain, in order to respond to their worries about financing problems or high financing costs. In consideration to its own features and needs of the industry chain, Company A's finance company designs a series of featured financial products for different phases of the industry chain, including financial instruments finance, factoring, warehouse receipt finance, purchase order finance, forfaiting, store set-up finance, etc.

The finance company provides financial services for the whole industry chain as to satisfy the capital liquidity needs of various links of the chain and expedite the purchase orders acquisition.

Unlike large corporations, medium-sized companies differ in their SCF approaches, in terms of strategic and structural construction. For example, Company B, with annual sales about USD 150 million, does not have any special policies in SCF for its suppliers or distributors, while Company C, with annual sales about USD 320 million, has made differential SCF policies for different parties across its supply chain.

Due to their weak positions in the supply chain, it is rare for SMEs to initiate any SCF policies. Our interviews also prove this statement.

### Main opportunities and obstacles in terms of SCF

#### Opportunities

According to Company A, in terms of the supply chain itself, the corporation can solve the financing demands of the whole supply chain, with buyers and sellers, as long as it has a comprehensive understanding and grasp of the demands along the chain. Satisfying such financing demands matches production and purchase orders, and in return can push forward the overall chain development. The virtuous cycle of the industry chain may then significantly lower the risks around SCF solutions. Furthermore, companies equipped with supply chain systems are generally in the real economy. Opportunities in SCF are also amplified with nation's support in the development of the real economy.

Company B considers that the major SCF opportunities is in providing a potential basis for sales increase for the anchor company and solving difficulties in obtaining finance by the suppliers and distributors. Company C considers that online SCF may simplify the financing procedures and expedite funds flow.

When asked about the main possibilities in terms of SCF in their business, company D, with annual sales about USD 15 million, replied that due to the good credibility of their counterparty (the buyer), when granting credit facilities, their bank lowers the requirements of the collateral security and offers lower pricing.

## Obstacles

However, when asked about the obstacles for SCF, Company A considers that the development of SCF lies in the industry itself rather than finance. If SCF is simply interpreted as finance and if the financial products costs are overly transited to the industry, it may add to the burden of the whole industry. The development of SCF may be effectively promoted if it aims to promote the chain's overall liquidity, improve the speed of acquiring orders from the market, and share the value of purchase orders created together. Company A considers that the biggest obstacle for SCF development is the lack of professionals truly understanding SCF and the industry, and the myopic behaviours in the designing and evaluating SCF products.

Even with top management support in SCF, it appears that large corporations are facing more obstacles internally. Coordination with and support from first-line managers in various areas are critical in implementing SCF solutions successfully, thus aligning different objectives from different teams within the organisation.

For medium-sized companies with full support from the top management, internal obstacles are not as visible as those perceived by large corporations in the process of implementing SCF. Medium-sized companies feel that the current SCF solutions provided by the banks have not fully met their expectations to increase sales to the greatest extent and take up their own already limited credit facilities. According to Company B, as an anchor company, their credit facilities have to be utilised in SCF solutions in supporting the suppliers or distributors and may limit the anchor party's own financial needs.

## Cooperation with banks or IT providers in SCF

It appears that most companies choose to cooperate with banks or IT providers in SCF, however, some of the large corporations treating SCF as a strategically important aspect usually set up their own SCF e-platforms and do not have much cooperation with banks in SCF.

Take company A as an example. Its main cooperation with banks is focused on credit facilities of financial instruments accepted by its own finance company. Currently, company A believes that most banks are its SCF competitors in onboarding its customers across the supply chain.

Company A cooperates closely with IT providers. IT providers are treated as suppliers and usually have in-house office in the company responsible for the development, upgrading and operation of the system.

Company A pointed that when they started the development of SCF, no suitable third-party platform could be found on the market catering to their special SCF demands. It is very hard for a third-party platform to satisfy their SCF demands if that platform does not have deep understanding of the industry.

Unlike the large corporations, the small and medium-sized companies tend to cooperate mainly with banks in SCF. However, when providing support to the parties across the supply chain, part of the anchor parties' credit facilities is taken up, and the finance is granted by the bank to the suppliers or distributors after the anchor company examines required shipping documents and confirms the transactions. Company C reports that they cooperate with a bank utilising the bank's e-platform in supporting its suppliers finance, and cooperates with other financial companies in the distributor finance.







I. REFERENCE INFORMATION

II. RECAP AND SELECTED HIGHLIGHTS

III. STATE OF THE MARKET

IV. TRADE AND SUPPLY CHAIN FINANCE

V. POLICY, ADVOCACY AND INCLUSIVENESS

VI. RE THINKING TRADE AND FINANCE



All the SMEs interviewed report that they cooperate with banks by using only a specific SCF solution. Company D mainly uses invoice discounting to get finance and meet their operational needs when trading with buyers with good credibility.

None of the SMEs interviewed has set up their own e-platform or is using a third-party platform.

### **Expectations from banks and other SCF providers**

There appears big contrast between companies with different sizes in their expectations from banks in terms of SCF. However, our interviews indicate that simpler financing procedures and lower financing costs are common expectations from banks and other SCF providers, and such expectations are even stronger from small and medium-sized companies.

For large corporations with internal SCF management, banks are seen as their competitors in SCF, and they also feel that banks are unable to meet their in-depth financing demand. Company A attributes the cause to the fact that the degree of understanding and knowing the supply chain by banks is less detailed and comprehensive than that of the corporation, since banks are not as close to the industry as the corporation itself, and banks lack the environment and conditions of doing so. Company A suggests that banks should adjust their strategy in SCF development and should act in cooperation instead of competition in providing competitive lower cost funds to support the corporation's SCF development. In return, banks may also benefit from acquiring credit assets with high quality and low risks.

Company B wishes that the limit of trade finance facilities could be increased along with the increase of the sales and the finance costs could be lower. Company C wishes that the approval procedures for SCF solutions may be further simplified and expedited so as to enable more efficient funds flow.

When asked about what SMEs expect from banks and other SCF providers, company D wishes that banks and other SCF providers simplify the financing procedures and lower financing costs.

### **Country policies favouring SCF**

Although SCF has been widely acknowledged and has received much attention in recent years in China, there were no country or local policies favouring SCF until recently, in an effort to solve the problems in the industrial structure transitions and difficulties for SMEs to obtain finance.

For example, on 16 February 2016, eight state departments including People's Bank of China, China Banking Regulatory Commission, National Development and Reform Commission China and others jointly promulgated Several Opinions on Financial Support in the Steady Increase, Structural Adjustment and Profits Enhancement of Industrial Sectors, which points out that "accounts receivable finance should be greatly promoted" and "more supply chains should be encouraged to launch the Movable Properties Finance Unified Registration Platform, urge large corporations and government procurement organisations to confirm account receivables so as to enable the SMEs suppliers to obtain finance".

**SCF has been widely acknowledged and has received much attention in recent years in China**



On 28 March 2017, the People's Bank of China, China Banking Regulatory Commission, Ministry of Industry and Information Technology of the People's Republic of China, China Securities Regulatory Commission and China Insurance Regulatory Commission jointly promulgated Guidance on Financial Support for Construction of Powerful National Manufacturing Industries, which encourages financial institutions to provide SCF business including account receivables pledge-based loan, factoring, etc., to satisfy the financial demands of the suppliers and distributors along the supply chain relying on the anchor parties support.

The People's Bank of China launched Accounts Receivables Pledge Registration Publicity System Platform in 2007, and on 31 December 2013, further launched the Movable Properties Finance Unified Registration Platform trial operation programme enabling the account receivables confirmation and finance application. However, the government-provided platforms and relative legal enforcements are still under construction, and the main users are banks and other finance providers.

Since relative policies have just been promulgated and specific measures for their implementation are not clear, almost all the companies interviewed do not have much knowledge about national policies for supporting SCF in China

### **Knowledge about the standardised industry terminology**

It appears that all the companies interviewed do not have knowledge about the Standard Definitions for Techniques of Supply Chain Finance; however, they are able to list some of the typical products in the market from SCF solutions. Nevertheless, the market illustrates a strong need for more knowledge of the standardised industry terminology, as it reflects market practice.



# Supply Chain Finance: Corporate perspectives

THE AUSTRALIA AND NEW ZEALAND BANKING GROUP

## Author

Mark Evans, Managing  
Director, Transaction  
Banking, ANZ

## Supply Chain Finance

Unlike other bilateral working capital facilities between a bank and borrower, supply chain finance solutions typically have the bank facing the buyer, or anchor client, while accepting offers of early payment from a supplier. Properly structured, these solutions can provide an economic benefit to both trading partners.

For larger corporate buyers in particular, the topic of supply chain finance solutions is becoming more prominent as optimising working capital continues to be a focus. While there is an appreciation of the benefits across the supply chain, it's important to note there is a geographical divergence in take-up from suppliers. We have heard from various corporate buyers that Australian and New Zealand based suppliers are cautious of creating a new norm of longer payment terms. They are also at the same time may be burdened by a deep-seeded perception that supply chain finance solutions portray distress of the supplier and is a last resort. Interestingly, this is contrary to the evidence we see in more mature European and North American markets where there is an obvious acceptance and championing of supply chain finance solutions. A key takeaway from recent buyer interviews is that education is crucial in changing this mindset across Australia and New Zealand.

More often than not, the first obstacle in structuring supply chain finance programs is securing alignment between the two trading partners. By removing prior negative perceptions and communicating the positive impact to the overall supply chain to those involved in the transaction, supply chain finance programs will increasingly be seen as a primary working capital tool for corporates of all sizes, in all geographies.

## Third party providers

We are seeing increasing competition from Fintechs in the short-term trade asset space, offering a range of online supply chain services via a single platform. Independence from financial institutions and a dedicated, customer-friendly technology focus is typically how Fintechs communicate their differentiation in the market. Globally, Fintechs have the potential to at least partially erode the prominent position of Banks directly facing and distributing their own products and services via proprietary platforms.

Payables finance programs initiated by large corporates are generally large value programs. While global financial institutions have taken the lead in syndicating large programs, there has been a recent rapid rise in the use of third party technology platforms developing and marketing supply chain portals, providing cloud-based interfaces between supply chain participants and funding relationship banks. This disintermediation of traditional providers (banks) by FinTechs creates an additional vendor relationship for

SCF should be  
viewed in a more  
positive light



all parties and generally removes the straight-through-processing advancements banks have made for their own supply chain portals. However from the corporates perspective, the advantage is the unbiased distribution of cross-sell for all relationship banks, with no one partner favoured to lead a program.

There is increasing collaboration between financial institutions and Fintechs, perhaps mitigating the risk of disintermediation and erosion of the market position of traditional providers. In some instances this collaboration includes invested capital in technology companies. While there has always been a focus on banks' proprietary platforms, improvement and innovation is essential to ensure the Bank can work with third party platforms if our customers require it.

### Corporate buying policy

By their very nature, supply chain finance programs, including Payables Finance techniques and programs under the wider SCF umbrella, are complex which makes them time consuming to implement and integrate with corporate treasury or accounting systems.

We are seeing buyers are overwhelmingly in favour and have company-wide support for supply chain programs. Each corporate has particular criteria they adhere to for initiating a supply chain program; however generally the cost, time and effort of implementation will mean a minimum number of suppliers offering a set minimum payment term is required before the corporate will invest necessary capital. In instances where this internally set hurdle is not reached the counterparties will use other options to optimise working capital. This may include other traditional trade instruments, or dynamic discounting which anecdotally has not gained much traction, particularly in the Asia Pacific region.

It's clear corporates are investing considerable time and energy in shortening, simplifying and reinforcing their physical and financial supply chains. It is incumbent upon relationship managers to stay close to their customers to understand and actively participate in working capital discussions, and once the decision is made to embark on a supply chain finance solution, to implement the right solution at the right time and for the right reasons.



## Editorial Comment: selected strategic and tactical implications

### Strategic implications

The foregoing interview highlights reflect a significant and material variance of views, geographically and by customer segment, about the nature, opportunity and downside related to SCF programs.

Whilst some suppliers in Australia and New Zealand hold the view that participation in an SCF program may be interpreted as a sign of financial vulnerability (exposed to the buyer through engagement in the SCF initiative), businesses in China commenting for purposes of these discussions appear to have embraced SCF, and determined that the potential benefits of successful programs are best viewed at an industry or "whole of the supply chain" level, and further that the positioning of SCF must be decisively in a broader context than simply finance.

The range of views outlined suggest strongly that further global education around SCF is timely and necessary, and that best practices related to the articulation, design and deployment of SCF programs would be of significant benefit to the community of trading companies and their supply chains. Leading SCF providers with track records in markets where SCF has achieved a level of positive acceptance and visibility can leverage this into compelling market propositions, or the basis for strong collaborative models.

SCF providers or those aspiring to develop business in this area have a clear opportunity to leverage much-publicised learnings about the need to engage suppliers, to involve non-finance leaders from buyer organisations and to target and streamline supplier onboarding, to materially advance the dialogue around and market uptake of SCF. Use and dissemination of the Standard Definitions for Techniques of Supply Chain Finance, and engagement with the Global Supply Chain Finance Forum, will prove valuable.

### Tactical considerations

Tactically, several aspects of the interview highlights in this section speak to the need for education, awareness-raising and dialogue around the characteristics and benefits of SCF, for buyers, suppliers and for the health and sustainability of entire supply chains.

Offsetting supplier concerns about the optics of financial weakness related to participation in an SCF program by positioning the SCF Bank as a trusted partner that will maintain supplier confidentiality, and encouraging buyer support by positioning SCF as a means of assuring the health of strategic suppliers, are both specific and tactical steps available to bankers in advancing market uptake.





# Market trends in Supply Chain Finance: Receivables Financing

INTERNATIONAL TRADE & FORFAITING ASSOCIATION

**Author**

Sean Edwards, Chairman, ITFA

The contribution to last year's survey by the International Trade & Forfaiting Association emphasised the flexibility of one of the techniques employed in supply chain financing. Forfaiting is, of course, not the only technique to be used when seeking to provide finance along the physical supply chain. The Standard Definitions for Techniques of Supply Chain Finance published last year by ICC, ITFA, BAFT, EBA and FCI defines supply chain financing (SCF) as "the use of financing and risk mitigation practices and techniques to optimise the management of the working capital and liquidity invested in supply chain processes and transactions. SCF is typically applied to open account trade and is triggered by supply chain events. Visibility of underlying trade flows by the finance provider(s) is a necessary component of such financing arrangements which can be enabled by a technology platform".

Employment of the optimum technique at the appropriate trigger point is part of the art of the trade finance banker; the Definitions aim to assist this process. The slow-down in the growth of trade and even worse, trade finance, has been widely recorded and attested to, but SCF has been seen as an area where expansion has occurred and which offers potential. This is because trade receivables have not been sufficiently monetised or exploited or doing so has been too expensive or impractical especially amongst SMEs which, to date, have, in many cases, been limited to the factoring market.



## ITFA members survey

The findings show:

It has been another fairly steady year for trade finance, although banks are more positive than non-banks. Non-banks, have higher average transaction values, but banks have to a large extent seen their average transaction values increase.

Emerging markets appear to be strongest, although the majority of responses for developed regions

(North America and Europe) were that markets had stayed the same. Given that commodity prices fell back so substantially in 2015, this stabilisation of the trade finance market would have been expected but still demonstrated resilience.

Risks to trade finance are, perhaps predictably AML and KYC, as well as bank regulation. These feature much more strongly than the other areas but it is banks that are driving the responses rather than non-banks who were less likely to see these as an issue.

### LARGER DEALS DOMINATE THE MARKET:

# 8.3

## USD MILLION

Mean transaction size of respondents active in payables discounting

# 7.9

## USD MILLION

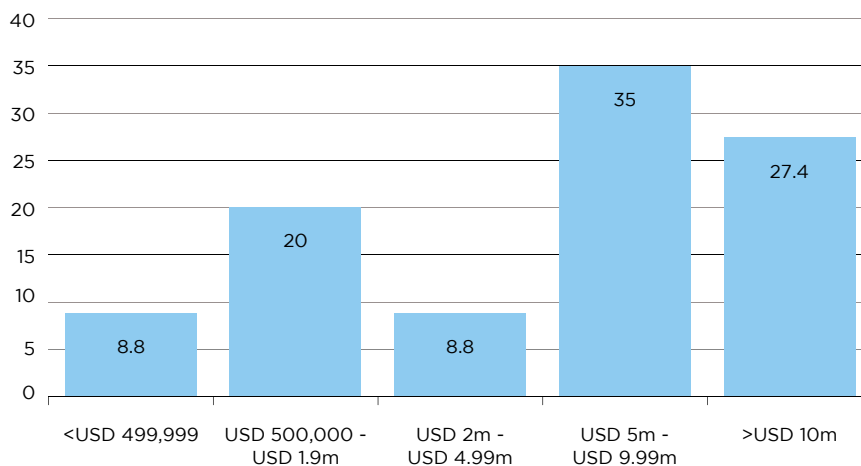
Mean transaction size of respondents active in receivables discounting

# 7.8

## USD MILLION

Mean transaction size of respondents active in Trade Finance loans

**Figure 79: Average value of trade finance transactions, % of respondents**



Source: ITFA member survey, 2015-16

The more joined-up solutions of SCF provide a springboard for scalable, coherent, broad and elastic approaches to the needs of SMEs as well as bigger players.

Data on this largely private market has not been easy to find. In this association's contribution last year an estimate of the size of the Chinese forfeiting market was given at USD 30 billion. Clearly, this is only one market in one country, albeit a large one. ITFA has surveyed its members, with the assistance of Equant Analytics, to help shed a light on this promising market which has become something of a beacon in the recent gloom. The headline findings are interesting and encouragingly show healthy volumes and the significant involvement of non-banks (FinTechs, insurers and others).

Non-banks have a significantly higher average trade finance transaction value than banks at USD 12.1 million compared to USD 4.2 million. This group is dominated by insurers and the average value for FinTechs is much smaller. (This is not discouraging, however, as insurance represents a growing channel for risk distribution-see below) Similarly, non-European average transactions are substantially higher at just over USD 10 million on average compared to USD 4.5 million in Europe. Over a quarter of the market consists of relatively large average deal values, over USD 10 million, which will include some significant individual transactions. As much of SCF, especially in receivables financing, is flow repeat business, this finding demonstrates that the participants in this market are capable of deploying considerable resources. Volumes are also healthy.

The number of deals done each year is illustrated in Figure 80. At first glance, it appears that the biggest grouping of respondents is in the 300+ deals per year category. However, there are some differences as follows:

- 60% of banks did over 300 transactions a year compared to just over 13% of non-banks
- 37.8% of European respondents did over 300 transactions a year compared to just 6.8% of non-European respondents.

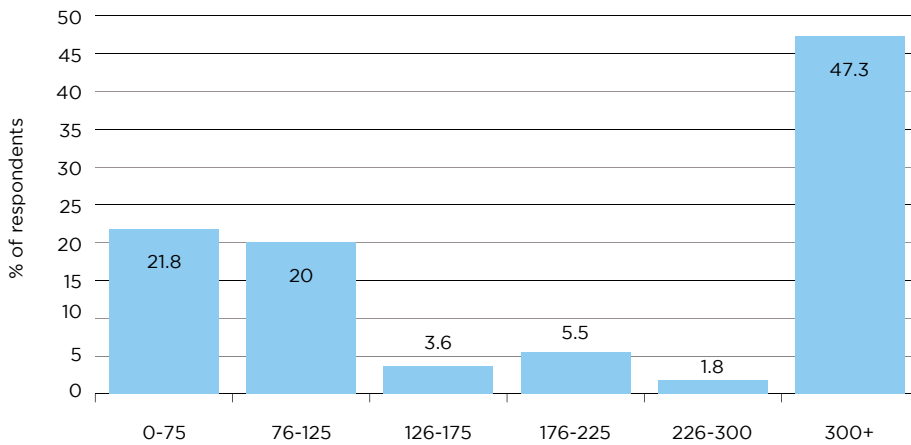
Traditional centres of trade finance are therefore still strong in underpinning the market. This is not at the expense of the emerging markets however.

## Geographic markets

The emerging regions of the world are still expanding according to respondents to this survey. Asia Pacific, MENA, Central and Southern America and Sub-Saharan Africa all showed more respondents seeing growth than decline. A larger number of respondents reported declines for North America and Europe than reported increases, but this still leaves a large number saying that the conditions had not changed in all regions, as shown in Figure 81.

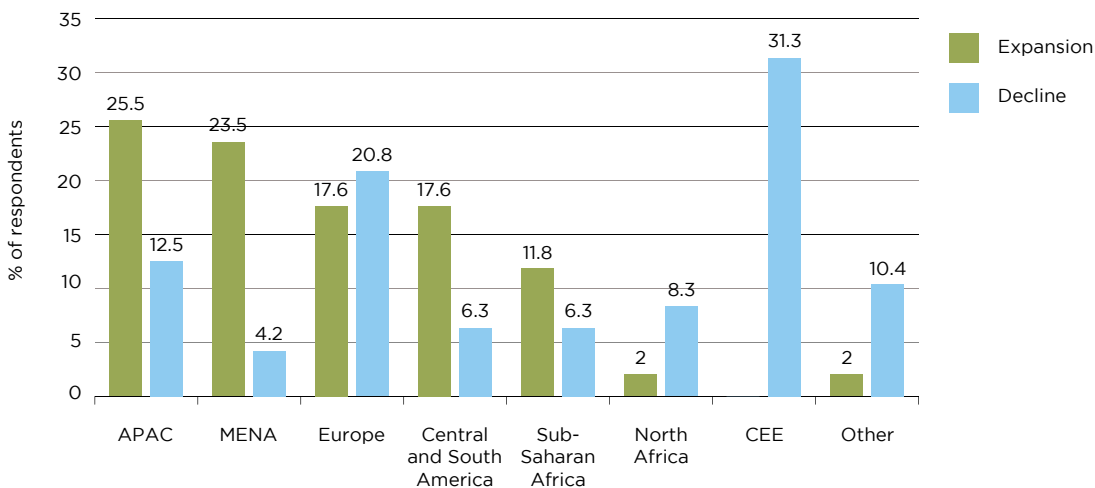
Respondents from organisations not based in Europe saw the largest increase in demand for trade finance products in the MENA region (27%).

**Figure 80: Number of trade finance transactions done per year (% respondents)**



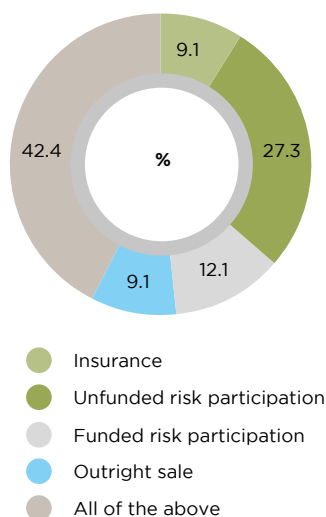
Source: ITFA member survey, 2015-16

**Figure 81: Global regions with biggest expansions and declines in demand for trade finance products, percentage, total sample**



Source: ITFA member survey, 2015-16

**Figure 82: Preferred method for selling or distributing risk, percentage, whole sample**



Source: ITFA member survey 2015-16

Unsurprisingly, Europe-based organisations saw the largest increase in demand from Europe itself (24.2 compared to just a 5.6% increase for non-European organisations.) In fact, those respondents whose organisations were based outside Europe experienced the largest decline in demand from the region; at 29.4%. The same decline in demand was experienced in Central and Eastern Europe, also by non-European based organisations. Interestingly, European respondents were far more likely to say that the value of transactions had increased suggesting that although demand may not be improving, the value of transactions may be.

Responses have not been affected by changes in SME demand. In other words, it is likely that SME demand remains the same and has not affected the overall changes in the trade finance market. Respondents were seeing growth in emerging markets to a greater extent than they were seeing declines, but Sub Saharan Africa remains the region where respondents saw the biggest constraints. This may be because KYC and AML are also the biggest risks to trade finance products and, as Sub Saharan Africa does have KYC and AML constraints, the region appears to be disproportionately impacted.

### Distribution

Distribution of assets is not often picked up in surveys of trade finance as this is an inter-bank or bank-insurance market. The presence of effective distribution channels, however, underpins the availability of finance in the primary market fueling what should be a virtuous circle. Forfeiting, for example, integrates “distributability” into its structure and is thus particularly effective. 69% of the respondents to the survey sold risk assets. Of these, 90% of respondents said that they sold bank assets and 69% said they sold corporate assets. Of those organisations that sold financial instruments or corporate assets, 27.3% preferred unfunded risk participation as a means of selling and distributing risk while 42.2% preferred to use a combination of the available methods. (Figure 82)

Interestingly banks were more likely to sell bank assets and corporate assets than their non-bank counterparts. Similarly European financial institutions were more likely to respond that they sold both types of assets than non-European banks.

### Conclusion

SCF is perceived as a broad and deepening market. In part, this may reflect the need to find a saviour for the under-supply of finance for both SMEs and in the emerging markets. The survey, whilst relatively small, mines data only from those at the sharp-end of SCF; the results suggest that the different approaches to SCF set out in the Definitions are supporting, and can continue to support, both groups. Careful choice of SCF techniques will enhance the ability to effectively link financial and physical supply chains. The availability of finance to banks themselves must not however be disregarded as show the findings relating to distribution. This can be characterised as a second financial supply chain which supports the financial supply chain facing the ultimate consumers of finance, namely the exporters and importers who make up the physical supply chain. If trade finance needs a champion SCF is a serious contender for the crown.





## SCF IN ACTION: FORFAITING CASE STUDIES

**The near collapse of a Spanish solar energy company has been the subject of much attention within the SCF community primarily in relation to its controversial payables financing programme.**

A lesser known aspect of this company's restructuring has been more positive for banks and has shown the inherent strength and security offered by the use of traditional forfaiting instruments. Promissory Notes issued by the company's South American subsidiaries and guaranteed or avalised by the parent company were the subject of a separate restructuring which was able to ignore the now worthless covenant value of the parent. The promissory notes constituted "two name" paper and whilst on issue only the avalising parent company was taken into account in credit terms, the issuer remained fully liable for its obligations. Those obligations were restructured without loss to holders. Although other structures could arguably have achieved the same result, the use of promissory notes was convenient, operationally straightforward and legally robust.

Turning to emerging markets, in Moldova forfaiting has been successfully employed by the local subsidiary of a major western European bank to support imports of capital goods for local Telco companies with the assistance of EBRD. The use of forfaiting to import capital goods to reconstruct Europe after the Second World War is often seen as dry history of limited contemporary relevance. As the Moldovan experience shows, emerging markets can also benefit from a technique which is just as important today as it was in the post-1945 world.



## Editorial Comment: selected strategic and tactical implications

### Strategic implications

Forfaiting typically involves relatively high-value transactions, certainly when compared to traditional short-term trade finance such as Documentary Credits, and can involve substantial activity in higher-risk developing markets, with non-banks playing a significant role in the provision of this service globally.

Forfaiting encompasses the character of a long-established banking and financial mechanism, that has been successfully integrated into Supply Chain Finance as a technique and as an important element of the SCF value proposition, with material positive impact in developing and emerging markets.

Providers of trade financing and SCF that seek to grow their market presence and the scope of their offerings ought to take a strategic view on extending technical and delivery capabilities (along with credit, risk and balance sheet capacity) beyond so-called “vanilla trade finance” to include Forfaiting, in its own right and in parallel, as a potentially effective bridge between traditional trade finance and SCF techniques.

### Tactical considerations

Forfaiting appears to be an area where concrete opportunities exist for banks and other players in the trade financing space, can explore truly complementary partnerships and alliances, and where such alliances ought to be operationalised in the short-term. Technical competency, delivery capability and access channels to Forfaiting has the potential to support both traditional trade finance and SCF.

# Market trends in Supply Chain Finance: Factoring

FCI

**Author**

Peter Mulroy, Secretary General, FCI

## Factoring industry achieves growth, albeit at a slower pace

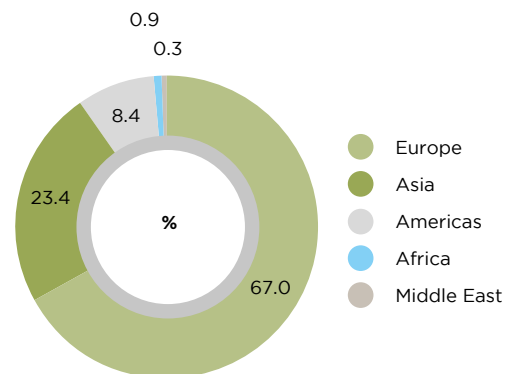
The global factoring statistics were released by FCI for the year 2016, and for the second year in a row, we continue to witness a slowdown, having increased only 0.35% last year. The Industry has overall held its pace with many markets showing significant continued growth. These advances have been offset by a continued reduction of volume from China, however, where the downturn has also affected cross-border factoring figures, which recorded the first decline since 2009. The total volume determined for 2016 amounts to EUR 2,376 billion, slightly higher than in 2015 where it reached EUR 2,367 billion as indicated in Figure 83 below.

European markets show an increase of close to 2.5%; however, it must be remembered that the figures collected are expressed in euro and British pound sterling, highly influenced by its currency fluctuation, represents over 20% of the European volume. Converting the pounds sterling UK figure into euros records a drop of over 13%, however denominated in pounds sterling, the market from year to year increased over 1%. The rest of the “mature” markets like Italy (close to +10%) France (+8%) and Germany (+4%) show a continued upward trend, whilst, at the other extreme, Turkey’s reduced exports pulled down its total market

**Figure 83: FCI 2016 global factoring statistics and market share by region**

	2015	2016	GROUP RATE % CHANGE
Europe	1,557.0	1,593.0	up 2.31%
Asia	596.6	555.6	down 6.89%
Americas	187.4	199.5	up 6.46%
Africa	18.7	20.4	up 8.93%
Middle East	8.0	7.5	down 6.89%
Total	2,367.8	2,376.0	up 0.35%

All figures given in EUR billion



Source: FCI

## The global factoring industry is growing, albeit at a much slower pace



figure, continuing its decline to generate a decline in volume of roughly 10%. It is worth highlighting that the Russian market increased by +20% and the Netherlands by +26%.

In the Americas, due to the significant reduction in import factoring volume stemming from the slowdown in China, the North America market recorded a decrease of over 5% but the USA domestic factoring market increased by 3%. The South American countries' volume grew by over 20% thanks to the performance of Brazil (over 50% increase), Argentina (+22%), Mexico (+17%) and Chile (+12%), all in part stemming from the strengthening in their local currencies but also from the rebound in commodity prices as a result of the improvement in the global economy. The future of the Industry in the region still looks very promising and expectations are high.

The Africa region recorded growth of 9% even though South Africa, representing the largest market in Africa with an over 70% market share, saw a depreciation in the rand by nearly 20%, which makes this growth rate even more remarkable, considering that South Africa alone grew by over 11%. It is hoped that the efforts of new players in sub-Saharan Africa soon start to show positive results. The Middle East witnessed a decline of nearly 7%, in part stemming from the overall reduction in commodity prices over the past two years, but also stemming from the slowdown in investment and trade from China, all which affected trade in the region.

Asia was, as said, highly influenced by China, as the factoring industry there declined in 2016 by 15%, and if the decline in 2015 is included, the market has seen a reduction of close to 28% since the industry's peak in 2014. For nearly 15 years, China has been on a tear, increasing at unparalleled rates of growth compared to most other markets, and surpassing the United Kingdom as the largest factoring market in the world, to only lose the distinction in 2015, as a result of the slowdown. But after nearly 15 years of uninterrupted growth, it is not surprising to report for the first time that the factoring market in China has experienced its first major test. Like most periods of economic malaise, risk increases, and the experience from this disruption in China was no exception.

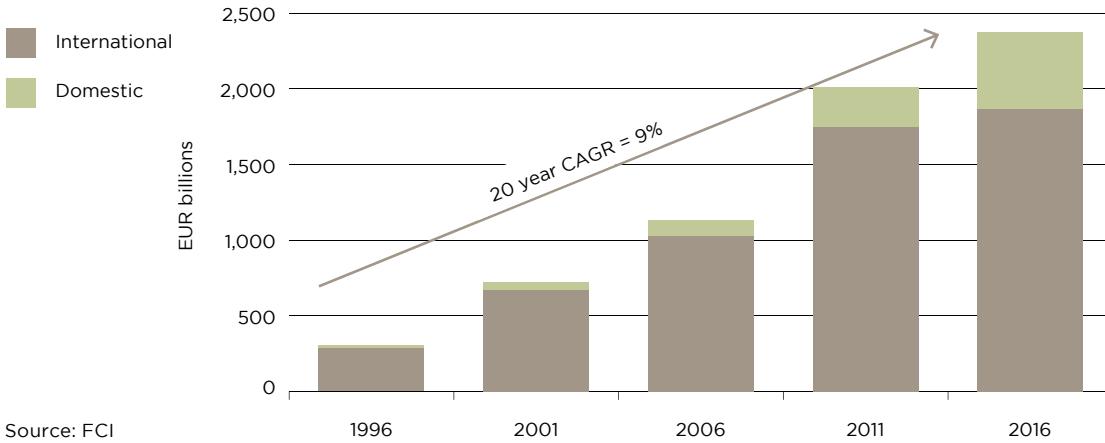
The market experienced a dramatic increase in fraudulent activity, and nearly every bank factoring enterprise in China was impacted. Capital stringency also played a role in the reduction, which was reported as a contributing factor for the fall in domestic RMB denominated factoring volume. Some of the regional players in Asia were also affected by the slowdown in China, as other traditional strong players such as Taiwan (-10%) and Japan (-9%) experienced significant declines. However, other markets bucked the trend, as Hong Kong (+28%), Australia (+14%) and Singapore (+4%) all experienced solid growth.

Since 1996, the global factoring industry has been growing at a relatively fast pace, increasing on average nearly 9% per annum. However, the most significant engine of growth has been the rise in cross-border factoring during these two decades, growing from less than EUR 30 billion in 1996 to over EUR 507 billion in 2016, as can be seen overleaf in Figure 84.

A decade ago, cross-border factoring accounted for less than 5% of the total, and domestic over 95%. Since then, cross-border factoring has grown at a much faster pace, and today cross-border factoring accounts for 21% of the total, and domestic 79%, as shown above overleaf in Figure 85.



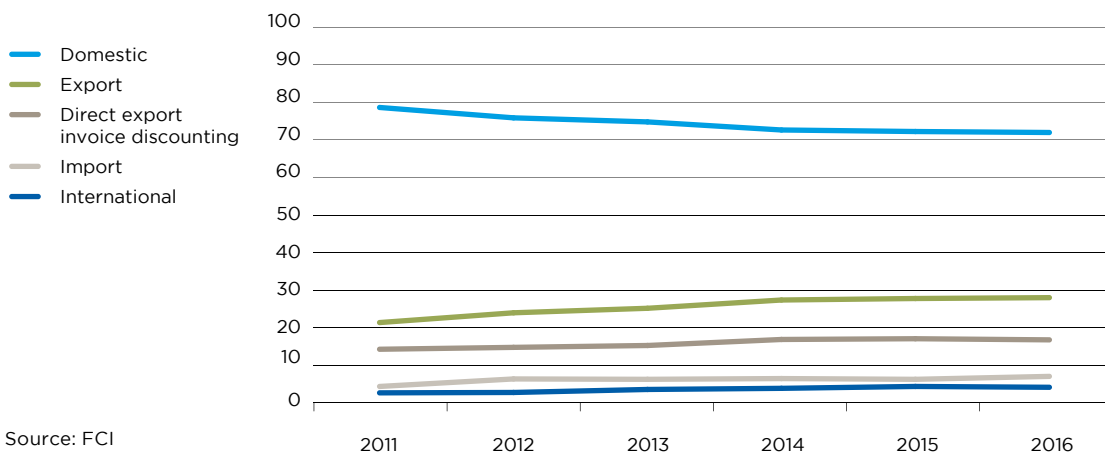
**Figure 84: Global factoring volume, 1996-2016**



Source: FCI

However, for the first time since the great recession ending in 2009, cross-border factoring declined, generating EUR 507 billion in volume last year, a decrease of -4.2% over the same period. In fact, for the first time in decades, global trade grew at a slower pace than global GDP, an unusual phenomenon. In fact, since the end of the great recession in 2010 until 2016, domestic factoring grew by 5% on average, however international cross-border factoring grew even faster, at a rate of 13%, as can be seen in Figure 86 opposite.

**Figure 85: FCI members share by product**



Source: FCI

**Figure 86: Total factoring volume, 2010-2016**

	2010	2011	2012	2013	2014	2015	VARIATION		
							2016	2015/2016	CAGR
World Domestic Factoring	1,402,331	1,750,899	1,779,785	1,827,680	1,857,410	1,838,366	1,868,855	1.66%	4.90%
World International Factoring	245,898	264,108	352,446	402,798	490,114	529,379	507,112	-4.21%	12.82%
World Total	1,648,229	2,015,007	2,132,231	2,230,477	2,347,524	2,367,745	2,375,967	0.35%	6.28%

Source: FCI

International factoring represents the largest percentage of volume compared to any other period over the past two decades. The growth in cross-border factoring has again been driven by an increase in open account trade, especially from suppliers in the developing world, pushed by the major retailers/importers in the developed world, and the acceptance of factoring as a suitable alternative to traditional letters of credit. The greater China region has played the most important role in this impressive growth story, however as mentioned above, since 2014 China has been in decline by nearly 28%, which has had a significant impact both on volume in general and cross-border volume in particular.

Founded in 1968, FCI has grown into the world's representative factoring network and association with 400 members in 90 countries. In 2016 the activities of the International Factors Group were integrated into FCI. Today, FCI is truly the global representative body for the Factoring and Receivables Finance industry, and is the world's largest factoring network, with member transactions representing approximately 84% of the world's international cross-border correspondent factoring business conducted in 2016, as can be seen in Figure 87 below.

FCI Members account for close to 60% of the world domestic volume. In 2016, domestic factoring only grew by 1.7% over 2015, indicative of the general slowdown in global GDP.

Factoring is considered to be a product designed to offer financing to SMEs. Funding is offered based upon the accounts receivables created by the client: With a factoring solution, the factor agrees to pay to the seller an agreed percentage of approved debts as soon as the receivables are assigned to the factor. The factor will often also undertake all credit management and collections work. There will normally be a charge for the collections service and, if it is required, for bad debt protection as well as a discount charge for finance provided in advance of collections. Not only is most of the business conducted within the framework and membership of FCI, but FCI also provides a legal foundation to conduct cross-border correspondent factoring. The General Rules of International Factoring (GRIF) form the legal basis under which nearly all cross-border correspondent factoring business transactions are conducted, and this legal framework has been accepted by nearly every international factoring company around the world. FCI members also use a proprietary communication system called edifactoring.com. Like the SWIFT messaging system, edifactoring.com provides a sound and secure means, by which members can issue factor guarantees, send invoice data, issue dispute notices, and send payment messages.

# 13%

**Growth of international factoring from 2010 to 2016**

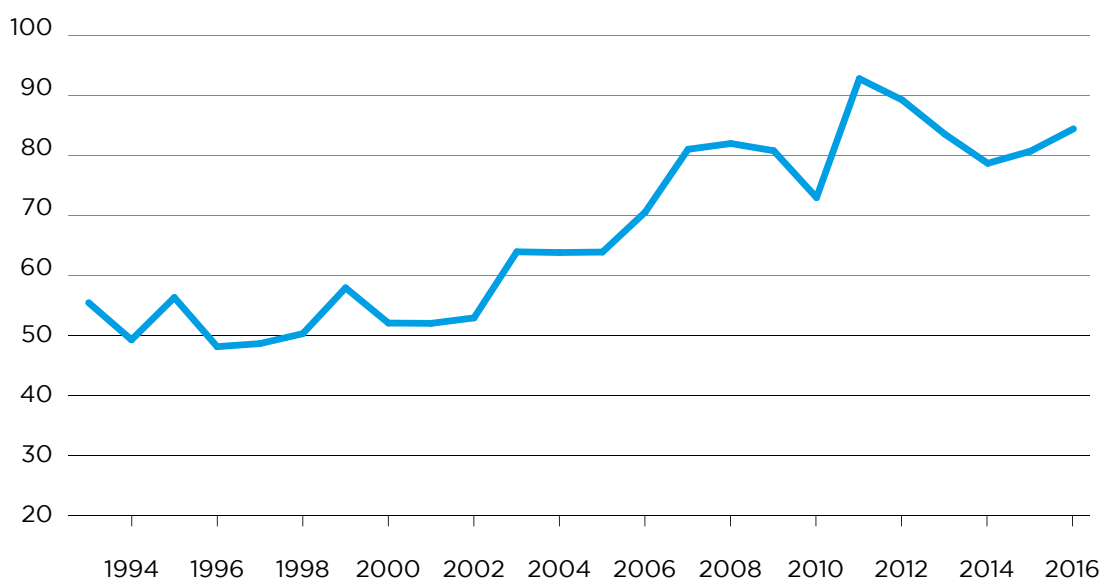
We have seen the factoring industry double in size since the financial crisis in 2009. What was a relatively small component of finance at the turn of the century, receivables finance has become a dominant player in most major markets around the world, and as such, the stakes are even greater today. Alternative forms of factoring, like reverse factoring/confirming have evolved to complement this unique form of financing open account trade. The significant increase in world factoring volume has been driven by a systematic growth in open account trade, which has been led by commercial bank run factoring businesses, especially in Europe and Asia. Commercial banks dominate the space in most markets. In Europe alone, over 90% of the factoring industry is generated by bank-owned factoring subsidiaries and in most of Asia, trade finance units of commercial banks control the vast majority of the factoring activities there. In fact, only until recently, banks in China were the only parties permitted to operate a factoring activity. However, commercial non-bank-owned factoring enterprises are playing a large role in the US, UK, and China, and with the rise of FinTechs, more and more non-bank players will have a significant impact on the industry. And in some markets, like the US, UK and Brazil, factoring is unregulated, giving commercial factors an advantage over their bank counterparts in the traditional factoring field.

