WT/WGTDF/W/89

7 March 2019

(19-1364)

Working Group on Trade, Debt and Finance

EXPERT GROUP MEETING ON TRADE FINANCE – 28 FEBRUARY 2019

INFORMAL REPORT BY THE WTO SECRETARIAT

1 INTRODUCTION

1.1. The objective of the February 2019 meeting was twofold: (i) to take stock of the current market situation; (ii) discuss progress on initiatives aimed at addressing the global trade finance gap, namely trade finance facilitation, capacity-building, and a dialogue with institutions part of the Financial Stability Board's (FSB) on compliance issues.

1.2. In his opening remarks delivered on behalf of the Director-General, the Deputy Director-General said that trade flows had been sustained by relatively healthy economic activity in the world's major economies, although the last two months of 2018 had been weak. In the past decade, the share of intra-developing countries' trade has increased from one quarter to one third of global trade flows. This means that a bigger share of the trade finance market supported transactions in developing countries and between developing countries. Trade finance gaps remained prominent – some US$1.5 trillion annually. Gaps can be explained by low levels of financial inclusion, lack of human capacity and high perceptions of risk, including that of regulatory risk.

1.3. In the past year, the Director-General of the WTO, Roberto Azevêdo, had reflected with WTO Members and heads of partner institutions on progress made since he had launched in 2016 the Trade Finance and small and medium-sized enterprises (SMEs)' initiative. The Director-General's proposals were fourfold: support multilateral development banks' trade finance facilitation programmes by way of advocacy; help increase capacity building support; maintaining an open dialogue with trade finance regulators; and continuing to track trade finance gaps. Thanks to the mobilisation of development institutions, the amount of trade supported annually had increased to some US$30 billion in 2018. The objective of trade finance programmes of multilateral development banks was not to fill the entire gap, but rather to support trade in challenging markets and to facilitate learning-by-doing by local financial institutions. The foot print of multilateral institutions had increased thanks to the cumulated and sometimes combined efforts of the International Financial Corporation (IFC), the Asian Development Bank (ADB), the African Development Bank (AfDB), the African Import Export Bank (Afreximbank), the European Bank for Reconstruction (EBRD), and Development and Islamic Trade Finance Corporation (ITFC). Direct funding of transactions also supported directly traders, notably SMEs. This SMEs focus was very prominent in trade finance facilitation programmes. The Asian Development Bank alone had supported trade transactions of 3,500 SMEs in 2018. Progress had also been made in addressing knowledge gaps in local financial institutions. Multilateral development banks had boosted their capacity building work on trade finance, in collaboration with the International Chamber of Commerce (ICC) and the WTO.

1.4. The Director-General had worked in the past 18 months with the Chief Executive Officer of the International Financial Corporation and the Chair of the Financial Stability Board (FSB) to address some of the regulatory challenges met trade finance providers, notably in developing countries. The Director-General has talked several times to Governor Carney. Both leaders agreed to their small, incremental steps strategy. It payed off. The WTO and IFC participated in workshops on the promotion of KYC utilities. The WTO invited Gerard Hartsink, Chairman of the Global Legal Entity Identifier Foundation (GLEIF) to present at the WTO. The WTO, the FSB and the World Customs Organization examined synergies between the Legal Entity Identifier and the WCO's Trade Identification Number. Work in this area was on-going. The WTO has been a tireless advocate of Multilateral Development Banks' own repositories on customers. Joint missions in the field have been gathering experts from the FSB, IFC, WTO and multilateral development banks, to deliver knowledge on trade finance and on compliance requirements. More was expected in 2019. Finally, at the Annual Meetings of the IMF and World Bank in October 2018, the Director-General and Philippe Le Houérou, CEO of the IFC, co-hosted a session on Financial Inclusion in Trade, aimed at discussing future inter-institutional steps that would be necessary to reduce the US$1.5 trillion global trade finance gap. Heads or senior officials of the IMF, EBRD, Islamic Development Bank, African Import Export Bank and FSB also participated in this public session. It was decided that more inter-institutional cooperation was needed to address the shortages of trade finance hindering the trade opportunities of many developing countries. DG Azevêdo and Philippe Le Houérou decided to do a short booklet, sharing best practices (a collection of country cases) on regulatory compliance in trade finance. This would be a joint publication, opened to partner institutions, which would be "launched" at the 2019 Aid-for-Trade Global Review.

