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The All-Party Parliamentary Group

Trade & Export Promotion

Chairs: Lord Waverley & Gary Sambrook MP

REVIEW OF UK TRADE FINANCE

APPGTRADE.UK

SECRETARIAT: ICC UNITED KINGDOM

Background

Founded in September 2020, the APPG for Trade & Export Promotion brings together the experience of parliamentarians from all political persuasions supported by business, unions, consumers, academics, NGOs and civil society. We are working to promote an inclusive, sustainable approach to global trade involving all aspects of the trade agenda.

If you are interested in supporting the work of the APPG for Trade and Export Promotion please contact us: secretariat@appgtrade.uk

Mission and Purpose

- Work for a comprehensive strategy to global trade
- Bring the voice of prospects and prosperity to the heart of the national debate
- Encourage an inclusive and sustainable environment
- Foster dialogue between parliament, business, unions, consumers, academia, NGOs and civil society

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Foreword

<u>**RE-FRAMING THE TRADE FINANCE GAP**</u>

The global trade finance gap, short-term working capital to fund SME trade, has ballooned from $1.5 trillion to $3-5 trillion during the pandemic, with a £2 billion gap in the UK alone. This issue has been treated for too long as a niche banking and finance problem and as a result not been given the airtime it deserves because those most impacted are trading SMEs.

The issue needs to be re-framed, placing SMEs at the centre of the discussion and looking at the issue through the lens of ensuring economic recovery is got right. If trade is to be at the heart of the recovery, then the working capital has to be available to SMEs to enable them to trade.

50% of trade finance applications are from SMEs, yet over half are rejected despite trade finance having low default rates. If trading SMEs are adversely impacted from market failures in the trade finance sector, and are unable to access working capital, they cannot fund exports overseas. Lack of capital is not the sole issue with less than 8% of SMEs served by traditional forms of trade finance.

⋆A real opportunity exists to bring many more SMEs into the trading system and to lower the cost of finance if solutions can be found. This should be viewed as an imperative as In the context of month on month exports falling since Q4 2019.

The Cole Commission identified that cumbersome, duplicative, and mostly manual bureaucracy now costs £60,000 for a bank to onboard a SME. This is an inordinately high barrier to overcome for both banks and SMEs. Treating low risk trade finance in the same manner as other forms of higher risk finance is equally ill-advised. This is reinforced by the International Chamber of Commerce having proved through their ICC Trade Register that trade finance is a low-risk activity.

A solution to the first problem is to find more efficient ways to handle the bureaucracy now advanced technology is available that did not exist 20 years ago. The solution to the second is to adjust the risk weighting requirements to reflect actual risk so that there is a more proportionate, evidence-led regulatory regime. Both solutions require action from government and regulators.

The issues stem from two policies dating back to 9/11 and the financial crisis, both of which were designed to stop financial crime and stabilise capital markets, are at the heart of the problem. Neither policy was designed to generate growth and jobs. 20 years on and in a different context, it should not be a surprise that there is a calling for change. Initiatives that accelerate digitisation are part of the solution and will help in time solve some of the £2 billion UK trade finance gap but not enough if taken alone as a policy solution. Technology innovation in the non-bank trade finance, fintech market and skills can be added to the mix, but again they do not form a solution within themselves either.

It is time to address the market failure in the mainstream trade finance sector head on and that means addressing regulatory barriers. We must de-couple the notion that the SME trade finance gap is the price we pay for establishing capital market stability and tackling financial crime. The evidence can demonstrate that trade can be increased without compromising stability or efforts to fight crime.

A more transparent and inclusive debate in the broader setting of trade facilitation is required rather than leaving this in the hands of global financial regulators. They have not addressed the problem partly because of the limited perspectives being applied. More voices are needed at the table and specifically by those representing those who are not able to access finance as a result of policies in which they have little say.

The conversation needs to be reframed, bringing industry to the table to agree solutions that enable the growth of SME trade, and with it more jobs and prosperity across the regions of the UK and overseas.

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Recommendations

1. Re-framing the problem - industry should re-frame the challenge of the trade finance gap in the context of the post Covid, economic recovery, enabling more SMEs to trade, generate jobs and improve livelihoods across the towns and cities of the UK, and importantly in the high growth markets with which we need to trade.

2. Government-Industry Working Group – A joint government/industry working group should investigate the issues raised in more detail. It should comprise HM Treasury, DIT and the International Chamber of Commerce should form.
This should include a review of SME capital weighting requirements on banks as well as smart solutions to remove excessive manual activity and unnecessary duplication and cumbersome bureaucracy to help bring down the cost of onboarding. The working group should look for best practice outside of trade finance to see what lessons can be drawn between what is an acceptable versus making life easier for SMEs to trade, for instance in the use of credit cards and tackling consumer fraud.

Building on these recommendations, a formal response to the APPG including practical solutions would be helpful.

3. Cross departmental working group - DIT should be more actively engaged on trade finance across the board, beyond solely export finance and help to foster dialogue across departments, most particularly with Treasury. We recommend DIT build on successful approaches elsewhere and set up a joint Treasury / DIT working group as they have done for the trade and development agenda.

4. Skills – DIT should review the curriculum for its plans for a nationwide trade academy and ensure that trade finance and trade enabled financial crime are incorporated into the programme. This should cover key topics such as sanctioned markets and tackling illicit forms of finance.

Bank Sepah International

Scope

The global recovery depends on SMEs being able to access trade finance for the short-term working capital, yet the global trade finance gap has more than doubled to $3-5 trillion since the pandemic hit. This paper will underlying reasons and consider the case for a review of the regulatory regime applied to trade finance or alternative solutions that may tackle the trade finance gap and unleash working capital to drive SME growth. In particular it looks at the important role of the UK plays in enabling global trade, helping SMEs overseas and our trade partners, to access trade finance.

The Problem

At a time when trading conditions are physically harder, due to COVID restrictions imposing additional costs on supply chains, it is estimated that the global trade finance gap has grown substantially. However, this gap is not new there have been several reports in recent years on the subject, concluding that there is a significant and growing trade financing gap. In a low interest rate environment, negative in some major currencies, the opportunity for UK and European banks as well as other financing institutions to support a clear demand in what has traditionally been a low credit risk business, based on physical goods with intrinsic value, would seem highly attractive.

Why then is there a trade finance gap? The simple answer is Risk! But not credit risk, the International Chamber of Commerce has produced statistics over many years to show trade finance is a low credit risk business. It is financial crime risk in its various guises that restricts the financing of trade, the stock phrase that 'trade finance is a high financial crime risk business' without understanding of the mechanisms involved and consequently the true risks, has led to additional compliance costs for banks and financing institutions. Trade finance by its nature requires international payments, correspondent bank relationships and is in high demand for developing markets, all of which have come under scrutiny for financial crime risks. This has led to firms and their banks having their accounts restricted or exited as larger 'clearing' banks have decided that the financial crime risk is prohibitive for that business type, customer type or geographic market.

Trade Finance Products and the risks:

There are different types of trade finance products where the financier is in possession of different information which fundamentally changes the financial crime risk profile. Below are some examples grouped by characteristics.

Lending Products

Invoice discounting: Either individually or a grouped facility, the discount (loan) is secured against outstanding invoice receivables. The borrower (seller) remains responsible for collection of the debt.

Factoring: Similar to invoice discounting but the lender is responsible for collection of the debt, in practice the borrower often arranges for payment of the invoice/receivable.

Forfaiting: Forfaiter buys the export receivable on a without recourse basis, normally with a longer maturity (repayment date) than in factoring. The forfaiter is a specialist who will often have no ongoing customer relationship with the seller.
Buyer credit or loan: The buyer is given a loan to purchase the goods either by a local bank, specialist overseas financier/bank or ECA.