The explosive growth of the industry, especially since the start of the financial crisis, is in large part inspired by an enhanced perception of risk globally, but also stemming from the shift from overdraft /unsecured credit facilities to receivables-based financing. This shift is also enhanced by the introduction of Basel II/III rules and the favourable treatment they impart on banks from a capital treatment standpoint.

**The factoring industry has doubled in size since 2009**



**Figure 87: FCI's share of world international cross-border factoring**



Source: FCI

Today, a significant percentage of non-recourse factoring is credit insured, and there are still some unresolved questions from regulators whether this risk mitigation technique can be considered a guarantee of payment, and hence receive capital relief under the Basel rules, ultimately allowing the banks and their factoring subsidiaries capital optimisation.

FCI has been in discussion with the credit insurance industry and industry players to come to a definitive and consistent message. But one common denominator exists today between regulators, and that is the understanding that factoring is a safe and secure form of financing. Governments, development banks and industry stakeholders have come to understand and appreciate that factoring is a secure and reliable method of financing trade and an invaluable means of providing liquidity to SMEs, the engine of growth and creator of employment in most economies.

The lines between factoring and receivables finance and traditional trade finance continue to blur, as more and more banks develop receivables finance strategies within their organisations. As such, the ICC Global Survey 2016 is an excellent vehicle to promote factoring. It is also valuable to potential new companies interested in developing cross-border receivables finance activities as an alternative to traditional letters of credit and documentary collections. As a contributor, it is our hope that this fine publication will contribute to a better understanding of our industry.

**Factoring's explosive growth is in large part inspired by an enhanced perception of risk**



### Editorial Comment: selected strategic and tactical implications

#### Strategic implications

The increased positioning of factoring as a mainstream financing and SCF solution and technique provides the impetus for greater collaboration between traditional providers of trade finance, and those focused primarily on various forms of factoring. This can be well accomplished in the context of SCF as a common umbrella framework.

Common regulatory challenges and the opportunity for closer collaboration in effective servicing of SMEs around the world, combined with a shared strategic interest in cross-border trade, suggest strongly that a strategic industry level dialogue and concrete collaboration be initiated,

perhaps initially through the sharing of industry data and benchmarks, and thereafter through combined advocacy work and the complementary development of additional market propositions under SCF.

#### Tactical considerations

Lessons related to effective risk management and fraud prevention can usefully be shared on a regular basis and in systematic fashion between banks engaged in trade and receivables finance, and providers of factoring solutions in support of cross-border commerce. Specific activities that result in the overall reduction of risk around cross-border finance will equally serve all participants in the market.





# Export finance market trends

TXF

*Based on TXF-ICC Global Export Finance Survey 2017*

**In a year in which country risk profiles have morphed, elections have confounded, regulatory changes are being extensively discussed and lender appetite is returning, the TXF-ICC Global Export Finance Survey 2017 gives the export finance community a chance to outline the market's current trends and challenges. The survey incorporated the views of approximately 100 senior export finance practitioners, from Global Heads of Export Finance at leading banks, to CEOs at Export Credit Agencies and CFOs at major exporters and importers.**

#### **Authors**

Hesham Zakai, Associate Director and Max Thompson, Reporter, TXF

## **Pricing poses a problem**

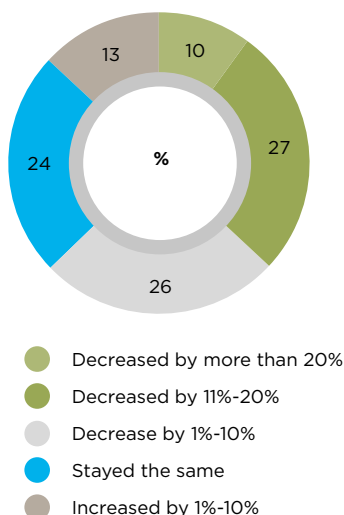
Given that pricing is a core factor in profitability, and therefore instrumental to the outlook of an export finance solution on which many corporates rely, the survey gathered the industry's view on patterns in and drivers of pricing.

Two thirds of respondents cited a decrease in pricing over the last year: 27% of respondents saw a drop by 11-20%, 26% cited a decrease of 1-10%, and 10% claimed pricing had decreased by more than 20%.

24% said pricing had stayed the same, while the remaining 13% cited an increase between 1-10%. The low pricing environment is a serious rejoinder to expectations set out in the previous year's survey, when nearly half of respondents said they expected it to go up.

This time, when asked whether pricing would go up or down in the next 12 months nearly half (46%) of respondents said it would stay the same, 28% said there would be a decrease, with the remaining 26% citing an increase in pricing.

**Figure 88: How has pricing in export finance changed over the last year?**



Source: TXF Global Export Finance Survey 2017

Low pricing will be a serious issue for many bank practitioners specifically, who may be able to weather a short-term situation of this kind, but for whom a longer term trend of low pricing may become unsustainable.

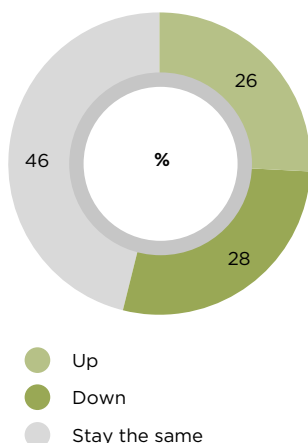
Over half of respondents (58%) claimed the key driver of pricing was competition, including levels of liquidity in the market, while a fifth of respondents cited compliance and regulatory requirements, including Basel III. The low interest rate environment externally has driven a stronger interest in trade finance as an asset class, and thus these larger pools of liquidity could have led to downward pricing pressures.

Non-bank respondents were more likely to identify compliance and regulation requirements as a driver of pricing than banks were, suggesting a perception issue. The remaining 18% said a lack of available projects was a key determinant of pricing.

When asked specifically about Basel III being priced into export finance deals, two thirds (65%) of respondents concurred. This is a 6% increase on last year, a reassuring trajectory that is likely to continue as we move towards Basel III implementation deadline. Nonetheless, 15% reported that Basel III was still not being priced into transactions and 20% were unsure.

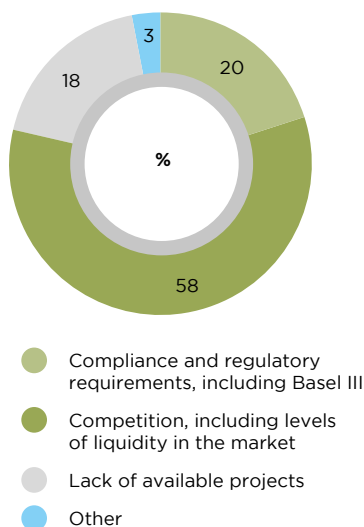
When looking at responses of non-banks only, a third were unsure as to whether Basel III was being priced into their export finance deals. While this is likely to be because banks want to manage their 'under-the-bonnet' requirements internally, it does leave open the possibility of greater discussions between banks and clients about regulation and further impacts moving forward.

**Figure 89: Do you expect pricing to go up or down in the next 12 months?**



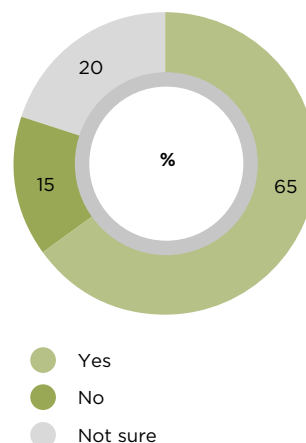
Source: TXF Global Export Finance Survey 2017

**Figure 90: What is the key driver of pricing in the market at the moment?**



Source: TXF Global Export Finance Survey 2017

**Figure 91: Is Basel III being priced into your export finance deals?**



Source: TXF Global Export Finance Survey 2017

## The intersection of pricing and direct lending

The consensus across banks and non-bank respondents was that while ECA direct lending occasionally treads on the toes of the private market, it can also complement bank lending. It can also, moreover, influence the key issue of pricing discussed above. Respondents observed that the availability of commercial interest reference rates (CIRR) for small size or challenging jurisdictions can often drive a deal to direct lending.

Bank respondents commented that ECA direct lending caused competitive problems, especially if direct lenders entered the presently well-engaged markets. The overwhelming sentiment is that ECAs should only offer direct lending as a last resort where bank capacity is not available, or to help provide supplementary funds for project finance transactions in difficult markets, thus making it more useful than a competitive threat.

The direct lending question is also important because it helps to adumbrate how the export finance business with banks is evolving, with many now focusing more efforts on arranging and structuring, expertise that ECAs cannot so readily compete with.

The main threats commercial banks perceived were of being crowded out in a limited supply market, alongside the aforementioned slight difference in pricing with the current record low CIRR.

The low CIRR rate will have marginally contributed to the decrease in pricing witnessed over the past year, as more players opt for the cheap ECA funding option, and in turn, banks drop their margins to compete. For example, Hungarian Export Import Bank (HEXIM) and Export Development Canada (EDC) last year co-financed Perusahaan Listrik Negara (PLN)'s development of eight GE-supplied mobile power plants. The 12-year USD 436 million debt was priced at a fixed CIRR rate of 2.56%.

At present, qualitative responses to the survey suggest respondents do not feel ECA direct lending is being substantially used in favour of SME financing, where it could close a market gap. Instead, it has absorbed.

This compounds issues for SMEs, in a market in which only 47% of respondents believe is doing enough to support SMEs. The reasoning for this varies from the cost and complexity of the tool to a belief that it is not the primary role of ECAs to support this market segment. It is a challenge that is being tackled across trade finance, from short to long term financing, and which can be propelled by new solutions being found in digitisation, simplification and harmonisation.

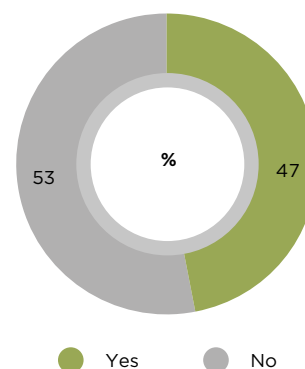
## Fee decrease broadly in sync with pricing

The majority of respondents saw a decrease in bank fees over the past year: 28% cited a 1-10% decrease, 17% claimed fees decreased by 11-20%, while 9% saw a decrease of more than 20%.

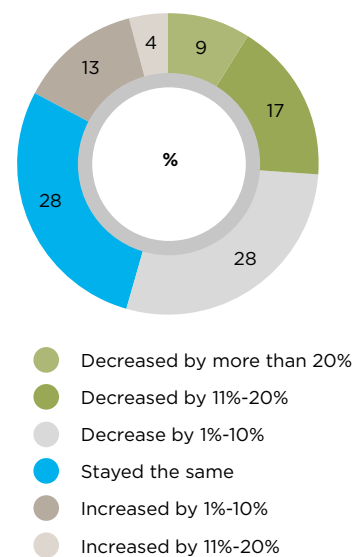
13% cited a rise in fees by 1-10% and 4% said the increase had been between 11-20%.

Only 11% of banks reported an increase of any kind in bank fees, compared with around 30% of non-bank respondents. This tightening of fees comes despite an increase in prohibitive factors, some of which are delineated here.

**Figure 92: Are ECAs doing enough to support SMEs today?**

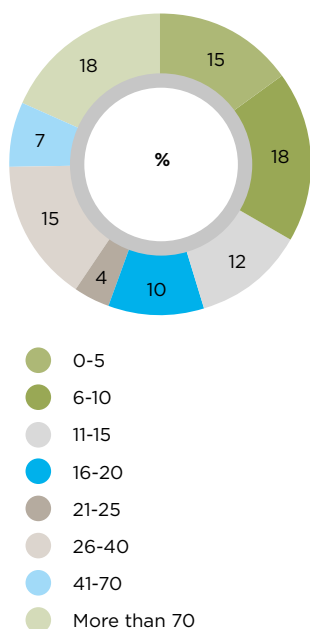


**Figure 93: How have bank fees in export finance changed over the past year?**



Source: TXF Global Export Finance Survey 2017

**Figure 94: In how many export finance deals were you involved in 2016?**



Source: TXF Global Export Finance Survey 2017

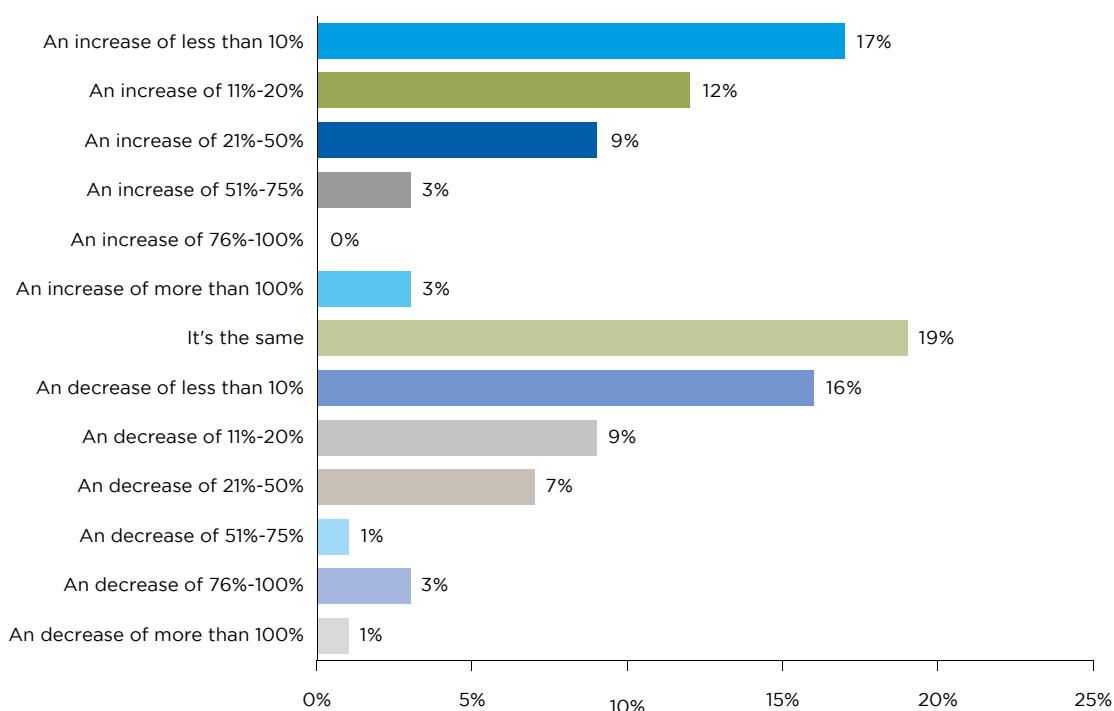
### Growth is present – but tempered

These aforementioned barriers contribute to a growth landscape that shows no discernable uniform pattern, with an emerging picture instead of mixed fortunes across the board for participants. The positive news is that 62% of respondents were involved in at least as many deals in 2016 as in 2015. This growth was generally modest with 29% of respondents seeing their deal activity rise by 1-20%. A very small number, however, (3%) were involved in at least twice as many export deals in 2016 as in 2015.

On the other hand, a very sizeable minority of 38% saw a decrease in activity, although for 65% of those, the decrease was one of less than 20%.

Generally, then, while there are more practitioners experiencing growth, the uneven distribution of growth and prominence of business decline for a significant section of the market suggests a competitive landscape which is yielding both winners and losers.

**Figure 95: How does that compare with 2015?**



Source: TXF Global Export Finance Survey 2017



## Legal worries curtailing growth into new markets

When asked about the most prohibitive factors to doing export finance deals in new markets, legal issues were cited as a top concern. A third of respondents felt that one of their three biggest hurdles in that regard were either regulatory requirements (52%) or sanctions (42%). Both of these issues have a degree of fluidity, so the challenge remains for market respondents to adopt stable internal mechanisms for managing them. In comparing responses this year with last year's, it appears the industry has not successfully done this and the compliance landscape continues to be a burdensome one: in last year's survey, 40% of respondents struggled with legal and regulatory hurdles (versus 52% this year).

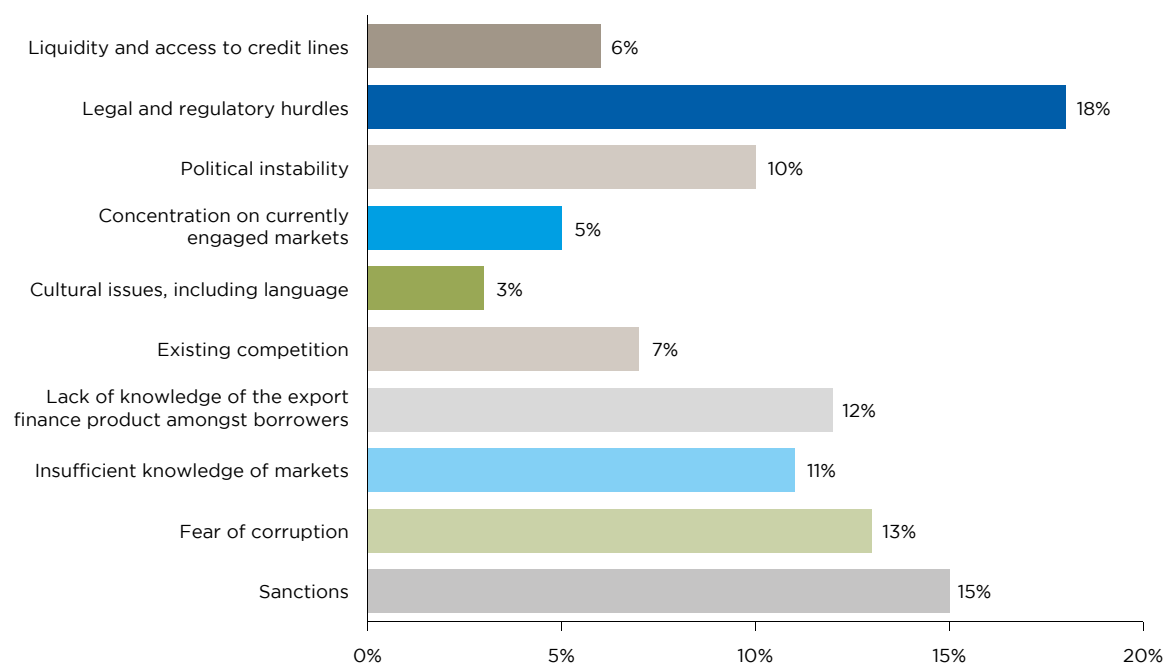
Corruption also figured highly, with 36% citing it as one of their main barriers. Given export finance is a tool designed to make possible business that may not otherwise go ahead, this is thus unsurprising given the risk profile of some of the markets it is present in.

Gaps in knowledge were also significant among both corporates and financiers. 30% of participants felt that a lack of knowledge of new markets was holding them back from doing business there, while 35% worried most about prospective borrowers' understanding of the export finance product. The proliferation of the ICC Working Group on Export Finance, inter alia, could help to combat this by better harmonising and marketing the product to potential users.

Other issues, including political instability, competition, access to credit lines and liquidity and cultural issues were found to be smaller concerns. On political instability, this is a big move from last year, when it was identified as a key deterrent by 43% of respondents.



**Figure 96: What do you see as being the most prohibitive factors to doing export finance business in new markets?**



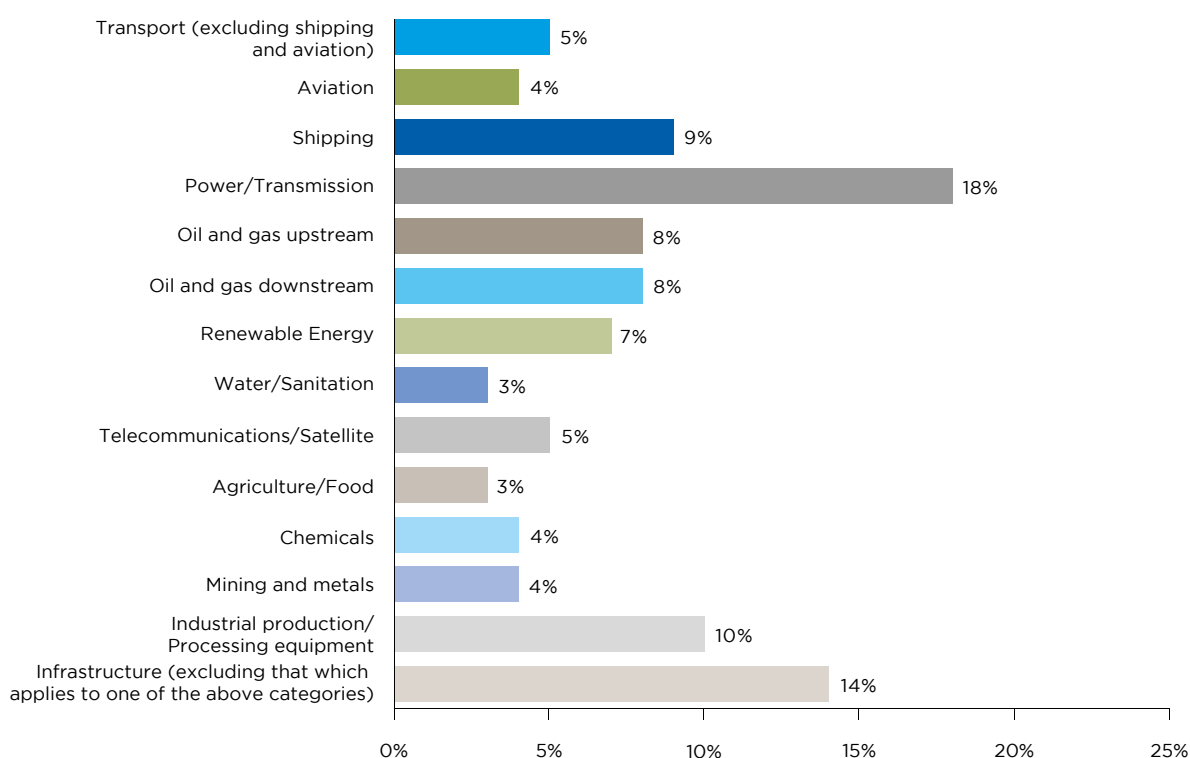
Source: TXF Global Export Finance Survey 2017

## Power and infrastructure come out on top

Power and infrastructure were particularly active sectors of the export finance market, figuring in the top 3 sectors for 18% and 14% of respondents, respectively. Despite recent concerns about the shipping industry, it still figured fourth in the list, with 9% of respondents citing it as a key sector. Oil and gas upstream and downstream were both cited as a top sector by 8% of those surveyed. However, renewable energy came up close behind at 7%, indicating the growing activity in the renewables sector, perhaps bolstered by recent limits on the development of new coal fired power plants.

The future trajectory of renewables is now under particular scrutiny as the road ahead for the Paris Agreement is debated. Nonetheless, with emerging powers such as India pushing on determinedly towards non-fossil fuels and China making statements in support of global action against climate change, it looks to be a sector that will enjoy considerable growth.

**Figure 97: What were your top sectors for export finance?**



Source: TXF Global Export Finance Survey 2017

## Americas providing ample opportunity

Egypt was the top borrower market for 2016, as the country continues its push to meet its vast energy needs and the government of Abdel Fattah el-Sisi continues to receive backing from international partners. More power deals have been done in the country and that trend is expected to continue.

Despite the travails of its own ECA – US Ex-Im – the USA came in second as borrower market, reinforcing the fact that export finance is not a product used only for exporting into emerging markets. The Americas as a whole provide significant opportunities to exporters and financiers, with Brazil and Mexico also figuring in the list of top borrower markets.

Other popular destinations included Indonesia, Russia, China and Turkey.

## A holistic view of the export finance solutions

A dominant message that has surfaced from previous iterations of this survey was the extent to which export-finance was a round-the-cycle solution that was predicated on strong relationships. With this in mind, this year's survey set out to build on that finding and understand further how banks position and view the product internally, and what broader bearing it has on their relationship with clients.

Firstly, when asked to consider the export finance product offering in its totality, bankers almost unanimously agreed (97%) that it benefited their financial institution's commercial relationship and customer intimacy. This positive enhance of the client relationship is supplemented by a second strong finding, which is that the export finance solution helps to secure repeat business (90%).

One area of potential concern, however, is the mixed feeling respondents had towards export finance being a factor of complexity and delays. Three-quarters of respondents stated that they either agreed or were neutral on the assertion that complexity and delays were a feature of export finance, adumbrating the industry's needs to continue to try and find ways to speed up and simplify the process.

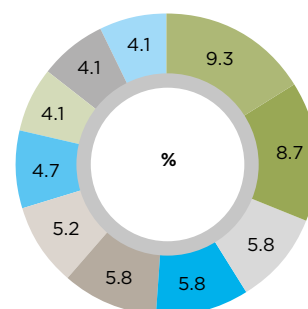
## Figure 99: Consideration of the export finance product offering in its totality

From a banks' perspective, do you agree that export finance is:

ANSWER OPTIONS	AGREE	NEUTRAL	DISAGREE
Key to winning the commercial deal	53	47	0
A factor of complexity and delays	39	39	23
Benefits your commercial relationship and customer intimacy	94	6	0
Helping to secure repeat business	87	13	0
A necessary evil	6	25	69

Source: TXF Global Export Finance Survey 2017

Figure 98: What were your top three borrower countries in 2016?



Source: TXF Global Export Finance Survey 2017

On the whole, working relationships between banks and ECAs appear to be in a very good state

### “What a bank wants”: in ECA partners

Consistency – which in turn fosters predictability and leads to more effective planning – and flexibility are the key features that banks value when dealing with an ECA. 60% of respondents stated that these two factors were ‘extremely important’, with the latter being most helpful in the form of ECA flexibility on the question of terms and structures. Given a more rigid approach has the potential to preclude deals, the industry collectively faces a balancing act between a well-understood product offer that is consistent and predictable, without sacrificing the flexibility that allows it to pivot in different directions to help get transactions over the line.

Interestingly, the least important factor was commercial support – with 10% stating it was not important at all and over half claiming it to be a neutral factor. This suggests either: 1) A feeling of a strong commercial position among banks at present, or 2) The delineation of an ECA’s role as being other than to provide commercial support.

On the whole, working relationships between banks and ECAs appear to be in a very good state. The vast majority of banks believe that they have a forward-looking relationship with each of the ECAs that they are most actively cooperating with, for example on matters of sharing upcoming commercial opportunities, key markets, and working together in advance of transactions being secured. While this is certainly a healthy dynamic for the export finance sector, it should be noted that despite these strong relationships, it is still the exporter or importer that drive business and thus often determine the make-up of the bank and ECA in any given transaction.

### “What a bank wants”: in product and innovation

When it comes to products and innovation, structure flexibility (90%), the quality of the guarantee (85%), and claims procedure & track record (also 85%) were identified as either extremely important or fairly important features for banks, collectively reflecting the appeal of a strong, secure, backed-up deal.

The least important feature was an ECA’s direct lending capabilities with a fifth of respondents claiming it to be not important at all and 60% claiming it to be a neutral factor, corroborating the aforementioned inference of how banks view the primary roles and offerings of ECAs.

When respondents were asked to rate their top ECA on the same range of factors, the highest and lowest ratings broadly mirrored the most and least important features identified, with quality of guarantee ranking extremely well and direct lending capability ranking relatively poorly. Effectively, there appears to be a consensus that the ECAs are doing better on those parameters where banks would consider their support to be most valuable.

### The strive for a level playing field

Several respondents – from banks and non-banks alike – wish for the export finance product to be simplified. Among the top concerns cited were overly complex documentation, the need to level the playing field between ECAs operating in various countries and overly stringent (and at times contradictory) regulation. These concerns were expressed by banks and non-banks in fairly equal measure. Others’ wishlists included revisions to stringent rules on local content to better reflect a globalised world, a full board for US Exim, and more standardised documentation.

Linked to this was a feeling that the product is not understood by non-specialists. One bank respondent wished for “better understanding of what we do from C-suite management,” while several others felt that financial regulators did not understand the low-risk nature of export finance.

### Key challenges remain

Banks’ views are all fairly well aligned when it comes to key challenges in the industry: almost all respondents were worried by: stringent regulation; unmanageable Know-Your-Customer (KYC) and Anti-Money Laundering (AML) requirements; and excess liquidity coupled with a lack of bankable deals, leading to fierce competition and unsustainable low pricing.

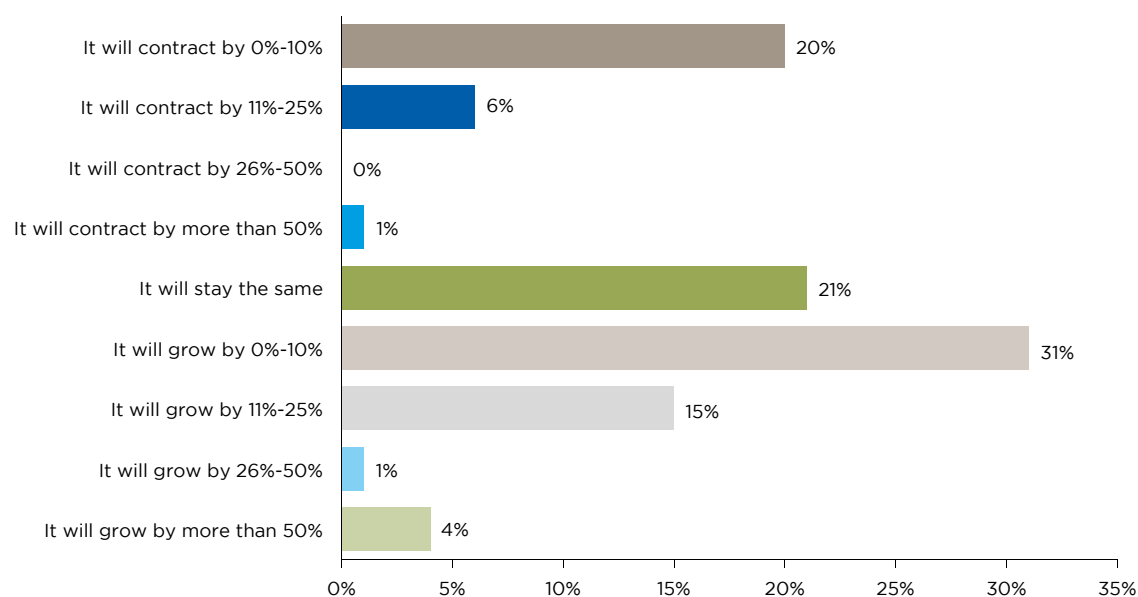
These concerns, however, were not clearly echoed among non-banks. For those parties, the most pressing issue was a shortage of projects and high competition for the projects that are available. Other concerns cited included: insufficient cooperation between multilateral financial institutions (MFIs) and other market players; the industry’s inability to effectively serve small and medium-sized enterprises (SMEs); and insufficient product knowledge.

### On a more positive note...

There was plenty for the industry to be optimistic about. Many banks were positive about new technological tools which will surely help address the aforementioned concerns about the complexity of the export finance product and the lack of standardisation. Many are also continually enthusiastic about growing in new markets and sectors, with one citing enjoyment in being part of a “global business with diverse cultures and new experiences.” This enthusiasm was shared among non-banks, who find satisfaction from “Enabling projects that make a material difference to the economies in which they are developed” and being part of an industry where “every deal is different, with new players and new structures.”

**Banks agree on the challenges of stringent regulation, KYC/AML requirements and competition**

**Figure 100: What do you think will happen to the export finance market in 2017?**



Source: TXF Global Export Finance Survey 2017





## Editorial Comment: selected strategic and tactical implications

### Strategic implications

Export finance, generally understood to refer to the medium and longer-term end of the trade financing market, is supported by a combination of export credit and export insurance/guarantee entities, often operating under a hybrid commercial/public policy mandate, and a range of private sector providers. The variance of value propositions and operating models makes it challenging to offer broad statements or conclusions, but illustrates the organic way in which a range of models have evolved around the world, to meet a variety of market needs.

Like the work of multilateral institutions, the contributions of ECAs in particular, and those with at least a partial public policy mandate not constrained by commercial viability, have been shown to be of critical importance to trade and trade financing. The peak of the global crisis illustrated this reality very clearly, at a time when the ongoing relevance of ECAs was being openly debated.

The response of survey participants indicating that they view relationships with ECAs as largely forward-looking, and the positive expectations about technology and its application to export finance combine to bode well for the industry. At the same time, some challenges persist in delineating clearly where the activities of banks and those of ECAs are complementary versus competitive. Even the most policy-driven ECAs are actively seeking to expand their value proposition and offerings to the market, thus some degree of tension between collaboration and competition is likely to remain a feature of the export finance business.

As new ECAs enter the market, primarily those based in high-growth emerging markets, the question of an optimal operating approach remains key to the provision of trade finance globally.

Strategically, market observations combined with the foregoing survey findings argue for thoughtful selection of partner ECAs not only based on geographic focus, but on the basis of an understanding of the mandates and priorities of each ECA, including any policy drivers that might enable support of an otherwise commercially

untenable deal. The dynamics around export finance pricing are notable, including the material mismatch between expectations voiced last year and results observed.

As with the short term trade finance business, the risk of a « race to the bottom » and the possibility of being trapped in a price commoditisation spiral must be monitored. Value-based discussions around the critical importance of export trade, and enabling export finance, merit careful consideration.

### Tactical considerations

The importance of enhanced and more frequent dialogue and interaction between export finance providers and ECAs (as well as private risk insurers and others) cannot be overstated under current conditions in global trade.

Common reference points in understanding the changing nature of trade – across complex supply chains with integrated sourcing and production – and the dynamic nature of the risks being mitigated, are increasingly important to establish at the transactional and working levels. Standard requirements, and more meaningful expressions of the « national interest » that ECAs are meant to protect beyond a one-dimensional 'local content' requirement should be the subject of candid discourse at both the strategy and the relationship/transaction levels.

Banks and other providers of export finance will benefit from a comprehensive understanding of the types of support available globally, with such insight potentially leading to awareness about a wider range of options than those most obviously identified, for example, by the geographic focus or base of a particular ECA.

Equally importantly at the tactical, transaction level, far better and more nuanced understanding of the competitive/complementary dynamic between provider and ECA will benefit trade, and will help improve the deployment of available capacity in financing trade.



# Export Credit insurance market trends

BERNE UNION

## Author

Vinco David, Secretary General, Berne Union

## The State of the industry

The export credit and investment insurance industry is currently in a rather healthy state, both for private and public suppliers of cover. However, there are a number of risks that could change this benign situation. These risks are clustered around three themes: premium levels, claims and regulation.

### Positive results for 2016

But first the good news. 2016 was a positive year for most insurers. Business levels increased slightly to USD 1.87 trillion of insured exports and foreign investments (including guarantees and direct lending from a number of ECAs). Berne Union members continue to provide support for a significant proportion of world cross-border trade: 11%, benchmarked against the USD 16.9 trillion figure recorded by the WTO for 2016.

Applying a more fine-grained examination however, we can observe some variation in trends between the different categories of insurers.

New trade-related business for 2016 was made up USD 1.63 trillion in short-term export credit insurance and USD 134 billion in medium and long-term cover provided by official ECAs. Private members insuring medium and long-term exports and state obligations reported USD 25.5 billion in new business. Insured foreign investments from all Berne Union members meanwhile rose to USD 69 billion.

On the one hand, private insurers of trade credit and political risk insurance were able to expand the volume of their business to almost USD 1 trillion – approximately 9% higher than in 2015 and accounting for the first time for more than 50% of total Berne Union business. Public insurers of short-term trade credit, medium/long term export credit and foreign investments, meanwhile, generally saw a small decline in volumes covered. However, at USD 900 billion, this total volume for 2016 is still a strong figure, and a positive indicator of a healthy industry.

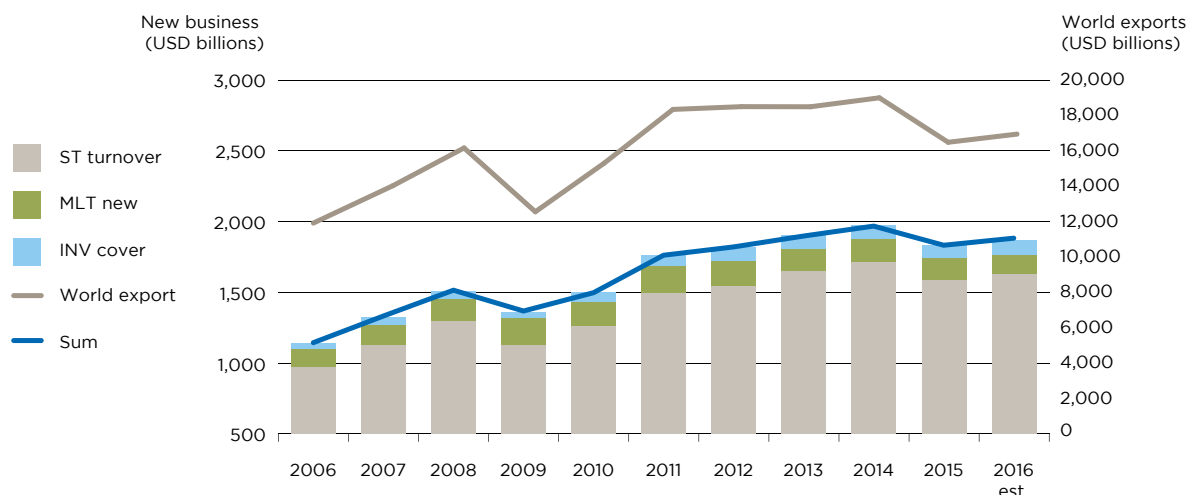
Berne Union figures on new business are seen to track trends in overall volumes of world trade and are regularly benchmarked against WTO figures. Comparing the two graphs also shows the resilience of credit insurance and the tendency for insured volumes to fall less sharply than the overall economy – demonstrating the counter-cyclical function of the industry.

# 1.87

USD TRILLION

Value of insured exports and foreign investments in 2016

**Figure 101: Berne Union new business & world exports, 2006 - 2016**



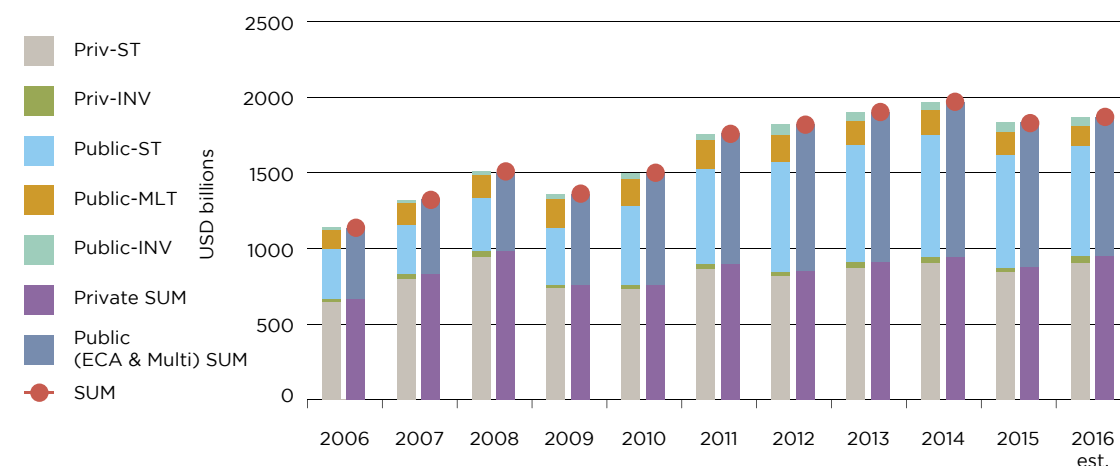
Source: Berne Union

Berne Union figures on new business are seen to track trends in overall volumes of world trade and are regularly benchmarked against WTO figures. Comparing the two graphs also shows the resilience of credit insurance and the tendency for insured volumes to fall less sharply than the overall economy – demonstrating the counter-cyclical function of the industry.