2 MARKET SITUATION

2.1. The meeting started with a review of the current market situation. Global banks confirmed that demand for trade finance had been sustained in 2018, in most regions of the world. Price competition had been strong, in a context of relatively abundant liquidity for them. However, the context was one of continued consolidation of the financial industry. Digitalization was at the top of the agenda of large institutions to reduce the cost of processing trade finance transactions. While in trade large "buyers" benefited from increased digitalization of transactions, smaller companies being part of different supply chains suffered from the existence of too many uncoordinated digital platforms. The industry tried to address the "digital island" problem. Global banks increasingly pursued an "originate-and-distribute" model, aimed at raising the velocity of their balance sheet; other players would be called on to hold trade finance assets. Such developments resulted in mixed outcomes for SMEs. In developed countries, many SMEs benefited from the drive of the trade finance industry towards supply-chain financing and the expansion of electronic commerce. However, other SMEs, including those operating downstream of industrial supply chains in developing countries, lost from the continuing trend of terminating correspondent banking relationships. Less correspondent banking meant more selectivity by banks in taking on new customers. SMEs were also the most vulnerable company segment in the face of increasing compliance requirements.

2.2. While the emergence of regional banks was a positive aspect of bank consolidation in the Middle East or Africa, liquidity remained a constraint for second and third tier banks. There were, though, a trend towards the creation of new correspondent banking relationships, notably between developing country banks, consistent with the expansion of South-South trade. The financial architecture benefited from these new links. While African banks showed greater optimism in the future, the situation within Africa was one of contrast: countries with a strong potential attracted most available financing, while other countries in Northern and Western Africa faced a deterioration of trade finance availability. Banks still faced a significant shortage of US dollars due to the absence of US banks in the continent; multilateral institutions had to offer US dollars clearing services, including to local central banks, by obtaining US dollar resources from Asian markets. In Latin America, banks had significant amounts of available liquidity, but, despite their increasing cooperation to better serve the larger clients, little of liquidity had reached SMEs. The prospects for SMEs was likely to improve with the current expansion of supply chain finance and e-commerce in Latin America. In Asia, volumes of trade finance had also increased in line with the expansion of trade, particularly in the first half of 2018, but de-risking had started to hit the region as Chinese banks were subject to tighter compliance requirements. In this context, banks were given objectives to support SMEs. In the middle-East, the consolidation of banks continued, in a context of rising demand for trade facilities. It had been another modest year in Europe, although the demand for trade finance facilities for extra-EU trade, notably with Asia, increased. All in all, the trade finance environment was one of increasing concentration, but also collaboration between banks regarding investment in technology to reduce the use of paper documents and modernize procedures of trade finance. In the presentation by the Financial Stability Board, it was confirmed that the number of correspondent banking relationship around the world had continued to fall. Still, the volumes of finance within the remaining channels kept rising, thereby confirmation in a growing concentration of (trade) finance flows.

2.3. One feature of trade finance markets has been a resurgence of country and political risk. The trade credit insurance industry, while covering higher volumes of trade, also recorded a significant increase in claims (losses). The demand for alternative products such as factoring also increased in line with the expansion of trade. Alternative players such as funds provided liquidity where this was most needed, in developing countries and for SMEs. New laws allowing for factoring have been adopted in Egypt and India. Financial technology institutions (Fintech) would also help in tailoring the risk profiles of individual clients in a more accurate and automated way. Professional associations for trade finance focused on easing compliance, improving cyber security standards, and promoting the low risk profile of the industry.