Working Capital loan: Normally from local bank or specialist lender to either, the seller to finance production, or the buyer to finance the purchase.
Supply Chain Finance: May use any of the lending products, at any point in the supply chain. Often the borrower benefits from a higher credit rating of their customer, improving the percentage of the value of the goods covered, the term of the loan or interest rate.

Generally, financial crime mitigation is driven by the borrower’s knowledge or investigation of the parties involved. Although some documentation will be required, there is limited ability to cross check or verify documents.

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Traditional Products

Letters of Credit (L/Cs): Provide certainty of payment by replacing the corporate credit risk with a banks obligation to pay against specified documentation evidencing the good's quantity and quality together with shipment details, supported by transport documents and possibly insurance documents.

L/C negotiation, discounting or refinancing: Once the L/C has provided enhanced credit quality and the certainty of payment either immediately (at sight) or a future date (usance); the bank can lend by financing the buyer or his bank (at sight), or purchasing/discounting the future receivable (usance) from the seller.

Standby L/Cs and Guarantees: Generally, default instruments providing a bank guarantee of payment in the event of the purchaser's failure to meet its obligation. Again, by substituting a bank credit rating for that of the purchaser the option to finance becomes viable.

Generally, these products are supported by a variety of documents and whilst fraud is always a risk, the variety of documents, ability to cross check and obtain third party verification, for example by checking the container or ships whereabout, reduces the capacity for these instruments to be used for financial crime; when processed by experienced practitioners.

Payment Systems

UK model: Although the UK payment systems have recently seen wider direct participation, having been the subject of re-organisation and improvement and new entrants to the market, the traditional model of the 'Clearing banks' holding settlement accounts with the Bank of England and providing clearing or agency services for the many smaller players (banks and fintechs) remains. The various payment systems, CHAPS, Faster Payments, BACS and the Cheque and Credit Clearing are all dominated by the Clearing banks, many of whom are not UK banks and all of whom have international businesses or major parts of their business located in other jurisdictions. This means they are subject not only to UK rules and regulations but also to those of other countries which makes the cost of compliance a burden they are unwilling to bear for some business or customer types and some geographies.

There is no 'right' for a UK based bank to have a settlement account with the Bank of England and the infrastructure costs make it uneconomic for smaller players to join the clearing club.

EU model: In the EU there is a legal right for any credit institution to hold a Target2 account with an EU Central Bank, which can be used to settle Target2 payments or SEPA credit transfers. As every bank holds a direct account with a Central Bank which is not influenced by other jurisdictions with payments between banks and countries settled through the Central Banks in those countries the system is not subject to the pressures and complexities of the multijurisdictional regulation imposed on the major international banks. The infrastructure is in place with the Central Banks and the system accessed by SWIFT message or internet without the need for costly infrastructure for small players with limited volumes.

As a result, banks within the EU are able to support a wider selection of businesses, customers and geographies. The payments market has wider direct access, is more competitive and can better support trade finance payments

Correspondent banks and developing markets

As mentioned above the larger international banks are subject to various, potentially differing compliance regimes and so have in recent years become understandably more conservative but it is those very banks who provided the strong correspondent networks that many smaller local or regional banks relied upon. In particular banks in developing markets have found themselves without access to international payment systems and have had to bank with other local or regional banks who have been able to maintain their networks. At a minimum this leads to delays and additional costs and as the international banks turn away from such 'upstream correspondent relationships' these banks, in turn face the prospect of losing their international accounts.

Traditionally London has been a hub for branches or subsidiaries of foreign banks, it made London the primary banking market in the World. For many of these foreign banks trade finance was the initial driver for their business helping to meet demand from UK and foreign traders, as well as the needs of their home market. As this produced good profits, they moved into other London markets providing liquidity for syndicated lending, foreign exchange, derivatives and securities markets. The same pressures on Clearing banks and large international banks that pushed them to reduce their correspondent networks also apply to their relationships with foreign banks in London, which has resulted in the accounts of those foreign banks being restricted or sometimes withdrawn. As a consequence, some of those foreign banks have withdrawn from trade finance business and in some instances have withdrawn from London altogether.

All of this further restricts the availability of trade finance in the London market and particularly the traditional products supplying both UK traders and the developing markets

Role of Technology

Technology undoubtedly has a strong role to play in the future supply of trade finance, be it Optical Character Recognition, Artificial Intelligence and digitisation reducing paper and automating the traditional products or the Fintechs providing wider access to payment systems or entering the lending product markets. The implementation of the automation and digitisation is underway albeit subject to the application of suitable legal frameworks. However, the Fintech business models are built on using technology to streamline processing systems, regulatory and compliance regimes have yet to be fully embedded into these organisations which are recognised by the regulator to have vulnerabilities to financial crime

Recommendations

Reform of the regulatory environment for banking or trade finance is not an option we should consider at this time. The PRA and FCA work together providing good oversight and regulation of the financial markets and players therein. We must not be drawn into changing our financial crime regimes from their current alignment with worldwide best practice. The UK's Joint Money Laundering Steering Group guidance is currently being re-written with the chapter on trade finance including input from the Association of Foreign banks, in London. This will help the UK remain at the forefront of financial crime prevention whilst promoting understanding of the true risks by product.

To help address the trade finance gap and at the same time support London and the UK as a primary financial centre it is access to the payments systems and support for wider inclusion of London's banking and infotech community, which will ultimately provide most benefit. To this end the following would be recommended:

1.All UK domiciled and regulated banks be given the right to hold settlement accounts with the bank of England and direct access the UK payment systems.

2. The UK payment systems, CHAPS, Faster Payments, BACs and Cheque and Credit Clearing be required to permit any UK domiciled and regulated bank to join their system directly.

3.The UK payment systems, CHAPS, Faster Payments, BACs and Cheque and Credit Clearing be required to provide low volume, low-cost infrastructure to facilitate direct access to their systems.

4.The Bank of England join the Euro Target2 network as a central clearing bank and provide direct access to the system for all UK domiciled and regulated banks/credit institution.

5.The UK government support the ICC in the formulation of a legal framework for the digitisation of trade and associated finance in the UK to ensure the UK remains at the forefront of these technology developments. With the right framework, market demand will drive the technology and encourage participation.

Federation of Small Businesses (FSB)

About

1. The Federation of Small Businesses (FSB) is the UK's leading business organisation representing small businesses. Established over 45 years ago to help our members succeed in business, we are a non-profit making and non-party political organisation that is led by our members, for our members.

2. FSB welcomes the opportunity to submit written evidence to the Trade & Export Promotion APPG on tackling the trade finance gap. We would be happy to provide further detail on any of the issues raised.

The case for regulatory reform for trade finance

3. Smaller businesses often do not know how to mitigate the risks of exporting – they are disproportionately affected by trade barriers and lack the human and financial resources available to larger firms to overcome them. Export finance therefore has a role to play in increasing the number of UK SME exporters.

4. However, smaller exporters report a lack of access to export finance as a key challenge when looking to internationalise. Many younger businesses are unable to access traditional debt finance due to security requirements, based on the probability of default.

5. UK Export Finance (UKEF) is a significant potential source of finance for small exporters. However, many UKEF mechanisms rely on the work being underwritten by banks, which decreases the number of deals reached with small businesses. Small and micro-businesses generally do not meet the high requirements of government-backed bank delegation schemes and trade finance mechanisms. UKEF support therefore tends to benefit medium over micro and small businesses.

6. There is also a lack of awareness of current trade finance options available to small businesses via UKEF. FSB members have reported that although the products offered by UKEF are comprehensive, application processes would benefit from shorter turnaround times and simpler requirements for smaller businesses.

7. Changes to the current framework are therefore needed to ensure that small businesses are better able to access and benefit from trade finance.