### Claims trends

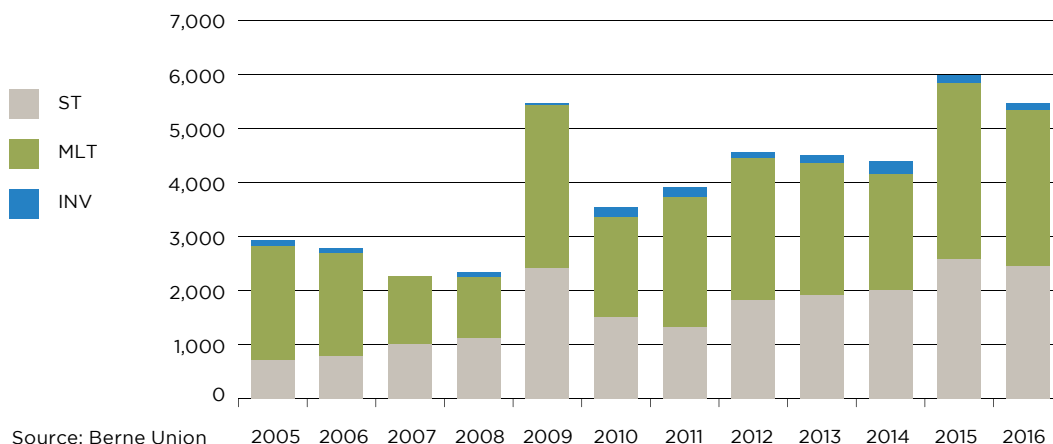
Claims payments decreased in 2016, compared to the previous year. In 2015 the total volume of claims paid as a result of insolvency or political events was 6 billion dollars: last year this figure was half a billion dollars less. While this is a positive adjustment, it should be noted that, in context, these figures are still high – comparable, in fact, to the levels seen in 2009, at the depth of the credit crisis. This leads to some observations about the risks the industry is facing at the moment.

**Figure 102: Berne Union new business private & public, 2006-2016**



Source: Berne Union

**Figure 103: Berne Union global claims paid, 2005 - 2016**



Source: Berne Union

### Premium levels compared to claims

Premium levels in the private market are historically relatively low, both for short-term business and for medium/long term credit and investment business. This is largely due to strong competition between private providers of cover.

In the short-term area this is mainly seen in competition between the world's three largest providers: Euler Hermes, Atradius and Coface, although other private or semi-private insurers also participate.

In the medium/long term credit and investment insurance area we have seen a large increase of capacity over the last few years, while demand has remained stable. There are currently about 60 providers of this type of insurance worldwide. Although this business has certainly proved to be profitable over the last few years, one can doubt whether this is the main reason for growing market participation from both insurers and other capital market investors. Due to the sustained low interest rates and bond yields for currencies such as the US dollar and the euro, investors are looking for investments with higher returns and one option is, indeed, credit and investment insurance.

We can see, then, that it is mainly drivers from the supply side keeping premium levels depressed and once interest rates start to increase one can expect the supply of capacity to wane, which may eventually lead to an increase in premium levels.

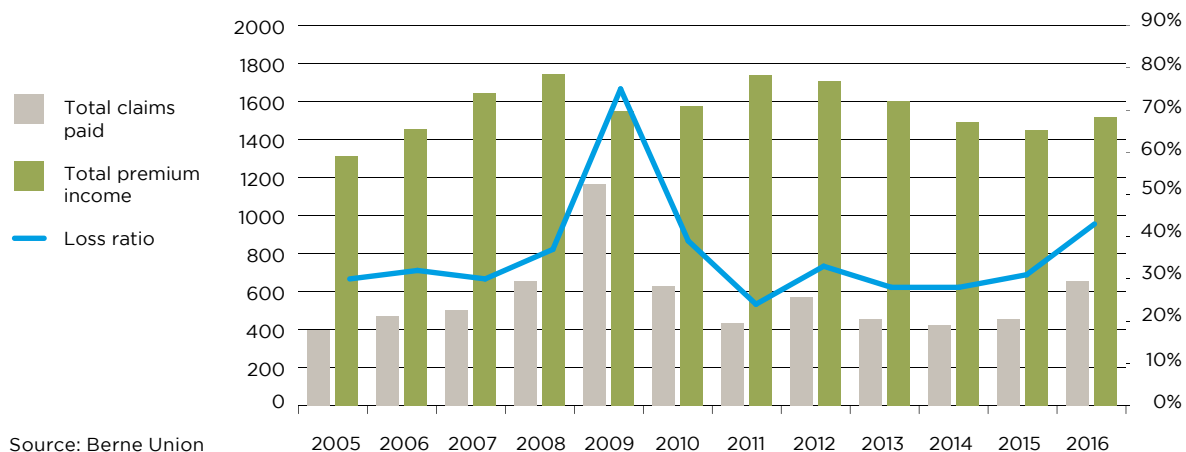
From the graph we can see that total premium income for this business has declined almost 17% between 2011 and 2015. 2016 figures suggest a stabilisation of premium income, but with claims peaking again, the loss ratio for ST business follows suit; current indications put this at around 43%.

While this data only represents a subset of Berne Union members – and does not therefore give a complete picture of absolute volumes – it is illustrative of the general trend towards softer pricing in the private market.

With claims peaking again, the loss ratio for 2016 ST business follows suit. Current indications are a stabilisation in premium income, and a loss ratio of around 42%.

**Strong competition between private providers has driven premium levels down**

**Figure 104: Private members' ST loss ratio, claims paid and premium income**

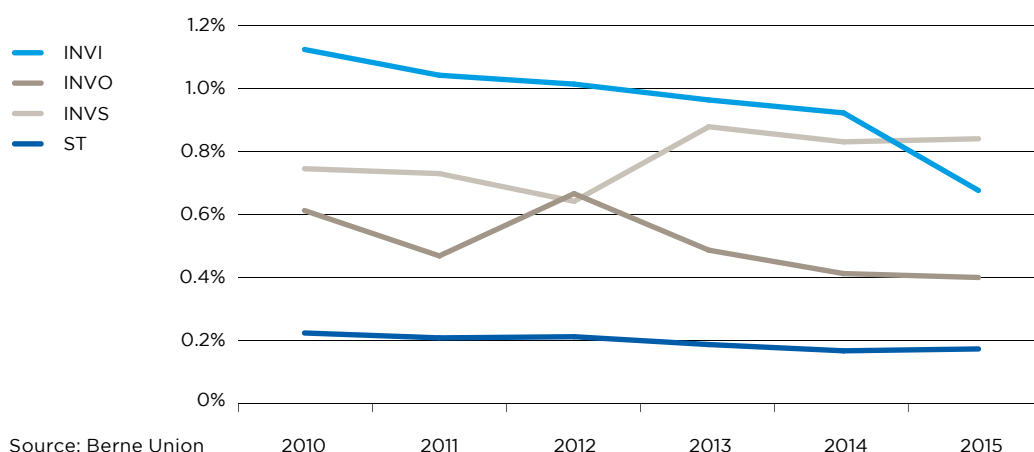


Source: Berne Union

Figure 105 shows the average pricing - calculated as premium income / exposure - for each reporting line within the Berne Union. In this graphic, INVS designates cover for sovereign obligors, while INVO represents credit cover for other private buyers. ST and INVI are the short-term credit and investment insurance lines described above.

This illustration confirms the observation that it is pressure from the supply side driving down premium income, through pricing competition, rather than falling volumes of business.

**Figure 105: Average pricing by reporting line for private members of the Berne Union**



Source: Berne Union



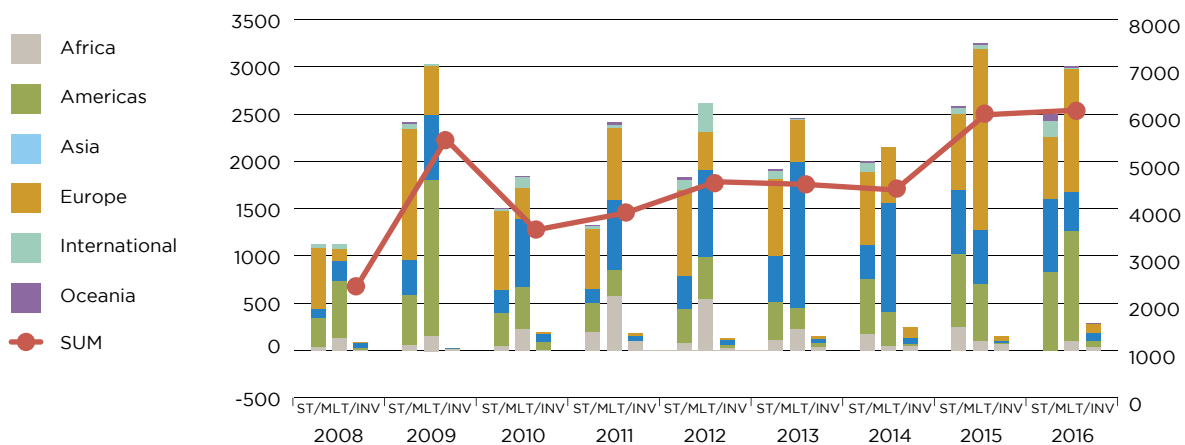
## Claims levels

The industry is currently profitable because claims levels are under control. For the business as a whole, average loss ratios are stable at around 30%, keeping risks manageable and appetite high. However, as we have seen above, strong competition and the resulting soft market (for private insurers) has the potential to disrupt one side of this equation and the current, relatively benign, situation may change if high volumes of claims remain sustained. If premium levels continue to fall, as claims rise, the resulting situation would not be financially sustainable for insurers.

We have seen this situation before, i.e. during the credit crisis from 2008, and although a new crisis is not expected, claims payments have been markedly high in both 2015 and 2016. Indeed, combined claims reported by Berne Union members across all lines of business – including both private insurers and ECAs – are higher for these years than at any time since 2009, as shown in the graph above.

Due to the relatively low prices of almost all commodities on the world market over the past few years, countries in Africa and Latin America, dependent on those commodity exports, are especially at risk. This situation has a negative impact both on companies active in these sectors, as well as on the economies of these countries as a whole. Indeed, the top country for claims in 2016 was Brazil, where Berne Union members paid a total of USD 860 million in claims last year – around 16% of all claims paid worldwide.

**Figure 106: Claims by region and reporting committee, all Berne Union members, 2008-2016**



Source: Berne Union

## Protectionism – through its impact on trade – could impact the topline of insurers



Figure 106 also neatly illustrates this trend, with claims in the Americas showing high growth in 2016, especially for MLT business, which is generally speaking more closely correlated with the economic health of emerging markets.

But there are of course also risks in high income countries and despite a mild economic uptick at the moment, claims here are still significant. The agenda of the US administration and Brexit will certainly impact international trade flows, but to what extent and in which sectors is not yet known. These lead to the third theme: regulation.

### Regulation

Trade barriers have never been good for trade. There is an abundance of evidence that, on its turn, international trade is good for prosperity. Self-evident as this may sound, not all politicians enshrine this ideal in their policies and calls for protection of national industries are common these days. While there are sometimes good reasons to temporarily protect selective national industries in their cradle phase; or a very limited number of industries deemed as strategic for a particular country; in general, protectionist measures eventually lead to a decline in productivity.

Typically, these kinds of political measures rather lead to a misallocation of resources and ultimately harm the competitiveness of those industries they sought to protect. Good examples are the US shipbuilding industry or the so-called 'zombie companies' in China. But also, of course, exporters to countries that build trade barriers are affected. If, for example, the US administration implemented trade barriers, then certainly countries like Mexico and Vietnam would feel the impact, given the large proportion of their exports bound for the US.

Worryingly, the number of calls for protectionist measures has increased of late, and notably in high-income countries where previously such sentiments have been rather exceptional.

As said, protectionism is not good for trade, and hence not good for export credit and investment insurers. Cross-border trade may decrease, impacting the topline of insurers. But it may also lead to a riskier environment with more insolvencies. There are no signs yet that this is happening, but this is certainly a development for our members to monitor.

Another area of regulation relevant to our industry is that of banks. Banks are essential for the financing of trade and exports, and for providing working capital to exporters and their suppliers.

For very good reasons, this bank regulation – now Basel III (some say Basel IV) and its implementation at national or regional level – has become stricter, partly as a consequence of the credit crisis. Banks have become better capitalised and in general this is a good thing. But implementing these regulatory measures with a broad brush could lead to less capital being available for the financing of export and trade. That would, obviously, not be a good thing for export and trade, and thus, eventually, for prosperity and, more mundane, the topline of credit insurers.

Banks, in particular European banks, have to some extent – and with support of the Berne Union – been able to demonstrate to regulators

that the financing of export and trade is not such a risky business at all, certainly if covered by (public) insurers. The European Commission, for example, has launched a proposal for the implementation of Basel III whereby the financing of trade and export covered by public insurers will attract lower capital requirements than originally proposed. This is a laudable development, but may not tackle all areas of insured export and trade financing. It is primarily up to the banks – as the institutions that are regulated – to see whether a broader capital relief is needed to fully continue financing trade and export, but as insurers of trade, members of the Berne Union continue to stand behind the risk transfer products they provide.

On a more positive note: In the course of tackling these regulatory challenges, banks have become more aware of the positive impact credit insurance can have on their balance sheets – not only for capital requirements reasons, but also by enabling them to better manage their aggregates.

### **In summary**

The export credit and investment insurance industry has recovered remarkably well after the global credit crisis. It is currently reasonably profitable, largely due to the fact that claims are under control. But this may change if claims continue at elevated levels for longer periods. Claims levels can be expected to rise if commodity prices remain low (affecting commodity exporting countries) and if more trade barriers are put up, affecting countries with large exports to countries implementing these protectionist measures.

Stricter bank regulation, too, can impact trade and, hence, the results of our industry. However, both exporters and members of the Berne Union have shown quite some resilience and adaptability to a changing environment and despite these challenges, there are compelling reasons for an optimistic perspective on the future of the industry.



## **Editorial Comment: selected strategic and tactical implications**

### **Strategic implications**

The important role of Berne Union members, both public sector and private sector as providers of risk insurance and guarantees, was firmly reinforced in the majority of jurisdictions as a direct result of the global crisis. While the industry reports overall solid recovery, recently high claim levels are concerning. Additionally, discussions continue about the translation of export credit cover into more favourable capital treatment.

Strategically, it is a compelling proposition to bring together the advocacy capabilities of ECAs and

their client banks and trade finance providers, to argue in favour of appropriate regulatory and capital treatment of ECA-backed trade financing, whether in the traditional space, or in SCF where risk mitigation and the role of ECAs is growing.

### **Tactical considerations**

There is opportunity at the transaction level for greater dialogue between export credit practitioners and trade financiers, whether a public policy dimension is involved in the work of the ECA or whether the organisation is primarily private sector in orientation.





I. REFERENCE  
INFORMATION

II. ECAP AND SELECTED  
HIGHLIGHTS

III. STATE OF  
THE MARKET

IV. TRADE AND SUPPLY  
CHAIN FINANCE

V. POLICY ADVOCACY  
AND INCLUSIVENESS

VI. RETHINKING TRADE  
AND FINANCE









# Policy, Advocacy and Inclusiveness: Shaping the Global Architecture for trade

Foreign direct investment – pulling it out of a rut >

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Making trade work for all >

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Impact of MDB trade facilitation programmes, regional insights >

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Selected elements of international advocacy: trade, finance and development >

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Sustainable trade and the role of the banking industry >

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SME competitiveness outlook >

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Protectionism in the 21st century and trade barriers faced by firms >

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Legal and regulatory issues adversely affect banks in trade and supply chain finance >

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Compliance issues: taking the client perspective >

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# Foreign direct investment – pulling it out of a rut

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

**Since the global financial crisis of 2008, global foreign direct investment (FDI) has remained anaemic. FDI flows declined again in 2016 – by 2% to reach an estimated USD 1.75 trillion. This was the fifth decline in eight years since the crisis, and was punctuated by persistent weak global economic growth and meagre gains in global trade volumes.**

#### Author

James Zhan, Director of Investment and Enterprise at UNCTAD

The crisis has hurt confidence like seldom before and investment flows have been floundering since. In the single year that there has been solid growth in FDI flows – 2015's rise of 36% – this has been largely propelled by mergers & acquisitions (M&A) or corporate reconfigurations for tax purposes, which add little or no productive capacity to the world economy, nor do they tend to create jobs.

The decline in FDI was not equally shared across regions, reflecting the heterogeneous impact of the current economic environment on countries. The regions that bore most of the brunt were Europe (-6%); Developing Asia (-15%) and Latin America and the Caribbean (-14%). The decline in flows to developed countries was tempered by modest increases in flows to North America (+9%) and a sizeable increase in investment in other developed economies, notably Australia and Japan.

Transition economies were among the only other countries that decisively deviated from the downward trend, with FDI to these economies rising sharply (+81%). The United Kingdom also bucked the trend. Despite the Brexit vote, the UK saw an almost eightfold rise in FDI, to USD 254 billion largely on the back of a surge in M&A. For most of the rest of the world FDI inflow growth was modest – or negative.

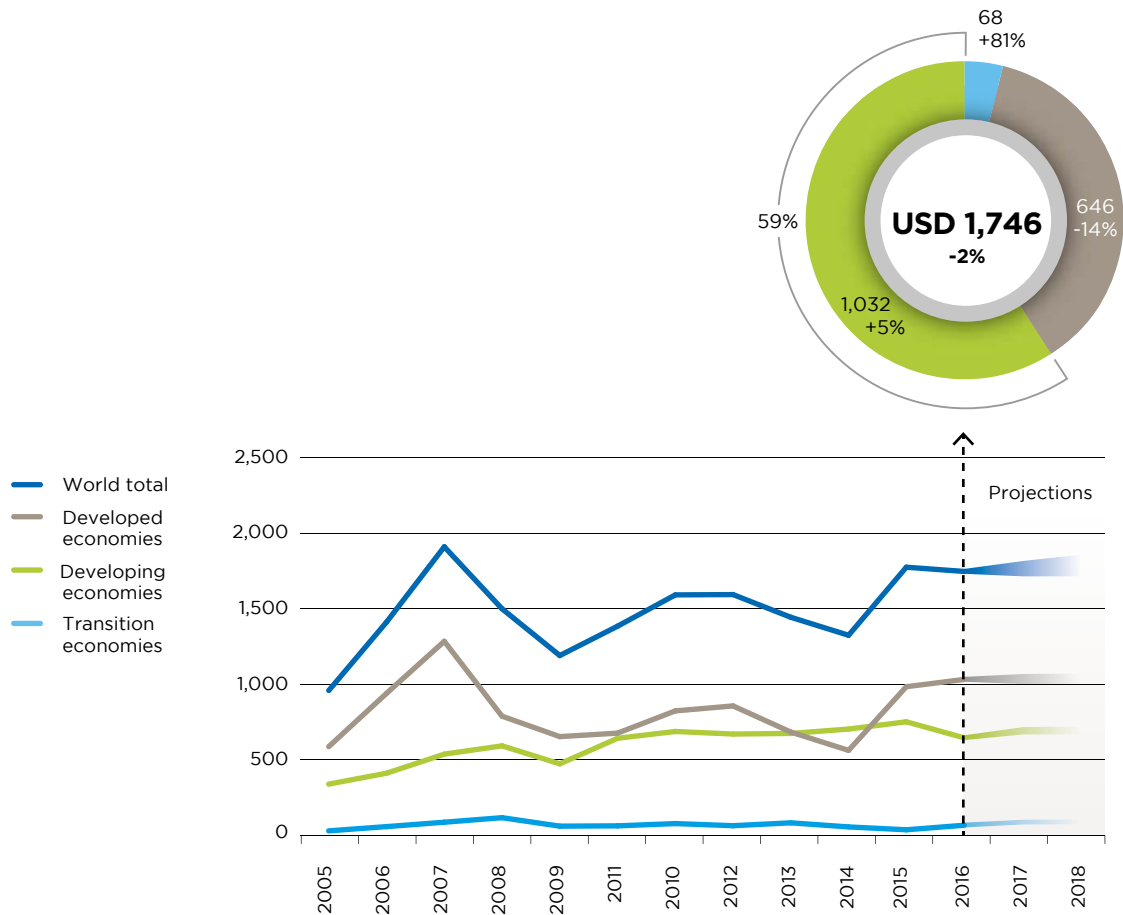
Slowing economic growth and falling commodities prices weighed particularly on flows to developing economies in 2016. Inflows to these economies fell by 14% (to an estimated USD 646 billion), faltering on the significant decreases in flows to Developing Asia and to Latin America and the Caribbean. Because of the wide decline in flows to developing regions, the share of developed economies in world FDI flows rose even further, reaching 59% of the total.



Figures cited from UNCTAD's World Investment Report 2017, which was published on 7 June 2017.

[http://unctad.org/en/PublicationsLibrary/wir2017\\_en.pdf](http://unctad.org/en/PublicationsLibrary/wir2017_en.pdf)

Figure 107: FDI inflows, global and by group of economies, 2005-2016, and projections, 2017-2018



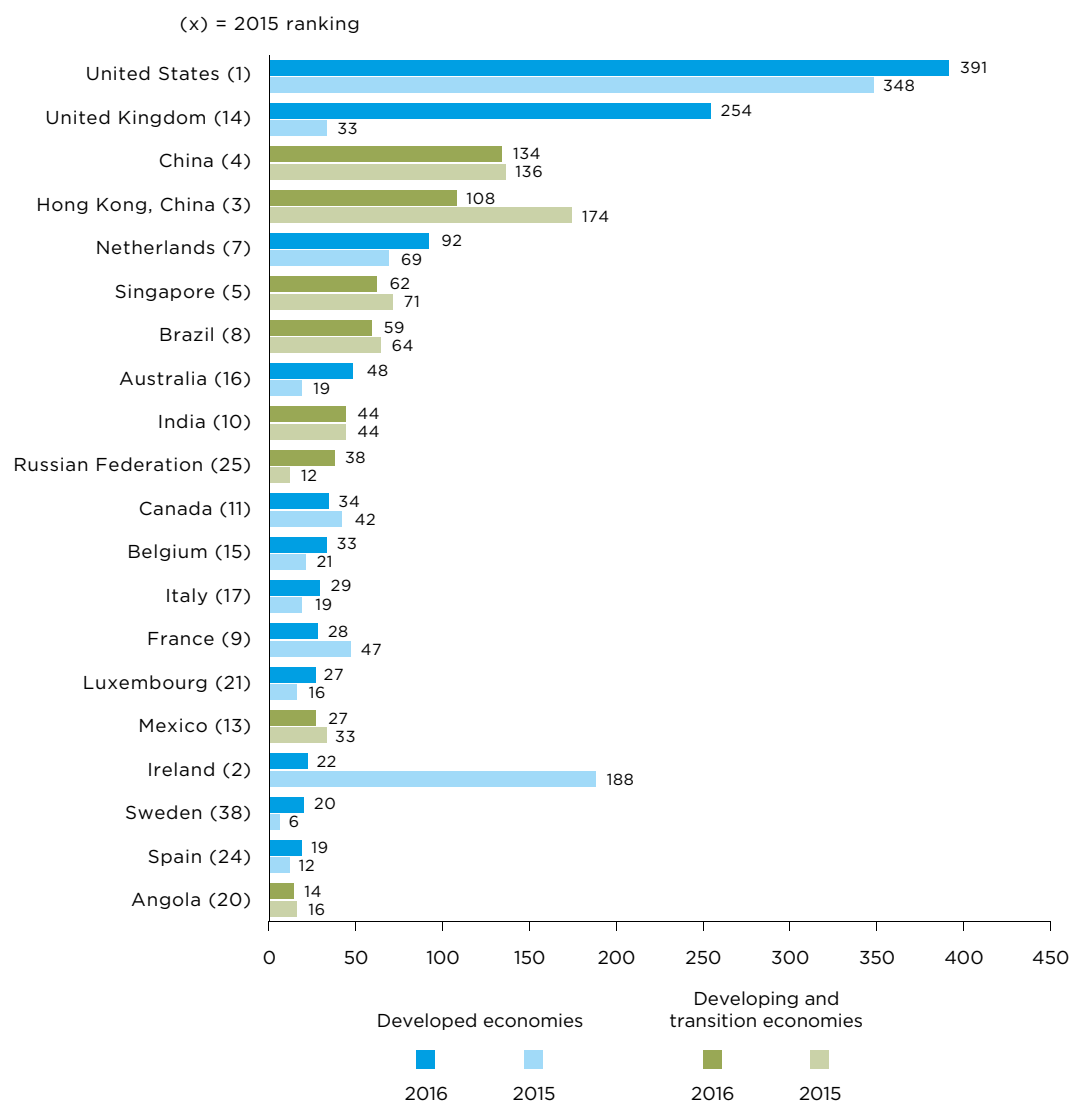
Source: UNCTAD World Investment Report 2017

The United States remained the largest recipient of FDI, attracting an estimated USD 391 billion, followed by the UK with its USD 254 billion vaulting up from 12th position in 2015. China remained in third position with record inflows of USD 134 billion.

Economic fundamentals support a potential rebound in FDI flows in 2017. Global economic growth is projected to accelerate in the coming year, rising by 3.4% compared to the post-crisis low of 3.1% in 2016. Growth in developed countries is expected to improve, including in the United States through fiscal stimulus.

Emerging and developing economies are also forecast to rebound in 2017, led by improved growth in natural-resource exporting countries on the back of expected increases in commodity prices, especially for crude oil. Moreover, greater economic activity will help boost world trade volumes, which are forecast to expand by 3.8% in 2017, compared to just 2.3% in 2016. In this context, investment activity may also quicken, by some 10% in 2017, according to UNCTAD projections.

**Figure 108: FDI inflows, top 20 host economies, 2015 and 2016**



Source: UNCTAD World Investment Report 2017

Nevertheless, significant uncertainty remains that could have a material impact on the scale and contours of a recovery. The “normalisation” of monetary policy in the United States – after nearly a decade of historically low interest rates – could result in a significant shift in the composition of capital flows, with implications for exchange rates and financial systems throughout the world and especially for developing economies. There is also substantial uncertainty about the shape of economic policies in the near-term, especially in developed economies, which may serve to dampen FDI.

Political developments such as the UK’s unfolding European Union exit strategy, announcements by the Trump administration in the United States to withdraw from the Trans-Pacific Partnership (TPP), as well as elections in Europe have all heightened these uncertainties.



## FDI recovery continues along a bumpy road



For emerging and developing economies, a protracted period of developed-country investor uncertainty could undermine a rise in investment flows to these countries. A key concern for policy makers continues to be how to reactivate productive investment in their economies to generate employment and spur on productivity.

Despite the acceleration in economic activity, the International Labour Organization estimates that global employment growth will continue to decelerate in 2017, falling to 1.1%. To take full advantage of the improving global economic environment, countries ought to prioritise actions to stimulate domestic and foreign investment through appropriate policy measures. In recent years FDI flows have largely been shaped by cross-border M&As that have not necessarily resulted in a concomitant increase in gross fixed capital formation.

Investment promotion activities to attract greenfield projects could pay significant dividends, especially considering that the value of greenfield announcements globally, while an imprecise indicator, suggest that the capital expenditure levels of foreign affiliates remain well below their 2008 peak.

To that end, countries may consider bringing their investment policies in line with UNCTAD's Investment Policy Framework for Sustainable Development with the objective of making investment work for sustainable development and inclusive growth.

FDI recovery continues along a bumpy road. Of particular concern is the sharp drop-off in announcements of manufacturing investment projects, which play such an important role in generating badly needed productivity improvements in developing economies.

Injecting impetus into flaccid investment has become a global priority. The scope and influence of investment on the global economy has grown significantly: investment now is responsible for almost a quarter of global output and propels some 80% of international trade by means of global value chains.

Moreover, ambitious targets set by the international community to improve economic, social and environmental development under the Sustainable Development Goals (SDGs) will need vast resources. By UNCTAD estimates annual global investment of between USD 5 trillion to USD 7 trillion (of which USD 3.3 trillion to USD 4.5 trillion in developing countries) is required between now and 2030 if meaningful progress is to be made with the SDGs. Current levels of investment in SDG-relevant sectors leave an annual investment shortfall for developing countries of USD 2.5 trillion – an amount that outstrips the combined value of public investment, aid flows and remittances. It is therefore clear that private sector investment will be crucial to ensure the successful implementation of the SDGs.

How to unlock and facilitate investment for this purpose should therefore be an issue of central concern to policy makers. Yet, investment facilitation measures are a low-profile feature in most countries' policy suites. An UNCTAD survey of FDI policies shows more than 1,000 new investment policies were set up over the past decade. Of these 323 were investment promotion and facilitation measures, the overwhelming majority of which related to investment incentives and Special Economic Zones, while only 24% could be classified as concrete investment facilitation measures.

This means a range of relatively inexpensive, yet potentially valuable, policy fixes that can stimulate investment flows are not utilised. Investment facilitation measures could include clearing up opaque legal or administrative requirements faced by investors, cumbersome operating environments, and costly business requirements. Fixing these constraints could be a compelling key to unlock investment flows, and create a business environment that would keep investors invested.

Investment policies at the international level are similarly devoid of investment facilitation measures. In most of the existing 3,300 international investment agreements (IIAs) concrete investment promotion and facilitation actions are either absent or weak. UNCTAD examined 1,200 IIAs and found that only 22% of these treaties contain some sort of investment facilitation provision. Even those agreements that explicitly deal with investment facilitation issues command few, if any, effective measures. Far more work than this would be needed to win over investors.

To address this gap, UNCTAD crafted an Action Menu for Investment Facilitation<sup>6</sup> that systematically signposts policy options, which can be adopted and adapted by countries at the national and international level to create a better operating environment for investment. The overarching rationale is to unlock investment flows, particularly in productive sectors, and contribute towards sustainable development.

In brief, the action areas propose to:

- Promote accessibility and transparency in the formulation of policies, regulations and procedures relevant to investors. This can include a centralised registry of laws and regulations; and a mechanism to provide information about changes in procedures, standards, technical regulations and conformation requirements.
- Enhance predictability and consistency in the application of investment policies through, for instance, systematising and institutionalising the application of investment regulations.
- Improve the efficiency and effectiveness of investment administration procedures. This can be done through shortening and simplifying licensing, registration and tax-related procedures; establishing online one-stop approval authorities; and clarifying the roles of different levels of government.
- Build constructive stakeholder relations, through establishing and maintaining mechanisms for regular consultations and dialogue with investment stakeholders through the lifecycle of investments.
- Designate a lead agency or ombudsman with a mandate to address investor complaints and suggestions; track and manage disputes; manage information flow; and liaise with relevant government institutions.
- Establish monitoring and review mechanisms for investment facilitation, such as diagnostic tools and indicators on the effectiveness of administrative procedures; and measuring the performance of institutions responsible for investment facilitation.
- Enhance international cooperation on investment facilitation, notably through consultation between relevant authorities, collaboration on anti-corruption efforts, and institutional exchanges of expertise.
- Strengthen investment facilitation efforts in developing country partners, through technical assistance and support in a range of areas, including

**There is a range of relatively inexpensive, yet potentially valuable, policy fixes that can stimulate investment flows**



6

Investment Facilitation and Promotion: a Global Action Menu available at:

<http://investmentpolicyhub.unctad.org/Upload/Documents/Investment%20Facilitation%20Action%20Menu.pdf>

bolstering transparent and effective administrative procedures; building capacity for the preparation of regulatory feasibility studies; as well as building actual institutional capacity, including those of investment promotion agencies (IPAs).

- Enhance investment policy and promotion in developing country partners, including through policy reviews and the design of effective investment promotion strategies; and building capacity to provide post-investment or aftercare services.
- Enhance international cooperation on investment promotion and facilitation for development through provisions in IIAs. This can include advocating for high corporate governance standards and responsible business conduct by outward investors; encouraging home countries to provide outward investment support, such as political risk coverage, investment insurance or facilitation services; and establishing consultations between relevant authorities or formal collaboration between Outward Investment Agencies and IPAs.

As is clear from the above, the areas for action are framed along two axes – the first set of proposals can be deployed by countries in their own interest; the second set of action lines are aimed to smooth the investment environment of developing country partners and stimulate global collaboration around investment facilitation. In the absence of a formal governance mechanism for global investment – akin to the WTO that governs trade – the spark to kindle formal collective collaboration is absent.

Still, organisations such as UNCTAD, work unceasingly in the area to develop expertise and collate best practices to help steer countries in the right direction. The ultimate aim is to incrementally pave the way for greater international cooperation in an area sorely in need of such.



## Editorial Comment: selected strategic and tactical implications

### Strategic implications

Historically, practitioners have been able to make clear distinctions between trade activity and cross-border investment flows, and could usefully debate whether trade follows investment activity or investment in international markets follows trade. In the last decade however, the interdependence and linkages between trade and investment have been highlighted in a framework referred to as “Integrative Trade” (S. Poloz, Export Development Canada).

Investment flows and the need to understand capital markets dynamics and practices is increasingly relevant to senior leadership in trade finance. This is potentially relevant on two levels, firstly in terms of understanding developments in trade flows as they link to flows of capital.

Secondly, capital flows could usefully be linked to the need for non-bank capital to help address an acknowledged USD 1.6 trillion in unmet demand for trade finance.

### Tactical considerations

Trade finance practitioners have been driven in the last decade or so, to better understand the wider context in which trade financing is provided. This is observable in the shift in discourse between trade financiers and their clients – from bilateral importer/exporter transactions to more complex supply chain-based interactions, and from financing and risk mitigation to broader working capital-based discussion.

Tactically, the potential for leveraging insights into FDI flows as a means of assessing emerging trade activity merits specific and focused consideration.



# Making trade work for all

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

## Author

Ken Ash, Director of Trade and Agriculture, OECD

Trade is in trouble today. Since the economic crisis, trade growth has slowed to a virtual standstill, while anti-globalisation sentiments in some parts of the world make it increasingly difficult for governments to open markets further. What can we do?

We can start by acknowledging that concerns underpinning the backlash against globalisation are real: relatively low economic growth in most advanced economies over the past decade, rapid technological change, growing inequalities within many countries, a widening productivity gap between firms, and stagnant wage growth for many workers.

We should also recall the facts on trade openness: trade has helped lift more than a billion people out of poverty, reducing inequalities across countries. Trade lowers prices, with particular benefits for low-income families that spend a higher proportion of their income on tradable goods such as food and clothing. And trade can stimulate growth; OECD analysis estimates that reducing trade costs by an amount equivalent to implementing the WTO Trade Facilitation Agreement, for example, could boost global GDP by 1.5%. By contrast, closing markets can stifle growth, open economies tend to grow faster, create better jobs, and salaries and working conditions are generally better in companies that trade.

We have to be clear that trade alone did not create the conditions that led to anti-globalisation sentiments, and trade alone will not solve them. Trade can be an essential part of a sustainable solution, but we need a much more integrated policy approach to make the whole system work better and fairer, addressing the following three areas.

### **We need to create the environments at home where expected benefits can materialise for more people through policies that promote opportunity, competition and innovation.**

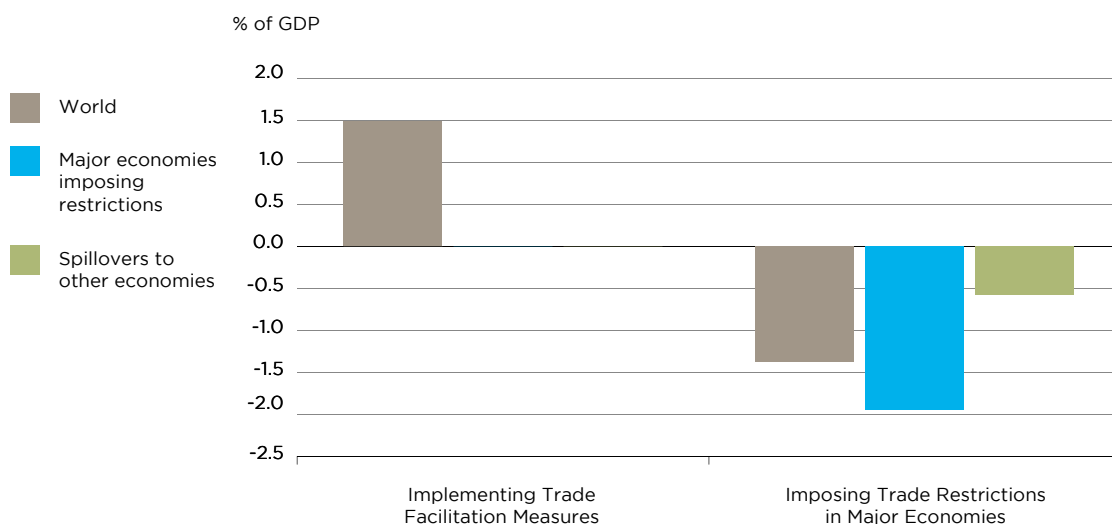
This means reducing the unnecessary costs that policies can unintentionally impose on traders, and which make it particularly difficult for MSMEs and young firms to participate in international trade, to grow their businesses and create jobs. Reforms to address trade facilitation and restrictions in services trade offer significant, immediate, and widespread benefits – including for manufacturers.

It also means investing more in people, in providing equality of opportunity (health, education, skills) for girls and boys, women and men. It means connecting people to jobs and markets through investments in physical and digital infrastructure. And it means transparent regulations that enable competition, underpinned by the rule of law, providing confidence to investors, firms and citizens.

**Trade alone did not lead to anti-globalisation sentiments, and trade alone will not solve them**



**Figure 109: Estimated medium term impact on GDP of alternative trade policy scenarios**



Source: OECD METRO model; and OECD calculations

### Making the international system work better

We need to do more to bring everyone along, to ensure that temporary setbacks, whatever the cause, do not turn into lifelong disadvantages. This means:

- Providing activation frameworks to bring more people into the labour force and to make work pay, while improving their employability and expanding their job opportunities
- Anticipating and responding to changing skill needs and better use of skills in the workplace
- Promoting labour market inclusion for under-represented groups – notably women, youth and older workers
- Strengthening temporary income-support policies and counter-cyclical social spending
- Linking entitlements to individuals rather than jobs so that they can support mobility and be portable from one job to the next
- Considering special measures to revitalise regional economies, as trade shocks can be concentrated in regions where there may be few other employment opportunities, and to encourage entrepreneurship.



### **We need to make the international system work better, harnessing the full range of international economic co-operation tools**

Trade is also shaped by a wider set of issues about how countries interact with each other in the global economy – from cooperation on financial regulation, taxation and combatting bribery and corruption to ensuring responsible business conduct, workers’ rights, and environmental protection. The international economic cooperation toolkit to address these issues includes legally binding multilateral and regional rules, voluntary guidelines and codes of conduct, and policy transparency and dialogue. More needs to be done, drawing on all of these tools, to level the international playing field for businesses and for consumers.

To make the system more free, fair and open we also need to address unfinished business in areas from agriculture to services, and to tackle ‘new’ issues, from competition to digital policy. And importantly, we need to do more to ensure that everyone, from companies to countries, plays by the agreed rules.

The “how” of trade agreements is also important. Trade policy-making needs to become a more open conversation, one where more people can debate the issues, assess the pros and cons and feel a greater sense of confidence that the trade-offs inherent in reaching agreements make sense.

### **Making trade work for all**

The world is closer and more integrated than ever before; policy needs to catch up. Only a more modern, progressive, comprehensive and coherent package of international, trade and domestic policies can help ensure that trade contributes to better lives for more people.

Trade policy-making needs to become a more open conversation



## **Editorial Comment: selected strategic and tactical implications**

### **Strategic implications**

The notion that populist backlash against trade and globalisation has some foundational legitimacy has been acknowledged in numerous contexts, as has the need to do something to ensure greater inclusiveness and more equitable distribution of the economic benefits of trade.

Strategically, the opportunity for financiers to influence the discourse around the positive contributions of trade, and the value and impact of well-directed financing, is one that requires careful consideration. Interactions with end-clients, as well as with policymakers provide unique opportunities for effective advocacy in support of trade and international engagement.

### **Tactical considerations**

Providers of trade finance and SCF can enable greater inclusiveness at the transaction level, by ensuring that SMEs and trading counterparties in developing markets have access to adequate levels of trade finance. Additionally, trade financiers can ensure that systemic factors – including misaligned regulation – that increase the cost or complexity of trade are mitigated through effective advocacy. Just as finance, including trade finance, has evolved a thoughtful view of the importance of considering social, environmental and other broader impact in selecting which trade flows to finance, the industry can and now should, likewise take a wider view on the importance of inclusiveness and on the commercial value of ensuring the sustainability of the global trade architecture within which trade finance and SCF are provided today.



I. REFERENCE INFORMATION

II. ECAP AND SELECTED HIGHLIGHTS

III. STATE OF THE MARKET

IV. TRADE AND SUPPLY CHAIN FINANCE

V. POLICY, ADVOCACY AND INCLUSIVENESS

VI. RETHINKING TRADE AND FINANCE



# Impact of MDB trade facilitation programmes, regional insights

## International Finance Corporation

**In 2004, IFC conceived the Global Trade Finance Program (GTFP) as a worldwide bank network linking emerging market institutions with international banks for the purposes of facilitating trade and creating new opportunities for emerging market firms to participate in global value chains. Following GTFP's success, IFC embarked upon other initiatives, like the Global Trade Liquidity Program (GTLP) and Critical Commodities Finance Program (CCFP), to extend the availability of trade and commodity finance in emerging markets.**

Growth has been rapid: while IFC supported USD 300 million in trade in all of 2005, by 2014 it was enabling the same volume of trade every five days. In FY16, all of IFC's Trade Solutions programs together supported USD 19 billion in emerging market trade.