2.4. Trade finance support by multilateral development banks in the poorest countries was a mirror of trade finance gaps. Demand remains high for multilateral support, notably in view of the reduced network of international banks and a heightened perception of anti-money laundering and know-your-customer (AML-KYC) regulatory risk. The African Development Bank and Afreximbank’s regretted that upstream correspondent banks in Africa had been cutting links temporarily or permanently, leaving significant US dollar shortages. Africa had suffered a reduction of at least 12% of the number of foreign banks ready to confirm letters of credit. Afreximbank's objective was to link itself to 550 African banks by 2021, and to become one of the "hubs" for African trade banks in their relations with the rest of the world. Local banks faced difficulties in meeting the cost of compliance and the need for training was immense. Afreximbank had introduced its repository on customer due diligence information. The AfDB had provided trade credit totalling US$1.3 billion in 2018 (US$8 billion in cumulated support since the beginning of the programme in 2013). The AfDB partnered with the ITFC to offer 500 scholarships for trade finance staff of African banks, to take on the qualifying trade finance course delivered by the International Chamber of Commerce. The Africa Trade Finance Gap study will be updated in 2019.

2.5. The ITFC shared similar concerns regarding the poorest countries of the Organization of Islamic Co-operation (OIC). The rejection rates of SMEs requests for trade finance stood around 60%. Support by the ITFC to trade finance had reached US$5.2 billion in 2018, with a cumulated amount of US$45 billion in the past 10 years. The ITFC had also launched its Sovereign Energy Fund, with a starting capital of US$500 million. The ITFC emphasized its increasing involvement in trade and trade finance training. The EBRD also attributed part of the trade finance gap in its countries of operations to the lack of correspondent banking relations. While a decade ago the EBRD could count on an active set of about 100 correspondent banks, this number had fallen to about 30. Although it provided for 100% guarantees to trade loans, the EBRD could not find counterparty banks for several countries because the transaction amounts were too small (Belarus, the Republic of Moldova, the Kyrgyz Republic). The problem had become circular: the cost of compliance for these countries was on the rise because of the small amount of transactions. As the number and value of transactions was further falling, thus the cost of compliance per transaction was further increasing. The EBRD had engaged into a comprehensive effort in training compliance officers of banks, in cooperation with the International Compliance Association.

2.6. The Asian Development Bank reported for the second year in a row a 40% increase in the demand for its trade finance facilities. The ADB had supported 4,500 trade operations in 2018 (90% of which were guarantees), involving 3,500 SMEs, and totalling US$6.3 billion. Its programmes focused on Asia's less-developed countries (Viet Nam, Cambodia, Pakistan). Compliance issues were also prominent in the region. Recent attendance of the Financial Action Task Force meeting led to think that rules on trade-based money laundering could further be tightened, with the risk of adding to current compliance challenges. The representative of the ADB provided a presentation of the scorecard initiative, and subsequent workshop to be organized in March 2019. The initiative benefited from the support of the expert group, which intended to contribute data and analysis. All in all, multilateral development banks (MDBs) had increased their support to trade operations in 2018 relative to the previous year, to close to US$30 billion. The geographical "foot print" of multilateral organizations had also increased.

2.7. A representative of the FSB Secretariat updated the group on the FSB action plan on assessing and addressing the decline in correspondent banking, in the context of trade finance. As outlined by WTO senior management, step-by-step cooperation involved the promotion of due diligence utilities, such as the Wolfsberg questionnaire, the SWIFT repository of due diligence information, regional repositories created by multilateral development institutions, and international identifiers to be used by entities engaged into international financial and trade relations. In this context, the WTO and FSB worked at creating synergies between the Trade Identification Number of the World Customs Organization and the Legal Entity Identifier sponsored by the FSB. Regarding capacity-building, the FSB, WTO and multilateral development banks have deployed their best efforts to incorporate compliance modules in trade finance capacity-building activities, and to deliver technical assistance together, "in the field". More joint technical assistance mission was foreseen in 2019, as capacity-building plans are now being shared by the organizations involved. The dissemination of best practices regarding compliance in the trade finance field was a priority. The joint IFC and WTO publication to be launched in 2019 will contribute to these efforts. Many of the potential actions discussed by participants, notably multilateral development banks, seem to fit with the potential solutions proposed by the FSB presentation. The meeting saw an overall positive engagement and some members of the expert group will be called to contribute in the coming months.