International best practice – lessons the UK can learn from overseas

13. UKEF's range of products is comprehensive and comparable with other export agencies around the world.

14. One area in which the UK could learn from overseas is through creating greater synergies between export finance and innovation funding. Other countries, such as the Netherlands, have combined their innovation and trade agencies to create better links between innovation funding and export finance. The UK could consider how best to create similar links – smaller firms can often access innovation funding but then may struggle to access further funds to support internationalisation.

The case for paperless trade and digitising trade documentation

15. Small businesses participating in international trade often have to contend with documentation overload. FSB therefore supports efforts to increase the digitisation of trade documentation and to streamline documentation requirements for small firms at the border.

The legal bottlenecks and other barriers to digitisation

13. SMEs require support to overcome barriers to digitisation at the domestic level. Adoption of digital technologies is still relatively low amongst smaller businesses and sole traders. Digital skills and reliable digital infrastructure are essential, but FSB research has found that significant numbers of small business owners lack confidence in their digital skills and poor broadband and mobile coverage is damaging to small businesses, hampering their ability to operate day-to-day.

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Evidence of barriers to accessing trade finance

8. Many of the businesses that have received UKEF support have been larger businesses. In 2018, 25 UKEF regional specialists arranged support for around 180 businesses, however many were larger businesses.

9. FSB research has also found that there is a lack of awareness of UKEF and its products among its members: in FSB's 2016 report Destination Export, we found that around half (48 per cent) of all smaller exports had accessed some form of export support, but only two per cent of smaller exporters had accessed UKEF products or services as a form of support.

The impact of COVID-19 on the global trade finance gap

10. While FSB does not have data to assess the impact of COVID-19 on the global trade finance gap, we have welcomed the actions taken by UKEF throughout the pandemic to introduce or expand measures to support UK exporters, including the expansion of the UKEF Export Insurance Policy (EXIP) to cover transactions with the EU, Australia, Canada, Iceland, Japan, New Zealand, Norway, Switzerland and the USA.

Practical solutions to improving access to finance

11. There is a clear need to communicate UKEF's services more effectively to smaller businesses and to make them more accessible. Practical solutions that would increase engagement from small businesses include:

- Ensuring that new schemes for SMEs are carefully designed, with shorter, simpler application processes, and a quicker turnaround.
- Establishing an export finance equivalent of a Bounce Back Loan, with a quick and simple approval process or tax relief for money spent on export activities.
- Ensuring that banks have sufficient knowledge about exporting at the local level.

12. The recent introduction of the General Export Facility (GEF) by the Government and UKEF contains promising features, including delegated authority to participating banks of up to £5 million per UK exporter and more flexible evidentiary requirements. While it is too early to assess the success of the scheme, FSB will monitor member uptake.

The Institute of Export & International Trade

UK Trade in 2021

The UK is embarking on a truly independent trade policy for the first time in over 45 years. Having regained control of the whole range of policy levers that can support export performance and its contribution to national prosperity, the UK faces important choices and opportunities. It is the moment to take stock of past policy and performance, and to plan how to use the UK's fundamental strengths and new flexibilities to succeed over the next decade.

Even before the pandemic, the pace of global trade liberalisation was slowing amid tensions between the major trading nations and blocs and a trend towards economic nationalism. Rapid technological change is altering the nature of trade, presenting previously unimagined opportunities but also calling for new regulation and creating potential barriers. Now that the UK has left the EU, businesses face new challenges in a less open trade relationship with our nearest and largest market. But with this comes a once in a generation opportunity to lead by example in rebuilding support for multilateral trade rules, resisting protectionist impulses and using trade policy to support environmental, health and social goals.

Looking ahead, the UK needs to forge greater coherence between its domestic and international aims. Trade and export policy should become an integral consideration in domestic economic strategy, so that businesses see a clear direction of travel, understand the priorities, know where they can get effective and well-resourced support, and have confidence in a stable policy and regulatory environment. There are many questions. A lively debate has started on which markets to prioritise, the UK's role in reforming the WTO, how to achieve first rate technological trade facilitation and how to minimise red tape. The political and economic choices involved in trade, which were often distant and abstract during our EU membership, are now more immediate for parliamentarians, businesses and the public. Through close collaboration between government and business there is an opportunity to build broad political, industry and public support for an ambitious new agenda.

Embracing Global Britain -Government's Priorities and the Free Trade Agenda

The UK's new trading independence presents some pivotal choices. They include FTA targeting and strategy, how best to support export promotion and inward investment, and domestic policy options. The UK can now tailor its approach more closely to national needs. There are real benefits to be secured but the choices will involve trade-offs.

The Government wants a Global Britain, with a wide international trading agenda, prioritising our most valuable markets and those with the highest growth potential and making optimal use of historical and diplomatic relationships.

The Government should build on the current FTAs with 60 countries to achieve its commitment to have 80% of international trade covered by FTAs within three years and its aim of having the value of exports equivalent to 35% of GDP. The focus should be on markets where the UK has high volumes of trade with room for further expansion, and markets where the UK has particular strategic or historical advantages.

Elements of UK Trade Policy
Steps already taken at home and abroad include:

• The early decision to create a trade department (DIT), bringing under one roof trade policy and trade promotion, and building trade policy expertise.
• Action to roll over all EU FTAs regardless of value. DIT has done well to ratify deals with South Korea and Japan, as well as signing agreements with Mexico, Canada, Turkey, Vietnam and Singapore which can be provisionally implemented prior to ratification.
• Maintaining generous EU preference programmes for the poorest developing countries, with the intention of adjusting them in future.
• The start of FTA negotiations with the US, Australia and New Zealand. Initial steps towards accession to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).
• Accession to the Government Procurement Agreement (GPA) and progress to finalise national commitments at the WTO.
• Strengthening overseas networks through the appointment of Regional Trade Commissioners, to establish senior presence in key markets and join up trade promotion and policy work.

• Introducing a Trade Bill to establish a Trade Remedies Authority (TRA), to police unfair trading practices which affect UK producers.
• Setting a new UK Global Tariff which seeks to simplify the system and liberalise for environmental goods, but also maintains negotiating leverage.
• New Whitehall governance and consultation arrangements with business.

Openness about Choices

The UK has been a consistent advocate of trade liberalisation and its openness to foreign direct investment has yielded economic benefits. But during EU membership some sectors have been sheltered behind the EU's external barriers while trading freely within the EU. As UK businesses become exposed to a wider range of global factors, a political pricing exercise is beginning on trade to establish where the balance of public, business and political opinion will lie.

The debates over chlorinated chicken and 'selling-off' the NHS reveal how quickly trade can become politicised. It will take skilful handling to balance the pursuit of economic advantage with legitimate sovereignty, security, social and environmental concerns. The Government has not yet made clear how far it means to go. In establishing an arms-length Trade Remedies Authority, it retained the power for ministers to reverse certain decisions for reasons of national interest. It has refrained from almost total liberalisation of import tariffs, although its new Global Tariff regime is relatively liberal and will provide UK industry with lower, simpler, more streamlined rates.

The initial FTA targets (the US, Australia and New Zealand) are likely to push for greater liberalisation, especially in agriculture. The headline GDP gains from the proposed FTAs look quite small and will take time to be realised, as is normal between economies that are already relatively open. The early FTA agenda and wish to join CPTPP are seemingly more designed to signal global political and strategic intent than achieve rapid economic gain. The Institute welcomes the drive and energy, though many of these early targets reflect the opportunity of low hanging fruit. We call for a clear strategy that focuses effort on how and where trade benefits can best be secured.

To build a long-term trade agenda the Government will need to increase trust with business, Parliament and the public. On sensitive issues of food standards and animal welfare, ministers have tried to allay concerns without binding their hands. To date, consultation of business has felt superficial and compares unfavourably for example with the way the US Trade Representative (USTR) involves US companies throughout negotiations. Neither the criteria used to determine the UK's top targets, nor the evidence behind decisions about negotiating objectives, have been sufficiently clear. The role of Parliament should also be clarified. MPs will wish to assert their views and represent constituency interests. The present light-touch approach to transparency, scrutiny and ratification does not match up to best practice in either the US or EU. Strong scrutiny and ratification requirements can also increase negotiating leverage.