GTFP provides risk mitigation by guaranteeing trade-related payment of obligations and comprises 279 eligible enrolled financial institutions in more than 90 emerging markets. The program provides up to 100% coverage on the country and commercial risks of individual trade-related instruments— including letters of credit, standby letters of credit, guarantees, bills of exchange, and promissory notes—issued by emerging market banks. In essence, the GTFP expands the amount of trade finance available to emerging market banks and their customers, and often reduces these customers' costs of obtaining credit. 12 confirming banks joined the GTFP network in FY16, while the program welcomed 10 new issuing banks in Argentina, Bangladesh, Brazil, Cameroon, Egypt, Sri Lanka, Turkey and Vietnam. Over 46,000 transactions guaranteed under the GTFP till end FY16 with no losses provide a significant demonstration effect.

## GLOBAL TRADE FINANCE PROGRAM (GTFP)

**90**

Number of countries of operation

**2005**

Programme commencement

**46,000**

Number of Transactions since commencement, to year end 2016

**53 USD billion**

Value of transactions since commencement

**1,300**

Number of correspondent banks

**0**

Claims to date



Technical training for issuing banks represents an integral part of GTFP. To complement IFC's financial product, the Trade Advisory Services program works closely with regional trade officers and investment teams to tailor training to meet the specific and unique needs of markets and clients. The advisory program helps expand emerging market financial institutions' operational capacity for trade finance through workshops, on-site capacity building, e-learning courses, trade certification and more. These training offerings seek to transfer current international best practices to local markets; upgrade the operational and technical skills of trade finance back offices; improve trade finance risk-mitigation techniques; and upgrade skills in structuring basic and complex trade finance transactions. Country-focused engagements may entail group training with banks or provide additional support to related entities, including central banks, bankers' associations, and chambers of commerce.

In FY16, IFC supported USD 1.9 billion in trade via its banking network in sub-Saharan Africa. Asia received USD 700 million in trade support through the GTFP. IFC guaranteed 18 trade transactions worth about USD 5 million in Myanmar, an FCS country supporting multiple transactions for import of food and agricultural goods such as refined sugar and wheat into Myanmar. Other examples include – working with Bangladeshi banks, IFC facilitated (a) the import of plant and machinery for setting up of new power plant and for maintenance of an existing power plant through three GTFP transactions totalling USD 39 million, (b) import of fuel to run the existing power plant through 15 transactions totalling USD 48 million in Bangladesh (c) import of plant and machinery from USA, Japan, Germany, Switzerland for setting up and maintenance of RMG unit through 20 transaction totalling USD 19 million. IFC Guarantees assisted trade in other regions as well: EUR 6 million in extended-term coverage on letters of credit supporting import of energy-efficient glass manufacturing equipment from the UK into Turkey; AED 6 million in performance guarantee coverage supporting export of telecommunications services from Romania to Abu Dhabi; and USD 2 million in letter of credit coverage supporting import of railway rolling stock from Ukraine into Georgia. Another transaction handled by a Lebanese bank enabled the shipment of USD 2.1 million of seed potatoes from the Netherlands to Iraq.

### **Mobilising partners for scalable financing solutions**

Leveraging the experience, infrastructure, and capacity for innovation honed under the individual transaction model of the GTFP, IFC has developed a set of Portfolio Solutions products to provide financing and risk mitigation on a broad scale to financial institutions working with emerging market obligors.

These larger-scale risk-sharing facilities under the GTLP and CCFP collect many small trade instruments into a single facility. A targeted, country-specific version called Working Capital System Solutions (WCSS) provides short-term loans to emerging market banks to inject USD liquidity into low-income countries where macroeconomic events have created foreign exchange constraints or otherwise hindered foreign investment. Since 2009, IFC has committed 33 trade portfolio risk-sharing facilities and 28 short-term working capital facilities with banks. Altogether the product has supported USD 72 billion in international trade. In addition to using funds from IFC's own account, Portfolio Solutions has mobilised more than USD 7.6 billion in additional funding through an array of governments, development finance institutions, and private insurers.

In FY16, IFC signed the Bansicredi Guarantee facility to provide access to finance to underserved populations of Brazil such as SMEs, family businesses, farmers and agribusiness producers. In addition, IFC also created the CCFP Bangladesh facility which makes two important contributions: 1) it supports industries and companies in key economic sectors other than the heavily-supported garment industry; and 2) it makes food items and energy more readily available and affordable, through the financing of key agricultural commodities and fuel. Through its 50-50% risk-sharing of the partner bank's portfolio for up to USD 350 million, Bangladeshi processors are able to avail increased financing limits to import critical commodities (e.g. sugar, edible oils, wheat, maize), which allows them to increase their production capacity from about 50% to 80-90%, leading to lower cost end-products to the local end consumer.

Through another facility, GTLP SMBC, IFC partnered with Sumitomo Mitsui Banking Corporation (SMBC) to invest up to USD 1.0 billion in a portfolio of trade assets originated by SMBC. The investment takes the form of a risk-sharing facility where IFC and SMBC will share the risk on a 50:50 funded basis. The GTLP SMBC facility provides trade finance to emerging markets (including IDA and IDA-blend countries) over its 3-year term.

### **Innovating approaches to commodity finance support**

In the aftermath of the Eurozone crisis, trade finance for critical commodities has emerged as an acute need for many emerging market countries, particularly in Africa, Eastern Europe, and the Middle East, which had relied heavily on European banks to support the majority of commodity trade flows. In response, IFC has created new offerings like warehouse finance and structured commodity finance to support global and regional bank partners in not only lending to banks but also financing their real sector clients. These product lines focus on funding trade flows of agricultural and energy commodities into and out of the poorest countries, including fragile and conflict-affected states. The warehouse finance product provides bank partners with liquidity or risk coverage backed by warehouse receipts, which can be used to extend financing to agricultural producers and traders ahead of export. The structured commodity finance product enables large cross-border commodity trade flows using collateral management to support lending at all stages of the supply chain: exporters/producers, trading companies, and importers/processors. Coupled with advisory services and other support, including the development of commodity exchanges in several sub-Saharan African countries, IFC's Commodity Finance products have emerged as a new vehicle for IFC to have transformational engagements, especially in IDA and FCS countries.

Since 2011, IFC has committed 18 warehouse finance facilities and seven structured commodity finance facilities, supporting USD 9 billion in international trade in critical agriculture and refined fuel commodities to ensure food and energy security, especially in IDA and FCS countries.

In July 2015, IFC concluded a USD 100 million investment with Vitol Bahrain E.C., as part of a USD 350 million trade finance facility. The Project finances 40% of Ethiopia's annual imports of gasoil and gasoline and marks IFC's first investment with Vitol, a major oil trading house. The project is a pioneering investment with one of the largest investors in

# 9

**USD BILLION**

**IFC support in international trade in critical agriculture and refined fuel commodities since 2011**



Africa (USD 9.5 billion in potential investments, including upstream gas development projects that are currently being discussed jointly with Vitol, IFC, IBRD and MIGA).

In FY16, IFC and Société Générale contributed to a facility that helped finance the purchase, processing, storage, and export of cotton seeds during the 2015 harvest season in Burkina Faso. As one of the largest companies in Burkina Faso, Sofitex is responsible for about 80% of the country's annual cotton lint production. While the number of cotton farmers hovers around 375,000, it is estimated that about 3 million people depend on cotton production activities for their livelihoods. Facility proceeds were used to: (i) finance the repayment of pre-harvest loans received from a pool of local banks in Burkina Faso; (ii) purchase seed cotton from farmers; and (iii) meet other working capital needs related to local cotton campaign. The financing of seed cotton purchases by Sofitex is critical to ensure prompt payment to the farmers.

In April 2016, IFC committed USD 50 million of a USD 150 million trade finance facility arranged by BNP Paribas (Suisse) SA. The project allows BNP Paribas (Suisse) SA to increase its financing to Nitron Group Corporation, an international fertilisers trading company – one of the largest merchant fertiliser suppliers to Latin America as well as a growing player in Africa. The facility will enable Nitron to increase its sales in emerging markets and continue financing a larger number of distributors and farmers, for whom availability and access to finance are limited. The facility is expected to benefit about 1 million farmers and improve food security, as well as poverty alleviation through improved farmer productivity.

### Market outlook and future directions

Since the financial crisis of 2007-08, banks in most countries have faced a combination of challenges that changed their decision-making calculus in order to remain active and ultimately support their clients, and thus help their countries to thrive. Banks have had to adapt to a surge of regulatory active activity in a compressed time period, and de-risking is an increasing concern. Changes in capital reserve requirements have limited the amount of capital banks have to invest in their customers. At the same time, there have been greater efforts to combat money laundering and terrorism financing. An incident-based standard for banks has given them flexibility to develop their own processes that monitor and assess customer risk, but leaves them subject to unspecified and potentially large fines. These requirements are also having a significant effect on financial institutions' profitability.

The financial effects of compliance risk have become material and unquantifiable for correspondent banks. Financial institutions have reported that the risk of money laundering and terrorism financing-related sanctions is a growing concern. Surveys of banks conducted since 2014 show a clear trend of rising spending on compliance. Formation and implementation of new capital and liquidity standards, coupled with compliance requirement increases have contributed to banks de-risking from certain markets and customers.

In early 2017, IFC conducted the "Survey on Emerging Market Correspondent Banking – 2017" to assess the impact of de-risking. The results of this survey is expected be published very soon. This survey finds that de-risking is affecting cross-border banking



activities, particularly those underpinned by correspondent banking relationships. De-risking and the loss or potential loss of CBRs may limit banks' provision of services, namely trade finance, remittances, and foreign currency settlements. De-risking may also potentially limit the contribution that banks and financial systems can make in maximising a country's stability and macroeconomic growth. Concerned about the decline in CBRs, multiple institutions, including at least 16 multilateral bodies, have engaged to support the clarification and consideration of broad guidance on compliance, application of said guidance by individual regulators, and the implications on participants in the formal financial system.

The market intelligence gleaned from network participants through direct data collection, such as the "Survey on Emerging Market Correspondent Banking - 2017" and from the "IFC Annual Issuing Bank Survey" referenced elsewhere in this report, as well as more informal contact with clients will continue to drive the future strategy and direction of IFC programs.

**De-risking is affecting cross-border banking activities, particularly those underpinned by correspondent banking relationships**

## European Bank for Reconstruction and Development

### EBRD TRADE FACILITATION PROGRAMME (TFP)

**27**

Number of countries of operation

**1999**

Programme commencement

**19,600**

Number of Transactions since commencement, to year end 2016

**14.7** USD billion

Value of transactions since commencement

**800**

Number of correspondent banks

**2**

Claims to date

**The TFP was developed to promote and facilitate international trade to, from and within the EBRD's countries of operations in Central and Eastern Europe, the Commonwealth of Independent States and the southern and eastern Mediterranean. Under the TFP, guarantees are provided to international commercial banks (confirming banks) thereby covering the political and commercial payment risk of transactions undertaken by participating banks (issuing banks) in the EBRD's countries of operations.**

The TFP was developed to promote and facilitate international trade to, from and within the EBRD's countries of operations in Central and Eastern Europe, the Commonwealth of Independent States and the southern and eastern Mediterranean. Under the TFP, guarantees are provided to international commercial banks (confirming banks) thereby covering the political and commercial payment risk of transactions undertaken by participating banks (issuing banks) in the EBRD's countries of operations.

At present, there are over 100 issuing banks in 27 countries participating in the programme, working with over 800 confirming banks and their subsidiaries throughout the world. The TFP can be used to guarantee any genuine trade transaction to, from and within the countries of operations. The EBRD guarantees cover for a wide range of goods and services including consumer goods, commodities, textiles, equipment, machinery and power supply as well as construction and shipbuilding contracts, cross-border engineering projects and other services.

In 2016, the programme's best year to date, the TFP's business volume rose to EUR 1.543 billion from EUR 867 million in 2015. In terms of individual countries, Ukraine generated the highest number of transactions, followed by Armenia, Cyprus, Belarus and Serbia.

In March 2017, the TFP passed another milestone by financing its 20,000th transaction. The landmark was reached with the issuance of an EUR 18,000 guarantee by order of Bank of Cyprus PC Ltd, Nicosia, Cyprus to Banca Popolare di Milano, Italy, covering the import of clothing from Italy to Cyprus.

## The Green TFP

In 2016, the EBRD launched the “Green TFP”. Green TFP facilities have the same terms and conditions as other TFP facilities but are available only for the financing of exports, imports and local distribution of imported Green Economy Transition (GET) technologies and services and require documentation on the energy and material efficiency benefits.

In its first year, the Green TFP supported 220 foreign trade transactions with GET technologies and services in 14 countries of operations with a total volume of EUR 198 million. Examples of such transactions are the import of wind power turbines from Germany into Ukraine or the import of hydroelectric power plant equipment from France into Georgia. The small average transaction amount of only EUR 900,000 demonstrates that the Green TFP supports mostly smaller projects.

## Technical cooperation

Foreign commercial banks are increasingly reluctant to establish trade finance facilities for smaller TFP partner banks, due to the high cost of compliance. It costs a bank the same or even more to do compliance for a small bank offering limited business than a larger bank offering more opportunities. This has the unfortunate effect of blocking out the most vulnerable from correspondent relationships.

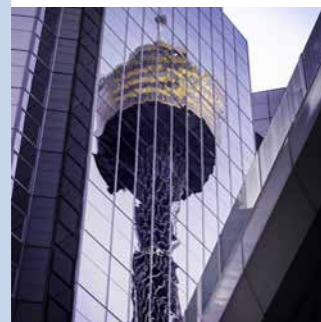
The TFP is therefore planning to develop a technical cooperation project under which consultants employed by the EBRD will assist TFP partner banks in the development of standardised compliance reports which will be regularly updated and meet the reporting requirements of the EBRD and most major foreign Confirming Banks under the TFP in different jurisdictions.

In addition, the TFP continues to play an important role in helping smaller partner banks to grow their trade finance business to a level where they can attract trade finance facilities from foreign commercial banks.

Technical cooperation has continued to develop and strengthen organisational capacities in trade finance, improve know-how and more generally, enhance the transition impact of EBRD trade finance operations. To achieve these objectives, a range of tools are used, including the provision of advisory services tailored to the needs of individual partner banks, training workshops and innovative internet-based training for partner banks’ trade finance staff.

Successful examples of such transformation include banks in Armenia, Belarus, Georgia and Mongolia. A few years ago, banks in these countries still needed TFP support for most of their trade finance transactions, whereas now they can already finance significant parts of their trade finance business with facilities provided by foreign commercial banks.

**The EBRD TFP  
has helped more  
than 170 partner  
banks establish  
a track record in  
trade finance**



# 73%

**EBRD partner banks that reported requiring continuous TFP support for trade finance transactions**

## The future

The TFP was established to build skills in partner banks and foster relationships with foreign commercial banks and has evolved over time to assist partner banks to sustain trade flows, particularly in times of market disruptions.

The programme has helped more than 170 partner banks establish a track record in trade finance. Although this is no longer the key objective of the programme, a small number of new partner banks will continue to be added each year.

Our main objective is now to help ensure that partner banks have trade finance credit lines in place to allow them to offer trade finance products to their clients, irrespective of the short-term considerations of commercial banks and the volatility of their risk appetite.

While the more advanced countries in central Europe and the Baltic region do not need our support anymore, TFP guarantee cover is still required by banks in CIS countries and less advanced countries in the Western Balkans.

A partner bank survey in 2015 showed that 73% of partner banks reported requiring continuous TFP support for trade finance transactions that foreign commercial banks are unable or unwilling to finance and 46% of partner banks (all of them small and medium-sized banks), need the programme to support most or all their trade finance transactions. We expect that smaller banks, banks in early transition countries and banks in countries with higher country risk, like Ukraine, will need TFP facilities for most or all their trade finance business for the foreseeable future.

Over the past years, we have seen demand for TFP support also in the Bank's newer countries of operations, including Greece, Cyprus and the southern and eastern Mediterranean region.

Larger TFP partner banks in the southern and eastern Mediterranean countries benefit from a high number of trade finance facilities provided by foreign commercial banks. However, in most cases these facilities are only available for smaller transactions and for tenors of up to 6-12 months. TFP facilities are needed for larger transactions and transactions with longer tenors. An example of a larger transaction guaranteed by TFP was the import of grain silos into Egypt, financed through a letter of credit with a tenor of 18 months. Egypt is one of the largest importers of grain and the silos will increase Egypt's grain storage capacity.

As for Greece and Cyprus, most foreign commercial banks are still unwilling to undertake any unsecured trade finance activity. The most active confirming banks have reduced their country limits and tenor lengths. TFP facilities support trade flows and encourage confirming banks to maintain relationships with selected partner banks until their commercial trade finance facilities are reinstated to suitable levels.



## Asian Development Bank

**ADB's Trade Finance Program (TFP) fills market gaps for trade finance by providing guarantees and loans through over 200 banks. TFP supported USD 3.09 billion in trade in 2016, which was a 24% increase from 2015 when it supported USD 2.5 billion. After a very slow first three quarters in 2016, business picked up dramatically in Q4 and has remained active through the first half of 2017. Increasing volumes likely reflect a pickup in international trade growth and some modest increases in commodity prices.**

### Background and markets

Of the 20 countries where ADB's TFP operates, its most active markets in 2016 were Bangladesh, Mongolia, Pakistan, Sri Lanka, and Viet Nam. TFP does not assume risk in the People's Republic of China, India, Malaysia, Thailand, and other relatively developed financial markets, focusing instead on markets where the private sector's capacity to provide trade finance is proportionally the smallest, leaving the largest market gap. In 2016, TFP expanded to the Pacific island countries and recorded its first transactions in Myanmar.

### Individual summary of activity (volumes & values to end 2016)

Since 2004, the TFP has supported more than 14,000 transactions across the region valued at over USD 26 billion—more than 9,300 of which involved SMEs - in sectors ranging from commodities and capital goods, to medical supplies and consumer goods. To help manage volumes, leverage resources and limits, and 'crowd in' the private sector as well as other participants, TFP shares risk with distribution partners: Swiss Reinsurance, International Enterprise Singapore, Australia's export credit agency (EFIC), OFID (OPEC Fund for International Development), FMO (a private sector-oriented development agency in the Netherlands), and in May 2016 TFP signed an agreement with Great Lakes Reinsurance (a wholly owned entity of Munich Re).

### ADB TRADE FINANCE PROGRAM

**20**

Number of countries of operation

**2004**

Programme commencement

**14,312**

Number of Transactions since commencement, to year end 2016

**26.18**

USD billion

(USD 25.60 billion of which are from 2009-2016)

Value of transactions since commencement

**200+**

Number of correspondent banks

**0**

Claims to date

## Summary of developmental impact

ADB's TFP supported over 1,500 SMEs in 2016. This figure is particularly important to ADB, as SMEs are known to be a major source of job creation. Moreover, ADB's annual study, 'Trade Finance Gaps, Growth, and Jobs Survey', substantiates that SMEs suffer most from a lack of trade finance support. TFP will continue providing as much support as possible to SMEs also through its growing Supply Chain Finance Program (SCFP).

ADB's TFP supports the development of the banking sector in the developing economies where it operates. Its rigorous due diligence and ongoing risk monitoring processes—and related feedback and benchmarking to banks—instil an appreciation for best practices in bank management.

Disseminating information about TFP's countries of operation and partner banks has created tangible developmental impact. ADB's TFP holds regular discussions with banks and insurance companies, including their risk management departments, to provide valuable information that helps these institutions move into frontier markets or maintain and enhance limits to support trade. The TFP's comprehensive due diligence and risk monitoring processes, along with its regular presence in its countries of operation, underpin its ability to provide valuable information.

ADB's TFP also provides training and seminars on trade finance and banking. ADB conducted seven training seminars in 2016, to the following countries: Nepal, Cambodia, Myanmar (twice), Mongolia, Uzbekistan, and the Philippines. TFP has also been holding annual regional conferences on trade finance in Central Asia, which has been well attended by banks in over eight countries in the region, including the Caucasus.

## Default/ claims or losses experience

ADB's TFP has had no defaults or claims since its inception.

## Innovations

TFP will be rolling out a new trade finance product in 2017 called the 'Funded Risk Participation Agreement', or FRPA—where TFP makes a disbursement to a partner financial institution against a basket of underlying trade transactions. Funds will be used to participate, on a 50/50 risk share basis, in 'issuing bank' risk connected to funded trade transactions (e.g., trade loans, discounting). When underlying transactions are settled, funds may be recycled for new transactions.

## Outlook for the future

ADB's TFP is poised to continue supporting trade in emerging Asia.

ADB has recently launched and is building its Supply Chain Finance Program (SCFP) to complement the TFP. The new SCFP will enable ADB to broaden its support for trade in developing Asia, especially among SMEs operating on an 'open account' basis.

TFP's Myanmar operations marked a milestone in February 2017 as it closed its first transactions in the market. Meanwhile, TFP's ongoing expansion to the Pacific is gaining momentum as TFP signed trade finance agreements with two Samoan banks in June 2016, and the first Papua New Guinea and Fiji agreements in May 2017. TFP concluded its first transaction in Samoa, supporting cocoa bean exports to Japan.



## Inter-American Development Bank Group

**The Trade Finance Facilitation Program (TFFP) supports Latin America and the Caribbean (LAC) banks to access international trade finance markets through guarantees, loans, advisory services and knowledge products. The Program seeks to promote development and economic growth in the region by expanding and diversifying the sources of trade finance available for LAC banks and ensuring liquidity in periods of market volatility. This way, the TFFP seeks to broaden and strengthen trade finance support available for LAC importers and exporters through their banks, facilitating the region's integration in global and intraregional supply chains.**

### Background and markets

The TFFP was approved as a delegated facility in 2004 by the Inter-American Development Bank's (IDB) Board of Executive Directors<sup>7</sup>. The Program has grown from 30 participating banks (both local and international) to over 200, and from a maximum approved exposure of USD 400 million to USD 1.5 billion. Effective as of January 2016, the Inter-American Investment Corporation (IIC) assumed administration of the Program, following the consolidation of the IDB Group's private sector activities into the IIC that year<sup>8</sup>. This historic consolidation aims to increase development impact of IDB Group's private sector operations, including the TFFP operations, by ensuring a wider and more efficient use of its resources.

As of December 31, 2016, the TFFP included 104 Latin American and the Caribbean Financial Intermediaries (LACFIs) in 21 LAC countries, with approved lines of over USD 3.13 billion, and a network of 130 Global Financial Intermediaries (GFIs) present in 37 countries.

The transaction volumes supported by the TFFP have also grown significantly during the life of the program. From annual volumes that ranged USD 200-300 million in 2008-2010 (measured as IDB's exposure at issuance), the Program reached a record of USD 1.2 billion in 2013. In 2016 with USD 992 million in processed transactions, the Program reached its second historic highest record.

### TRADE FINANCE FACILITATION PROGRAM (TFFP)

**21**

Number of countries of operation

**2005**

Programme commencement

**1,571**

Number of Transactions since commencement, to year end 2016

**6.45**

USD billion

Value of transactions since commencement

**100+**

Number of correspondent banks

**0**

Claims to date

# 6%

Decline in value of  
LAC exports in 2016

## Individual summary of activity (volumes & values to end 2016)

During 2016, 57 guarantees and 61 loans were issued and disbursed under the Program for a total USD 610 million IDB Group exposure at issuance. There were 1,792 underlying trade finance transactions supported with a face amount of USD 1.14 billion<sup>9</sup>. Mobilised funds through syndicated trade loans reached a record USD 381.5 million. At the end of the year, the TFFP had an accumulated exposure of USD 760 million in trade transactions.

The number of transactions and volumes were significantly higher in 2016 than in the previous year, almost doubling the number of loans and guarantees issued, and increasing the volume by 41%.

## Regional highlights during 2016

In terms of countries, banks in Brazil, the Dominican Republic and Guatemala accounted for 71.8% of the total volume of transactions supported through the Program's trade guarantees and loans in 2016. Transactions carried out by banks in Honduras, Ecuador and Argentina represented 14.2% of the volume generated, followed by banks in El Salvador, Chile, Peru and Costa Rica with 8.4%. Additional volume occurred in Bolivia, Nicaragua, Panama and Paraguay.

Also by volume, 82% of the total transactions were inter-regional trade (LAC trading with other regions outside LAC) and 18% were trade transactions intra-LAC.

From the total LAC exports supported under the Program, Brazil, Guatemala and Argentina shipped 73.2%. In terms of exported goods from LAC, 45.1% consisted of agriproducts, followed by 20.5% of manufactured goods and 19% of processed food. The main destinations of LAC goods were USA (23.8%), Switzerland (14.7%), Germany (7.7%), Chile (5%), China (4.6%) and The Netherlands (4.2%) in 2016.

On the import side, the major buyers in LAC were Dominican Republic (33.7%) followed by Guatemala (18.9%), Honduras (8.6%), Argentina (6.2%), Chile (5.2%), Ecuador (4.7%), and Panama (3.5%). In terms of imports, 30.6% came from USA, 14.7% from Brazil, 9.7% from China, followed by South Korea (9.6%), and Germany (8.8%). Main imported products were manufactured goods (35.7%), oil and gas (18.7%), vehicles (15.3%), agri-products (13.8%) and processed food (8.6%).

From a macroeconomic perspective, international trade volumes in LAC declined in 2016 for the fourth consecutive year. This represents a lower rate of export contraction due to the stabilisation of commodity prices. According to IDB's Trade Trend Estimates, Latin America and the Caribbean 2017 Edition: "In 2016, the value of Latin America and Caribbean exports declined an estimated 6%, which indicates a deceleration of the recessive trend that led to a sharp contraction of 15% the previous year. The relative improvement was due to the stabilization of commodity prices that seem to have bottomed out and, in some cases, showed signs of recovery. Export volumes, however, did not display sufficiently high growth rates to give a significant boost to the region's export performance, which lined up contractions in the past four years. The export decline slowed down noticeably in South America, while it remained relatively stable in Mexico and in some countries of Central America and the Caribbean."



7 Trade Finance Facilitation Program, Program Proposal (RG-L1003) PR-2871

8 Resolution AG-9/15 and CII/ag-2/15

9 With the data available as of 31 of December 2016

It is important to point out that, “the trade performance of LAC countries in 2016 must be placed in the context of lower and irregular growth of its main trading partners, particularly, China and the region itself, which translated into reduced demand for regional exports.... Exports to the region itself and to the US contracted more markedly than those to China, the rest of Asia and the European Union. The fall in intra-regional demand affected primarily the countries of South America, while the disconnection between the economic recovery in the United States and its import demand negatively affected the performance of Mexico and Central America.... In general, the reduction in imports from LAC was similar to that in imports from the rest of the world for most partners, with the exception of the European Union, whose global imports recovered, whereas those from LAC did not.”.

### Summary of developmental impact

The TFFP’s commitment to development impact is measured by: (i) the percentage of individual trade transactions supported for small and vulnerable economies (53% since the Program’s inception); (ii) the volume of trade transactions processed for small and medium enterprises (76% of the total since the Program’s inception); (iii) the percentage of intraregional trade supported (18% of the total since the Program’s inception); and (iv) the amount of third-party trade funds mobilised through syndicated loans and co-loans (almost USD 1.4 billion since the Program’s inception).

The TFFP intends to achieve a meaningful development impact not only through financial support but also through capacity building. The TFFP continues to roll out a training initiative started in 2014. Ten face-to-face training sessions for ten financial institutions in 8 LAC countries were held in 2015 under this initiative, and others will be benefiting from this type of training in 2017.

The TFFP continues to sign bilateral agreements with partner financial institutions that share our commitment of improving and expanding the trade finance resources available in the region. During 2016, 18 new financial institutions partnered with the IIC by joining the TFFP as confirming or participating banks. Also in pursuit of a greater developmental impact and strengthen its accountability, the TFFP has implemented a tool to measure the developmental impact and additionally for every TFFP line provided to banks in the Region.

### Default/ claims or losses experience

There have been no defaults since the Program’s inception in 2005.

### Innovations

Product innovation and enhancement are priorities at the new IIC. IIC is currently working on developing solutions beyond direct financing or partnering with financial institutions (FIs) to deploy its financial support. The IIC looks to enhance its effectiveness in supporting end-beneficiaries. This includes trade finance. Tapping into the existing knowledge of supporting trade through FIs under the Trade Finance Facilitation Program (TFFP), the IIC has created a new area dedicated to trade and supply chain, encompassing the TFFP and supply chain financing for corporates and micro, small and medium enterprises (MSMEs). The expansion to include supply chains strengthens financial inclusion for

**The TFFP offers not only financial support but also capacity building**





MSMEs given their critical role in the supply chain of anchor companies, particularly relevant in priority subsectors such as agriculture.

This renewed focus on supply chain finance and the cash conversion cycle occurs in a context of growing supply chain complexity and international economic uncertainty. CFOs, treasurers and finance teams face challenging times. Tough trading conditions demand financial resilience. Liquidity constraints reduce options for external funding, especially for MSMEs. Finance teams are shrinking with higher compliance costs, increasing pressure for full financial transparency and market uncertainty. The adoption of new FinTech technologies is disrupting the financial services industry at all levels, cutting out traditional sources of financing such as banks.

In these challenging times, unlocking the capital tied up in traditional supply chains becomes every company's priority. The IIC is developing a suite of financial and non-financial products to improve LAC suppliers' and buyers' cash conversion cycles and/or mitigate the risks associated to their supply chains.

They include both transactional trade finance products (such as receivables discounting, unfunded trade receivable commitments, etc.) and structured trade finance products (such as pre-export finance, warehouse finance, inventory finance, etc.). The development of these new supply chain products aligns with IIC's innovation, impact and capital strategy, and is part of the efforts of the Inter-American Development Bank Group to promote productivity and economic growth in LAC.

### Outlook for the future

The IDB Group envisions minimal changes in trade finance demand in 2017 vis-a-vis 2016 levels. Pricewise, the region will continue to enjoy a comfortable liquidity position, although the recent economic downturn in certain markets will continue to put upward pressure on prices, a tendency that could be exacerbated in those markets and segments affected by de-risking activity.

Looking forward, as reported by IDB's Trade Trend Estimates, Latin America and the Caribbean 2017 Edition, the risks to regional export growth have fallen but remain tilted to the downside, "The prospects for a reversal of the downward trend are associated with a scenario in which commodity prices continue to improve despite the foreseeable appreciation of the dollar, and the region returns to a growth path, thereby reigniting the intra-regional trade channel. An acceleration of external demand, particularly in the United States and China, would sustain exports, while the resurgence of trade protectionism would bias the forecast downward. Those countries whose real exchange rates are depreciating may benefit from improved price competitiveness that, in turn, could stimulate manufacture exports and reduce the region's dependence on commodity trade." In this context, it is urgent to implement trade promotion and trade finance facilitation policies that contribute to reverse the downward trend and to support trade diversification.



#### Reference

Trade Trend Estimates Latin America and the Caribbean 2017 Edition- Paolo Giordano, Kathia Michalczewsky, Alejandro Ramos. Copyright © 2016 Inter-American Development Bank

<https://publications.iadb.org/handle/11319/7984>.

## African Development Bank

**AfDB's trade finance program was established in February 2013 with the objective of reducing the trade finance gap in Africa which is estimated at USD 100 billion annually. The program provides partial payment guarantees to confirming banks (Risk Participation Agreement – RPA) as well as foreign exchange liquidity support to local banks and soft commodity aggregators/corporates respectively.**

Private sector financial institutions (including regional development banks) and commodity corporates operating in all 54 African countries can benefit from the program. Sovereign-owned entities that meet certain criteria are also eligible for support.

### Summary of operations in 2016

During the year AfDB approved USD 960 million of trade finance facilities in the form of guarantees, short-term liquidity and equity. This included the payment of country membership subscriptions (equity) to Africa Trade Insurance Agency (ATI) for Ethiopia, Côte d'Ivoire, Benin and Zimbabwe to enable companies in these countries benefit from ATI's trade credit insurance facilities.

The effects of the fall in the prices of key export commodities in 2015 spilled over to 2016 and continued to negatively impact the foreign exchange reserves of many African countries, thereby constraining the availability of foreign currency for international trade. Countries such as Nigeria and Angola were hard hit. Consequently, many global banks became cautious and curtailed trade finance lines (both confirmation and liquidity) to banks in these countries. This is in addition to international banks' continued shedding of correspondent banking relationships on the continent as a whole. To cushion the impact of these decisions, the AfDB acted swiftly in 2016 to provide counter-cyclical trade finance loans to financial institutions in various countries. In Nigeria for example, 3-year short-term trade loans were provided to the following banks – USD 300 to First Bank of Nigeria, USD 50 million to FSDH and USD 310 to Ecobank Group for use by its subsidiaries including Ecobank Nigeria. This support was pivotal in enabling these banks to settle outstanding trade obligations and facilitate the import/export of essential commodities.

The second continent-wide trade finance survey of financial institutions was conducted in 2016 and the results are expected to be published soon. To cap it off, as a result of the achievements of the trade finance program and taking due cognizance of the relevance of the bank's interventions in trade finance, the 2017 'sunset date' of the program was lifted in September 2016 to make it a normal business activity. This followed the creation of a dedicated trade finance division in late 2014.

### TRADE FINANCE DIVISION

**54**

(All African countries)

Number of countries of operation

**2013**

Programme commencement

**1,300**

Number of Transactions since commencement, to year end 2016

**5 USD billion**

Value of transactions since commencement

**329**

Number of correspondent banks

**850,000**

USD

Value of claims to date

## Summary of development impact

From August 2013 to December 2016 AfDB supported more than 1300 trade transactions involving 85 financial institutions in at least 20 African countries for a cumulative trade value in excess of USD 5 billion. Of this amount intra-African trade accounted for more than USD 1 billion, representing 20 % of total trade supported. The bulk of the support was in the form of RPAs (portfolio guarantees). Approximately 50% of the transactions are attributable to SMEs.

The program has provided significant support for the import and export of essential commodities and intermediary goods that are vital to the socio-economic development of African countries. For example, agriculture, forestry, and fishing and manufacturing respectively account for 28% and 22% of the total value of trade supported. Mining and quarrying accounts for 32% and is made up of mainly petroleum products.

## Default/claims experience

In 2016 AfDB settled default claims of approximately USD 850,000 from one of its major confirming banks under the RPA instrument. The claims relate to 9 letters of credit confirmation transactions of a local bank that went into receivership. This was a unique situation as the issuing bank was taken into receivership by the central bank without any forewarning.

## Outlook and future direction

2017 is proving to be a year of modest growth and consolidation as various economies and financial institutions adjust to the ‘new normal’ environment of low export commodity prices. Overall, the outlook for the continent is positive and the Bank looks forward to increased engagement with all its partners to help reduce the trade finance gap in Africa over the coming years.

Meanwhile, AfDB is working to provide more technical assistance (capacity building) to local banks in Africa. In our 2016 ‘Trade Finance in Africa’ survey, when asked what are the major impediments to the growth of their trade finance business, banks cited inadequate staff capacity as one of the significant constraints. This lack of capacity contributes to the slow roll out of various non-traditional trade finance products such as supply chain finance and other structured trade solutions. AfDB is therefore exploring various forms of partnerships to provide trade finance e-learning training solutions for local banks in Africa.

In response to growing market demand, the AfDB is also looking into the possibility of offering single trade finance transaction guarantees (direct guarantees) to underwrite 100% of issuing bank payment risk. This will complement the existing RPA instrument that provides only partial risk guarantee. Direct guarantees would be highly beneficial to international confirming banks that have strategic ambitions to grow their trade finance business on the continent but do not currently have well-established local correspondent banking relationships. Equally important is the desire to promote the use of alternative trade finance instruments across the continent. In this vein, AfDB is exploring among others the possibility of providing supply chain finance facilities to various banks.

In an era where MDBs strive to leverage their balance sheets to ‘do more with less’ AfDB would continue to pursue collaboration opportunities with other sister institutions active in trade finance in Africa in areas such as co-sharing of risk, provision of joint short-term liquidity facilities and capacity building support to local banks and co-sponsorship of thematic trade finance related surveys and research initiatives among others.

2017 is proving to be a year of modest growth



## International Islamic Trade Finance Corporation

**Despite the significant stresses and headwinds of the global commodities market, ITFC was able to register a relatively good performance in 1437H-1438H (2016).**

The year had two key features: higher disbursement (up 5.5%) as the focus on disbursement led to good improved disbursement rate of approved operations. This followed ITFC's new orientation to prioritise disbursements in order to drive tangible impact for its customers. In addition, for some regions, ITFC's enhanced regional presence translated into faster implementation of approved operations, and hence higher disbursement levels. However, approvals decreased for the year, reflecting the impact of a more challenging business environment in several member countries.

Most approvals financed operations in the sector of crude and petroleum products (60% of the total commitments), followed by agriculture (13%) and minerals and chemicals (6%). The regions having received most finance are Asia and CIS with 48%, followed by MENA (35%) and Sub-Saharan Africa (17%). Of the total commitments by instrument, 70% were sovereign, 20% bank guaranteed; 7% structured, 2% unsecured and 1% credit insured.

In terms of approvals by country, the top 10 having received most finance are, as follows:

Egypt	USD 892 million
Turkey	USD 860 million
Pakistan	USD 694 million
Bangladesh	USD 403 million
Cameroon	USD 208 million
Morocco	USD 193 million
Djibouti	USD 175 million
Burkina Faso	USD 174.6 million
Tunisia	USD 160 million
Indonesia	USD 144 million

### TRADE FINANCE FACILITATION PROGRAM (TFFP)

**4.8 USD billion**

1437H-1438H (2016)  
Approvals

**26%** 

Approvals decrease compared with 1436H

**4.8 USD billion**

Disbursements

**5.5%** 

Disbursement increase compared to 1436H



## Supply of medicine and medical product in Djibouti

Djibouti is uniquely positioned in the horn of Africa and at the crossroad of the Indian Ocean and the Red Sea. In its Vision 2035 and five-year development strategy (2015-2019), the country envisages becoming East Africa's regional trading hub. Furthermore, with its large and modern ports infrastructure, including a petroleum terminal and another one under construction, the country has a great potential to become a regional trading hub, mainly in the energy sector.

In addition to ITFC support to the energy sector, ITFC also extended a revolving facility line amounting to USD10 million to contribute in securing a supply of medicine and medical products in Djibouti. The financing falls under the Health Component of Djibouti Integrated Trade Program and it supports the government of Djibouti in its efforts to universalise access and affordability of healthcare services and products, in particular to the most vulnerable segment of the society at the most competitive prices. At the same time, ITFC will provide the executing agency CAMME with market access support, by facilitating CAMME participation in regional B2B events and field visits in producing countries.

## Sustaining support and solidarity with member countries in challenging times

### Shifting from transaction-based to integrated program approach

ITFC is moving to programs that integrate the two core instruments of the Corporation's interventions, i.e., trade finance and trade-related capacity building. These programs will be directly linked to achieving ITFC's three main strategic objectives, which are:

- **Expanding Intra-OIC trade;**
- **Supporting the diversification process of member countries' economies; and**
- **Global growth in Islamic finance.**

The overarching goal of the integrated program approach is to enhance the overall developmental impact of ITFC's intervention.

The following boxes present two cases, one in Indonesia and the other in Turkey, which highlight ITFC's new program approach. In the case of Indonesia, ITFC designed an export development program to support Indonesian coffee exporters. Whilst in Turkey, ITFC was able to link a cotton trader to cotton exporters in West Africa and as a result, facilitated direct buying between the Turkish trader and the West Africa cotton producers benefiting both sides.

### Agriculture, food security, and health

ITFC's interventions in agriculture continued to cover commodities that helped create jobs, improve productivity, alleviate poverty, and bolster food security. It is worth mentioning that ITFC provides significant support to food security in sub-Saharan Africa where a large portion of the trade finance portfolio is allocated to the agricultural sector, which has strong impact on enhancing food security for farmers. In fact, agriculture accounts for the largest share (54%) of ITFC's trade financing portfolio for sub-Saharan Africa. It is worth mentioning that although agriculture financing is primarily for cash crops (namely cotton and groundnuts), it, nonetheless, helps boost food security as farmers use part of the agricultural inputs funded by the financing to grow their food crops. In addition, the funding allows farmers to receive timely payments for their crops, thereby enhancing their household income. Furthermore, there are financing operations, albeit small, specifically designated for food security. This amounted to USD 17 million in 1437H-1438H (2016) and was for the government of Mali (cumulatively USD 42 million).



