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Working Group on Trade, Debt and Finance

EXPERT GROUP MEETING ON TRADE FINANCE – 29 MARCH 2017

INFORMAL REPORT BY THE WTO SECRETARIAT

1.1. The objective of the March 2017 meeting was twofold: (i) to take stock of the current market situation (ii) to examine possible areas of cooperation between participants based on proposals by the WTO Director-General in his 2016 publication: "Trade Finance and SMEs". Such proposals are: boosting trade finance facilitation programs, reducing the knowledge gap, improving synergies on capacity-building and gap detection.

1.2. In his opening remarks delivered on behalf of the Director-General, the Deputy Director-General stated that, based on the evidence provided by the Asian and African Development Banks' surveys, trade finance gaps had remained high but stable at USD $1.6 trillion (some 10% to 15% of trade finance markets), and was falling disproportionally on small and medium-sized enterprises' (SMEs) trade. Fifty-eight per cent of SMEs saw their trade finance requests rejected. This situation could not continue since SMEs were the heart of wealth, job creation and innovation. Trade finance gaps with the greatest trade opportunities were highest, notably in developing countries. The lack of trade finance was therefore an obstacle to building a more inclusive trading system.

1.3. Since the publication of the Director-General's proposals, progress had been made. WTO and G-20 Members had supported the Director-General's efforts and recommendations. The Director-General had met heads of organizations, such as the International Trade Finance Corporation (ITFC, part of the Islamic Development Bank's Group) and of the World Bank's International Finance Corporation (IFC), with a view to moving the trade finance agenda forward. He had agreed with the CEO of IFC to co-host a high-level dialogue with the main stakeholders, scheduled at the fall meetings of the IMF and World Bank in October 2017. The idea was to bring together multilateral development banks, private sector representatives, prudential and other regulators, at head of institution level. A preparatory meeting for multilateral development banks was scheduled to be co-hosted on the first day of the Aid-for-Trade Global Review.

1.4. The high-level round table would address some of the proposals of the Director-General and his partners, including the scaling up of trade finance facilitation programs and increasing their synergies. New and innovative ways of seeking synergies were welcome. Training efforts also needed to be increased. A dialogue with regulators, notably in the area of know-your-customer (KYC) and anti-money laundering (AML) could usefully be conducted to address the trade and development dimension of trade finance. Finally, efforts to track the trade finance gap needed to be enhanced.

1.5. The meeting started with a review of the current market situation. The contrast characterizing the situation in recent years had narrowed. The market could thus be described as being dual, with excess liquidity for large lenders and "premium" clients, the large traders. At the lower end of the market, small and medium-sized enterprises (SMEs) suffered, both in developed and developing markets, from the impact of reduced correspondent banking networks, the greater selectivity of banks, and the focus of the largest institutions on the best rated "customers". Participants confirmed a firming up of trade demand in recent months, in all regions of the world; which, in turn, contributed to reduce excess liquidity gaps at the higher end of the market. In Latin America, Brazil had bottomed out, whereas in Asia the mood was more confident. The rise in trade demand in countries such as Indonesia, Viet Nam, and Bangladesh, in market segments previously dominated by China, was noted. Most participants confirmed a stronger outlook for commodity markets, benefiting Sub-Saharan Africa and the Middle-East and North Africa (MENA) region.

1.6. The (modest) improvement in the trade outlook did not necessarily mean an immediate improvement in trade finance market conditions at the lower end of the market, particularly for SMEs. In China, the combination of Basel III implementation and stricter caps on lending actually meant a greater selectivity of clients. At the same time, China was implementing stricter KYC-AML requirements; with the result that large Chinese banks have had to close many correspondent banking relationships. This "flight to quality" was also affecting the commodity sector, as confirmed by a leading commodity trading firm. Excess liquidity was focused on the largest companies, but could not be fully absorbed, leaving SMEs to be dependent on financial facilities extended by these companies. While a pan-African bank representative indicated that the reduction of correspondent banking relationships in the continent had slowed down, the knock-on effect of previous reductions and prudence in accepting new ones was seriously affecting trade finance in Africa. A large United States bank clearing US dollar transactions noted that the "precautionary" mindset on KYC-AML implementation had forced out small African banks, despite their impeccable due diligence records. In the MENA region, the introduction of new bankruptcy laws has been affecting SMEs. In Europe, the perception of KYC-AML risk was very high in view of the potential fines to be applied. This was confirmed by the representative of the European Bank for Reconstruction and Development (EBRD), who stated that AML-KYC requirements had become so tight that some countries, notably in Eastern Europe, had become virtually "un-bankable".