Working through multilateral forums

In the current trade environment, and linked to the weakening of the WTO, the imposition of unilateral tariffs is a growing problem. These affect many UK goods exports, for example for the automotive and whisky industries in markets such as India and the US. On the other hand, where the COVID-19 pandemic has led countries to liberalise some import tariffs, there is an opportunity to make this permanent. The UK should continue to use all its tools, unilateral, bilateral and multilateral, to improve access and predictability for exporters.

Non-tariff barriers are far more restrictive to global trade than tariffs. FTAs and work in the WTO have had some success in removing these, but we need to do far more. Nontariff barriers often affect services providers and are rooted in domestic regulations, with strong political lobbies behind them. On-the-ground support to navigate them is strong in some markets, but remains patchy, particularly for less experienced exporters, and it can require sustained senior-level intervention. Having left the EU, UK importers and exporters now face a wider array of NTBs at EU and Member State level and in the UK. It is important that a political focus on full FTA agreements does not squeeze out other, lower-profile but potentially more productive routes to improving access, for example through negotiating mutual recognition of standards or qualifications

Strong trade defence and dispute settlement mechanisms are vital to protect businesses from unfair and illegal practices. As a new player in trade disputes after EU exit, the UK should have a clear voice in defence of UK export interests in the WTO, and help restore the WTO's ability to arbitrate and enforce rules. It is also important that the UK has effective resources and systems for trade remedies at a national level. The Government should work to understand the most significant competition issues facing UK businesses, for example in steel production, so that it can prioritise trade defence action based on value and deliverability.

Promoting UK exports

FTAs and multilateral agreements bring many increased opportunities for exporters but Government can deploy a wider trade tool kit – at home and abroad – to boost exports. This includes practical steps to promote export opportunities in specific markets and narrower sectoral or regulatory deals to remove local barriers. Although good in parts, trade promotion support to business has lacked consistency and continuity. The 2018 Export Strategy aimed to link government support at home and abroad as the first step in a renewed focus on improving export performance. The Government aims to invest £20bn in high-growth businesses by 2027 and has increased investment in Growth Hubs and directly to SMEs through the British Business Bank. The HMRC-backed UK Customs Academy, delivered by the IOE&IT, provides a blueprint that supports and encourages those new to international trade. The business community has welcomed the Strategy, but it has not yet delivered the step change they were hoping for.

Many UK firms, particularly SMEs, do not export because they are not aware of opportunities, are risk averse or find the bureaucracy off-putting. SMEs that do export have concentrated heavily on Europe – the destination for 83% of SME exporters – and now face increased obstacles. The Government has recognised that SMEs will play an important role in reaching the 35% trade intensity goal and DIT has pledged to include specific SME chapters in FTAs. Government and SMEs should work together to identify the main barriers and develop the UK's approach.

In DIT's 2017 national survey of exporting behaviours, 30% of SMEs cited lack of knowledge as a key barrier to exporting. The 2018 survey found that 27% UK businesses did not know where to go for advice and support, with only 6% saying they would go to a government department or DIT. Several initiatives have been launched, such as a 2019 financial package supporting exporters and businesses in their supply chains, and the 2020 Export Growth Plan that established a £38m Internationalisation Fund for SMEs and appointed 64 new DIT Trade Advisers.

But resources remain stretched given the ambitious agenda, and the Government's Export Growth Plan recognises that more is needed. Business and government can do more together to strengthen support and eliminate duplication.

HMG's online offer is not sufficiently coherent. The websites of the Department for Business, Energy and Industrial Strategy (BEIS) and DIT offer advice from different perspectives. Similarly, a business must engage with HMRC for one type of rules of origin certificate and DIT for another. The Government should work to streamline and unify these efforts alongside those of trade associations, chambers of commerce and Local Enterprise Partnerships (LEPs).

Technological facilitations

Take-up of trade opportunities by UK businesses is linked to their ability to overcome practical barriers and handle paperwork. The Government aims to deliver 'the world's most effective border' by 2025, and yet global progress in easing trade facilitation is slow. The UK should become a leader in using technology to remove obstacles for firms, many of whom are now engaging with customs processes for the first time.

The Trader Support Scheme (TSS), which facilitates trade between Great Britain and Northern Ireland, and in which the IOE&IT is a partner, is a good example of such innovation.

WRITTEN EVIDENCE FOR THE ALL PARTY PARLIAMENTARY GROUP

Tackling the Trade Finance Gap, The Case for Regulatory Reform

Submitted by Professor Jason Chuah, Professor of Commercial and Maritime Law, City, University of London

8 April 2021

1. Context

For the purposes of this submission, I shall take trade finance to mean:

- Short term financing (often not exceeding one year) which is essentially linked to the import and export of goods.
- The financing usually provided by banks, though in some countries, also by state backed export credit agencies, development banks, etc.

Trade finance, as defined by the Bank of International Settlements, serves two purposes:

- To provide working capital tied to and in support of international trade transactions, and/or
- To provide a means to reduce payment risk.[i]

A very common trade finance product offered by the banks is the letter of credit. This is a bank backed undertaking to pay the exporter simply upon the exporter's tendering of "conforming" shipping and trade documents. Conforming documents are those required by the bank which show on their face that the underlying contract of sale had been properly performed[ii]. The financing bank is not interested in the actual performance of the underlying contract of sale[iii] – merely that the documents required should show on their face satisfactory performance of the trading contract.

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Trade finance might be differentiated from trade credit. Trade credit is what the firms themselves are able to offer their trading partners by means of credit. There are several factors that influence the decision of a firm to offer trade credit:

- Creditworthiness of the partner;
- Trust and long term trading relationship;
- Access to guarantees and other risk reducing services offered by third parties (i.e. the intervention of third parties to help pursue the debt or to share the risk of non-payment[iv]), such as factoring, receivables discounting, forfaiting;
- Public or private credit insurance;

- Cost and convenience of pursuing the debt in the foreign jurisdiction.

  That last factor is especially relevant to intra EU trading. In my research, I had argued that where there is a perception that recourse to judicial protection of commercial debts is more readily available because of the single European civil justice area, EU (and UK) firms would be more receptive to trading on open account terms (rather than use the letter of credit)[v]. With Brexit, as firms seek to trade more extensively beyond the single European area, ready access to letters of credit as form a trade finance will therefore be especially needful. It should also be noted that trade supply chains are interconnected; most firms are *both* importers and exporters. For example, exporters need to import parts and materials to manufacture their products. This supply chain context which extends beyond European markets[vi] makes the use of the letter of credit even more important.

with Brexit, ready access to letters of credit as form a trade finance will therefore be especially needful.

2. Legal and regulatory obstacles

I see the following to be key *legal and regulatory* obstacles to access to trade finance:

(a) Cost of regulatory compliance following on from proposals under Basel III.
(b) Cost of economic sanctions, money laundering and terrorist financing regulatory compliance.
(c) Legal rules which have not caught up with paperless trade and digitisation.
(d) Regulatory and legal responses to the facilitation of banking procedures and digitisation

2.1 Cost of regulatory compliance following on from proposals under Basel III

There is extensive literature and commentary on the impact of Basel III on the supply of trade finance. The debate seems to be this –to what extent, a bank's exposure to trade finance risks should be accommodated in banking regulation. In fact, both the proponents of Basel III and those who are concerned about the impact of stricter regulation on trade finance broadly agree that losses on short term trade finance portfolios historically have been low.[vii]

In my opinion, as trade finance portfolios are off-balance sheet, they are quite low risk[viii]. – meaning that there is no cash paid out upfront and the cash is only paid out if certain conditions are met (so it is "contingent").