## ➤ Indonesian coffee export development program

ITFC, in partnership with the Association of Indonesian Coffee Exporters (AICE), launched its flagship program, called the “Indonesian Coffee Export Development Program” in August 2016. This program, the first of its kind for ITFC, provides financing and capacity building to the Indonesian coffee industry.

Indonesia is the fourth-largest coffee producer and exporter in the world and this sector is vital for the socio-economic development of the country. In 2015, coffee exports brought in USD 1.6 billion of foreign exchange revenue and it supports the livelihood of 2 million farmers in Indonesia. Of the total production, 96% of the coffee is grown by smallholding farmers whose productivity yield has room for improvement. Access to financing to the SMEs in the coffee industry is a perennial concern and conventional ways of extending funding is not sufficient.

With this Program, ITFC is mandated to improve the lives of 2 million farmers and inject much-needed liquidity into the coffee supply chain through the provision of capacity building and extending trade financing. As a trade solutions provider, this Program will allow ITFC to have an indelible mark on the Indonesian coffee sector by advancing trade and improving lives.

### Rationale of the program

Indonesia is among the world’s top coffee producing and exporting countries. Most of the production constitutes the lower quality Robusta type. Robusta represents around 75% of the coffee produced while the remaining 25% are of the higher quality Arabica type, which is more expensive on the world market, have a milder taste and contain approximately 70% less caffeine than Robusta beans. Similar to regional coffee giant Vietnam, the bulk of Indonesia’s coffee bean production consists of the lower-quality Robusta.

Indonesia is the fourth largest exporter of beans, after Brazil, Vietnam, and Colombia. Over the years, coffee exports have dropped due largely to El Nino effects and partially due to rising domestic consumption in Indonesia. Indonesian coffee consumption continues to expand, growing at a faster pace than production. Industry contacts report that growth is being led by soluble coffee consumption, as well as ready-to-drink beverages such as bottled coffee.

The traders and large corporate companies complete the coffee supply chain and they play a significant role in the exports. These players have the logistics, infrastructure and marketing capacity to influence the

buyers in the global markets. To many of these players, the United State is the most favoured destination for their exports, followed by the EU and Japan.

### Challenges

With more than 96% of the production in the hands of the farmers, the lack of a formal establishment and organisation amongst the smallholders presents the biggest obstacle to transfer information and education, and access financing. To overcome this, the government has encouraged the farmers to form cooperatives. Though cooperatives are a better set-up to disseminate information to farmers, access to financing has been a consistent challenge for them. Banks have been reluctant to lend to cooperatives and hence many farmers are not able to gain access to financing that is crucial to increase the production and value of the coffee beans. AICE has cited the following challenges, affecting their members and limiting the potential of the Indonesian coffee industry.

MNCs are involved directly in upstream purchase and with their financial strength, they are able to push down prices for coffee farmers;

- Limited capital to expand the coffee plantation amongst farmers;
- Lack of knowledge on coffee planting amongst farmers, resulting in low yield; and
- Low technology integration in production and export process.

The above challenges can be summed up in two themes: access to financing and capacity-building. These themes strike a key chord in ITFC’s mandate and IDB’s strategy.

- Financial inclusion: extending trade financing to the smallholders and SME traders, who are the backbone of the coffee industry, is vital,
- Developmental impact: extending capacity building to the farmers and cooperatives will directly impact the lives of the 2 million coffee farmers as productivity increase will enhance their income levels and subsequently the coffee exports of Indonesia;

These challenges present ITFC with an opportunity to transform the lives of 2 million farmers and leave an indelible mark on the Indonesian coffee industry. The ITFC’s program is designed to address the above challenges by combining trade finance and capacity building program to bring an integrated trade solutions to the coffee exporters.



I. REFERENCE  
INFORMATION

II. ECAP AND SELECTED  
HIGHLIGHTS

III. STATE OF  
THE MARKET

IV. TRADE AND SUPPLY  
CHAIN FINANCE

V. POLICY ADVOCACY  
AND INCLUSIVENESS

VI. RE THINKING TRADE  
AND FINANCE



## ➤ Supporting the groundnut sub-sector in Senegal and the Gambia

Groundnut products are of significant importance to Senegal and The Gambia at many levels. As a basic food crop, groundnut plays a central role with respect to poverty reduction and food security as it provides source of income for over 1.1 million small-scale farmers in both countries. It also contributes to livestock feeding and export earnings.

Groundnut crop cultivation, processing, and trade further impact their socio-economic development. In terms of its contribution to foreign exchange earnings and the reduction of trade deficits, groundnut products averaged about 27% of total Gambian exports and less than 5% of Senegalese exports, according to the findings of a joint study conducted by ITFC and ITC in 2011. In both countries, local value addition through small- and medium-scale processing is considered essential for both the development of the national industrial fabric and an increase in the value of exports.

In view of the above, ITFC went into financing the sub-sector in both Senegal and the Gambia. Given that the state, through established state-owned enterprises, is involved in the marketing of groundnut in both countries, ITFC works with the governments to finance the sub-sector. Since ITFC's intervention in the sub-sector, a total aggregate financing of about USD 200 million has extended to the two countries for the purchase of groundnuts from local farmers at farm-gate prices established at the beginning of the trade season. The purchased nuts are semi-processed for export to various destinations in Europe and Asia.

A major impact of ITFC financing of the groundnut sub-sector in the Senegambia region is that it eliminated credit buying of nuts by the Groundnut Company. In the past, farmers sold their nuts against Promissory Notes issued by the Groundnut Company. Thus, there had been times when farmers delivered their groundnuts only to be paid many months after the sale of their nuts, forcing many farmers to find alternative means of selling their nuts for cash. This used to cause considerable hardship to the farming communities given that for most of these farmers, groundnut farming was their sole source of income. With ITFC's intervention, it considerably changed this practice. In a testimony given by the National Food Security Processing & Marketing Corporation (NFSPMC) of The Gambia (formally called the Gambia Groundnut Corporation), credit buying of groundnuts from farmers is now a thing of the past as farmers are paid cash at the various Seccos (buying points).







## Editorial Comment: selected strategic and tactical implications

### Strategic implications

The role of international financial institutions (IFIs) and multilateral financial institutions has been irrevocably demonstrated to be critical to the assurance of adequate levels of trade finance, particularly in times of crisis and especially in developing economies, currently exhibiting high growth rates and also at the centre of a global discourse on economic inclusiveness.

Trade finance providers, including banks, have an opportunity to further engage with IFIs particularly in the context of compliance-based de-risking and a global contraction in the network of correspondent relationships that are critical to enabling trade.

The strategic importance of positive reputational impact linked to supporting developing economies and facilitating trade-based inclusiveness cannot be overstated, and the commercial opportunity associated with the pursuit of lucrative opportunities in emerging markets is likewise worth consideration.

### Tactical considerations

IFIs partner as much with local financial institutions in frontier and developing markets, as they do with international institutions in facilitating access to trade finance. Trade financiers may have an opportunity to express support for increased support and expansion of IFI trade finance programs, either directly through transactional engagement, or by advocating with senior leadership at the multilaterals.

Public advocacy in articulating the benefits and value of IFI support can help advance the evolution of these programs, and contribute directly to increasing global capacity in delivering trade finance in some of the most complex and challenging markets in the world.



# Selected elements of international advocacy: trade, finance and development

## Author

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The International Chamber of Commerce and the Banking Commission as one of numerous Policy Commissions within the ICC undertake numerous activities in support of the success of the business community globally.

The Banking Commission has a core focus on international banking, principally trade-related financing, both traditional trade finance and supply chain finance. In addition to a long history of rulemaking, standard-setting and thought leadership in the various areas of work of the Banking Commission, the team spends significant time and energy in advocacy work on numerous aspects of the business of financing international commerce.

The Banking Commission is one of the two largest policy commissions of the ICC, supported by a Secretariat team in Paris, led by a Commission Chair, and further supported by an Advisory Board and an Executive Committee. Senior leadership of the Banking Commission is made up of trade and supply chain finance executives from around the world and senior experts from across various functional areas of trade financing. The work of the Commission is broad in scope, but nuanced in approach.

We refer to a significant portion of our activities and industry engagement work as advocacy: advocacy which encompasses awareness-raising, education, and dialogue with industry stakeholders, including regulatory authorities and senior leaders in various international institutions.

In the pre-global crisis environment, trade finance was an esoteric, poorly understood and underappreciated discipline. The most robust of Internet search engines would have located little in the way of meaningful information about this domain prior to 2008.

The peak of the global financial and economic crisis brought sharply into focus, the importance of trade as a driver of economic growth and value-creation, and almost immediately, led political, business and international institution leaders to draw the critical connection between trade and trade finance.

The critical role of trade finance in enabling up to 80% of global annual merchandise trade flows is now explicitly acknowledged and is a core element of the current discourse related to trade and trade-related financing.

**The peak of the global financial crisis brought trade finance into focus**





## The Banking Commission has been at the core of advocacy work with the Basel Committee and other industry dialogue

The ICC Banking Commission, independently and in collaboration with the Asian Development Bank, the WTO, BAFT, the IMF, the World Bank and others, has invested significant effort in raising the profile and visibility of trade finance in policy, business and academic circles around the world.

Beyond the conception, authoring and dissemination of flagship publications like this report and the ICC Trade Register “Global Risks in Trade Finance” Report, the Banking Commission has authored numerous policy papers, articles for industry press, and delivered presentations at industry events around the world.

The Banking Commission has been at the core of advocacy work related to trade finance with the Basel Committee on Banking Supervision, aimed at achieving risk-aligned capital treatment of trade finance – an area of work supported by extensive data collection and analysis linked to trade finance-related credit risk. The scope and demonstrably positive impact of this work is reflected in the ICC Trade Register Project, and the related report published annually since 2009. The latest edition can be accessed on the ICC website<sup>10</sup>.

Beyond capital adequacy, the Banking Commission is heavily engaged in industry dialogue and analysis around compliance issues related to trade and trade finance. Know Your Customer, Anti-Money Laundering, and Countering the Financing of Terrorism are all areas of material impact to the business of financing trade, and all areas where the Banking Commission is active, in part through our Regulatory and Compliance Working Group, as well as engagement in the multi-bank industry initiative called the Wolfsberg Group<sup>11</sup>.

Perhaps less widely known is the Banking Commission’s advocacy work at the highest levels of international policy, through the World Trade Organization, the annual B20/G20 Summits and Task Forces, and the more recent status of the ICC as an official observer at the United Nations. Partnerships with the ADB and others have been critically important to the efficacy of the ICC’s efforts across these various contexts.

The WTO has been an advocate in support of trade finance under the current and immediate past Directors General, publishing several papers on the topic, and in 2016, authoring and distributing a major paper entitled “Trade Finance and SMEs: Bridging the Gaps in Provision”<sup>12</sup> The paper includes explicit consideration of the need to promote training and professional development in trade finance and also addresses a range of issues and recommendations about trade finance and SCF that advance the global dialogue around trade-related financing.

Notable in the launch of the paper, was a session at the WTO, at which the DG was present to speak to the objectives of the report, and at which the ICC was requested, along with a senior member of the IFC trade finance program, to address queries raised by WTO Ambassadors, Heads of Delegation and their teams. The delegates were exceptionally well informed about trade finance, including significant, specific details about the regulatory frameworks around trade finance and SCF.

The value of such profile, and such informed, thoughtful discourse around trade finance cannot be overstated, not only for trade finance, but for trade broadly defined, and for the creation of economic value, and the inclusiveness enabled through trade.



<sup>10</sup> To access the 2016 edition of the ICC Trade Register, please visit: <https://iccwbo.org/publication/icc-trade-register-2016/>

<sup>11</sup> For more information on the Wolfsberg Group, please visit: <http://www.wolfsberg-principles.com/>

<sup>12</sup> To access Trade Finance and SMEs: Bridging the Gaps in Provision, please visit: [https://www.wto.org/english/res\\_e/booksp\\_e/tradefinme\\_e.pdf](https://www.wto.org/english/res_e/booksp_e/tradefinme_e.pdf)

The ICC is very active and highly visible at the annual B20/G20 processes, including through the ICC G20 CEO Advisory Group, and more tactically, in various Task Forces under the B20 streams of work where recent engagement has resulted in significant attention on trade financing. Trade finance and SCF-related solutions and recommendations have been highlighted since 2015 in particular, and through the current B20/G20 cycle, hosted respectively by Turkey, China and Germany. In those high-level policy contexts, both trade finance and SCF have been successfully given significant visibility and profile around the world. Task forces focused on financing, on SMEs and on some combination of the two, allowed for energetic discourse on a topic that only a few years back was barely visible outside of a small group of practitioners.

The Task Force papers and recommendations are in the public domain, and have all been formally presented to the host Head of State in the wider context of the G20 activities. Educational content about the basics of trade financing, thought-leading commentary about emerging industry practice, and numerous case studies combined to present fairly detailed views on various aspects of trade, financing and inclusiveness/economic value creation, including in developing economies.

The practical impacts of these advocacy-based successes are still in evolution; however, it is clear that the level of awareness of the wider global community about the financing of trillions in trade flows is much higher as a direct result of the advocacy efforts of the ICC, the Banking Commission and our numerous partners and collaborators.

The advocacy work of the ICC reaches another level this year, with the unprecedented achievement of UN Observer Status by the ICC. The start of advocacy efforts in support of trade financing have been initiated at an Aid for Trade event in New York, a clear illustration of the importance ascribed to the work of the Banking Commission and to the subject of trade finance by the most senior levels of the ICC.

**The higher level of global awareness of trade finance is a direct result of the ICC's advocacy efforts**



## Editorial Comment: selected strategic and tactical implications

### Strategic implications

As it has done since its inception in the early 1900s, the Banking Commission will continue its role in leading the trade finance industry into the future. An ongoing part of the Commission’s essential role will be to continue to review and update the industry-leading rules for the financing of trade, and to develop and evolve these rules to underpin the latest methods and processes shaping the future of trade finance. Additionally, now and into the future, the Banking Commission will need to lead the industry in being a positive advocate for and a proactive influencing force in support of trade finance as it evolves and as commercial flows shift around the globe.

The efficacy and influence of the Banking Commission and of the ICC relies heavily on industry engagement, on the ability of the Commission to access and leverage world-class expertise as well as industry data and insight. It is critical for the Banking Commission, industry stakeholders and other partners to take a highly strategic view of the relationships and initiatives in the orbit of the ICC and to continue to engage actively in areas that are reactive to market needs, but also areas that are forward-looking and aim to advance the practice of trade finance, as well as the economic benefits, development and inclusiveness impacts that flow from trade financing.

Even as the Banking Commission remains committed to its rule-making roots, current and evolving market conditions demand that the Banking Commission and the ICC take a far broader view of trade finance, and in this evolution, the support of industry leaders, stakeholders and other influential parties will be fundamentally important.

### Tactical considerations

Today and over the next few years, the role of the Banking Commission will be to constantly review its existing rules and evolve them to account for new and expanding technological developments. As the speed of the evolution away from paper document and processes quickens the Banking Commission will need to change its current review and development processes to accommodate the faster environment for evolving its rules. It is imperative that the Commission be able to react quickly to a changing trade finance industry. As essential as industry rules will be to the changing trade finance industry, being able to react quickly to advocate for regulatory change and specific “asks” like risk-aligned regulatory treatment, for example, will require a constant process for monitoring and action with regulators throughout the world.



# Sustainable trade and the role of the banking industry

ICC BANKING COMMISSION SUSTAINABLE TRADE FINANCE WORKING GROUP

## Authors

Members of the ICC Banking Commission Sustainable Trade Finance working group

Sustainable trade is the key to global development. Not only does it spur economic growth, but it raises living standards, helps to fight poverty, and safeguards the environment. As the vital facilitators of global commerce, financial institutions have a unique opportunity to identify the dynamics of sustainable trade and help pave the way toward sustainable economic development for the future.

## Why is sustainable trade important?

We are living in a world of tremendous change with three main factors fostering transformation: First, the world's population level is continually rising, leading to increasing demands for food, shelter and energy availability in a planet with finite resources. Second, a global increase of living standards enables the growing middle class to change their consumer habits and to adopt different lifestyles. Third, supply chains are becoming more complex due to worldwide sources of labour, digitisation and new stakeholders examining environmental, social and governance (ESG) impacts. In response to these transformations, the United Nations adopted 17 Sustainable Development Goals in 2015 and the landmark UN Framework Convention on Climate Change (known as the Paris Agreement) came into force<sup>13</sup>.

## Connection between sustainable trade and banking

Given their central role in facilitating global trade flows, banks are particularly well placed to assist corporate clients in meeting their sustainability objectives. Indeed, because they possess the organisational infrastructure to mitigate risks, banks can help global trade achieve alignment with ESG practices. Using a qualitative approach to due diligence, banks can identify transactions, loans, and business relationships in which environmental, social, and ethical risks could play a significant role and thus need to be extensively researched, analysed, and evaluated before extending credit. Considering the volume of about USD 16.5 trillion of world trade in goods in 2015, the leverage of the financial sector in influencing adoption of sustainable practices in global trade should not to be underestimated.

Further drivers connecting sustainable trade with banking are government regulations. For instance, in 2014 the European Parliament adopted an ambitious directive prompting companies with more than 500 employees to disclose social and environmental information via



## ICC definitions of sustainable trade

The ICC defines sustainable trade as the business and activities of:

- Buying and selling commodities, goods and services,
- That meet such environmental, social and economic criteria,
- and that are capable of benefiting all actors involved to foster global sustainable development.



<sup>13</sup> For more information, visit <http://www.un.org/sustainabledevelopment/climatechange/> and <http://www.un.org/sustainabledevelopment/sustainable-development-goals/>



## Sustainability is now a permanent feature of corporate life and thus international trade

CSR-reporting<sup>14</sup>. The focus of this directive was on companies previously less affected by environmental legislation such as banks and insurers. As a result of this regulatory development, even smaller financial institutions are now called upon to fulfil new requirements concerning sustainability in their core business.

Furthermore, commercial banks' activities are increasingly critically observed by their own customers and stakeholders, as well as by the media, advocacy organisations, and sustainability rating agencies. As a result, banks are being urged to play an active role in promoting sustainability and to rethink established practices in order to shape a sustainable future. But taking such steps does not just enhance financial institutions' brand value, reputation, or eco-rating: sustainable trade opens up new business opportunities to the banking sector! By working closely with development banks, commercial lenders can, for instance, mitigate risks and facilitate transactions in countries and markets previously difficult to access. Moreover, trade finance is one of the most effective ways to promote free markets and to integrate emerging economies into global trade flows. A similar example of a growing market arising from sustainability objectives are green bonds such as the climate awareness bonds regularly issued by the European Investment Bank in a long-term collaboration with reliable partner institutions. These financial products help achieve alignment with the Sustainable Development Goals established by the UN, and are structured to take environmental, social and economic criteria into account (e.g. conducting environmental and social impact assessments).

### Next steps at the ICC Banking Commission

There is growing consensus – in OECD countries and beyond – that sustainability is now a permanent feature of corporate life and thus international trade. Although the majority of large global companies agree that pursuing a sustainable approach can be an important aspect of long-term strategy and operations, there is not yet global agreement on how this should translate into the practice of sustainable trade. This lack of clarity is likely to constrain corporate commitment and action to some extent, and will almost certainly create challenges for governments wanting to put in place coherent, relevant regulation. The aim of the OECD and non-OECD financial sectors alike should be to seize the business opportunities available in sustainable trade, including establishing principles that introduce more detailed sustainability practices into trade and devoting a greater share of financing to clean energy and clean technology.

Recognising the importance of achieving this result, the ICC Banking Commission has formed a working group on Sustainability in Trade Finance constituted by trade finance and corporate responsibility specialists from commercial banks and international development banks. Starting by defining “Sustainable Trade Finance” as financial services that support trade transactions in goods and services produced or supplied in a manner that minimises adverse environmental or social impact or risk or that promote environmental protection or social benefits, the working group aims to leverage the expertise of the development bank participants to develop training and highlight available resources for Banking Commission members.



14

DIRECTIVE 2014/95/EU of the European Parliament and the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

Available online at <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095>



The objective is to heighten banks' awareness of the adverse environmental and social impacts that have arisen in supply chains including agricultural commodities and the various tools that can help them identify and better manage those risks. For example, unchecked clearing and burning of land in connection with producing palm oil has led to significant damage to tropical forests as well as air pollution and harm to wildlife. In response, a variety of certification bodies have been established to promote responsible practices in commodity production, and many large purchasers have committed to purchase commodities that are certified by established certification schemes. Available databases can be used to identify the ESG risks associated with specific commodities and provide guidance with regards to available standards and certifications the banks could refer to.

By sponsoring the efforts of this working group, the Banking Commission continues to play an active role in enhancing the role of the industry in implementing sustainable trade practices.



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## Editorial Comment: selected strategic and tactical implications

### Strategic implications

The role of banks and financial institutions in enabling the pursuit of commerce and in the creation of economic value is widely understood, even by industry critics and by thoughtful analysts who perceive opportunities for banks to meet traditional metrics of success, while taking greater ownership of the social impact of their activities.

Just as environmental considerations, once on the fringe of commercial considerations, have moved to the center of responsible

leadership, so too, the issue of sustainability in its numerous iterations, is becoming increasingly central to the strategic planning processes and priorities of senior executives.

Trade finance, by definition a cross-border and global business, enabling trade across a range of fundamentally important products and sectors, inevitably involves flows that raise questions of sustainability. As financial institutions contemplate the potential to contribute to the pursuit of business

on sustainable terms, trade financiers are particularly well-placed and suited to taking a leadership role in this area.

### Tactical considerations

Trade finance practitioners and industry leaders ought to pursue engagement with multilaterals seeking to promote sustainable trade, and should look to advance innovative initiatives like the Sustainable Shipment Letter of Credit, or variants of such a mechanism, while concurrently supporting efforts to develop supply chain traceability solutions linked to sustainable sourcing.



I. REFERENCE INFORMATION

II. ECAP AND SELECTED HIGHLIGHTS

III. STATE OF THE MARKET

IV. TRADE AND SUPPLY CHAIN FINANCE

V. POLICY, ADVOCACY AND INCLUSIVENESS

VI. RETHINKING TRADE AND FINANCE



# SME competitiveness: thinking strategically about regional integration and regional value chains

INTERNATIONAL TRADE CENTRE

**Trading across borders has become increasingly important to the competitiveness of enterprises of all sizes. Regional and global markets hold opportunities not only for business expansion and revenue growth, but also for technology transfer and learning. Yet, operating beyond national markets is often a risky and complex endeavour for SMEs.**

#### **Authors**

Marion Jansen, Chief  
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When SMEs do consider exporting, they lean towards neighbouring countries and/or international value chains for their first cross-border operation. Transaction costs tend to be lower in both cases than for alternative scenarios. Language and cultural barriers tend to be lower when exporting to neighbouring countries than to more distant trade partners. Exporting through value chains can notably reduce costs related to the implementation of standards. Evidence from ITC's Standards Map, for instance, suggests that in over one quarter of voluntary sustainability standards reviewed, producers can share implementation costs with other supply chain actors, often the lead firm.

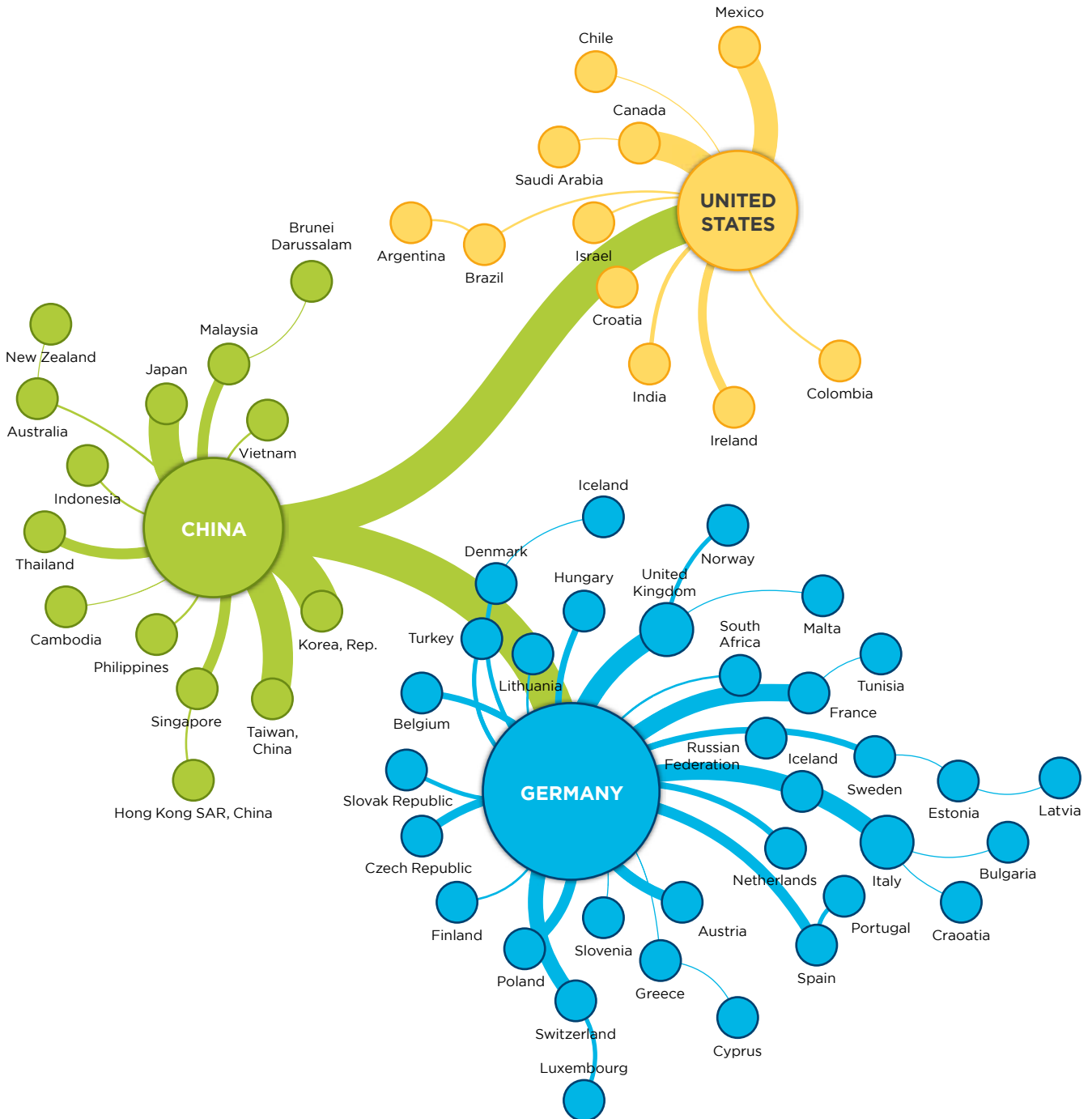
#### **Accessing regional value chains**

It is, however, not necessarily easy to enter international value chains. Often, SMEs are better positioned to enter regional value chains than global value chains (GVCs), given lower requirements for rigorous certification and less consolidation than in global value chains allowing for a large number of suppliers. Regional value chains are also more prevalent than the global ones. Sometimes, both regional and global value chains are operating in the same markets, like in the case of apparel value chains from the perspective of sub-Saharan African firms. These firms are faced with one global value chain that is driven by final demand from the United States and FDI from Taiwanese transnational producers and one regional value chain that is driven by both final demand and FDI from South Africa.



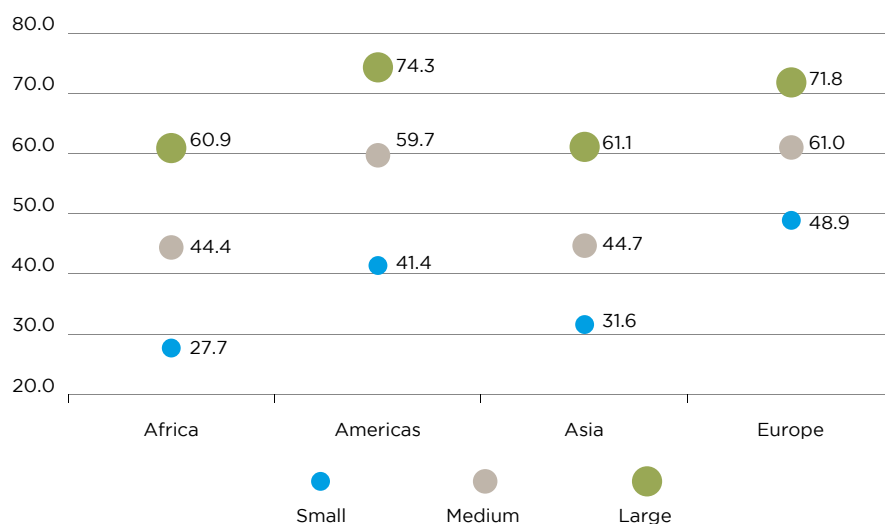
Evidence from the World Bank suggests that many value chains are mainly active within a region, other than truly globally, as reflected in Figure 110.

**Figure 110: Factory Americas, Asia and Europe**



Source: Santoni, Gianluca, and Daria Taglioni (2015)

**Figure 111: Competitiveness score by region and firm size**



Source: ITC SME Competitiveness Outlook 2017 (forthcoming)

Notes: Based on 109 countries. The scores are simple averages of sub-scores across Compete, Connect and Change pillars. Regions are defined based on the geographic classification by the United Nations; Oceania is excluded due to limited data availability.

For firms not integrated in any of these value chains yet, the question arises: how to become attractive for international lead firms. The competitiveness of individual firms or clusters of firms in relevant value chain segments will play a fundamental role and differences in competitiveness across regions are still significant. Information on SME competitiveness by region, for instance, suggests that it may not be straightforward for small or even medium sized African firms to enter ‘factory Europe’ because of the sizeable gap in competitiveness between them and European counterparts of similar size. Figure 111 illustrates by region how small, medium, and large-sized firms differ in their average capacities to compete, connect, and change.

Integration in regional value chains can be a stepping stone for SMEs to enter GVCs. It is also the case that policy making at the regional level can matter for access to GVCs. Indeed, in order for SMEs to take full advantage of market opportunities arising from open markets, it can be important to leverage economic relationships with neighbouring countries whilst shaping attractive national policies, and investing in firm-level competitiveness.

### Behind-the-border measures for global value chain integration

Trade agreements and relevant national policies can contribute to improving SME participation in GVCs and their positioning within GVCs. Addressing behind-the-border aspects can influence a country’s attractiveness to lead firms who are deciding to outsource production functions. When firms split their value chains across borders, they expose their capital as well as know-how to new international risks. In such cases, firms have concerns regarding the safety of their investment abroad, whether their intellectual property is respected, and if there is a functioning legal apparatus against any violations.



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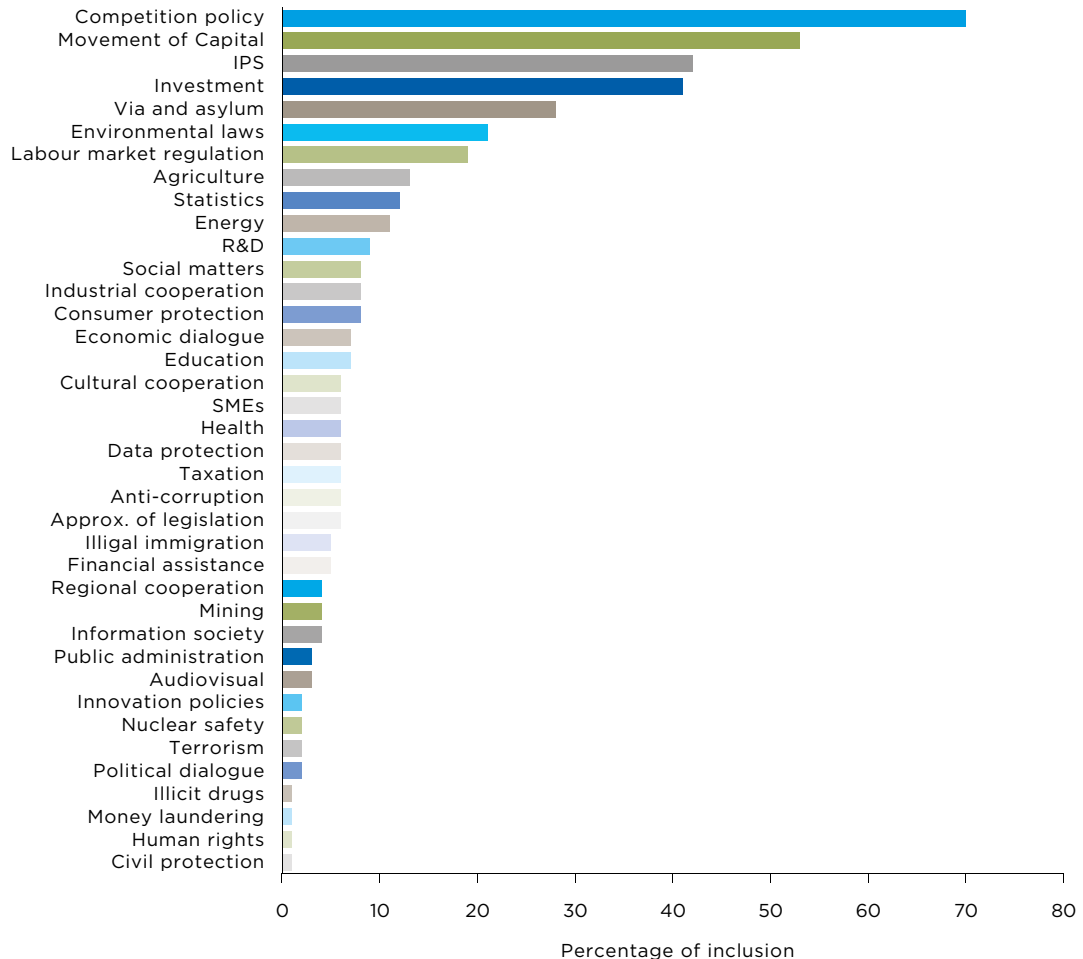
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SME Competitiveness Outlook 2017 (ITC, Geneva, forthcoming), <http://www.intracen.org/SMEOutlook/>



**Figure 112: Frequency of legally enforceable provisions in trade agreements**



Source: World Bank. Content of Deep Trade Agreements (Hoffman, Osnago and Ruta, 2017)

Notes: Included are all the agreements still in force in 2015. Averages are by agreement.

Only legally enforceable provisions are plotted. Based on 261 agreements.

Arguably, the GVC agenda can even be viewed as primarily a “domestic” one where better national policies carry more weight than multilateral ones. Harmonisation of certain national policies can be conducive to the smooth operation of cross-border production, thus generating deep forms of integration. Both deep regional trade agreements (RTAs) and bilateral investment treaties (BITs) attempt to address these concerns with an increasing number of provisions tailored to the needs of GVC actors.

The recent proliferation in trade agreements covering aspects beyond current WTO commitments may be a reflection of this. For instance, policies geared towards investment and competition are becoming increasingly important within such agreements (Figure 112).

The SME Competitiveness Outlook produced yearly by ITC, focuses on the factors influencing the performance of SMEs in global markets. The 2017 edition analyses regional integration and regional value chains and their impact on SMEs, with particular attention on factors enabling SMEs’ entry and upgrading in GVCs.

In this context, ITC has produced an empirical analysis of trade agreements, controlling for the presence of bilateral investment treaties and country-specific determinants. Value chain participation is defined in terms of the value-added embodied in exports looking both backward and forward from a reference country. Backward linkages are the foreign value added in the reference country's exports (integration as a "buyer"), and forward linkages are the domestic value added used as input to produce exports in the destination country (integration as a "seller").

The signing of a deep trade agreement appears to be good from both "buyer" and "seller" integration perspectives. Deep trade agreements are associated with an 11% increase in foreign value addition and a 7% increase in domestic value added re-exported to third countries. The magnitude of the results is especially important in the case of integration as a seller, as deep trade agreements achieve much more than agreements of average depth (which only lead to a slight increase of 1% in domestic value added in exports). These findings support the idea that being a member of deep trade agreements makes it easier for local firms to integrate into international value chains.

For policy makers in developing, emerging and industrialised economies alike, the above implies that the region can represent an important door to the world. Regional value chains can be stepping stones for national SMEs to enter global value chains, and regional policies can contribute to attract global lead firms and thus facilitate access to global value chains for national SMEs.



## Editorial Comment: selected strategic and tactical implications

### Strategic implications

The imperative to better serve SMEs and to enable their ability to pursue commercial success and engagement in international markets is one that is described as a priority by many jurisdictions around the world. The importance of SMEs as engines of economic growth and as creators of employment is widely reported, as much in OECD economies as in developing markets.

In this context, banks are often not able to service SME clients to the degree required, given the level of coaching and resourcing this requires, and the commercial realities of servicing SME customers.

Banks are increasingly expected to balance financial performance with some level of consideration for their impact on and obligations to the wider societies within which they operate, and part of that expectation is to better support SMEs domestically and in pursuit of engagement in international supply chains.

Trade finance providers are particularly well placed to facilitate such development, as one example, through certain techniques of SCF that can facilitate access to affordable financing for SMEs. Collaboration with public policy and international institutions mandated to support SMEs can be a compelling way for banks to position to better serve SME clients and counterparties around the world.

### Tactical considerations

Banks committed to servicing SMEs but perhaps not best placed to do so unilaterally, can explore partnerships with organisations like the ITC, the World SME Forum and the SME Finance Forum among others. Trade financiers in particular ought to explore how to viably ensure the health and success of SMEs that are often key suppliers in global supply chains – many already recognised as "strategic suppliers" in the context of best practices in supply chain management.



I. REFERENCE INFORMATION

II. RECAP AND SELECTED HIGHLIGHTS

III. STATE OF THE MARKET

IV. TRADE AND SUPPLY CHAIN FINANCE

V. POLICY, ADVOCACY AND INCLUSIVENESS

VI. RETHINKING TRADE AND FINANCE

# Access to Trade Finance for SMEs and first-time clients of banks in Africa – from the perspective of financial institutions

AFRICAN DEVELOPMENT BANK

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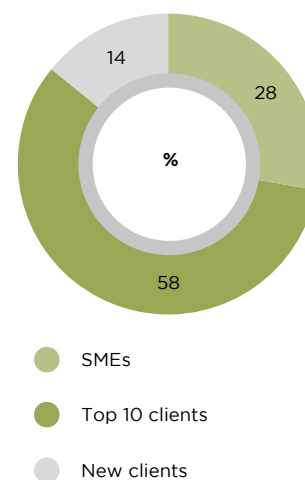
Following the positive market reception of the African Development Bank's 2014 report on the continent-wide trade finance in Africa survey, a second one was undertaken in 2016. One of the areas that was further interrogated this time around is the issue of access to trade finance for SMEs from the perspective of financial institutions. More than 240 banks from 49 countries across Africa completed the survey, and the results are telling in many ways, though not entirely surprising.

Access to trade finance is critical for SMEs to expand or intensify their international trade activities, but such financing often does not come easily for them. This is certainly not unique to Africa and our survey results suggest these SMEs face similar difficulties as their counterparts in other parts of the world. While only 28% of the trade finance assets of banks in Africa are on account of SMEs, top 10 clients on average account for 58% and first-time trade finance clients 14% respectively. This share of SMEs is disproportionately low given that they account for at least 80% of all private sector employment in Africa.

This picture is consistent across all the regions (North, West, East, Centre and South) irrespective of income grouping of countries (low income countries versus middle income countries), level of fragility (fragile and transition countries versus non-fragile states), or ownership structure of the banks (locally-owned banks versus majority foreign-owned banks).

The high concentration of trade finance among a few top clients of banks may be explained by the fact that large corporates tend to be more financially sound, less risky and have well-established long-term relationships with banks. By contrast, the low exposure to new market entrants could reflect the fact that these clients by definition have no established trade finance track record, are not yet considered by banks as reliable counterparties, and are therefore perceived to be less creditworthy despite the evidence that they are not necessarily as risky as SMEs. It is conceivable that in general banks place a premium on long-term relationships despite the long-held view that trade finance is transactional in nature.

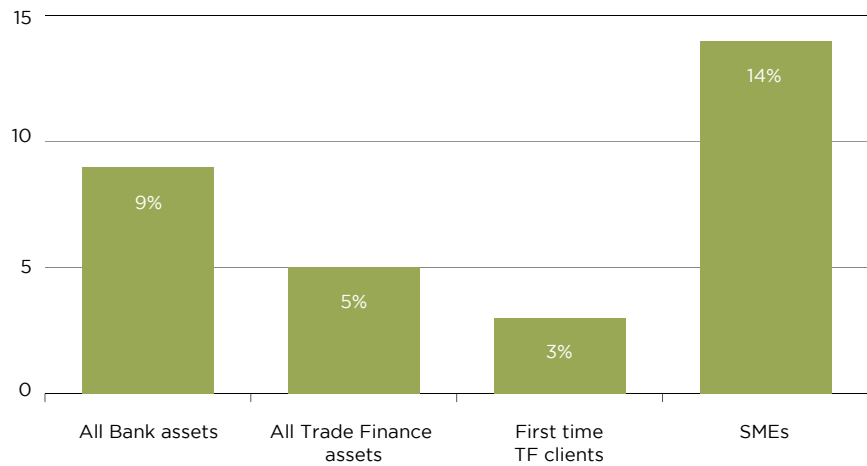
**Figure 113: Composition of the trade finance portfolio of banks in Africa**



Source: AfDB



**Figure 114: Default rate on banks' trade finance activities across customer groups**



Source: AfDB

### Are SMEs a risky client segment?

Although SMEs are recognised as the engine of economic growth in Africa and therefore require all the support to increase their access to trade finance, our survey found that this client segment has a default rate of 14% and is therefore considered to be riskier than both large corporates and first time trade finance clients of banks. This relatively higher level of risk could be one of the main reasons why SMEs account for a proportionately low share of the trade finance portfolio of these banks.