1.7. Representatives of multilateral development banks (MDBs) said that trade finance facilitation programs had been designed to support small trade transactions in the poorest countries. These countries cumulated poor country risk and a high perception of AML-KYC risk. MDBs could only do so much.. The CEO of ITFC shared his concern regarding the poorest countries of the Organization of Islamic Co-operation (OIC). He emphasized the growth in ITFC's portfolio, in particular towards SMEs. The ITFC had already stepped in, increasing its support to trade in the OIC by 15%. The African Development Bank (AfDB) was also making progress. The 4-year sunset clause regarding the African Development Bank's trade finance facilitation program had been lifted, which meant that trade finance had become part of the normal operations of the bank. The AfDB welcomed risk-sharing agreements with partner institutions. The EBRD had a record year in supporting trade in 2016. It stepped in to alleviate liquidity shortages in Egypt, Greece and Cyprus. The EBRD-supported trade transactions helped supply essential commodities and goods for the local population. Many countries were struggling to keep correspondent banking relationships, as a result of KYC-AML procedures. The EBRD had to put in place a platform on information exchange for due diligence, as local companies and banks could simply not comply with the 40 or more minimum guidelines imposed on them. The Asian Development Bank (ADB) was increasing the scope of its programs, now operating in 20 countries. The ADB has been increasing the risk that it assumed under risk-participating agreements, and new funded risk distribution programs. On AML-KYC, it was coordinating a pool of data on compliance infraction among banks, an early warning system, and the promotion of a global legal identifier. All in all, current support for trade by MDBs was stable, at around USD $30 billion a year, compared to a USD $1.6 trillion trade finance gap in developing countries.

1.8. Professional organizations made several points. The International Chamber of Commerce's (ICC) Banking Commission wished to step up its advocacy role and to set up meetings with the Basel Committee on Banking Supervision. Creating standards for digital finance was also a priority. The Berne Union and International Factoring Association reported a slower increase in insured trade credit and factoring flows in 2016, contrasting with the record increases of the past decade.

1.9. It was clear that efforts were being made to scale up trade finance facilitation programs, in one direction or the other, either by extending countries' coverage, or by supporting new categories of banks and traders. Demand for supply chain finance programs was increasing. MDBs, such as the ADB, were looking at how to respond to such demand. Innovative products were also being proposed to operators (factoring arrangements). The ITFC presented ideas for the creation of a multilateral development bank (MDB) SME Trade Fund, structured in two sub-funds: (i) a trade finance fund for SMEs, and (ii) a technical assistance facility to offer a comprehensive solution to increase the competitiveness of SMEs involved in trade. Some early reactions were offered during the meeting. In general, institutions wished to move towards a higher-level of risk coverage (up to 100%).

1.10. Regarding capacity-building, there was an overall desire by private and public institutions to team up on delivering more technical assistance, hence reducing the "knowledge gap". This implied that professional organizations from the private sector cooperate with multilateral

development banks, with a view to increasing potential global outreach and minimize costs. This was gradually happening. For example, the ICC e-learning institute was cooperating with Factoring International and other professional institutions, while obtaining the support of the Asian Development Bank. This was a good start.

1.11. Participants committed to improve gap detection and mapping. Considerable progress has been made by the Asian and African Development Banks, through their respective trade finance gap studies, which were being updated. Almost all participants in the room, including MDBs, the ICC banking commission, the FCI and the Berne Union, contributed to the Asian Development Bank survey. There was strong support for the continuation of such surveys in the future.

1.12. As in previous years, there had been a fair amount of discussion on non-prudential regulatory issues described as "know-your-customers" (KYC) requirements and anti-money laundering regulations (AML). For the WTO, the question was to define the possible "trade" content of any future dialogue with the OECD's Financial Action Task Force (FATF), and more generally with the Financial Stability Board (FSB). Any future dialogue needed be fact-based. To this extent, the analytical basis for linking AML-KYC requirements, on the one hand, and de-risking, on the other, had been relatively weak. The expert group took note of the recent reports by the World Bank, International Monetary Fund (IMF) and Bank of International Settlements (BIS), highlighting the relationship between the fall of correspondent relationships and its impact on financial exclusion. The BIS had issued broad recommendations on how to address some of these problems. Supervisors should follow a risk-based approach, provide greater clarity and stability on the extent of obligations, and promote a greater use of KYC "utilities", etc.

1.13. The expert group also supported the greater use of utilities such as the KYC repository, which had been created by SWIFT. Already, 2500 financial institutions used it. However, the SWIFT repository needed to be further promoted, including by regulatory authorities. Other information-pooling initiatives had been mentioned. To save certain countries from trade finance exclusion, the EBRD had to establish an information-pooling platform for KYC purposes, for trade companies and bankers in Eastern Europe. However, it was noted that the exchange or pooling of information was severely constrained by countries' privacy laws. The ADB strongly argued in favour of the generalization of the Global Legal Entity Identifier, as a way to promote KYC-AML implementation while reducing its cost. In general, the expert group requested a dialogue with FATF to be able to design a "rule-book" for trade finance, as AML-KYC requirements had become too much of an "open-book". Such a rule book could simply be extracted from the very complex overall rule book of the FAFT. It was felt that trade finance, which was a very organized and documented business, was only too often mixed with less documented financial transactions (such as remittances), and had to suffer excessive controls.

1.14. The 2016 BIS report on correspondent banking had called for a greater dialogue between financial institutions and the FAFT. The report promoted the use of utilities mentioned above, and that of the Global Legal Entity Identifier. As stated on several occasions, the WTO Secretariat indicated that it would be happy to engage, to the extent that the WTO could bring value and data to that dialogue. It also considered that the industry had to collect the necessary data and formulate its own terms of dialogue with regulators. The establishment by the industry of a clear agenda for such dialogue should therefore be a priority. Collecting the appropriate data should follow.

1.15. The Deputy Director-General noticed, during this meeting, a positive engagement in supporting and implementing the WTO initiative in favour of reducing trade finance gaps in developing countries, with a focus on SMEs. The process of building support within the WTO will continue. Some members of the expert group may be called upon to contribute in the coming months, notably in the context of the round tables mentioned above.

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