The Basel III reform introduces, for present purposes, two requirements:

- All previously off balance sheet items are to be included when working out capital ratios (that is to say, the entirety of the bank's business is now considered, not merely parts of it).
- A new leverage ratio – this a requirement that so-called tier 1 capital[ix] will be needed to support letter of credit business. For a majority of banks, the leverage ratio is at least 3%, or 33:1. For the larger banks, the leverage ratio could be even stricter. Much depends on the weighting given to a particular product. The of letter of credit is to be weighted at 100% in the set formula. If the letter of credit is collateralised, then it is weighted 20%. That means:
  - For a letter of credit priced at £100, the bank must set aside £3 of tier 1 capital to back it.
  - Where that letter of credit is collateralised, then the bank only needs to commit 60p of tier 1 capital in support.

The at-first-blush answer might be to collateralise the letter of credit but whilst that might work for the bank, it makes the letter of credit quite unappealing to the importer. The alternative for the importer would be to pay the exporter directly to avoid the cost and inconvenience, but obviously that means access to trade financing ceases to be a useful option.

collateralising the letter of credit … makes the letter of credit quite unappealing

2.2 Burden of economic sanctions, money laundering and terrorist financing regulatory compliance

The provision of letter of credit is subject to relevant regulations on sanctions, money laundering and terrorist financing. The letter of credit is intended to be an autonomous payment instrument – meaning that the banks or providers should not have to be inquire into the actual outworking of the underlying contract of sale between the exporter and importer. This principle is enshrined in the common law[x] and the ICC Uniform Customs and Practice on Documentary Credits Publication No 600[xi]. However, there is, as to be expected, an overriding legal precept, namely, that the letter of credit cannot hide behind the principle of autonomy and be used to commit a breach of laws on sanctions, money laundering and terrorist financing or indeed any illegal acts.

That said, there are four notable challenges/constraints from a legal and regulatory perspective.

2.2.1 Conflicting sanctions regimes

There are at times conflicting sanctions regimes. For example, when the Trump administration imposed economic sanctions on Iran in 2018, the EU extended[xii] its 1996 Blocking Statute[xiii] to counter those US sanctions. The Blocking Regulation was made in 1996 to "protect EU operators engaged in lawful international trade and/or movement of capital, as well as related commercial activities, against the effects of the extra-territorial legislation specified in its Annex" and in 1996 the Annex had referred to Iran, Cuba and Libya. It goes further than "protecting" EU firms and extends to imposing **an outright prohibition** on EU firms (and banks) from complying with US sanctions laws. The practical problem for banks is that they operate transnationally and the risk of breaching EU law if they complied with US sanctions law is simply too significant for them to commit to offering letter of credit services.

2.2.2 Lack of clarity in stipulations in the letter of credit dealing with sanctions, money laundering and terrorist financing risks.

unclear anti-sanctions clauses damage the attractiveness of letter of credit

Banks routinely incorporate, in their letters of credit, clauses exempting them from payment if the letter of credit infringes or potentially infringes sanctions, money laundering or terrorist financing laws. The problem for the exporter (and importer) is that many of these clauses have not been tested in the courts of law and their practical effect and legal scope are not clear[xiv]. Such clauses clearly run counter to the principle of autonomy described above and whilst it would follow that an English or common law court would construe them narrowly, that does not resolve the lack of clarity for the traders. Moreover, different banks use different forms of words – some highly detailed and others fairly superficial[xv]. Thus, from the perspective of the trader such clauses damage the attractiveness of letter of credit-based trade financing.

2.2.3 Regulating the legal role and responsibilities of digital platforms

The use of digital platforms for trade and supply chain finance is an important development but there is, as yet, a lack of clarity in the regulatory framework as to the legal standing, role and responsibilities of these platforms – especially when these platforms may not have a physical location for the purposes of regulatory control. Thus far the approach has been to encourage self-governance and soft norms setting by the industry. However, there does need proper clarification as to the role and reach of the law, both for the enforcement of contractual rights and responsible behaviour.

a lack of clarity as to the legal standing, role and responsibilities of digital platforms

2.2.4 Deterrent effect of "Know your customer" policies.

Money laundering and terrorist financing regulations rightly impose on banks the duty to verify their customers prior to accepting their business as a first step to fight crime. The Financial Action Task Force and other organisations have identified trade finance based money laundering and terrorist financing as posing a significant risk[xvi]. It is undeniable that the risk is real (aided by the fact that trade finance is usually premised on the principle of autonomy whereby the banks seek to transact with the customer at arm's length)[xvii]. From the legitimate trader's point of view, there are some structural and intrinsic obstacles. Small and medium sized enterprises are more likely than large well-established firms to be rejected when KYC and due diligence protocols are applied strictly. Whilst not calling for the KYC and due diligence processes to be relaxed, there are practical measures that could help. For example, following Brexit many firms have been seeking Authorised Economic Operator status from HMRC[xviii] – I would suggest that those firms which have been awarded AEO status (covering both revenue and security vetting) could perhaps be given fast track preference by the commercial banks. Banks could also do much to provide clarity and information to SMEs seeking trade financing as to the due diligence process. That would demystify the application and checking processes for the trader and help them respond constructively to requests for information and data.

Another setback is the failure of correspondent banks in less developed economies to meet AML compliance standards. That has led to a contraction of the number of correspondent banks being able to advise or confirm letters of credit on behalf of issuing banks from more advanced economies. From an international development perspective, that in turn has a deleterious impact on companies in developing countries accessing trade finance. Direct or indirect[xix] contribution, by means of funding and expertise, to the AML compliance training of correspondent bankers in key developing countries could help.

the failure of correspondent banks to meet AML compliance standards … has led to a contraction in letter of credit [services]

2.3 Legal rules which have not caught up with paperless trade and digitisation.

Specific aspects of the law which require updating, in this connection, are:

2.3.1 Recognition of electronic records

Although UK law is better than most in recognising that any legal requirement for instruments to be in writing or signed could be satisfied by electronically, some of the legal provisions dealing with negotiability, transfer or assignment of rights represented by the document or signature in question would need clarification. For example, the Bills of Exchange Act 1882 provides for the acceptance of a bill of exchange (as commonly encountered in the use of documentary credits as a form of trade finance) to be valid, the acceptance must be "written on the bill and be signed by the drawee"[xx]. However, it is unclear how that would be satisfied in a digitised context. Similarly, although the transfer of the rights and liabilities represented by an "electronic bill of lading"[xxi] is recognised, that is not because the electronic document is treated as equivalent to the paper bill of lading. The latter is a legal *instrument* – mere physical transfer of the document will pass on rights and liabilities to the transferee. To the contrary, an "electronic bill of lading" although called a bill of lading, seems to work legally on the basis that every time a transfer of rights and liabilities is intended, a *new contract* comes into place (called "novation"). A more direct and straightforward recognition of

a direct and straightforward recognition of legal equivalence between the paper and electronic document is preferrable legal equivalence between the paper and electronic document is preferrable, in the interest of clarity and continuity of trade practices.

Another area for reform is the notion of a “holder” – the law provides for various rights and liabilities for the holder of an instrument such as a bill of lading or bill of exchange. Often this connotes a person with the possession of the document[xxii]. That definition could be problematic for the cyber-environment. In blockchains for example there may be many who would have “access” to the electronic data/document in question.