Interestingly, the average default rate of first-time trade finance clients is a relatively low 3%, far below that of both SMEs and trade finance market average. The reason for this observation was not explored in the survey but it is most probable that banks apply more stringent credit criteria to this group of clients compared to others, and hence the low default rate.

More generally, the non-performing loan ratio (default rate) of trade finance assets of banks in Africa is estimated at 5%. This is considered modest compared to the non-performing loan ratio of 9% of all asset classes but significantly higher than the global average default rate of less than 1%.

However, the riskiness of SMEs varies significantly from one region to another. While the rate in Central Africa is as high as 31% and almost double that of West Africa (16%), East and Southern Africa have default rates of 11% each.

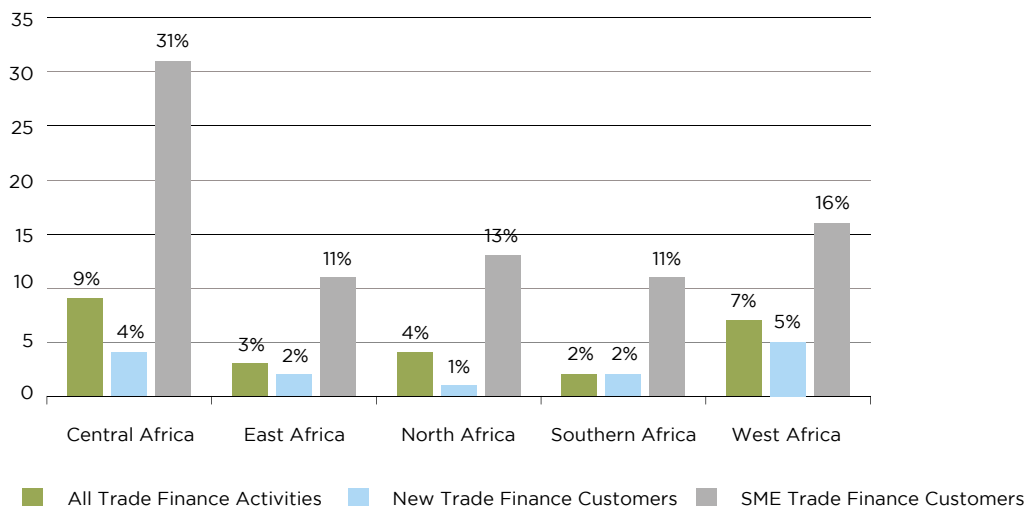
### Why banks reject the trade finance requests of their clients, especially SMEs

Given the relatively high riskiness of SMEs, it is therefore not surprising that the most frequently cited reason why banks reject the trade finance requests of clients in general is weak client creditworthiness (36%).

Another major reason is insufficient client collateral (30%). These findings corroborate earlier studies and suggest that weak credit infrastructure in Africa is a major bottleneck to increased access to trade finance, particularly for SMEs.



**Figure 115: Default rate on banks' trade finance activities across customer groups by region**



Source: AfDB

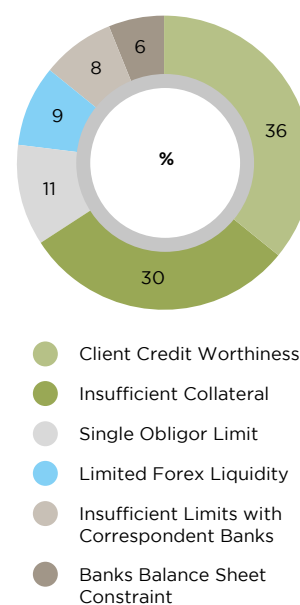
It is worth noting that banks in fragile states and countries in transition are more concerned about sufficiency of limits from their international correspondent banks when making trade finance credit decisions compared to banks operating in non-fragile states. Indeed, international correspondent banks tend to allocate smaller limits to banks in countries that are perceived to be high risk compared to more stable countries.

### What can we all do together?

Considering the importance of SMEs to African economies and the growing evidence that they are relatively risky, adequate measures should be taken to enhance their creditworthiness and consequently facilitate their access to trade finance. For this to happen, however, various stakeholders including MDBs like AfDB should increase the level of collaboration with local banks and other stakeholders on the continent.

The disproportionately low level of trade finance dedicated to SMEs and the high rejection rate of their trade finance requests due to weak creditworthiness could be a reflection of the stringent credit risk assessment banks apply to this client segment. On the other hand, the high default rate attributable to SMEs may also be a consequence of inadequate understanding of the sector or lack of internal capacity in banks to assess, quantify and manage SME risk. MDBs and other institutions would contribute to the achievement of the twin objectives of increased financing to and de-risking of SMEs by building the capacity of local banks in SME client relationship management and risk mitigation.

**Figure 116: Reasons banks reject clients' trade finance requests**



Source: AfDB

Similarly, MDBs could also consider various ways of incentivising local banks by, for example, underwriting SME default risk through the provision of tailor-made SME trade finance portfolio guarantees. This will allow local banks to gradually build their knowledge about SMEs and develop appropriate risk management techniques to eventually increase the level of financing made available these clients without external incentives. We have observed a growing demand from banks for this type of support.

Alternative financing mechanisms and financial technology solutions such as SCF, FinTechs and dedicated trade finance funds hold significant promise for bridging the trade finance gap in Africa, especially for SMEs. In recent years we have witnessed the emergence of trade finance funds and greater use of trade credit insurance as sources of alternative finance or means of risk distribution. Institutions like the AfDB are well placed to promote the effective use of these instruments and mechanisms, facilitate greater collaboration between FinTechs and banks, and support local banks to move up the learning curve by enhancing their capacity to offer various SCF solutions such as payables financing and factoring among others. The use of these instruments is still limited in most African markets.

Finally, MDBs and other institutions committed to bridging the trade finance gap in Africa could do more to understand the trade finance needs and challenges from the perspective of SMEs themselves. As the body of knowledge on the gap from the supply-side perspective increases, a lot more collaborative research ought to be done on the demand-side as well. This will enrich our understanding of the challenges and opportunities and provide us with a more complete picture required for effective stakeholder engagement in increasing access to trade finance for SMEs.



### Editorial Comment: selected strategic and tactical implications

#### Strategic implications

Africa, like Asia and Europe, is often referenced as if it is a homogenous region, when in reality, there is a wide spectrum of characteristics to markets and regions on the continent. Significant growth rates and potential, coupled with favourable demographics, and an emerging focus on technology complementing still rich sources of commodities, points to a high-value market for trade and trade finance.

The high default rates reported relative to trade finance in other regions requires effective risk mitigation at the transaction level, and suggests a targeted industry-wide initiative may be required,

in the form of technical assistance and capacity building supported by IFIs, to bring default and loss rates in line, with focus on both local providers and clients.

SCF appears to present significant opportunity on the continent, thus awareness-raising initiatives can have material positive impact on the region.

#### Tactical considerations

In tactical terms, raising the technical competencies of locally-based trade financiers, whilst concurrently assisting trading parties, particularly SMEs, to better understand the nature of trade and trade financing would appear to be matters of high priority.

# Protectionism in the 21st century and trade barriers faced by firms

KOMMERSKOLLEGIUM  
- SWEDISH NATIONAL BOARD OF TRADE

## Author

Per Altenberg, Senior  
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Recently, the Swedish National Board of Trade finalised two major projects devoted to protectionism. The first report, called “Protectionism in the 21st Century”, synthesises international efforts to monitor protectionism. In the report, we apply a comprehensive view of protectionism, including barriers to trade in goods, trade in services, investment flows, movement of people and data flows.

The second project is a business survey of trade barriers faced by Swedish firms. The sample size was 2000 firms; 1700 of these firms trade internationally, 850 of which replied.

Below, we summarise the results of these two reports.

## Protectionism - a global view

The approaches to protectionism vary widely between international institutions and independent analysts. There is no consensus as to what defines the term. Crucially, however, all surveyed institutions (WTO, OECD, UNCTAD, World Bank, European Commission, USTR and Global Trade Alert) highlight two core elements:

- (1) the discrimination of foreign economic operators, or
- (2) trade restrictiveness.

In the end, we conclude that a discrimination approach is the most appropriate to frame issues related to protectionism. It combines normative legitimacy (non-discrimination is a central WTO principle) with practical application (it does not require advanced quantitative analysis). In addition, there is arguably implied intent whenever foreign economic operators receive less favourable treatment than domestic commercial interests.

## Trends in 21st century protectionism

During the 2008 global financial crisis, fears arose that protectionism would follow in the wake of the large fall in world trade. To address that risk, the G20 committed to “refrain from raising new barriers to investment or to trade in goods or services”. It is clear from our analysis that this standstill pledge has not been honoured and that governments currently introduce far more protectionist measures than they remove.

**Governments  
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## Countries increasingly resort to discretionary and non-transparent measures instead of tariffs

### Trade in goods

Tariffs - that were on a downward trajectory during the latter part of the 20th century - have levelled out in many major economies during the first part of the 21st century. One potential explanation for this is the fact that countries maintain tariffs in order to use them as bargaining chips in ongoing and future trade negotiations. The paradoxical consequence is that 21st century trade negotiations might prevent rather than promote tariff liberalisation.

For many non-tariff measures, we observe an increase in protectionism in recent years. Countries increasingly resort to discretionary and non-transparent measures instead of transparent and well-regulated trade barriers. Developments with respect to subsidies, localisation requirements and public procurement are particularly worrisome from this perspective. They represent non-tariff measures that affect a great deal of trade and are subject to a high degree of discretion.

An important consideration related to the increase in non-tariff measures has to do with their impact on governance. Historically, good governance considerations meant that quantitative restrictions, which require market access allocation through licences, were banned by the GATT. By contrast, tariffs declared in advance and openly published were allowed. Unfortunately, this historical lesson appears to have been lost in the early 21st century. In the future, therefore, particular priority should again be given to restricting discretionary and non-transparent non-tariff measures.

Finally, for trade in agricultural goods, we identify a long-term trend toward reductions in agricultural support in many OECD economies.

### Investment and services

Most countries consider it to be in their own interest to continue to liberalise FDI and services supplied through local establishment. At the same time, many restrictions on entry, ownership and operations remain, and localisation barriers to trade and investment are on the rise.

### Movement of persons

Continued high barriers to labour migration and the temporary movement of persons is a source of considerable concern. There is a risk that renewed public perceptions of migration as a threat, could reverse previous positive trends.

### Data flows

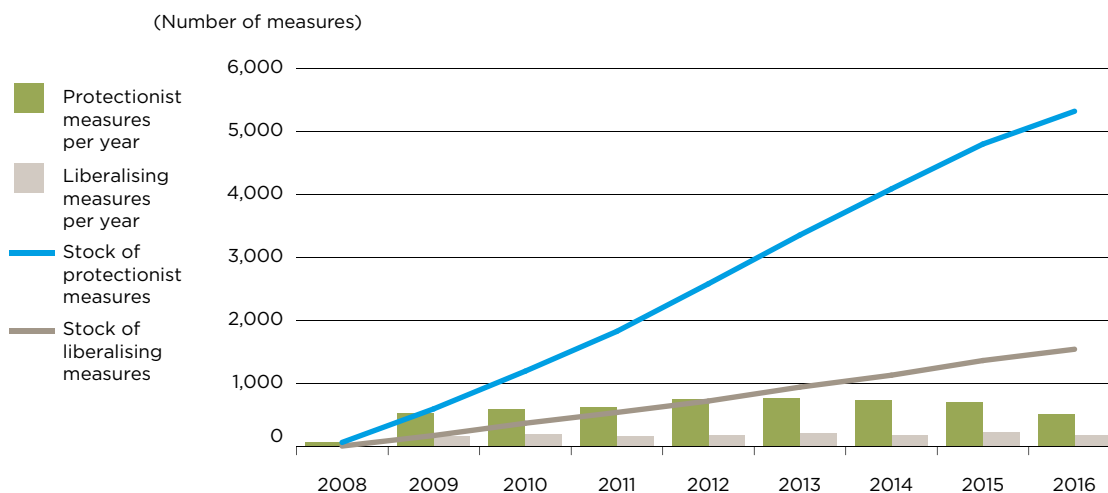
Rising restrictions on the movement of data is a growing problem that threatens to fragment the global digital economy and raise the cost of goods and services. More and more restrictions are being put in place and they are likely to have an increasingly negative impact on trade. At the same time, the ICT revolution has made it easier to circumvent trade barriers by opening up new modes of supply or making alternative modes of supply less costly.

### Summing up

There are worrying indications that protectionism is on the rise again. While trends with respect to agricultural support, FDI and services supplied through local establishment largely appear to be moving in the right direction, tariff liberalization has run out of steam and several types of non-tariff measures have experienced a rapid increase in recent years. New restrictions on data flows and the risk of a backlash against the movement of persons, add to a situation of growing concern.



**Figure 117: Protectionist vs. liberalising measures – number of measures introduced since 2008 and still in force by end of each year**



Source: Global Trade Alert.

## Protectionism – a business perspective

Below we present the overall results of our survey of trade barriers faced by Swedish firms. First, the results from questions that refer to trade with other EU countries (64% of Swedish trade in 2016) are presented. Then we discuss the part of the survey related to third country trade (36% of Swedish trade in 2016).

### Trade within the EU

Some of the most common problems facing Swedish firms inside the EU are product adaptation due to national regulation, unequal opportunities with respect to trade in services and VAT procedures (Figure 118). For these three issues, the share of firms who indicate problems is at least 15%. Since our last survey in 2009, improvements can be detected for product adaptation and trade in services, while problems with VAT procedures remain unchanged.

Based on these results, work on reducing regulatory differences within the EU should remain a priority. Further harmonisation to facilitate the free movement of goods may be necessary, especially in areas where mutual recognition isn't working properly.

Relatively few Swedish firms (3%) experience problems with barriers to data flows within the EU. The same is true for firms that depend on e-commerce. 15% of the respondents say that they sell goods or services via e-commerce to other EU member states. Of these, 10% report problems of some kind. Despite these relatively modest figures, an ambitious implementation of the Commission's digital single market strategy remains important, particularly in view of the current growth in EU e-commerce.

Finally, only 3% of firms indicate difficulties in moving staff within the EU. It is important to keep in mind, however, that the survey's questions were addressed to firms. Experience from the EU's SOLVIT network indicate that natural persons often experience barriers to mobility within the EU.

An encouraging result from the survey is the fact that 90% of firms answered that they do not experience problems with any particular EU member state. Work to further reduce barriers to the flow of goods, services, capital, people and data within the Union is therefore best done through the regular legislative process and the regulatory simplification work.

### Barriers to trade with non-EU countries

Customs procedures and tariffs are among the biggest problems identified by Swedish firms in exporting to third countries. Among large firms (accounting for nearly 70% of Sweden's exports to non-EU countries) roughly 50% state that they have problems with high tariffs and cumbersome customs procedures. Furthermore, more than half of the firms are unaware that the EU free trade agreements allow for duty free exports. Among the firms that are aware of this opportunity, the survey shows that large firms use it to a much greater degree than small- and medium sized firms.

In view of this, we recommend that tariff liberalisation at the WTO become an EU priority. If tariff liberalisation cannot be achieved multilaterally, zero-tariff treatment within the framework of sectoral agreements such as ITA or the EGA is a potential way forward since this option eliminates the problems that firms face with rules of origin in free trade agreements.

Another major problem that Swedish firms face when exporting to countries outside the EU has to do with regulatory transparency. 30% of firms respond that they have problems finding out which rules apply in the destination country. EU trade policy and development cooperation should therefore continue to promote good governance, openness and transparency.

One in four firms responded that they have had to adapt their goods or services due to national regulations outside the EU. The result confirms the view that adjustment to technical rules is a significant problem in global markets. It thus also supports the need for international regulatory cooperation at the WTO as well as in free trade agreements.

The share of Swedish firms experiencing problems with trade in services outside the EU has increased since 2009, but is still relatively low. The deteriorating conditions for trade in services outside the EU are worrying, since conditions for services exports within the EU appear to have improved (see above).

According to the survey, barriers to the establishment of investments in third countries is not a major problem for Swedish firms. At the same time, 13% of Swedish firms experience problems with localisation requirements for foreign direct investment.

Barriers to the movement of persons are not seen as a significant problem in trade with non-EU countries. However, in some countries, including the US and China, we came across problems of this kind in deep interviews carried out with a smaller selection (24 in total) of firms. In

Customs procedures and tariffs are among the biggest problems identified by firms exporting outside the EU

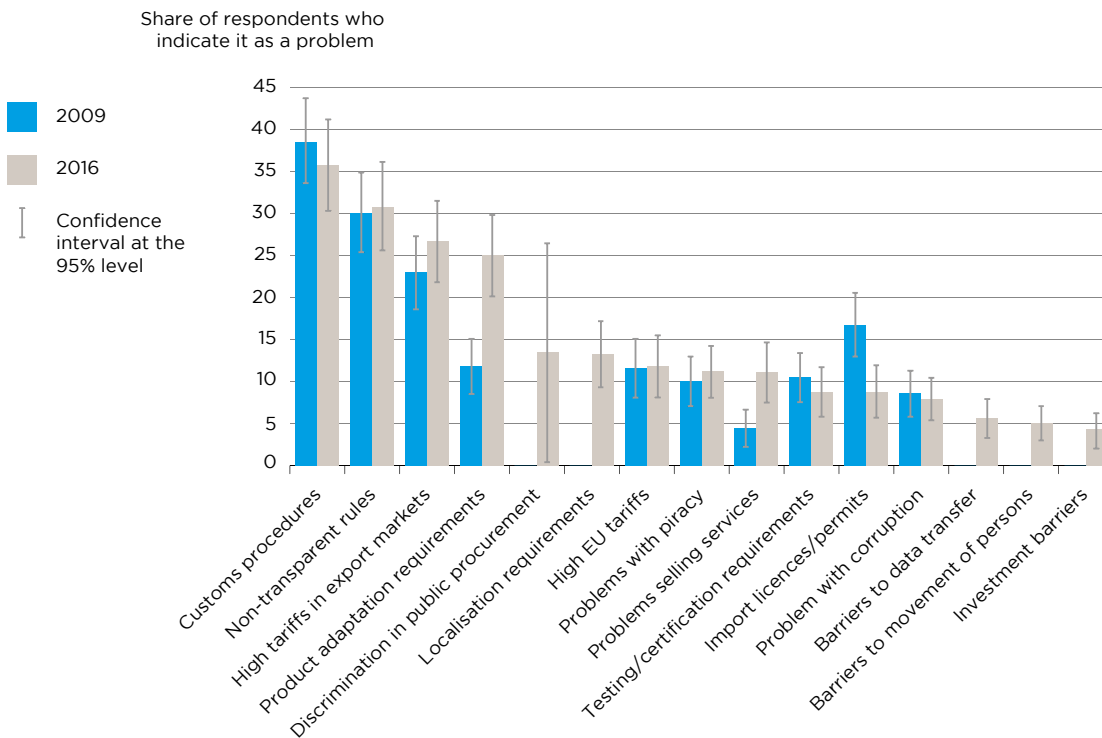
these interviews, several firms also expressed dissatisfaction with current procedures related to movement of persons to Sweden.

Despite rapidly increasing barriers to data flows, only 6% of Swedish firms experience a problem outside the EU. However, as before, our assessment is that firms are likely to experience growing problems with barriers to the movement of data and that the issue should therefore be given a high priority.

Finally, with respect to geographical priorities, four markets outside the EU are particularly important for Swedish firms. These are Norway, the United States, China and Russia. Interestingly, the country that most Swedish firms experience problems with is Norway (30% of the firms who say that they have problems with a certain country indicate Norway). This result most likely reflects the fact that Norway is Sweden's second largest export market, but it might also have to do with expectations. Exporting to Germany (Sweden's largest export market), Denmark (third largest) or Finland (fourth largest) require no customs procedures since they are all part of the EU customs territory, whereas exporting to Norway requires the fulfilment of customs procedures. In this context, we note that, in the future, EU customs procedures are also likely to apply to the United Kingdom. In addition, firms indicated India, Brazil, Japan and Turkey as important markets, either because firms want better access or because they view them as particularly difficult.



**Figure 118: Problems Swedish firms face outside the EU**



Source: Swedish National Board of Trade



## Editorial Comment: selected strategic and tactical implications

### Strategic implications

Candid and forthright discourse on the topic of protectionism is critical in the current geopolitical context, and the proposal to attain clarity of definition as to what constitutes protectionist behaviour is important to that discourse.

The notion of discriminatory treatment of foreign actors is intuitively clear, robust and relatively easy to address or target, and providers of trade-related financing can actively assist clients in identifying, articulating and advocating against such practices, in conjunction with similar efforts by chambers of commerce and diplomatic commercial services.

Financial institutions with a strong advisory element to their trade finance and SCF offering may even link the call for cross-jurisdictional regulatory consistency, with a related call for cross-border consistency in product level technical standards.

### Tactical considerations

As financial services firms engage further into SCF and the wider context of supply chain management, and develop greater expertise in logistics, customs clearance issues and other core aspects of the physical supply chain, opportunities may present at the transaction level, to assist clients in effectively navigating primary impediments to market access, such as customs clearance.

The ICC, focusing on greater dialogue, collaboration and alignment between our various Policy Commissions and our various member groups and partners, such as the World Chambers Federation and the World Customs Organisation, could provide added-value support in addressing these issues.





# Legal and regulatory issues adversely affecting banks in Trade and Supply Chain Finance

SULLIVAN & WORCESTER

**Can non-bank entrants benefit from their less regulated environment to make an impact on the market?**

**Author**

Geoffrey Wynne, Partner and Head Of Trade And Export Finance Practice, Sullivan & Worcester UK LLP

## **Banking regulation - where are we?**

Following a meeting of the Basel committee in March this year, the Chairman Stefan Ingves, announced that the committee has made further progress towards the finalisation of the Basel III reforms (called by some Basel IV). Amongst the proposed revisions to the Basel III accord are stricter capital rules and restrictions on the use of complex internal models used by banks to assess their risk. Despite the further progress reported by the Basel committee, delays are anticipated.

The expected delays are not helped by the changing attitudes from the US towards global banking regulation. This change in attitude could not only pose further delays to finalisation, but lead to a greater fragmented approach to financial regulation, negatively impacting those institutions wishing to operate on a global scale.

Basel III was implemented in the EU by the Capital Requirements Regulation (CRR) and the Capital Requirements Directive. As will be seen below this has some implications for trade finance which are not positive in some cases.

The proposed Basel reforms do not relate specifically to trade finance. They do not address one of the biggest shortcomings of Basel III for certain trade finance banks. The issue in question is the restriction on the types of assets that banks adopting the Standardised Approach can use as credit risk mitigation under Articles 194 to 217 of the CRR. These banks cannot use either receivables or physical collateral as eligible credit risk mitigants as these are expressly reserved for banks operating under the IRB Approach. This is a significant restriction given that many trade finance structures involve taking security over physical goods that are being financed and/or security over receivables generated by the sale of

such goods. The approach taken to credit risk mitigation under the CRR fails to recognise the knowledge and expertise that many smaller trade finance institutions have and places them in a disadvantageous position compared to their counterparts who operate under the IRB Approach. There are more issues to consider which adversely affect trade finance.

### Basel IV

There are proposed changes to the risk-weighted asset framework which will impose restrictions on the ability of banks to use an internal model for calculating regulatory capital in favour of a standardised approach. While these changes are intended to reduce differences in the way in which the internal ratings-based model is applied by banks and to reduce regulatory complexity, these do not appear to have been welcomed by market participants. These changes arguably have some effect in levelling the playing field between those banks who are subject to the Standardised Approach and those who are subject to the IRB Approach. They do nothing to help banks generally feel comfortable in the trade finance area.

### Other regulatory problems

Earlier this year in the UK the Policing and Crime Act 2017 came into force. The act includes provisions allowing the HM Treasury to hand out fines of up to GBP 1,000,000 for breaches of financial sanctions.

This should be looked at together with requirements on banks to comply with sanctions and anti-money laundering (AML) requirements. All of these lead to tighter requirements in the area of compliance, with provisions being looked at relating to “know your customer” (KYC). All of this leads banks to being very cautious in this area. Taken to an extreme, many banks are de-risking as will be seen below.

Other regulatory issues set to impact financial institutions include minimum levels of total loss absorbing capacity (TLAC), which should be implemented by 1 January 2019 and affect the 30 banks identified by the Basel committee as being globally systematically important. The levels will increase from at least 16% of the group’s risk-weighted assets (RWA’s), to at least 18% from 1 January 2022. There seems to be little good news for banks wishing to conduct trade finance.

### Non-banks entering the market

The banking landscape has changed significantly over the past decades. The breadth and scale of regulatory reform has arguably contributed to the rise in “shadow banking”, or market-based finance. The last decade in particular has seen a rise in FinTechs entering the market and partnering with some of the arguably more forward looking traditional financial institutions in a bid to revolutionise traditional finance practices, including trade and supply chain finance.

Market-based finance is not new, the European Commission issued an economic paper in 2012 which assessed the impact of non-bank financial institutions (NBFIs) on the stability of the financial system. The paper considered the range of players present in market based finance, including money market funds, private equity firms, hedge funds, pension funds and insurance undertakings, central counterparties, and UCITS (Undertakings for Collective Investment in Transferable Securities) and

The approach taken to credit risk mitigation under the CRR places many smaller trade finance institutions in a disadvantageous position

exchange traded funds. The European Commission has continued in its efforts which it sees to improve the market and recently published an Action Plan on Building a Capital Markets Union.

More recently, there has also been the rise in “peer-to-peer lending” and “crowd funding”. Some of the platforms used in the EU will be subject to MiFID II (Markets in Financial Instruments Directive II), whereas others may not be. However, they will likely be subject to their own nation’s laws. These are not banks and are not subject to Basel III as it currently stands.

### **Levelling the playing field**

Non-banks may have been attracted to the market as a result of the comparatively reduced regulation surrounding their activities, but in order to achieve a level playing field, regulation may be exactly what is required by the regulators.

The changes brought about by the implementation of the Payment Services Directive mean that traditional banks will undoubtedly incur increased costs related to security for example, since they will be sharing access to their customer’s accounts with non-banks. Traditional banks are subjected to a wide range of regulation compared to that of NBFIs. However, it is not the case that NBFIs are not subject to regulation, including, for example, national laws and sanctions provisions. Unless or until this happens, there may be advantages that NBFIs have and should exploit.

### **Advantages for NBFIs**

In light of the above, can and should NBFIs exploit advantages to become more involved in trade finance lending? In looking at this what are the advantages?

The key advantages that NBFIs have relate to their not being required to comply with requirements relating to the whole risk asset framework and restrictions on capital requirements.

This means that making funds available in the market is to a great extent something that NBFIs can achieve by their own fund-raising activities.

As noted above, banks are seeing themselves restricted by internal compliance particularly around KYC. The result of this, in many cases, has been called de-risking. Put simply, banks are not prepared to maintain relationships which they see as being costly from a compliance point of view. They are terminating these relationships. Many of these are in emerging markets and often are local banks who were useful eyes and ears on the ground. Equally, onboarding new relationships are seen to be too expensive and risky. Thus, new lending opportunities particularly in trade finance in the emerging markets are not being taken up. In fact, a paper released by the Financing for Development forum estimated a USD 1.6 trillion shortfall in trade finance funding. The result of this is that there are whole areas of opportunities which NBFIs can exploit.

NBFIs can be more flexible in setting up their own rules to onboard relationships and as to how they set up facilities for these relationships. Where their own fundraising is outside the bank markets this works well. It is an unfortunate effect of new regulation that where funding to a NBFIs is dependent on bank finance then restrictions are often put on NBFIs in raising funding.

**Non-banks  
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comparatively  
reduced  
regulation  
surrounding  
their activities**

This is not to say that NBFIs can go into arrangements with their eyes closed. These entities are equally bound by laws relating to sanctions, AML and financial crime. All of this needs checking, but against a background of being satisfied within their own rules. NBFIs can also take advantage of FinTech solutions in the area of compliance and the tracing of goods. This reduces risks in these areas. It allows these institutions to be more fleet of foot.

NBFIs are making an impact in the market. However, they are not the solution but perhaps regulators will look at the opportunities and not restrict NBFIs but perhaps to be flexible for banks more widely.

### The future

The future is further complicated by the upcoming exit of the UK from the EU (Brexit). As such, there is uncertainty as to how the UK will adopt measures under Basel III and indeed Basel IV. For the moment, this may be a side issue to the question as to who provides finance for trade. Access to finance is what trade needs. If NBFIs can be a greater part of this then that must be good news.



## Editorial Comment: selected strategic and tactical implications

### Strategic implications

The global regulatory environment will continue to change and compliance requirements will become more intrusive to the operating environment of banks. The industry will need to continually work to ensure that regulators appreciate and keep in focus the vital role of trade finance, ensure and that it is treated in a manner which aligns with its risk profile. Practitioners must continue to highlight adverse impacts of unintended regulatory consequences upon on SME market participants and the developing world. As more non-banks enter the trade finance business it will be important that regulators take a holistic view of the market and of consequently evolving regulatory requirements.

At the same time, it is critical that industry leaders continue proactively in efforts to develop and earn greater trust from the market, and to support the shared objective of a robust and sustainable global financial system.

### Tactical considerations

The industry will need to work with new entrants in the field to ensure that common standards and risk profiles are applied across the globe. It will be essential that existing banks, non-banks and FinTech companies cooperate to the benefit of trade finance as a whole and jointly develop the future environment for trade finance and for fast-growing supply chain finance.





# Challenges of global trade in an environment of increasing regulatory controls

THOMSON REUTERS

## Author

B.C. Tan, Head of Global Trade Proposition, Thomson Reuters

The perception of compliance as a serious obstruction to global trade has been a topic that has received much attention in recent years. In the 2016 edition of the ICC Global Trade and Finance Survey, it was identified as a critical issue with 90.3% of the respondents citing Anti-Money Laundering and Know-Your-Customer regulations as a very significant impediment to trade finance.

There are numerous sound arguments that rightly maintain the importance of having these regulatory controls in the financial sector and by extension the trade finance sector; which is causing further pressures on the global trade financing gaps.

However, an equally crucial reality is that the costs to financial institutions for non-compliance are real and costly; with multimillion dollar fines and penalties increasingly becoming a norm for failure to comply with AML controls. Furthermore, with personal liability of compliance officers increasingly imposed (60% of firms are expecting the personal liability of compliance officers to increase in the next 12 months), the appetite for risk-taking is lower than ever.

## Why are SMEs most impacted by regulatory controls?

The sheer cost and complexity of compliance has significantly curtailed the risk appetite of many financial institutions, often balancing cost to benefit in their choice of geographical and market participation. Based on a Thomson Reuters survey conducted in 2016, financial institutions today each spend on average USD 60 million a year on KYC procedures alone.

In a climate of heightened cost sensitivity; many financial institutions are highly concerned about managing the costs of their AML/ KYC programs measured against the expected revenue from their market participation and their perceived risk of operations in those markets. This to some extent begins to explain why SMEs and developing economies tend to be at the losing end of de-risking type activities – where profitability is often a key consideration in the cost/benefit analysis, and where the systemic lack of reliable background information can often heighten reputational risk perceptions.

While we do need to become accustomed to the new operating environment where regulatory controls are the new norm, there are certain aspects that the industry as a whole needs to address cohesively. Namely to work as an industry to reduce the cost of compliance and client onboarding, and the standardisation of documentary requirements in compliance procedures.

The sheer cost and complexity of compliance has significantly curtailed the risk appetite of many financial institutions



## Editorial Comment: selected strategic and tactical implications

### Strategic implications

Regulatory authorities and trade finance leaders have sought to find an equitable and effective balance between the necessary imperative to assure properly stringent regulation, and the need to allow for the conduct of legitimate, value-creating business that supports economic inclusiveness and drives growth.

Current political dynamics risk shifting the landscape, but in any event, the need to strive for risk-aligned regulatory treatment, in capital and compliance requirements, remains. Strategically, trade finance providers, risk insurers, industry bodies and other informed advocates ought to enhance and increase collaboration, complement regulatory engagement with messaging aimed at political leaderships, and must in parallel continue to show genuine progress in assuring the prudential management of assets and of transactions.

Regulatory authorities likewise ought to continue to advance in balanced treatment of various lines of business, recognising that broad-brush approaches are unlikely to achieve desired results. Likewise, the commercial impact of regulatory requirements must be acknowledged as a reality.

### Tactical considerations

Tactically, trade financiers ought to enhance industry-level collaboration aimed at increasing the consistency, efficiency and acceleration of compliance processes, as well as reducing the overall cost of compliance. Industry-wide utilities, robust, data-supported advocacy and the development and dissemination of regulatory best practices.

Despite financial institutions spending on average USD 58 million a year on client onboarding procedures, it continues to take an average of 24 days to onboard a new corporate client at a financial institution. What further compounds the issue is that corporates operating across multiple jurisdictions often find themselves having to maintain multiple banking relationships; where the Thomson Reuters survey found that companies on average maintain 11 banking relationships globally. So essentially, the effort and cost of compliance can often be compounded 11 times for the same company seeking trade finance.

What further compounds the issue is that often the 11 financial institutions might have different standards, rigor and documentary expectations in their onboarding and routine KYC procedures – highly complex and taxing for companies. National KYC utility type arrangements would be particularly relevant to the trade finance industry, where the cost of KYC checks can be greatly reduced by removing the duplication of effort brought about in having multiple banking relationships.

The Financial Action Task Force (FATF) founded in 1989 by a G7 initiative was tasked to develop and coordinate policy efforts to combat money laundering on a global level. After publishing its first set of recommendations on international AML standards in 1990; it underwent several revisions with the most recent being the 2012 version. A key change in the 2012 edition advocated for an operational adoption of the risk-based approach (RBA), moving away from a more universal and prescriptive approach.

As a result of the adoption of RBA, national regulators and financial institutions find themselves in a situation of having to interpret KYC policies and align their procedures to comply based on best effort and best ability basis. This to some extent explains why there appear to be different standards of compliance requirements across jurisdictions and institutions. SMEs and companies operating in jurisdictions not traditionally accustomed to such rigorous compliance procedures would certainly find it challenging, if not simply frustrating. There is an opportunity for policy makers and trade bodies even at a national level to provide assistance to SMEs in navigating these complexities.

The guidance papers issued by the Monetary Authority of Singapore and the Hong Kong Association of Banks around combating Trade-Based Money Laundering and trade finance compliance should be interpreted as positive efforts to introduce some level of standardisation in compliance procedures. However further relief for SMEs could come in the form of education and advisory assistance on the necessary documents helpful to compliance procedures.





# Rethinking Trade and Finance: Digitisation and the State of FinTech

**Digitalisation in trade finance: accelerating the journey >**

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**The digitisation of trade >**

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**Digital transformation and Supply Chain evolution >**

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**Disruptions in the Supply Chain and Blockchain >**

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**Data is the new oil in B2B Banking >**

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**Accelerating the role of FinTechs in trade banks >**

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**Leading industry players discussing the state of digitisation in trade and finance >**

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# Digitalisation in trade finance: accelerating the journey

ICC DIGITALISATION WORKING GROUP

**The growth of digital processes – including blockchain, straight-through processing, big data, and artificial intelligence – is driving the shift to paperless trade**

## Authors

Alexander Goulandris, CEO, essDOCS and Michael Vrontamitis, Global Head of Trade, Product Management, Standard Chartered, ICC Digitalisation Working Group co-chairs

For trade finance, digitalisation is influencing business models and strategies for corporates and banks. This is primarily due to its power to simplify and reduce costs, while also allowing banks to better serve small- to SMEs and stimulate trade flows. The benefits of digitalisation are now widely accepted and were largely outlined in last year's report, which highlighted its capacity for reduced risks, increased speed, improved working capital management, efficiency, transparency, and operational improvements, to name but a few.

In times of slowing trade growth, the wider macro-economic benefits of digitalisation also deserve attention. In fact, the World Trade Organization (WTO) estimated that technological progress will have the largest impact on GDP levels by 2035, accounting for 9% higher or lower GDP levels in developed countries. In emerging markets the variation is even greater – up to 20% higher/lower GDP in Brazil and 55% in China<sup>15</sup>.

When the cost of processing a Letter of Credit (LC) decreases, so too does the entire cost of trade finance – which enables financial inclusion. The ease of process also facilitates customs clearance procedures – allowing goods to move through supply chains more easily and reach consumers faster.

Overall, emerging markets have been the fastest adopters of digital practices, with the high implementation rate of mobile technology – “M-Pesa” in East Africa, for instance – demonstrating both regional sophistication and a willingness to experiment and try new technologies. Similarly, Asia has seen fast-movers tapping into digitalisation early on, also helped along by the pro-digital agendas of their governments, who see the future as a data economy.

There are clear signs that momentum is growing in the industry. Last year, for example, commodity trader Cargill and Wells Fargo collaborated on the first electronic export LC along the US to Taiwan shipping route,



15  
World Trade Report, 2013:  
Factors shaping the future of  
world trade.

[https://www.wto.org/english/res\\_e/booksp\\_e/world\\_trade\\_report13\\_e.pdf](https://www.wto.org/english/res_e/booksp_e/world_trade_report13_e.pdf)

using the essDOCS digital platform. This development marks the first time Cargill used a third-party buyer export LC for an e-bill of lading, and for Wells Fargo it is the first use of an e-bill of lading – reducing the process from over 10 days to five days or less.

### Digital islands

Still, despite significant progress and developments, a considerable amount of work remains to be done for the trade and trade finance industries to appreciate the benefits of digitalisation. Digitalisation has yet to reach the critical turning point where there is sufficient appetite in the industry, and benefits are realised.

Many players are good at digitising their own processes, operating in digital “silos” or “islands”. The challenge lies in linking up these digital islands – enabling them to communicate.

Of course, this means that the whole supply chain needs to digitise and realise the true potential of digitalisation in the physical supply chain. For many, there is a misconception between the process of converting paper documents into an image and passing it onto banks – which is in fact not digitalisation. True digitalisation enables data extraction and analysis, with the aim of improving business processes.

If trade finance is to be digitalised, the industry needs to also focus on enabling the movement of goods. Indeed, the banking industry’s objective of removing paper has in part met with limited success because efforts have been focused on digitising the financial supply chain while often ignoring the physical supply chain.

### Accelerating the digital journey

So how can the trade finance industry enable players to connect faster? Focusing on collaboration between industry players, removing any uncertainty with regards to legal standards and rules, and accelerating the adoption of industry know-how will accelerate the pace of digitalisation. Let’s take each in turn:

#### Collaboration

The entire trade finance ecosystem needs to grow to help bring different players – from the seller, the buyer, the financing party, government bodies, and others – online. Collaboration between banks, corporates, FinTechs, and other industry players will therefore be crucial in helping digitalisation reach critical mass.

As a start, industry efforts should focus on the digitalisation already happening in the market, and on leveraging the benefits of digitalisation by enhancing connectivity. Creating a framework or platform enabling stakeholders to speak to each other more effectively will connect the digital islands and allow these players to share their practices.

Of course, commercial interests are the driving force behind the uptake of digitalisation. The industry should therefore tap into the demand for digitalisation and encourage banks and corporates to become involved, particularly where digitisation is already in place and growing. Incentives to collaborate on digital platforms will also prove important.

The challenge lies in linking up digital islands – enabling them to communicate



What's more, government collaboration will play a crucial part in moving along the process. Lessons can be drawn from government support in the Asia-Pacific region, along with the experimental mind-set seen in some Africa countries. Overlooking a fear of failure can be aided by first trying out digital experiments in contained environments, in order to speed up introduction into the wider market.

### Standards and rules

Uncertainty around practice, rules and regulations are all barriers facing the digitalisation journey. In order to facilitate the shift to paperless trade, minimum standards and clearly defined rules will accelerate know-how and allow banks and corporates to more easily connect to digital platforms. Just as the shipping industry began using a standard 20-foot container for referencing cargo volumes from the 1950s to 1970s, the trade finance industry needs to find its very own container model for digital trade. Indeed, the 20-foot equivalent unit (TEU) industry standard allowed for the same container to be used on different transportation methods – solving the issue of a previously slow and difficult manual process. The idea of a minimum set of standards ensures that all service providers are working to the same criteria.

Similarly, developing a set of minimum standards for the digital connectivity of service providers across legal, liability, information security and technology will remove legal uncertainty. Today, while technology is well-placed to connect platforms, the discussion of who has liability of data from one platform to another must be considered. In fact, the information and security around platforms requires a lot of due diligence, which can take months.

Among other areas, ICC's Working Group on Digitalisation aims to evaluate ICC rules such as the electronic UCP and ensure these are "e" compliant, enabling banks to accept data versus documents. This also extends to e-bills of lading, minimum liability standards, minimum security standards, and minimum reference data standards – compatibility with the World Custom Organization's (WCO) data model, for example, in addition to recommended formatting standards (e.g. XML data formatting), and standard forms for IT reviews.

Clearly, guidelines are crucial to the evolution of digitalisation – allowing for shared past experiences and faster learning. These will also help certain players to analyse risk on platforms and understand the effects of digitalisation on the rest of their business. Similarly, enabling rules and ensuring enforceability around some of the documentation is crucial to encouraging companies to digitise processes faster. Providing guidance in one single rule book, fully covering the electronic delivery of documentation, will provide the confidence needed for trade financiers. Overall, the more the information provided, the easier it will be for digitalisation to be adopted.

### Practical solutions

International trade spans different countries and regions, all at different stages of digital evolution. Digitalisation will therefore begin to happen in the context of one or more trade corridors with forward-thinking parties and industries more amenable to digital practices. Industry players need be encouraged to try digitalising in pockets, which will also help the industry achieve a minimum viable ecosystem involving buyers, sellers, banks, ports, customs and carriers – across multiple industries.

The more the trade finance industry can alleviate concerns about digitalisation, the faster it will happen

The greater use of current technologies is also providing opportunities that the industry has not had before. For instance, it's no secret that banks are increasingly looking to the application of blockchain to trade finance. There are significant opportunities to tap into these technologies, and, similarly, to use data analytic tools and machine-based tools to make informed credit decisions and forecasts, and to monitor risks.

#### Collaboration is key

Clearly, the more the trade finance industry can alleviate concerns about digitalisation, the faster it will happen. What's more, it is clear that no one institution can fully digitise alone. Collaboration between banks, corporates, industry players, via digital platforms will be the determining factor in the pace of which the trade finance industry shifts to paperless trade.



### Editorial Comment: selected strategic and tactical implications

#### Strategic implications

The strategic focus of the trade finance industry must decisively evolve beyond preliminary discussions and initiatives related to dematerialisation of documents under traditional instruments, to a broadly-based, industry-wide effort to digitise trade finance in the wider context of digital trade. Creative and non-traditional collaboration, the willingness to adopt potentially disruptive technologies and business models, and the imperative to align with client needs and expectations ought to be part of the strategic landscape around digital trade and finance.

Advocacy efforts aimed at facilitating legal, regulatory, accounting and other key stakeholders' acceptance of digital trade finance must

accompany the numerous proofs of concept and the various platform-based solutions under assessment. As with the corporate payments space, trade financiers may find useful lessons and insights in the retail experience of individuals, with consumer ecommerce platforms like eBay or solutions like PayPal or Alipay serving as launch points for similar models in the wholesale banking arena.

#### Tactical considerations

Tactically, leading adopters of digital models linked to trade and trade financing can usefully place additional emphasis on the operational and transactional considerations linked to digital trade, including focused consideration of compliance issues, fraud risk issues and related areas of practical, implementation-level concern.



# The digitisation of trade

MISYS

## Authors

David Henna, Head of Trade and Ben Jarrold, Senior Marketing Strategist, Misys

Prior to 2008, global trade had been growing at approximately 1.5 times the rate of global GDP thanks to the expansion of global supply chains and associated cost reductions, especially in emerging markets. Since 2008, trade has not only suffered the negative impact of increased regulation but also a significant slowdown in investment. The decline of trade as a share of economic activity is paradoxical in a world where connectivity is on the rise and transportation costs are falling.

As a software vendor servicing the needs of the trade finance market, Misys has dedicated much of its strategic development capacity in recent years to regulatory compliance and de-risking. We have now reached a decisive inflexion point where the emphasis has shifted away from the negative influence of mandatory compliance towards the positive potential of digital technologies providing a strong platform for trade to re-establish its pre-eminent role in the global economy.

## Doing nothing is not an option

In the last ICC Trade Finance survey 65% of banks said their business is only digitised to a very limited extent or not at all. Given the radical shifts in the competitive landscape, doing nothing is no longer an option. CBInsights has estimated that more than USD 24 billion has been invested in financial technology in the past 12 months. It is thought that as many as 350 million more businesses could begin exporting as a result of the move towards digitisation, adding as much as USD 29 trillion to the digital economy in the next decade.

Whilst it is acknowledged that trade is a particularly difficult business to digitise due to the number of participants and documents across the supply chain, the opportunity to translate documents to data and to transform business processing from analogue to digital is huge.

Digitisation is a highly complex journey, involving the amalgamation of multiple streams of external data to enable dynamic risk and pricing calculations, followed by the often larger challenge of managing changes to internal process. However, more and more banks have come to realise that digitisation is the only way to future-proof their trade business.

With digitisation comes the ability to extend connectivity across the trade ecosystem. This is of vital importance in the face of ever more complex corporate value chains and the fragmented technology landscape that persists across trade, supply chain finance and trade lending.

All banks providing traditional trade instruments as part of their working capital finance services are constrained by long-established paper-

# 125

USD/ STANDARD LC

The minimum by which courier charges could be reduced

# 50

USD MILLION

Estimated potential cost savings the digitisation of the trade finance business could achieve

based and labour-intensive processes. Replacing these processes with largely automated transactions based on digital flows will have a positive impact on operational risk and efficiency, helping banks to adhere to the complex web of compliance rules and offering greater insight into customer business, all of which will increase profitability and open up new market opportunities to support business growth.

Digitisation of trade finance is also being driven by the continuing move to open account and the increasing demand for supply chain finance. By its very nature, SCF has to be digitised to make the business viable at any scale.

The SWIFT 2018/19 messaging changes for letters of credit and guarantees will impact every bank doing trade finance. It will lead banks to either upgrade costly legacy infrastructure or take advantage of the situation to implement a best-of-breed front-to-back trade finance platform. Overcoming the SWIFT challenge is vital to maintaining or increasing competitive levels of digitisation.

### What will the digital trade bank of the future look like?

Moving forward, a truly digital bank will support paperless processing and communication to and from its customers. It will use external services to establish title of digital documents such as electronic bills of lading and airway bills and to exchange digital certificates of origin, Insurance certificates, invoices and purchase orders. The bank will be able to consume data that determines the location and quality of goods in transit. It will have an open architecture and ethos that enables collaboration with financial technology platforms, government agencies, system Integrators, and other service providers in order to be at the centre of the ecosystem of supporting the needs of corporate clients.

A digital bank will be advantaged because it will be able to leverage data to understand better operational, market, industry and customer risks and thereby ensure optimum use of the bank's capital. The bank will understand better and be able to predict future customer demand and therefore improve sales potential. The bank will improve customer self-help through greater access to data whereby corporates can interface to their own ERP systems and run predictive data analytics across their working capital needs. Digitisation will open new market opportunities as there will be a better understanding of risk. With current data limitations banks are focusing mainly on large corporate business. Obtaining more data through digitisation and applying predictive analytics will allow banks to manage more efficiently the risks associated with the SME market.

### The metrics of success

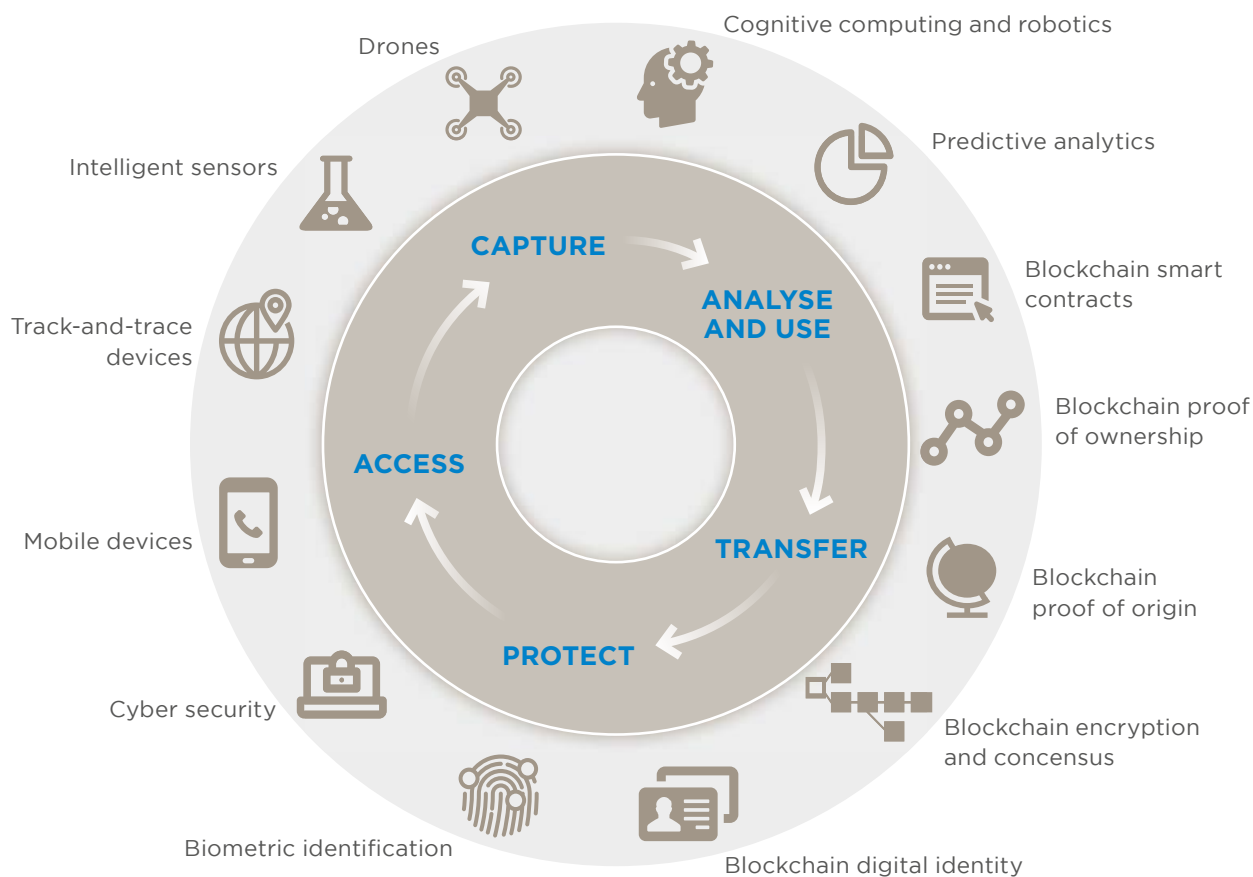
In collaboration with our strategic partners essDOCS, Misys has conducted research at a number of banks to quantify the benefits of digitisation, including the integration of paperless trade into the bank's back office processing.

Conservative estimates at one bank demonstrated that digitisation of the trade finance business has the potential to achieve cost savings of up to USD 50 million per year. Others have estimated they can save two hours per transaction by not handling paper; they can also save much of the 30% of time spent on compliance with automated per transaction

**30%**

of time spent on compliance with automated per transaction compliance could be saved

**Figure 119: Future considerations for digital trade and supply chain finance**



Source: Misys World Trade Symposium Executive Summary

compliance and reduce by some 15 minutes per document check with an automated pre-check solution. Courier charges could be reduced by at least USD 125 per standard LC.

In the case of a corporate customer active in commodities, the critical ratio of days sales outstanding (DSO) was reduced from 15 days to 4 resulting in improved cash flow, improved predictability/forecasting, improved inventory management and reduced risk.

The banks we have worked with estimate that with a fully integrated front-to-back solution, some 10% of clients could be converted to digital in Year One, rising to 30% in Year Two.

### What else does the future hold?

Last year's buzz was all about blockchain. Thankfully that conversation is now moving more sensibly and constructively on into the world of distributed ledger technology coupled with smart contracts and smart objects. But already there is a further shift of emphasis towards new and exciting innovations in artificial intelligence, machine learning and 3D printing.

Of particular interest is the opportunity for digitisation to be applied beyond commercial gain e.g. in the context of sustainable trade. The Internet of Everything enables us to create smart objects that can be tracked along the supply chain. If we can track the whereabouts and condition of goods in transit then we can better manage operational risk. If we can do this during transit why not do it at source to guarantee provenance of goods? Embedding sensory and wireless technology within objects makes it possible to trace and transfer ownership of property digitally. These smart objects can transmit data regarding identity, condition and surrounding environment. Such advances in technology will not only create new opportunities for value creation but also present new challenges for regulators and policy makers. Banks will need to add KYO (Know Your Object) to KYC.

### A call to action

At the recent Banking Commission meetings in Jakarta the ICC launched its new Working Group on Digitalisation. This is an important development that emphasises the continuing influence of the ICC and provides an opportune moment for industry experts and stakeholders to play an active role in shaping the next generation of digitised trade finance.



## Editorial Comment: selected strategic and tactical implications

### Strategic implications

Digitisation of trade financing and of platform-based SCF is occurring in a wider context – one where truly transformational dynamics are taking shape, that will inevitably change the fundamental nature of the physical supply chain, from logistics and delivery processes, to decision processes and drivers to traceability and sustainability.

While trade finance faces specific and at times esoteric challenges in its own path to digitisation, the promise of these developments is better seen and appreciated with a holistic view of developments in the digitisation of complex global supply chains.

Senior leaders with an innovation mandate in trade financing will do their institutions and the industry – as well as the global economy – a great service by

advancing digital trade. The potential to facilitate engagement in international markets by 350 million businesses globally is a clear target with material potential to impact trade corridors and supply chains.

### Tactical considerations

Steps taken to date to quantify the operational, financial and other concrete impacts of digitisation, including in the context of traditional trade finance and SCF, have shown material progress. Industry participants will benefit from additional, detailed metrics across trade finance activities and across global supply chains.

Initiatives to collect, analyse, share and benchmark data in this arena should be encouraged, actively supported and adequately funded to ensure maximum leverage and value from such efforts.



# Disruptions in the supply chain and Blockchain

PwC

## Authors

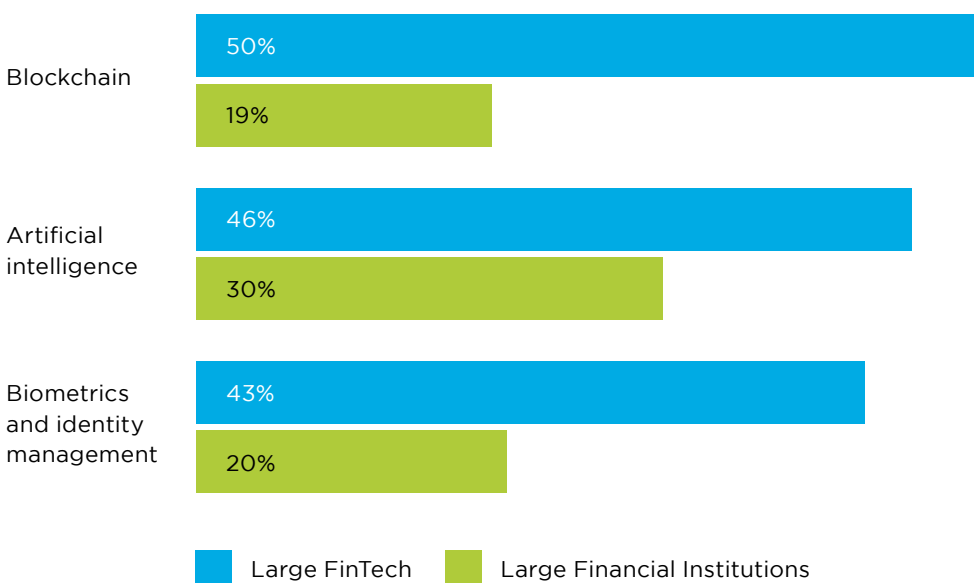
Seamus Cushley, Director, FinTech and Michael McFall, Principal Data Engineer, PwC

## Introduction

Among the many catalysts of innovation in modern industry, technology is often credited as perhaps the greatest contributor. And while technological innovation is not new, recent developments in emerging technologies have opened up genuine possibilities to disrupt many of the ideas and businesses we take for granted (Figure 120). One only has to look at fields such as AI, AR/VR, and IoT to see how quickly progress can be made and applied to real-world use. Blockchain is another example of an emerging technology, and one which has the potential to fundamentally transform how organisations interact, transact and share data.

**Figure 120: Focus on emerging technologies<sup>16</sup>**

Percentage of large companies that identified these emerging technologies as the most relevant to invest in within the next 12 months.



Source: PwC Global FinTech Survey 2017

Trade finance and supply chain management are areas considered ripe for innovation

### What is blockchain?

A blockchain allows multiple parties to transact through a single, shared, decentralised ledger, where each party witnesses the same view of that ledger, but no one party can independently control or manipulate the content therein. In what has quickly become a burgeoning field, several flavours of blockchain already exist today. Private blockchains are those confined to a single organisation, operating exclusively within those bounds. Consortium blockchains are shared between multiple organisations, but with explicit onboarding required to participate. Public blockchains are those which operate on the public internet (e.g. Bitcoin, Ethereum), and are accessible by anyone wishing to participate.

Blockchains are also differentiated by the functions they support - Smart Contracts provide the ability to embed business logic & rules within ledger transactions, allowing predefined actions to be orchestrated by the contract code itself. What all blockchains have in common however, is that they are underpinned by a combination of cryptography and the means to reach consensus between all parties.

Every action is timestamped and logged independent of all other parties, and without the need for any central arbiter. Blockchains can also provide the ability and choice to protect sensitive information given the necessity of the use case/application.

Consequently, it is possible to build a system which provides transparency, confidentiality, and speed of execution across multiple parties, while reducing risk, reconciliation effort and cost for all.

With this capability, it is easy to see why blockchain technology continues to garner interest in a wide variety of industries.

### Disruption potential for trade finance and supply chain management

Trade finance and supply chain management are areas considered ripe for innovation. Particularly for SMEs and those in developing and emerging economies, where the high risk of fraud has been an ongoing concern for credit suppliers. High operational cost, lack of access to traditional financial services and opacity of the trade cycle also present barriers to entry. Blockchain technology offers considerable promise, not only as a means of streamlining and improving existing processes, but also as an enabler for new products, services and transaction types. Trade finance is seen as one of the most attractive initial FS use cases with 80% of banks identifying trade finance, corporate lending and reference data as holding the most potential for new business models brought on by the technology.<sup>17</sup>

Existing trade finance is often associated with high operational burden & cost, owing to a typically paper-heavy process and lack of cohesion between participants in the transaction cycle. Blockchain offers the potential for a fully digitised process, with all documentation and participant actions logged on the chain, secure and visible to all required parties, while reducing the cost of handling, processing and reconciling independently for each party involved.

By improving cohesion and reducing the cost to each participant, the barrier to entry can be lowered, improving accessibility of trade finance services and further driving adoption.<sup>18/19</sup> This network effect is likely to

entice new service providers to the ecosystem, potentially resulting in a new breed of products and transaction types - e.g. responsive insurance governed by a smart contract, fraud detection based on transaction history present on the blockchain and the insight that can be gleaned from that data, automated reporting for risk, compliance, sanctions and regulatory purposes, consolidated AML/KYC compliance, tax/duty calculation, alternative payment & settlement methods, such as escrow services, etc.

Risk and traceability is another key area for trade finance, particularly due to the disconnected nature of steps in a typical trade cycle, and the challenges that poses for visibility and transparency. Blockchain solutions help to address those concerns, allowing all participants to see the same consistent view of the transaction, with confidence that the data is authentic, verifiable and protected against fraudulent alteration, deletion or destruction by any unauthorised or malicious actor.

Furthermore, the level of inclusion offered by blockchain solutions allow regulators and/or auditors to directly participate, enabling issues or violations to be detected and addressed early in the cycle. This has not gone unnoticed in many industries, Maersk, the world's largest container-shipping line, has produced a proof-of-concept initiative, using blockchain to digitise ship cargo inventories<sup>20</sup>, while others have investigated using blockchain to provide assurance and authenticity of products in the supply chain.<sup>21</sup>

## Summary and conclusions

Blockchain has progressed quickly in a reasonably short space of time, and we expect that pace to continue unabated. 2015-2016 was a period of learning for many, with early adopters developing PoCs to prove feasibility of the technology and surrounding business processes. 2017 will see learning continue, with some electing to develop prototypes to validate real-world scenarios and applications. In the next few years, we expect this trend to continue and increase in pace, with fully fledged production applications certain. In a report by PwC 77% of respondents to their survey expect blockchain to be in production systems or processes as soon as 2020.<sup>22</sup>



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## Editorial Comment: selected strategic and tactical implications

### Strategic implications

Distributed Ledger Technology, and the more specific Blockchain variation, are at the early stages of evolution and market uptake. Whilst trade financing appears to present some compelling use cases for the application of this technology, industry leaders appear to be following a two-pronged approach: launching PoCs and exploring strategic alliance opportunities while leveraging the positive impact of well-timed press releases, while at the same time, taking a cautious, limited-scope approach to implementation.

Several market initiatives have carefully avoided taking early decisions about the underlying technical architecture, preferring a more considered approach focused on business need and impact, as opposed to pursuit of the latest technology for its own sake.

The business of financing trade presents – even demands – numerous levels of innovation and perhaps a material degree of transformation, whether through careful application of OCR, artificial intelligence or wider-ranging digitisation. Strategic decisions linked to evolving practices

and technical capabilities around supply chain management offer ample opportunity for evolution, where DLT and Blockchain may or may not be the optimal option. Early adopters may derive a market advantage, but as with numerous other initiatives aimed at bringing trade financing to the twenty-first century, there is risk in proceeding without a clearly defined need or value proposition. Fundamental questions about regulatory treatment of DLT-based architectures and transactions remain, and as in the first days of the telephone, the usability and usefulness of DLT may depend heavily on far-reaching adoption, globally, given the nature of the business

### Tactical considerations

In tactical terms, trade finance executives and their management teams must become conversant in DLT and Blockchain technology, and should undertake critical assessments aimed at understanding the applicability, clear value proposition and likely uptake of DLT-based solutions in the financing of international trade, whether as an internal solution or as an enabler of cross-industry or multi-provider collaboration.



# Accelerating the role of FinTechs in trade banks

SIMMONS & SIMMONS

## Author

Jolyon Ellwood-Russell, Partner,  
Simmons & Simmons

There is a revolution under way in the financial services sector, and it is accelerating innovation at a startling pace. It has become clear that FinTech, and the digitisation of trade based finance are no longer just phrases or buzzwords. There is not a day gone past without a triumphant press release from either a bank or trader claiming to have executed an international trade of cargo on the Blockchain – albeit all at proof of concept stage. There is clearly a wave of potential optimism associated with the benefit FinTech might bring to trade finance.

Smart contracts, Robo-advisors, Cryptocurrencies, Cross-border Remittance apps, RegTech, InsurTech and new alternative Finance Platform providers are all being heralded as providing real efficiencies to the trade and trade finance model. Such methods could reportedly reduce the costs of paper based trade financing by up to 15%. Such potential disruption, therefore, is impossible to ignore.

Conversely however, the FinTech sector is also experiencing some of the inevitable growing pains of a nascent industry, whether that is regulatory uncertainty or a general unwillingness to adopt new technology and adjust the existing business model.

In a recent study of Hyperfinance conducted by Simmons & Simmons of over 200 Financial Institutions, including many of the world's leading trade banks, only 7% believe they are at the forefront of innovation in the industry, and 59% of respondents view themselves as at the same level as their rivals, or lagging (hereinafter referred to as the "Hyperfinance report").

At the same time, 80% of innovation leaders say that digitally-driven products and services they have launched over the past three years have opened revenue growth. This contradiction shows that there is clearly a desire to accelerate digital innovation but only few financial institutions have the current know-how to structure their own digital strategy.

While some banks have their own Accelerator Programme, Incubator or Innovation Lab, creating their own environment for adopting formerly perceived disruptive technologies, the Hyperfinance report examined alternative structures that can be adopted to accelerate a bank's digital innovation.

**FinTech, and the digitisation of trade based finance, are no longer just phrases or buzzwords**



## Collaboration, partnerships and acquisition offer alternative paths to innovation

### Paths to innovation

Collaboration, as per the Hyperfinance report, is presently the most popular approach by the market. 55% of respondents are already undertaking this form of innovation. However, such a process is seen as a long-term strategy, with mismatching interests causing friction between the parties. Indeed, only 16% of respondents considered this method to be highly effective.

A Consortium can be highly effective in obtaining success from a wider participant pool, and helps to ease frictions that can be present between a smaller number of parties. Additionally, the advantage of having several parties with very different perspectives can be significant. Take, for example R3 consortium. Late in 2016 the R3 consortium and its member banks successfully completed prototype letters of credit using distributed ledger technology.

As can be seen by the teething problems that R3 has highlighted, a collaborative project based on goodwill can only go so far whilst each party considers it is in their best interests to contribute. There might be a time in the future for deeper collaboration with regulators, for example, but presently it would seem that most financial institutions are seeking an alternative path to innovation.

Partnering with a FinTech is the second most popular method of innovation. 48% of respondents cited this as their second strategy. Given the speed with which a partnership can be created, and the real advance that can be made when the parties forge a closer bond of trust, this is undoubtedly a method of innovation that trade-based financial institutions are considering as a way to innovate.

Partnerships, however, are inherently riskier than mere collaboration, given the closer ties each company will need to agree to. Indeed, 54% of respondents were concerned that the need to align different organisational cultures in such an environment would prove to be a significant challenge, and one that highly regulated multinationals are poorly equipped to resolve.

Acquisition, as possibly the strategy with the highest risk, is unsurprisingly the road that the fewest have travelled down so far. However, in the next 12 to 18 months this might start to change. 32% of respondents to the Hyperfinance report expected to undertake a corporate venture focussed on FinTech in that time span, and 31% expected to acquire a FinTech firm during this window.

However, this is with the assumption that the best targets develop enough to promote themselves. In Hong Kong it should be noted that, unlike the global appetite for acquisition, 66% indicate that a lack of certainty regarding the ideal target is putting them off acquiring a FinTech.

### Barriers to innovation to consider

Whilst strategies to enable innovation must be considered, there are also general risks that need to be considered and probably result in the current wariness of banks to join with FinTechs. These apply across the industry, and are key issues that trade banks should have in mind when considering how to mitigate potential risks of innovation.

Cyber-security: This is one of the biggest barriers to better partnering with FinTech firms and using RegTech solutions and is a huge hurdle that needs to be overcome for trade banks to feel confident about partnering with FinTech firms and implementing RegTech solutions. This will require careful due diligence and controls over access to systems and the data passed to the third party. It will also require robust but practical contractual protection that sets clear expectations around security and what happens in the event of a cyber-security incident.

IP: When in a joint venture (JV) or consortia arrangement it is vital to establish early on (ideally before any intellectual property (IP) has been created) the ownership and licensing arrangements of results. A more flexible approach to IP structuring is crucial. An institution's desire to own the IP when working with FinTech firms can have an impact on the effectiveness of collaboration.

Regulatory risks: Regulatory risk is a key concern for trade banks looking to partner with, acquire or invest in FinTech companies as well as implement new technology solutions. Some FinTech/innovative firms operate in newly regulated areas where there is a patchwork of new regulation across different jurisdictions. A key area of risk mitigation is, therefore, to ensure that the FinTech business has a clear understanding of the regulatory landscape in which it sits and a strong compliance culture.

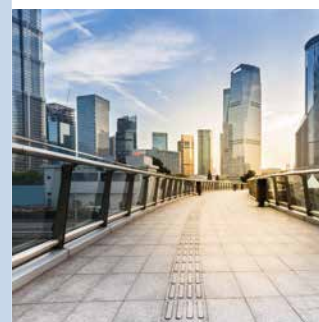
## Solutions

The Hyperfinance report identified 6 important steps to faster digital innovation that should be considered when considering a strategy to undertake Hyperfinance. Escape the 'Four Walls'. Whether it's creating a separate legal entity, or establishing an innovation lab within a start-up ecosystem, freedom from the bureaucratic culture of large financial institutions can be hugely beneficial to accelerating innovation and collaboration with other partners. Engaging carefully with the main organisation can help to ensure that the unit's innovation is a commercial success; 38% of respondents stated that doing so resulted in "highly effective" improvements on their digital innovation.

Adapt the on-boarding process. Large institutions can speed up the on-boarding of FinTech firms by adopting a more flexible and tailored approach to better reflect the agile nature of these entities. In particular, legal and compliance teams must be ready to use a business oriented approach to risk when collaborating with FinTech firms. Leaving potential collaborative projects to an institution's procurement team is often seen as and swiftly becomes an immediate barrier to successful execution.

Get pragmatic about IP. A flexible approach to IP is crucial. Licensing arrangements are increasingly important to FinTech firms' innovation in certain areas, particularly where it is clear they have a significant personal investment in their innovation. Banks that are comfortable with licensing structures can become early adopters – and gain further benefits. 47% of respondents considered this to be a significant challenge for their particular institution's attempts at collaboration.

**Regulatory risk is a key concern for trade banks looking to partner with, acquire or invest in FinTech companies**



Centralise a digital innovation strategy. As FinTech firms become more diverse in their activities and new FinTech hubs emerge globally, multinational banks need a coordinated plan of attack to keep both themselves and colleagues in other global offices up to speed with any new technology. A centre of excellence or centralised knowledge base is key for efficiently marrying the right innovations with the needs of the business, and being able to cross-pollinate ideas from one jurisdiction to another.

Know your partners. When carrying out due diligence on a potential FinTech partner, there is no substitute for spending time getting to know the founders and other senior staff in person. Asking the founders to describe their technology development cycle and their approach to compliance gives a much clearer view of the risks presented by an early stage business. It works better than asking them to fill in a 200-page procurement questionnaire and provide a raft of policies they may never have read.

Pick the right investment model. Outright acquisition of FinTech businesses could quash innovation, as firms might need to work with multiple players to develop cross-industry solutions. Taking a minority stake in a FinTech firm bypasses this risk, enabling financial institutions and asset managers to get closer to the development of the technology.

Despite its somewhat out-of-date and lowly reputation as a paper based archaic system, trade and trade finance has always been at the forefront of innovation and an early adopter of technology to facilitate the payment and movement of goods. From camel trains to the development of credit instruments, bills of exchange or the standardisation of the intermodal container, trade has adapted to the requirements and demands of its merchants. The current digital era is yet another opportunity for trade to push the boundaries of existing practices and accelerate bigger and better technological efficiencies for trade and trade finance.



### Editorial Comment: selected strategic and tactical implications

#### Strategic implications

Trade finance has enjoyed significant profile and visibility as an area likely to benefit significantly from digitisation and the creative application of emerging technologies to core aspects of the business. Options related to bank engagement in or with FinTechs are being developed and pursued at different rates; what is clear, is that there is a growing appreciation for the significant potential in bank/FinTech collaboration.

#### Tactical considerations

The operational considerations related to the deployment of transformational technologies, to the development of FinTech and bank partnerships, are proving to be of significant importance as was expected. Trade finance leaders can advance the efficacy and impact of the industry – already material on a global scale – by engaging in discourse around lessons learnt from early proofs of concept, and from consortium-based models that continue to present a potentially transformational proposition in the financing of global trade flows.



# Digital transformation and supply chain evolution

GT NEXUS

## Authors

Kurt Cavano, Founder, Vice Chairman, Chief Strategy Officer and Andy NG, Regional Vice-President, GT Nexus

Manufacturers and retailers continue to grapple with the reality that technology and customer empowerment have fundamentally shifted the way goods are sourced, produced, and sold. If companies don't embrace innovation, they face the same fate as Kodak and Blockbuster, as there is no shortage of IT-enabled upstarts that are looking to disrupt and take out the established players.

Supply chain excellence has become a differentiator in many sectors. The companies that keep pace with the ever-changing consumer by continuing to deliver quality products in a timely, cost-effective fashion will preserve market share and thrive. Digital transformation of the supply chain encompasses many innovation concepts including big data, 3D printing, cloud technology, the Internet of Things, and robotics – it is driving evolution in the supply chain today and leaders are racing forward, trying to figure out how to adapt.

About 75% of global supply chain executives consider digital transformation to be important for their business, according to a recent survey<sup>23</sup> of more than 330 executives across 20 countries conducted by Capgemini Consulting and GT Nexus. However, only about a third of them stated that they were satisfied with the progress they've made so far.

One huge challenge is the massive amount of data generated in the supply chain today. The introduction of more systems and sensors is only making that ocean of data more immense. Within the next five years, 94% of supply chain executives expect to receive more real-time status updates from across the entire supply chain. Some companies, such as Caterpillar<sup>24</sup>, are already using some of this advanced technology to better understand their global supply network and respond to changes in demand or disruptions in the supply chain in real time, by connecting the physical supply chain to the data supply chain.

Risk mitigation is also crucial. A recent survey of more than 250 North American supply chain executives found that about 40% of manufacturers<sup>25</sup> were affected by some sort of disruption in the past 12 months. These events can be anything from a natural disaster to breakdowns at suppliers and manufacturing sites, to fluctuations in currency and geopolitical risk, not to mention changes in consumer demands. Simply, there's no easy way to predict everything that might happen in a year. It's even more difficult to avoid risk altogether.



23 \_\_\_\_\_  
Digital Supply Chain Transformation Infographic: <http://www.gtnexus.com/resources/blog-posts/digital-supply-chain-transformation-infographic>

24 \_\_\_\_\_  
3 Problems CAT Solved to Save USD 250 Million in Excess Inventory: <http://www.gtnexus.com/resources/blog-posts/cat-saved-250-million-in-excess-inventory>

Levi's: Jeans Maker Launches Cheap Financing for More Ethical Factories: <http://www.gtnexus.com/resources/customer-stories/jeans-maker-launches-cheap-financing-for-more-ethical-factories>

25 \_\_\_\_\_  
State of the Global Supply Chain: A Research Report on the Top Issues Facing Industry Executives: <http://www.gtnexus.com/resources/papers-and-reports/state-of-the-global-supply-chain-top-issues-facing-industry-executives>

26 \_\_\_\_\_  
Toyota, Honda, and Nissan Suspend Japanese Vehicle Production after String of Earthquakes [UPDATED]: <http://blog.caranddriver.com/toyota-suspends-vehicle-production-after-earthquakes-strike-japan/>

27 \_\_\_\_\_  
Supply Chain Disruption: If It Can Happen to Toyota, It Can Happen to Anyone: <http://www.gtnexus.com/resources/blog-posts/supply-chain-disruption-risk-can-happen-to-anyone>

28 \_\_\_\_\_  
3 Supply Chain Moves that Make Fashion Environmentally-Friendly: <http://www.gtnexus.com/resources/blog-posts/3-retail-supply-chain-moves-for-sustainability>

29 \_\_\_\_\_  
Levi's: Jeans Maker Launches Cheap Financing for More Ethical Factories: <http://www.gtnexus.com/resources/customer-stories/jeans-maker-launches-cheap-financing-for-more-ethical-factories>

In situations like those Toyota faced in 2011, with the Japanese earthquake and tsunami, and even with the recent earthquakes that struck Japan<sup>26</sup> in 2016, we've seen that even the most admired supply chains are vulnerable to risk<sup>27</sup>. The best companies today are those that recognise disruption is unavoidable, and that agile, responsive networks are better suited to manage these risks than rigid, inflexible supply chains.

The supply chain has also become a vital part of a company's brand as today's consumers demand a level of social responsibility with the goods they purchase. A couple of decades ago, companies took their first steps to introducing more eco-friendly measures into their businesses. Then, we saw more evolution through carbon footprint reduction and fuel efficiency standards in logistics, and now we're seeing the emergence of electric trucks from Tesla.

Today, there's growing evidence<sup>28</sup> that these manufacturers and retailers have taken sustainability and injected it into their purpose as brands. Levi Strauss & Co. are on a mission to drive sustainability into their supplier base because they believe that ethical standards for how goods are produced are at the core mission of their brand. Levi's launched a program<sup>29</sup> that allows them to offer cheap financing to suppliers that score well in their sustainability performance index.

Whether it's the ability to shop in-store or online, the freedom to choose from a global selection of products, or the ability to share sentiment with a vast social network, consumers have more influence than ever. This shift has a profound effect on the supply chain. Retailers are building fewer stores, and big boxes like Target and Wal-Mart are converting their metacentres to act like distribution centres, shipping goods to online buyers and ensuring inventory is available to those who want to buy it, wherever they may be.

Meanwhile consumer goods manufacturers find themselves adapting to a rapidly-changing environment. The industry is working to get better at sensing demand and deploying postponement and segmentation strategies into their supply chain. There's also a sense that the role of the distribution centre is changing, with manufacturers working to get closer to demand, become smarter with inventory, and increase collaboration in supply chain execution with partner companies.

What connects all of this is information which puts technology at the core of supply chain excellence. Without it, the concepts described above would likely never happen. The better companies get at understanding the data throughout their supply network and act upon it, the more agile and responsive they will become, ultimately helping to keep up with some of the unpredictability and consistent change that comes with global business right now.



## Editorial Comment: selected strategic and tactical implications

### Strategic implications

Developments in global supply chains, driven by the emerging priorities of businesses around the world, provide a strong impetus for trade financiers to move forward on long-aspirational objectives to build client-centric propositions. As with several initiatives in the trade space and in the area of trade finance, the importance of clients leading the way by creating demand will be important to market development and adoption.

Strategically, the alignment between expectations emerging in the market, the ocean of data that will enable rich analysis, and the technological capabilities to undertake analysis as well as design and deploy solutions, is converging in a transformational way.

The linkages between supply chain visibility, traceability and the growing desire to conduct business on a sustainable basis are clear and growing, with implications yet to be fully appreciated, but it is clear that finance – specifically trade-related financing – can be an important enabler of these developments, just as it is a key enabler of trade.

### Tactical considerations

Tactically, developments in supply chain management and related practices demand a more comprehensive, informed and holistic dialogue between SME, commercial and corporate clients, and providers of trade-related financing. Front-line and operational trade finance staff, and those with SCF-related remits, have a significant opportunity to develop professional skills and domain expertise that extends beyond areas currently covered by trade finance units, to better serve current and emerging client needs.



# Data is the new oil in B2B banking

TRAXPAY

## Author

Markus Rupprecht, Founder and CEO, Traxpay

FinTech has often been portrayed as a disintermediation for banks. 18 years ago PayPal, at the time a new market entrant, began its quest to shake up the financial services industry and ultimately captured a very big piece of the B2C payment pie. It has been enormously successful, and other B2C payment providers have since joined the movement to challenge banks in this space. While banks continue to dominate in other B2C segments such as real estate financing, retirement planning, and consumer investment strategies, they must now turn their focus to threats looming in the market for B2B transactions – a global market that has been estimated to be worth more than USD 300 trillion annually.

## B2B networks: the new threat to the banks

There is an ever-increasing demand for integrated and innovative financial products in the B2B market. Enterprises are seeking convenience and flexibility, automated transaction processing, and optimised working capital. They need streamlined processes to succeed in the age of international commerce which has become infinitely more complex, competitive, and costly. For far too long banks relied on the monopoly they represented in the financial industry, and on their long-standing customer relationships. This has resulted in a huge innovation gap which new competitors are anxious to fill.

In recent years, B2B networks have developed an enormous global customer base on their platforms which connect suppliers, distributors and logistic providers, and simplify trading. They have now recognised the huge opportunity to supplement their SaaS revenues by cross-selling financial products to their customers. Ariba's partnerships with American Express, First Data and Prime Revenue, amongst others, speak to their ambitious goals in this regard.

In B2B business, banks face a very real threat of having to relinquish a great deal more to imminent competitors who will be able to execute a whole array of transactions within their networks. Should they not take action, they may be left to simply act as processors with access to central bank payment services and as market makers who take a transaction fee. A resulting price war based purely on cost efficiency could ultimately threaten their most important asset: the trust of their customer and the underlying personal relationship. If that is lost, banks will become nothing more than neutral, interchangeable service providers.

Unfortunately, history has proven that even the value of trust can be outweighed by the convenience factor; perhaps less so in B2B than B2C, but banks still should be very wary.

There is an ever-increasing demand for integrated and innovative financial products in the B2B market



**Banks' data analysis and credit decisions would improve significantly with a better data base**

### **The race for data**

In 2006 Clive Humby, the renowned data scientist and innovator, coined the phrase "data is the new oil!" Banks are desperate to capture the data that would enable them to cross-sell on a big scale.

Their data analysis and credit decisions would improve significantly with a better data base. For example, it is quite likely that an invoice which has been paid on time, every time for the past 30 months will also be paid next month. Alternatively, the risk of a one-off bill not being paid is substantially higher. Information on what an invoice is for can also help assess the risk of non-payment, as companies generally pay for strategically important purchases more readily than unimportant C goods even when liquidity is critical. By way of illustration, a company is more likely to prioritise paying the invoice for its servers than it is to pay for its last company Christmas party.