2.3.2 Smart contracts, blockchains and trade finance

Smart contracts should work well with the provision of trade finance and are well placed to support supply chain financing; an increasing use of trade finance. In a smart contract context, the exporter, importer and other participants in the supply chain can rely on the blockchain and will know quite specifically the conditions that trigger payment. The blockchain, like the banks in conventional trade finance, will not have any involvement in the underlying transactions. It will release payment entirely on whether the coded conditions have been met. Those conditions would be strictly defined by the input data. For example, the virtual presentation of the electronic bill of lading, certificates of quality, customs paperwork etc. The blockchain will not question if the contract of sale had actually been properly performed. So long as the electronic papers are in order, payment would be released. There are four legal considerations for policy and law makers:

- the legal principles currently applicable to letter of credit (notably the principle of strict compliance and principle of autonomy) may not apply automatically and their scope in the use of smart contracts has yet to be legally tested,
- legal recognition of the “smart letter of credit”,
- how general contract law should complement the use of smart contracts, and,
- how to respond to foreign laws which might render smart letters of credit unenforceable.

The adoption of blockchain technology in joint public and private financing initiatives could be useful in improving the provision of trade finance. In August 2020, the China National Clearing Center (CNCC), a subsidiary of the PRC Central Bank joined a consortium of three banks (Bank of China, China CITIC Bank and China Minsheng Bank) to apply the trio's current blockchain platform for forfaiting to CNCC's own forfaiting business. As such the upgraded system will be integrated with the PRC Central Bank's (People's Bank of China) large-sum payment system which in turn would lead to greater efficiencies and a reduction in costs for forfaiting and trade financing.

The adoption of blockchain technology in joint public and private financing initiatives could be useful in improving the provision of trade finance

2.3.3 ESG reporting and trade finance

The EU's Taxonomy Regulation requires banks to disclose the extent their businesses are committed to environmentally sustainable activities. In March 2021, the European Banking Authority (EBA) published an opinion recommending that a "green asset ratio" (GAR) should be used a KPI for banks. Banks are to disclose their GAR to show the extent to which the financing activities in their banking book (including loans and advances, debt securities and equity instruments) are associated with economic activities aligned with the Taxonomy Regulation and comply with the terms of Paris Agreement and the goals of the SDG. For off-balance sheet exposures (such as trade finance), the EBA recommends that institutions disclose a KPI on the proportion of taxonomy-aligned financial guarantees backing lending exposures and a KPI on the proportion of taxonomy-aligned assets under management for guarantee and investee companies subject to NFRD disclosure obligations. This proposal, if not proportionate or properly qualified, is likely to have a damaging effect on the provision and access to trade finance. In my opinion, other than raising awareness, the case for climate change benefits from the regulation has not been successfully made, given the degree of bureaucracy involved. The focus of the regulation is mainly on disclosure – not the substance of the bank's actual involvement in non-SDG compliant activities. There is an increased risk of "green washing", if not properly monitored. The UK should not commit itself to a similar

ESG reporting for banks, if not proportionate, is likely to have a damaging effect on …trade finance disclosure regime without proper due diligence and consultation.

2.4 Banking procedures and digitisation

Research shows that corporate banks offering trade finance, supply chain finance and cash management services suffer significant internal process inefficiencies[xxiii]. For various reasons, there has been poor communication and/or duplication in documentary trade processes, between internal and external clients. The matter is exacerbated when there are multiple parties, as is to be expected in trade finance and supply chain financing.

Onboarding processes are inefficient when manual handling is needed and there is no technology-based solution for extracting relevant data from reports. For the customer, the documentary trade processes lack real time visibility over the trade finance product's lifespan.

Communication can be improved by strategic use of AI, cloud technology, blockchain or web-based platforms (where real time activities are visible) and communications apps. Banks involved in working capital or supply chain financing should also be encouraged to adopt properly tested analytics to identify and prevent client default and improve supplier analysis. In time, better efficiencies could be achieved with AI learning from human decisions in risk assessment, operational matters and compliance activities.

communication can be improved by … AI, cloud technology, blockchain or web-based platforms and communications apps

Legal and policy challenges include:

- The impact of data protection protocols should be empirically studied; my own initial research suggests that the bluntness of the GDPR as a regulatory tool could well increase inefficiencies in banking documentary trade processes.
- Initiatives like the US Artificial Intelligence Initiative can assist in building an AI friendly regulatory environment to support better use, visibility and acceptance of AI in SMEs and trade finance providers.
- Encourage and contribute to the development of industry and international technical standards by establishing clear AI governance principles.[xxiv]
- Legal clarification of liability – *who* is ultimately responsible for machine-based or blockchain based acts and omissions?
- Legal clarification of the "*place*" where the breach of the law or contract is committed. This is especially problematic for technologies housed on cloud or at various servers or a blockchain in different countries. The question needs to be resolved for the purposes ascertaining which countries' courts have jurisdiction over an emerging dispute.

ENDNOTES

[i] BIS CGFS Papers. No. 50. January 2014; at p. 1 (Trade finance: developments and issues (bis.org))
[ii] ICC Uniform Customs and Practice for Documentary Credits Publication no 600 (2007), art 4
[iii] This is the so-called principle of autonomy.
[iv] See in particular products such as factoring and forfaiting. In the continent, avalising promissory notes as part of forfaiting is commonplace; this is a very much a paper-based system (indeed the aval as provided for in the Geneva Convention providing a Uniform Law for Bills of Exchange and Promissory Notes 1930, a very old convention pre-dating the advent of electronic digitisation, has not seen much change in use and practice). See Chuah, Law of International Trade (Thomson Reuters), 6th edn, 2019 pp. 676-677.
[v] Ibid, at p. 586
[vi] There is some continuity in judicial cooperation provided for in the Withdrawal Agreement.
[vii] See note i; at pp. 2, 25.
[viii] It means that no disbursement is made upfront; the payment is made only if certain requirements are met. Payment is therefore contingent on conditions being satisfied.
[ix] This is the consummate form of capital, from a regulator's perspective – it is core capital of the bank and includes equity capital and any disclosed reserves. As such, any bank's provision of services which are to be supported by tier 1 capital becomes more burdensome and costly.
[x] See for example The American Accord [1983] 1 AC 168
[xi] Art 4(a)
[xii] Commission Delegated Regulation (EU) 2018/1100
[xiii] Council Regulation No 2271/96
[xiv] See Chuah, Chapter 11 *"Islamic Letters of credit – Square Peg in a Round Hole?"* in B. Soyer & A. Tettenborn, "International Trade and Carriage of Goods" (Informa Routledge; 2015) which deals with so-called Islam compliant clauses in an "Islamic" letter of credit.
[xv] In my research for a public lecture organised by the National University of Singapore's Centre for Maritime Law and the Singapore International Arbitration Centre in 2016, I have sampled a number of such clauses in letters of credit issued by conventional merchant banks.
[xvi] FATF Study on Trade Based Money Laundering (2006) at https://www.fatf-gafi.org/media/fatf/documents/reports/Trade%20Based%20Money%20Laundering.pdf; also Asia-Pacific Group on Money Laundering, Typology report on Trade Based Money Laundering (2012) and the US GAO, Report to Congressional Senate "Trade Based Money laundering" (2020).
[xvii] See Chuah, Chapter 14, *"Money Laundering considerations in Blockchain based International Commerce" in* Zhao & Jia, **Maritime and Commercial Law in China and Europe,** (Routledge Informa) (2021)
[xviii] https://www.gov.uk/guidance/apply-for-authorised-economic-operator-status
[xix] Indirect contribution might include contributing to the work of the IFC/WTO, Bankers Association for Finance and Trade (BAFT) or the IMF in research, capacity building programmes and regional training courses.
[xx] S. 17(2)(a) Bills of Exchange Act 1882
[xxi] A shipping document often required by the letter of credit, as signifying due performance of the export contract.
[xxii] See for example s 2 Bills of Exchange Act 1882; although the definition in s 2 does not expressly refer to physical possession, the natural reading would suggest that possession is concerned with physical possession.
[xxiii] See https://www.intel.com/content/www/us/en/financial-services-it/solutions/capturing-the-ai-opportunity-research.html; also, Schmidt, Julian, Paul Drews, and Ingrid Schirmer. "Digitalization of the banking industry: A multiple stakeholder analysis on strategic alignment." (2017); Asif, Saadia, and Adrian Sargeant. "Modelling

internal communications in the financial services sector." *European Journal of marketing* (2000); PWC (2007): The Internal Control System: The Internal Control System: A Rapidly Changing Management Instrument; Krstic, J. & Dordevis, M. (2012).Internal Control And Enterprise Risk Management– From Traditional To Revised COSO Model. Economic Themes, Vol. 50 Issue 2, p151-166; International Federation of Accountants (IFAC) (2006). Internal Controls—A Review of Current Developments. Professional Accountants in Business Committee International Federation of Accountants