But exploiting this new kind of data is only the beginning of the potential for cross-selling.

It moves credit decisions to another level: today some banks utilise data that is months or years old to make credit decisions; the new era will enable automated decisions based on the most recent customer situation and behaviour.

Some banks, in an attempt to reach this ambitious goal, have recently taken to partnering with or investing in B2B networks. But this type of partnership is like playing with fire, and in the mid to long-term, if they do not choose carefully, they could very well get burned. Merely investing in a non-bank provider of invoice financing or factoring does not give a bank access to this invaluable data. And of course, the banks run the risk of being disintermediated by these very same partners.

### **The opportunity**

The complexity of wholesale banking transactions demands a very high level of technical and human expertise on both the customer and the bank's side, not only in terms of formal training but also experience gained within these organisations. Finance specialists like treasurers and CFOs are traditionally risk averse, which is a huge benefit for the existing bank/client relationship.

Despite the plethora of challenges to innovate and strengthen their competitive position for the future, many major corporate banks actually own networks of active clients which are much larger than those of their B2B network competitors, but which they do not exploit at all.

At its last Ariba Live Conference in Las Vegas, for example, the company claimed to have over 2.5 million customers. Of those, we can assume that approximately 1% are big buyers, approximately 25,000 large corporations. On the other hand, Bank of America, for example, boasts 3 million corporate customers.

Based on Metcalfe's law, global banks have the potential, in theory at least, to exploit an enormous network of potential customers. In addition, the question arises as to why the banks don't activate their own networks and begin offering SaaS products. Typically, only B and C goods are procured on B2B procurement networks such as Ariba. Banks could potentially enable transactions for those strategically important suppliers offering A-class items as well.

The financial services they might offer are also not limited to reverse factoring (payables finance) and dynamic discounting, but could include factoring as well as standard bank products such as credit lines. Those suppliers who often require refinancing have little regard for the product range, focusing rather on the best way to improve their liquidity shortages. Today, they have to optimise across the various silos mentioned above, which is complicated and in many cases not even possible. Offering them an integrated solution to these challenges would certainly generate a great deal of interest.

For example, a supplier has given his claims to a factoring company and usually does so with a range of letters, such as all his invoices to buyers whose names start from A to E. He issues an invoice to BMW, and although he has a good liquidity situation at the moment, he has to sell the invoice at a high refinancing rate to the factoring company. Conversely, if he writes an invoice to Volkswagen and needs the money urgently, he doesn't have the possibility of refinancing due to the terms of the contract. Refinancing of the invoice on an ad hoc basis would be desirable, but it is only possible if you have all the data required to automate the assignment.

On the other hand there are the cash-rich buyers who wish to invest excess cash for maximum return. While they would welcome existing reverse factoring offers, they would be even more interested in standard factoring offers for which interest rates are usually higher. On a flexible platform, they could step in and offer a better price than any third party. Especially in the case of the negative interest rates in Europe today, any CFO would see this as an attractive alternative. The risk of a direct settlement between buyers and sellers is zero, which makes the transaction all the more attractive.

There are also buyers who want more attractive payment terms for cosmetic reasons so as not to aggravate their suppliers or simply because they know their supplier wouldn't cooperate. With complete transparency it would be very easy to turn to an intermediary who could provide optimised solutions for the different needs of both parties. The consequence would be more flexible maturities on the basis of bilateral agreements between the buyer and the supplier or with the involvement of a third party.

One of the most important problems is still reconciliation in Accounts Payable and Accounts Receivable. As long as invoicing cannot be allocated with a fully-automated process, it is very difficult to refinance it on a flexible, ad hoc basis. It's generally accepted that the average invoice in B2B is worth EUR 10,000. A 60-day maturity at 3% would yield EUR 50 of interest. Since most reconciliation studies are based on higher yields, refinancing on a one-off basis makes little sense.

## Conclusion

There is no doubt that data will become ever more important in the future, especially in the B2B space. The question remains, however, whether banks will harvest and use this data themselves, leave the field to third parties, or work in tandem with them. Currently there are few providers that have established themselves as a partner who can help banks collect and analyse this data, without the threat of disintermediating them. Those who make use of big data and artificial intelligence to develop new products together while allowing banks to continue to control their customer relationships will be in great demand. And, coming back to Humby's analogy, the banks that find the right partner will have the opportunity to tap into the largest oil wells of the 21st century.

Providers who make use of big data and AI to develop new products while allowing banks to continue to control their customer relationships will be in great demand



## Editorial Comment: selected strategic and tactical implications

### Strategic implications

The industry is increasingly conscious of the tremendous potential inherent in an environment where massive amounts of data are coupled with unprecedented analytical capability. More recently, the complementary value of carefully selected strategic alliances is being brought into the mix through fast-growing FinTechs with compelling propositions.

The use of large amounts of data to inform credit decisioning and risk analytics is clearly an area of focus, and translating the potential value of

data from a range of sources in the international environment will be commensurately complex, but proportionately valuable. Trade financiers will advance the efficacy of the industry by assessing new sources of insight and data across borders and supply chains.

### Tactical considerations

The viability of collecting, validating and leveraging large amounts of data in support of higher-quality transaction-level decisioning merits greater analysis, both at the level of individual institutions and industry.







Roundtable discussion

Leading industry figures discuss the digitisation of trade

# Digitisation of trade finance – the state of play and the road ahead

Roundtable moderator:

**Vincent O’Brien**, Member of the ICC Banking Commission Executive Committee

Roundtable participants: left to right from top

**Alexander Goulandris**, CEO, essDOCS

**Edward Ribeiro**, Group Head, Trade Finance Operations, Ecobank

**Shehzad Sharjeel**, Head, Global Trade Finance Program, IFC

**Michael Vrontamitis**, Global Head of Trade, Product Management, Standard Chartered

**Jun Xu**, Deputy General Manager, Global Trade Services Dept., Jiangsu Br., Bank of China

**Adrian Rigby**, Chief Operating Officer, Global Trade and Receivables Finance, HSBC

**Dominic Broom**, Global Head of Trade Business Development, BNY Mellon

**Ana Kavtaradze**, Head of Trade Finance Department, Bank of Georgia

**David Meynell**, Managing Director, TradeLC Advisory

**Vinod Madhavan**, Head Transactional Products & Services, Africa, Standard Bank



**O’Brien (ICC): Let me set the scene. Our subject matter here is on the digitisation of trade, an expression which can mean different things to different parties but what we are focusing on is how we can advance and accelerate trade using advanced financial technology - FinTech.**

I see this as a process of evolution and not one of revolution and our discussion today is timely to say the least. When the WTO Trade Facilitation Agreement (TFA) came into effect on February 22nd 2017 after receiving the necessary ratification from two-thirds of the 164 WTO members, we reached a tipping point that will, in my view enable real progress in facilitating the digitisation of trade. Up until now, the lack of common trade facilitation standards at country government level has hampered the digitisation process.

The benefits for SMEs are obvious and it has been put forward that the TFA if properly implemented could boost trade with an extra USD 475 billion to be driven predominately by developing markets.

The TFA is also placing significant emphasis on minimising trade documentation, increasing transparency in tariff administration, fast-tracking customs management processes and enhancing information technology applications, which

will in turn lead to an inclusive supply chain environment for all stakeholders. As we know, a lot of these aspects are already appearing on the ICC radar screen.

Technology is obviously a key enabler here. There’s no doubt that trade, despite some shortcomings, boosts productivity, innovation, quality, wages and living standards. China has already proven all of this through trade with major increases in productivity, innovation and subsequently growth, which have contributed to the improvement of people’s lives.

Michael Vrontamitis, if I can turn to you. In our first Digitisation Meeting here in Jakarta yesterday for the ICC Banking Commission, you said something that resonated with me. You mentioned that within the world trade supply chain environment, there are ‘islands of excellence’, instances where technology is doing a great job in the facilitation of trade. But you also indicated that there are other areas which leave major room for improvement, where inefficiency and bureaucracy abounds. Please share with us a few more words on your concept of ‘islands of excellence’ and where this may take us to.

**Vrontamitis (Standard Chartered):** Sure Vin, the digitisation of trade is alive and it’s doing quite well but its stellar performance tends to exist in isolated instances or ‘silos’. That’s why I’m using the concept of ‘digital islands’, in that what I see are parties getting together,

usually within a vertical group. Whether it's the shipping industry or perhaps a corporate or logistics group that has developed an electronic data interchange or EDI network amongst their own closed group. The ability to connect all the parties within a supply chain, as of yet, does not really exist. So, what happens is that somewhere in the process the chain gets broken and we default back to paper. The challenge and indeed the opportunity is to enable these digital islands to interact with each other effectively using common digital standards and protocols, so that we can avoid paper. The WTO TFA is a great initial step, but it has placed a lot of its focus, at least in the early stages on the customs elements. I feel we need to broaden our horizons to connect customs, shipping companies, inspection companies and banks to all supply chain actors for this to become real digitisation of trade – no mean feat!

## Collaboration

**O'Brien (ICC): Michael, that makes a lot of sense to me. The TFA is driven predominantly by the WTO and World Customs Organization (WCO) and it is on record that the ICC has facilitated the negotiations, driven, by the need to radically improve the efficiency of cross-border trade, especially for SMEs. It is quite something that the TFA now becomes an official part of the multilateral trading system, which covers more than 95% of the global economy.**

**Speaking of islands, does anyone around this table have an 'island of excellence' in their mind where it can be demonstrated that technology is facilitating commerce and trade?**

### **Kavtaradze (Bank of Georgia):**

Vincent, as you know I represent a very small country; Georgia. Georgia has already taken several steps forward in terms of moving to digital and paperless business practices, but as you have inferred, government support is imperative. Just recently, in Georgia, with the support of our government we implemented a Blockchain system for the registration of land ownership in the land registry. This means the change of title to land is irrefutable, performed in real time and obviously minimises the possibility of title disputes.

**O'Brien (ICC): This Blockchain land registry for property title is alive in Georgia?**

### **Kavtaradze (Bank of Georgia):**

Yes Vin, it's live since February 2017. I understand that as of now above 100,000 land title electronic records have been registered. The benefit is that it provides a very transparent and secured real time information system, and by all accounts it is very user-friendly. Georgia is the first country to implement this Blockchain solution, which is quite impressive for a small country like Georgia. In terms of the next steps, the government plans to implement smart contracts on this Blockchain system to handle property transactions, notary services and possibly in time bank mortgages.

**O'Brien (ICC): Nice practical case study Ana. We will come back to smart contracts later, but perhaps others here in our group can share other cases of these 'islands of excellence' where financial technology can be demonstrated as facilitating trade.**

**Sharjeel (IFC):** There is one example that we came across while developing IFC Global Warehouse Finance Programme. The primary purpose of this programme is to finance commodities, in

particular, agri-commodities and so far, the IFC support has been predominantly in Africa where in several markets traditional small holding farmers are utilising mobile devices to trade their products in exchange for current commodity prices. It is so encouraging to see pre-conceived backward business processes making a leap-frog jump ahead of conventional trading platforms, in addition to the traditional physical commodity exchange market. The farmers are trading in a digital, mobile environment. Quite revolutionary in my opinion.

## Connectivity

**O'Brien (ICC): There's certainly no arguing with that amazing story Shehzad. One of the big barriers from moving away from paper, even in this great example from Shehzad is how do we get parties to trust the technology. What is the key ingredient that will make people trust a digital system and start using it?**

**Sharjeel (IFC):** It's similar to what Ana said. The benefits of the 'proposition' need to be transparent from the very beginning. When the benefits are clear, then similar to my Africa example, the adoption of the new technology is easy to encourage due to the premise of streamlining the real business process. When the technology provides blatant benefits, the adoption curve is very fast.

**O'Brien (ICC): I'm impressed. I would not have expected our first two 'islands of excellence' to come from Africa and Georgia. Jun, just before we started this session you mentioned that Bank of China has launched eURC transactions and is looking at implementing electronic rules for collections. To most people, that**

**sounds quite unbelievable, could you share some insights into how that might work?**

**Jun Xu (Bank of China):** Actually with assistance from essDOCS we tested the first eURC, or electronic rules for collections in China this year. During the process, there were some difficulties as there are no officially recognised rules for the electronic version of documentary collections. In the end, we had to look to the eUCP for guidance. Eventually, the process went through smoothly and we considered it a successful operation in evolving paper passed documentary collections towards the digital world. However, once again, the need for common agreed standards and protocols for such operations became very evident.

**O'Brien (ICC): So far so good. With our 'islands of excellence' we have seen a government supported land title registry example from Georgia, from Africa, we have seen the farmers digitally trade commodities using mobile telephony technology as well as the evolution of rules for electronic or digitised trade collections coming from China.**

**Rigby (HSBC):** What I would like us to consider is what the collective power of all these initiatives could yield, and how we can better connect these 'islands of excellence'. Several Blockchain initiatives have delivered early positive results, but it might not be so easy to change the rules of trade to fully realise the technology's potential, so I think we need more collective brainstorming of what the trade technology landscape might look like in 10 or even 20 years.

I see collaboration as the key to unlocking innovation and further digitising trade. The good news is that we're seeing more

collaboration in the industry than ever before - banks collaborating with other banks, banks collaborating with FinTechs, banks investing in FinTechs and working with the customs agencies. HSBC is fully embracing this new ethos in its collaborative projects, investments and partnerships.

That said, I think the industry does need to recognise and explain what we mean by 'paper. Essentially what we're talking about are title documents and other key trade processing documents. We need to better articulate what documentation might look like in the future for trade.

Another significant challenge is how we manage research and development whilst at the same time developing our existing lines of trade business, particularly in emerging markets. The internal effort, certainly within my organisation and I am sure it is the same within others - is significant. It takes significant resources to manage one collaboration, one initiative, one investment, or one new innovation moving in a FinTech company.

## Innovation

**O'Brien (ICC): Great insights Adrian. The key words coming through here are 'collaboration', 'connectivity' and 'innovation', all of which facilitate trust in new technology.**

**Ribeiro (ICC):** Can I add another keyword here? That is 'harmonisation'. This is a paramount requirement as it leads to reduced effort and minimises waste and risk. The solution, as Adrian said is 'collaboration' or simply put, working together to find solutions, but the solutions must have industry wide application. I can give the example

of Ecobank where technology is catching up fast and in some instances is leap-frogging in a similar manner to what Shehzad outlined. Ecobank now considers itself a digital bank and still evolving in the areas of trade, supply chain, retail and corporate banking across 30 countries. The benefits are tangible. The number of transactions processed end to end are up while the number of staff processing remains the same or reduced in some cases due to digitisation. This improvement in efficiency also provides the opportunity and time for staff to re-skill and find ways to deliver more value to the bank, which will bring greater rewards for them too. A lot of things are happening in terms of what technology brings, but harmonisation of the various units is critical if any institution will reap the full benefits of digitisation, otherwise we will waste a lot of time, money and human resources.

**Broom (BNY Mellon):** We are on the right track. For me the most important aspect is to understand the end user benefit. This is vital. Consider for a moment; if you look at some of the sister businesses to trade, like payments, there are significant number of examples of successful additions to the services, such as the SWIFT GPI Global Payments Initiative.

I think that's at the heart of what we need to do in trade. If you look at most commercial payments they tend to be related to some sort of settlement of a trade transaction. It's the back end of the process that we're all involved in. It may yet be early days yet, but it's already becoming broad based. A significant number of global banks, many of them represented here around the table, are taking an end user view to bring Blockchain or distributed ledger-type benefits to an existing infrastructure. I think that's another key element. In order

to achieve that end user benefit and to guarantee that accessibility, we need to discover better ways to evolve the processes and in turn the technology. Take it from where we are now to where we need to go. It has to be evolution, because there has been failure where some groups of individuals have had some very smart ideas, but as we all know getting those smart ideas adopted and implemented by the industry at large is often impossible.

## Accessibility

**O'Brien (ICC):** OK Dominic, we have a new keyword 'accessibility' which perhaps was not a priority in earlier thinking. Sticking with the theme of solutions and benefits for the end user can I ask David Meynell, the senior technical adviser to the ICC Banking Commission to share his views on what the ICC Banking Commission is doing in this context. Take documentary letters of credit on one hand and all the amazing advances in technology on the other. The reality is that we are still dealing with paper. This lingering with paper documents means trees are wasted, documents take too long to get through the banking system, cargoes and customs procedures get delayed, customers get stuck with documentary discrepancy fees, the list goes on. David: you will recall that an old friend of ours, Gray Sinclair, once said that 'discrepancy fees will be the death of letters of credit'. What is the ICC Banking Commission doing about these challenges?

**Meynell (TradeLC Advisory):** The future of documentary credits and the UCP are high on the agenda of the Banking Commission meetings and communications. There are severe problems in the paper world, we all know

that. We can talk about revising rules, reviewing practices, but in the end the base problem is the paper. We can improve the rules and processes as much as we like. eUCP have not been widely used unfortunately. We're also looking at eURC now in China. The ICC Banking Commission needs to integrate itself in a better way in this process. We have skills all over the world, not just in banking, in corporates as well, but we're not leveraging those skills as well as we should. We need to look at these processes in more depth, understand how digitalisation is changing our processes and adapt our rules to move in that direction. It's interesting to speak about the collaboration between banks and FinTechs; this is the future, but it's not a matter of combining the best of these two types of institutions, the matter is addressing the gaps that the industry has. Banks have issues such as short-termism. I spent many years in Banking, most recently as Head of the Product Management Team for FIs. I must say, one of my biggest problems each year was the budgets. We could spend significant time putting our budget together and then competing with other departments, other teams, other segments in the bank, yet still get no return. It is true throughout banking that many medium / long-term projects are killed off because short-termism brings in more immediate returns. If we look at a digital world today, this cannot function on such a model, so there is a big gap we need to address in the banks. Also in banking, now we face big challenges in respect of regulatory, compliance, legal aspects. And FinTech is yet to address that. We could do this together, FinTechs and banks, and we could address this challenge in trade.

**O'Brien (ICC):** Thanks David. I agree that we need to take the long-term view; we must collaborate, innovate, deliver on the accessibility challenge and not lose focus on the benefits for the end user customer. Here is an interesting story regarding ICC rules and China. I was a guest of ICC China in November 2016 at a conference in Beijing. Participants included bankers, lawyers and even a number of Supreme Court Judges. The discussion was great, but one Supreme Court judge asked me an interesting question 'We have had letters of credit for so long, tried and tested, and then the ICC moved on the Bank Payment Obligation BPO - legally these concepts are the same: one being a legal undertaking to pay against trade documents and the other an undertaking of payment against trade data. So why not evolve the rules instead of trying to reinvent the wheel? The Chinese bankers present, by and large supported this view, to incorporate the 'e' into the UCP, to facilitate and evolve rules that are tried and tested, even in the courts.

**Goulandris (essDOCS):** Good story Vin - I couldn't agree more!

**Rigby (HSBC):** Let's face it. We have had a few white elephants in the trade industry; a few initiatives that were developed but never found momentum. I think the developments that never materialised were not customer-centric enough. For me there isn't enough change in our industry that's driven by the end user. What we need to do is to talk to customers about what they like and what frustrates them about the processes of letters of credit, guarantees or collections and other forms of trade and supply chain finance. Even with the collaboration going on now with FinTech companies, we need to focus on customer-driven input.



**O'Brien (ICC): Adrian, that is so important. We appear to have consensus that a key ingredient has been missing – a clear determination of the needs of the customer as the end user of trade finance services and processes.**

**Madhavan (Standard Bank):** Agreed: we need to identify the problem that needs to be solved. For a long time, we missed that, in how we were working as trade bankers on our own. I was one of the guys who plugged for the BPO, and I'm not saying that BPO was wrong, not at all, what I'm saying is that it lacked an immediate problem solving statement.

The reason why I now feel this is so important is that, if I relate two sets of stories in Africa. The first one is M-Pesa, the mobile phone-based money transfer, financing and microfinancing service. M-Pesa had a very clear problem statement with a clear and immediately understandable solution for its target market. The second theme I feel passionate about is that solutions ideally should be locally developed, at least in the initial stages. Earlier we spoke about what I would call agile development, a way of being able to move ahead and not to have to wait for the full solution to go live, nor to have to wait for fully fledged rules to go live. And hence, it is essential, in my opinion, to allow FinTech companies or others to be close to the solution. We as bankers should step away in the initial phases. This is not easy, but we must let the innovation happen, on the ground; let it reach out to gain a level of critical mass. If we don't step away, we stifle new thinking. As trade bankers we carry baggage, we stifle the innovation by always looking at the worst case scenario.

In South Africa, there is a good success story that evolved using this development model called

'SnapScan'. It allows for electronic payments in the ecosystem with SMEs and smaller merchants. With out-of-the-box thinking, it completely sidesteps the card systems. This was something developed locally and then when they reached the critical mass it started to take over. I feel that the ICC, as the World Business Organisation, needs to act as enablers to facilitate innovative trade and payments solutions.

## Consensus

**O'Brien (ICC): Interesting fresh insight Vinod – any reaction around the table?**

**Goulandris (essDOCS):** Let me share some perspectives on this subject. First, with regard to digital trade finance, should the banks not participate, there would be no digital trade transactions. Critical mass cannot be achieved without the banks. Second, there are certain things that banks can own, but there are certain platforms that banks can't own. Some of you might remember a project called SeaDocs that was started by Chase Manhattan as it was then. This was a 1980s-project trying to do electronic bills of lading in the tanker industry, which failed as it was a proprietary Chase Manhattan platform. Commentators have since said that the reason that project failed was because other banks were unwilling to participate in a platform controlled by a competitor bank. We must understand that we need to maintain a neutral standpoint. If bank ownership is required, neutrality can be met by a consortium. In my opinion, it can't be attained by a single bank ownership, under any circumstances. Parties can hide behind Santander/HSBC ventures, but the market sees through it, due

to the platform essentially being controlled by a single bank. In sum, some FinTechs will succeed because there are banks behind them, but make no mistake, there are other FinTechs which are and need to be multi-bank, neutral platforms to succeed.

**Jun Xu, (Bank of China):** I was there when the Judge asked Vinod the question about ICC rules. She made a very good point. In creating ICC rules, we must think about the legal as well as the practical and operational aspects. Indeed, the letter of credit and the BPO are both bank undertakings. In China, we did a lot of promotion for the BPO, we translated all related ICC publication and we helped organise seminars. However, the uptake was small. A small number of customers were willing to explore the BPO for commodity trades and even then it was limited. For buyers, that don't want to pay early, they want the documents to be able to take delivery of goods and pay later. While sellers, they want to receive payment immediately, so the basic parties are coming from completely different stances. When making rules to digitise trade, we need to take a balanced approach and consider the interests of both parties, otherwise it will not be successful. The Chinese government is very active in supporting electronic commerce and trade. The government recently introduced favourable guidelines in supporting e-commerce, especially an e-commerce model infrastructure construction aiming at reducing tax and encouraging SMEs to get involved in e-commerce and e-trade. However, from my experience I know that KYC and AML will be big issues in the digitalisation of trade finance. Banks have no option but to comply with those regulations and procedures, so even if those



customers deliver documentation electronically, banks still need to go to customers and ask for the information and as of now this must be paper-based. As you can imagine this part digital/part paper approach is not well received by customers, the end users.

**Broom (BNY Mellon):** Well said. It is ultimately the end customer's perspective that matters. At the risk of being branded a trade heretic, I've long said that the BPO was a solution looking for a problem. Without a problem articulated by the end customer, the solution was never going to fly. Then we get into the whole competitive landscape. Truth be said, bankers are not particularly innovative people, the system has not fostered innovative thinking, because we've been trained for years to be conservative and cautious. Where I've seen pockets or 'islands of excellence' due to having the right actors doing the right thing at the right time and using the right mix of skills. Leaving FinTechs to be innovative to look deeply at the world from a problem-solving perspective is useful. If you look at the finance industry today, a lot of the FinTech development and a lot of the technological advances that have come through have been in the retail consumer space. There is a simple reason for this phenomenon: the consumer space is easy for outsiders to understand and therefore to create innovative technology solutions that really work. The banks' role is to promote, host, and create environments where such people can be innovative in development, focusing on early adopters for such solution based technology. In the trade world, we need to help the innovators understand our business, give them the freedom to innovate as this will in turn help ourselves.

## Transparency

**O'Brien (ICC):** Any alternative views around the table in the context of letting the FinTechs innovate?

**Vrontamitis (Standard Chartered):**

I have a slightly different view on this. I agree it's all about real problem-solving. I don't necessarily agree that you can let innovators sort of run off and let them innovate while the bank sits back waiting for the FinTech eggs to hatch. I see a lack of convergence in a bunch of sound technologies that can, with the right convergence, transform trade for the better. We must think convergence when we consider the new technologies of distributed ledgers, smart contracts, cloud computing, big data, machine-based learning, artificial intelligence and a whole lot of other technologies. The role for banks is not to sit back, but to look at how all these can be pulled together and enabled to meet client needs. Banks, working together, should be joining the dots to create new trade finance solutions, to solve some of the acute problems facing the market. One such example is the SME trade finance gap, banks could also consider using big data to solve some of the challenges around compliance, KYC and regulation. There are a lot of sound technologies out there, but when I talk to FinTechs, most appear fixated on the technology rather than on the problems that advanced financial technology and digitisation can solve.

**Broom (BNY Mellon):** We're in complete agreement – we must give the FinTechs direction as part of this collaboration process. I am also saying we must not embrace the FinTech innovation too tightly because we may squash and kill it.

**O'Brien (ICC):** Thanks Michael and Dominic, we now have a new keyword on the list 'convergence' and I'm glad we're all in agreement on the need for convergence in the technology. Speaking of end customers acting as early adopters, we have seen amazing innovations with technology in the payments sphere but what about letters of credit or guarantees? What about adoption early adoption there?

**Kavtaradze (Bank of Georgia):**

Here is another story from Georgia that might be interesting about digital guarantees. The national agency of public registry of Georgia has come up with a project to implement an e-guarantee platform. Of course, as you can imagine banks were reluctant at first. In my view, the government made a smart move in the early stages.

The banks were not part of the project early on, but only joined when the project needed real input and data. This e-guarantee platform was implemented in 2011 and now 90% of the Bid Security guarantees used in bidding for contracts, as well as Auction Guarantees are online through a digital platform. This has turned out very good for the end users. The banks were initially cautious about it, due to concerns about rules and legal considerations. The agency then adapted the rules and processes in response to the concerns raised by the banks. The e-guarantee for contract bidding is online, with a special registry platform to which banks have access. This isn't just restricted to the local situation in Georgia. International companies also participate in the bids since there are a lot of large infrastructure projects going on in Georgia at the moment, particularly in connection with the one out of four government's main pillars – promoting Transit & Tourism

hub is to finish all announced projects by 2020 connected to construction of spinal Highways, as well as projects related to rail, air and maritime. When we get the counter guarantees, even from Western banks, and we explain that the business is transacted in Georgia by an e-guarantee digital platform, they are quite surprised. Sure, we get a lot of questions from new users or adopters as you can imagine, but once familiarised and taken through the on-boarding process it works really well.

## Standardisation

**O'Brien (ICC):** So, Ana you are saying that you may receive a counter guarantee from a foreign bank as a SWIFT MT760 message, but the local guarantee to support the local bidding process will be entirely on an electronic platform without the typical paper chain.

**Kavtaradze (Bank of Georgia):** Yes, Vin. That is quite common situation in Georgia and has been running successfully for over 5 years now. Digitisation is very young in Georgia but without doubt it is alive and well developing.

**Rigby (HSBC):** It's not a surprise that the products growing the fastest, in our experience, are the ones with the strongest technology enabling them. Receivables finance in supply chain finance is one good example using advanced technology to approve electronic invoices or invoice batches. Such products are easier to specify, to evaluate, to implement and to administer.

**Ribeiro (Ecobank):** I'm wondering why it's taking us this long to drive the digitisation project? My sense at this roundtable is that the consensus is an optimistic one. Now it's really time to walk the talk and not just talk the talk.

**O'Brien (ICC):** Yes, that appears to be the consensus Edward. We now have real opportunities that hadn't presented themselves before. With the trade facilitation agreement of the WTO now in force, Governments are buying into the four pillars of trade facilitation, which are 'transparency', 'simplification', 'standardisation' and I know you will like the last one Edward 'harmonisation'.

Clearly the focus is more on customs and logistics in the early stages but these are trade functions which will not yield the expected positive results in isolation. This is our opportunity to shape the future of trade digitisation and this can be further enabled with the ICC now gaining observer status at the UN.

OK, our time is nearly up – we have a maximum of ten minutes remaining. I suggest we do a tour around the table with ten one minute stops. You have one minute to articulate the one thing or initiative that you feel can have the maximum impact on the digitisation with our collective efforts and the support of the ICC.

Ana, let's start with you.

**Kavtaradze (Bank of Georgia):** In the past, developing countries typically learned from advanced countries and that made sense back then. From what we discussed today we now need a more inclusive debate that is open, solution based and starts with a focus on the needs of the customer, which must then be reengineered using lessons we have learnt and which we are now sharing in this forum.

**O'Brien (ICC):** 45 seconds – well done, and Ms. Jun.

**Jun Xu (Bank of China):** My one point follows naturally from Ana's. When developing rules for the digitisation of trade we

need to think deeply starting with the needs of the customer. We already have tried and tested trade facilitating rules that work in the traditional trade finance environment. We need to evolve rules that will now facilitate trade in the digital world. As the Chinese judge outlined to Vin, whether an undertaking is paper based or digital, the nature remains the same. If our thinking is deep enough and sound enough then I have no doubt that the technology will provide the solution.

**O'Brien (ICC):** Good points, we need to understand the nature of the problems before we try to develop rules or technology to solve them.

Edward you must be keen to comment.

**Ribeiro (Ecobank):** We need to leverage the momentum being created by the WTO Trade Facilitation Agreement. We need to leverage the status of the ICC as an observer at the UN. We must get the message across that trade finance is an essential part of the trade cycle in all corners of the world. This means that solutions must be relevant to both sides of the supply chain financial and physical.

## Simplification

**O'Brien (ICC):** Thanks Edward, yes we need to consider the convergence of the physical supply chain with the financial supply chain.

**Meynell (TradeLC Advisory):** The most exciting development that I see in the immediate future is in respect of the Internet of Things. Embedding sensory and wireless technology within objects, making it possible to digitally transfer ownership of all kinds of physical property. Transmitting

data in respect of identity, existing condition and the environment in which it is based, will transform our industry. Banks and FinTechs should work together to see this happen.

**Rigby (HSBC):** Digitisation has the potential to be a great enabler of global trade, and it is essential that we agree on common standards to make trade simpler, faster and cheaper. So the industry as a whole needs to work very closely with policy makers and regulators to create the right regulatory framework for this technology, The TFA was a great step towards harmonising standards around customs, and I'm confident that further collaboration will help trade digitisation achieve scalability, so all parties can reap the benefits.

**Broom (BNY Mellon):** Developments in technology are integral to the success of trade finance, and APIs (Application Programming Interfaces) – tools that can be used to build software applications and also seamlessly link them together – could significantly enhance trade. Importantly, their inter-operable and customisable capabilities are enabling banks and clients to work far more collaboratively on the development of new solutions – allowing clients to benefit from customised, value-added offerings. By promoting ease of communication and an intrinsically collaborative environment, APIs have the potential to enact change across the trade landscape.

**Vrontamitis (Standard Chartered):** I am excited by the possibilities. Trade and trade finance will be digitised over the next decade or so. While we don't know what exact form this will take yet, I am fairly certain the steps the industry players from banks, logistic providers, FinTechs and governments are taking are moving this in the right direction.

**Goulandris (essDOCS):** Banks need to start setting digital trade solutions as soon as practical. Ideally, focus on solutions that are already operational rather than spend time working on proof-of-concepts that will not immediately advance your solution set. The ICC Digitisation Group is an important initiative that also needs everyone's support.

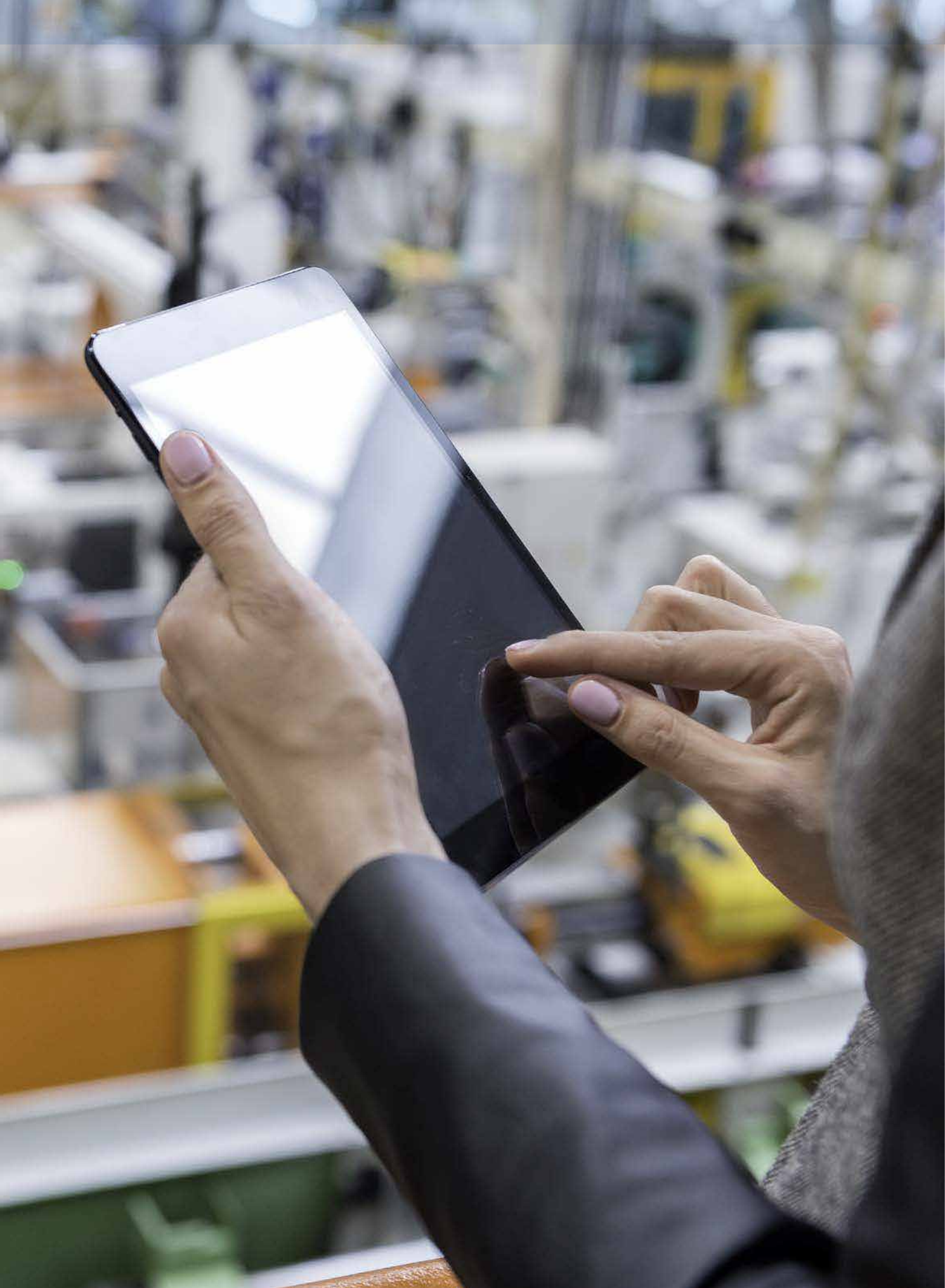
**Madhavan (Standard Bank):** Digitisation of trade and trade finance is inevitable and the pace of change will be even quicker in emerging markets, such as Africa – especially because of the resultant operational efficiencies and risk management. The actual use cases though, will depend on the specific problems they aim to solve or needs they aim to meet, on the ground. As ICC we have a role to play towards supporting digitisation, specifically by addressing hindrances, evolving standards in rules and practices (legal and otherwise) and educating participants in global trade.

**Sharjeel (IFC):** The digitisation of trade is an upcoming wave which would ultimately engulf everyone, and the two key drivers of this transition would be customer demand and intense pressure at banks' end to reduce cost. The timing of implementation may however vary among geographies but the lead would be taken by those who are willing to adapt, innovate and collaborate. The related challenge would be updating of trade rules to match this rapid change and it is on this front ICC would need to play its role.

**O'Brien (ICC): Thanks Shehzad. Everyone took less than one minute in our final tour de table. That was an exciting and great discussion!**

**Accessibility**  
**Collaboration**  
**Connectivity**  
**Consensus**  
**Innovation**  
**Simplification**  
**Standardisation**  
**Transparency**





I. REFERENCE INFORMATION

II. ECAP AND SELECTED HIGHLIGHTS

III. STATE OF THE MARKET

IV. TRADE AND SUPPLY CHAIN FINANCE

V. POLICY, ADVOCACY AND INCLUSIVENESS

VI. RETHINKING TRADE AND FINANCE

# Closing remarks

## **An invitation to reinforce trade finance market intelligence**

**Trade finance as an industry has received significantly more attention from regulators and policy-makers and has been more closely monitored since almost a decade, given its facilitation of international trade flows.**

### **Author**

Doina Buruiana, Project Manager,  
ICC Banking Commission

This consideration and examination has enabled several advanced studies in the characteristics and structure of the trade finance market, as well as in the past and future evolution of this line of business in finance. The ICC Banking Commission is privileged to have been entrusted with carrying out several of these, introduced at the joint initiative of key institutional pillars in international trade, finance and banking: BIS, IFC, IMF, World Bank, WTO, and regional multilateral development institutions, to name a few.

Significant progress has been made in understanding the nature of the industry, articulating its changing patterns and identifying its vulnerabilities. However, the current context calls – again – for a new approach in gathering data and insights from trade finance providers worldwide and providing the industry with robust market intelligence.

Access to reliable information is a must in any market conditions, but even more so in times as the current ones, fast evolving and prone to disruptions. Topics determining the present and future evolution of the industry, such as trade and trade finance digitisation, changing market forces with new entrants, weaker correspondent banking networks and reduced access to trade finance in specific customers segments and geographies are addressed, at length, in a multitude of independent studies developed by various players – international organisations, industry associations, banks, consulting firms, etc. Undoubtedly, all efforts are laudable and results valuable; however, industry practitioners, and the industry itself could gain from more comprehensive and better coordinated joint studies.

These arguments are also articulated by the WTO as recommendation number 6 in the report titled Trade finance and SMEs – Bridging the gaps in provision (2016), as well as in the Bank for International Settlements' Committee on the Global Financial System paper titled Trade finance: developments and issues (2014).

Motivated by our conviction in the industry's need to access comprehensive, robust and timely market intelligence, by our consciousness of the limited time and resources available in trade finance teams to participate in voluntary data collection exercises, as well as by our wish to avoid duplication of efforts – we are extending an invitation to our institutional partners to unite efforts together with the ICC Banking Commission in gathering data and insights from trade finance industry.

A combination of our collective insights, resources and networks to access more efficiently data and information from trade finance providers worldwide will certainly improve our capacity to explore and makes sense of the data gathered and much better assess current developments and foresee market changes.





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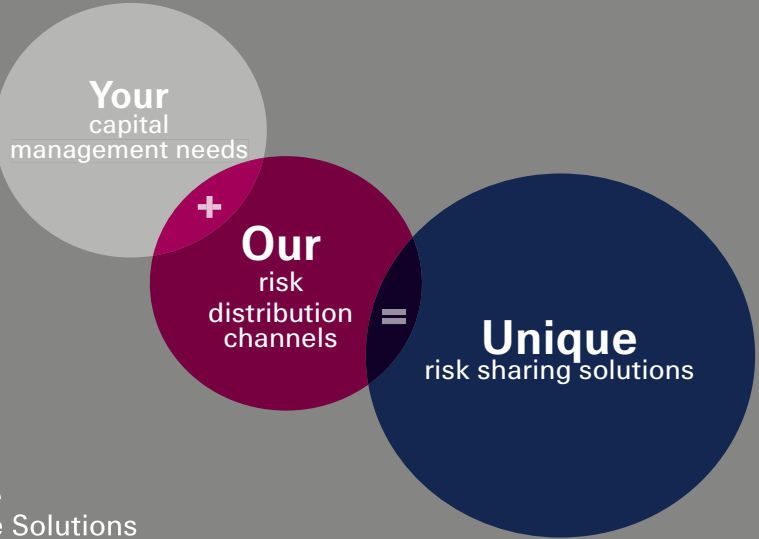
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Well-established collaboration with leading policymakers and trade association, including WTO (World Trade Organization), ADB (Asian Development Bank), Berne Union, EBRD (European Bank for Reconstruction and Development), IDB (Inter-American Development Bank), IFC (International Finance Corporation), IMF (International Monetary Fund), SWIFT, the World Bank and others.



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