[xxiv] See for example the OECD Principles on AI (at https://www.oecd.org/going-digital/ai/principles/)

Advisory Group on Trade Finance:

Awareness & Advocacy

INTERNATIONAL
CHAMBER
OF COMMERCE

ATF ADVOCACY MESSAGING:

Priming Trade Finance to “Save Our SMEs”

AN URGENT “SOS” CALL TO SAVE OUR SMEs

Available evidence points to an increasingly uncertain outlook for small businesses across the world

- The outlook for small businesses in emerging markets has deteriorated significantly in recent months – corresponding with warnings of a growing “stimulus gap” in many low- and middle-income countries.

- In Colombia, business failure rates in August 2020 were 60% above levels recorded the same month last year.

- ICC survey data from September shows that 53% of small businesses owners in least developed economies fear their firms will close permanently unless there is a significant improvement in their cashflow in next six months (ICC, forthcoming). A recent UN survey recorded a similar sentiment from a cross-section of SMEs in Indonesia (UNIDO, 2020).

- Advanced economies are by no means immune to this worrying dynamic.

- Official data from the UK highlights that 14% of small businesses had still not reopened their doors for trading in September (ONS, 2020). While data from online business directories in the United States suggests that 60% of businesses that closed due to government lockdown measures have now shuttered permanently (see e.g.: Yelp, 2020).

- A McKinsey survey, conducted in August, showed 21% of SMEs in France and Italy expect to file for bankruptcy in the next six months should prevailing economic conditions persist (McKinsey, 2020).

AVERTING A SMALL BUSINESS SOLVENCY CRISIS

SMEs need targeted support to access essential forms of working capital

- With the outlook for the global economy increasingly uncertain, SMEs are expected to remain highly reliant on short-term loans and working capital facilities to remain solvent well into 2021.

- But with credit conditions tightening as default risks increase, we are deeply concerned that the supply of bank finance will be insufficient to meet the liquidity needs of small businesses in the coming months.

- This is particularly the case as regards the supply of trade finance – a vital source of working capital for many SMEs which underpins upwards of 80% of global trade.

- All available data points to a risk of widespread retrenchment in the supply of trade credit to SMEs – particularly in emerging markets – mirroring trends seen during previous economic shocks in recent decades.

- Absent of proactive interventions at suitable scale to backstop provision by commercial banks, shortages of trade finance could prove a fatal blow to the survival hopes of small firms – starving them of essential liquidity and cutting off commercial opportunities as demand returns to the economy.

- While we welcome the interventions made by governments and development banks to-date, these are likely to be insufficient to meet the likely US$2 trillion of credit that will be needed to restore cross-border commerce to pre-pandemic levels.

TRADE FINANCE AS THE ULTIMATE "PHASE TWO" STIMULUS

Low-risk, targeted and short-term

- We recognize that governments and international financial institutions have limited space to provide further fiscal support to the real economy.

- In this context, we believe there is a clear business case for prioritizing interventions to support the provision of trade financing as a means of targeting available support on the immediate working capital needs of viable businesses – given that applications for credit are tied to confirmed cross-border transactions.

- Trade finance transactions should also present a much lower degree of risk to national exchequers – as compared to other forms of stimulus funding – given that the securitized nature of transactions and low default rates evidenced by ICC data (ICC Trade Register, 2019).

- The short-term nature of trade financing – typically, 60-180 days – should also obviate concerns regarding any long-tail risks of Covid-19 stimulus measures.

- With trade expected to be an essential vector of relief for SMEs, it will be essential to ensure that the supply of underlying credit is primed to enable its recovery to pre-pandemic levels in the coming months.

- By contrast, shortages of trade finance are likely to have a significant pro-cyclical effect on SME failure rates – in turn, creating significant ripple effects in global supply chains and throughout the financial sector.

TARGETING SUPPORT ON THE NEEDS OF THE REAL ECONOMY

Our agenda for action

- There are a number of immediately available measures that governments can take to prime the supply of trade financing to SMEs.

- Given the nature of international trade, it's vital that any such interventions are globally coordinated and, moreover, applied at a scale commensurate with the depth of the SME liquidity crisis precipitated by the Covid-19 crisis.

- Most fundamentally, the G20 must act to scale the provision of credit guarantees by government agencies and development banks to mitigate the likelihood of supply retrenching in response to weakened balance sheet position of SMEs and other macroeconomic risks.

- Applying regulatory flexibilities – in line with national measures taken to safeguard the supply of consumer credit – would also serve as an import means to safeguard the supply of trade financing to the real economy.

- Large-scale government/central bank purchases of trade assets – e.g. through securitized vehicles – should also be utilized to free up bank balance sheets to finance new SME-focused transactions.

- Priming trade finance offers the best hope for a resilient recovery from the pandemic in both emerging and advanced economies.

BACKGROUND:

Trade Finance and Risks to Supply in the Era of Covid-19

THE IMPORTANCE OF TRADE FINANCE

Essential for the real economy but a vulnerable market in which those most in need are underserved…

- Trade finance plays a **central role in the real-economy** underpinning an estimated 80 - 90% of global trade (WTO).
- Trade finance is a **proven low-risk asset class** – by way of example, default rates from 2008-2018 for import letters of credit average 0.36% and 0.45% for performance guarantees (ICC Trade Register, 2019).
- The global trade finance market was long considered liquid and well-functioning. But more recently, it has proven **extremely vulnerable to economic shocks** – most recently following the Lehman bankruptcy in 2008.
- The short-term, transactional nature of trade finance means that **supply can retrench sharply** in response to perceived risks – with "credit crunches" halting both imports and exports in several Asian and Latin American economies in the 1990s.
- **Small and medium-sized enterprises are often highly reliant on trade financing** – particularly those entering overseas markets for the first time – but face the greatest hurdles in accessing affordable provision.
- Globally, **over half of trade finance requests by SMEs are rejected**; against just 7 percent for multinational companies. Women-owned businesses are almost twice as likely to face difficulties obtaining trade credit than those owned by men (ICC, 2020).
- Regulatory changes (e.g. Basel III) have **rendered trade finance increasingly unattractive** to commercial banks over the past decade. Recent data shows a 23% decline in the number of banks providing trade credit in Africa between 2013 and 2019 (AfDB, 2020).

A CRISIS AROUND THE CORNER?

Signs of market volatility point to a looming supply shortage…

- Available evidence shows a range of emerging stresses in the trade finance market, including:
  - **Pricing volatility**, with anecdotal reports of increases in pricing for SMEs;
  - **A "flight to safety"**, with banks reporting that they are focusing their trade finance activities on existing multinational clients – and rejecting "almost all" applications from clients without pre-existing relationship and SMEs with weak balance sheets (AfDB and ICC, forthcoming);
  - A reported **60% increase in rejected applications** for trade credit insurance market in the United States (see: WSJ, 2020);
  - **Retrenchment** from sectors deemed to be high-risk – most notably, the exit of several major banks from the commodities trade finance market in August 2020; and
  - **Operational disruption** caused by reliance on hard-copy paper documentation.
- Looking forward, growing uncertainty in the global economy could create a "perfect storm" for widespread retrenchment in the trade credit market in the coming months based on historical experience.
- In addition to reports of about a looming wave of **corporate insolvencies**, recent IMF studies point to **growing sovereign risks** from a credit perspective — with the fiscal position of a swathe of emerging economies looking increasingly precarious.
- **Devaluations of local currencies vs. the US dollar** have also been shown to significantly constrain trade finance availability (BIS, 2020). Despite USD weakness in recent months, many developing countries have seen net depreciations against the dollar since the start of the crisis.

"WAIT AND SEE" WON'T WORK FOR THE REAL ECONOMY

Widespread trade financing gaps could prove a fatal blow for small businesses

- While we welcome the early actions taken by governments, development banks and regulators to provide support for trade finance in response to the early impacts of the crisis… we believe there is a **clear rationale for further coordinated interventions** to mitigate the risk of trade financing gaps inhibiting a post-pandemic recovery.

- ICC estimates that **restoring trade to pre-pandemic levels in 2021** – in line the IMF's "optimistic" recovery scenario – **will require an additional US$2 trillion of trade finance** to be delivered to the real economy compared with 2020.

- Risk appetite in the market will only be properly tested once demand for trade rebounds and/or stimulus funds fade from the economy. But, even with highly depressed transaction volumes, banks are already relying heavily on public risk guarantee schemes – with utilization of development bank programs typically 50% above pre-crisis levels.

- **Proactive interventions are vital to safeguard the viability of SMEs.** Recent ICC survey data shows that 53% of small businesses owners in emerging markets owners fear their firms will close permanently unless there is a significant improvement in their cashflow in next six months (UNCDF and ICC, forthcoming).

- With strained public balance sheets limiting scope for further government stimulus measures, trade is expected to be a vital lifeline for many businesses.

- Absent of proactive interventions at suitable scale to backstop the market, shortages of trade finance could thus prove a fatal blow to the survival hopes of small firms – accelerating SME failures, disrupting supply chains and eroding the productive capital of local economies.

HOW CAN POLICY-MAKERS HELP?

If we're banking on a trade-led recovery, we better make sure the banks can finance global trade

- There's a clear business case for proactive interventions to ensure the trade finance market is primed to support a rapid recovery from Covid-19.

- The good news is there are simple steps governments can take, at relatively minimal risk, to help maintain supply, including:
  - Enacting emergency legal reforms to **allow digital documents to be used in the processing transactions** – following the lead taken by India, Oman, Peru and the United Kingdom in phasing out requirements for trade documents to be presented in hard copy;
  - **Adjust the application of Basel III to trade financing** to free up capital to support SME trade;
  - Consider **large-scale government/central bank purchases of trade assets** – e.g. through securitized vehicles – to free up bank balance sheets to finance new transactions;
  - Ensure **export credit agencies sufficiently capitalized** to provide adequate support for short-term trade transactions – with appropriate transactions limits and no artificial restrictions on geographical coverage;
  - Significantly **scale the capacity of development bank schemes** to provide risk mitigation and liquidity at levels commensurate with the anticipated needs of the real economy; and
  - **Mandate development banks to take on greater levels of risk** for SME transactions for the duration of the crisis.

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2020 ICC GLOBAL SURVEY ON TRADE FINANCE

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- Olivier Paul – ICC Banking Commission

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We extend our appreciation to the 346 respondents to the Global Survey located in 85 countries for their comprehensive, considered and insightful answers to the survey, which are at the heart of the consistently high value and quality of this report. Survey responses, complemented by expert insight, content and commentary, underpin a publication unlike any other in the market today, richly valuable for practitioners, policy professionals, international development practitioners, academics, multilateral entities and a wide range of members of the global ecosystem of trade and trade financing.

Boston Consulting Group is a critical partner to the ICC and the Banking Commission in the conception, development and publication of two flagship ICC reports, this one and the ICC Trade Register. Our multi-year association has progressed to encompass a wider scope of collaboration, and has been instrumental in raising the robustness, quality and authoritativeness of these reports. Our thanks to the BCG team for its tireless work, proactive leadership and skilled program management: Sukand Ramachandran, Ravi Hanspal and Noah Mayerson.

We would also like to thank TXF for their ongoing support by providing insightful market data and analysis to the ICC Global Survey over recent years. Our thanks go the TXF team for their dedication to the project and invaluable contributions: Tom Parkman, Alfonso Olivas, Sergio Lopez, and Max Thompson.

INTRODUCTION

Foreword

John W.H. Denton AO,
Secretary General, International Chamber of Commerce

The year 2020 has not unfolded as anyone would have anticipated. The rapid spread of COVID-19 to nearly every country and territory in mere weeks has challenged assumptions about the resilience of the global economy and put tremendous strain on governments, businesses, healthcare systems and communities.

With supply lines and physical movement often curtailed in response, global trade as we knew it in 'pre-COVID-19' times has been significantly disrupted. The consequences have been severe, and the IMF predicts unsurprisingly the greatest drop in global growth since the Great Depression. Every day, the ongoing pandemic threatens the viability of businesses of all sizes and in nearly every sector. And as lockdowns in many countries remain in force, the devastating combination of labour constraints, travel restrictions and demand shocks continue to cripple business activity and escalate unemployment.

In such times, the role of ICC as the voice of global business is vital. Our work is animated by our clear priority to protect and preserve lives and livelihoods. As the only private sector organisation with a permanent seat at the United Nations, ICC has a crucial role to play in supporting the international response to this pandemic. And with an unparalleled reach across global business, we are uniquely placed to marshal key evidence to guide policymakers through their vital decisions.

This year's Global Survey indicates that banks are optimistic about the long-term future of trade finance and are looking to invest further to gain new clients, offer new products (such as supply chain finance), expand geographically and increase digital offerings. However, in the short term many banks anticipate a steep decline in trade flows due to COVID-19, with the majority expecting at least a 20–30% decline in 2020 from original forecasts. This broadly aligns with BCG's analysis in the Global Survey, forecasting a decline of between 11% and 30% in 2020 trade flows.

Enabling the shift to digitalised trade

ICC has already launched several initiatives to ensure that its global network can be put to best use in the fight against COVID-19. One aspect of our response to this crisis has incorporated key objectives to bring greater efficiency to the paper-based global trading system. Central to this is expediting the shift to digitalised trade, which the Global Survey shows is already underway but will need to accelerate in the wake of the crisis. Already this year, ICC has launched the Digital Trade Standards Initiative, a cross-industry effort to enable the standardisation of digital trade. This effort will bring greater economic inclusion, connect digital islands and ensure the all-important collective nature of formats and processes. We are also working with governments to implement broader legal

recognition of electronic documentation based on the uniform model law established by UNCITRAL. The far-reaching impacts of the pandemic have made plain that we must improve the outdated system of trade in operation at the outset of the crisis.

The fight to save SMEs and maintain open trade

One of the many benefits of a more digitalised trading system will be greater inclusion and increased opportunities for smaller businesses, which are the drivers of economic growth in most countries. The Global Survey reveals that financial inclusion was already a material concern for many trade banks even before the COVID-19 crisis, which is expected to have a disproportionate impact on SMEs. ICC has been vocal about the urgent need to support SMEs during and after the pandemic. In March, we launched an urgent call for decisive action to 'Save Our SMEs' and combat the economic repercussions of this pandemic. We are continuing to raise awareness of the challenges faced by SMEs with governments and international financial institutions and are providing concrete tools to help them stay in business.

Responding to a crisis for the benefit of all

Uniting our many efforts is ICC's guiding objective in these difficult times to preserve lives and livelihoods. We are committed to enabling effective response efforts to the public health and economic crisis created by COVID-19 as it is happening, and we are intent on shaping a recovery phase that leads to a more resilient global economy and trading system.

We will ensure that our unparalleled network of 45 million businesses worldwide is positioned to help policymakers take decisions based on the best evidence available. And we will ensure that the private sector plays its part in mitigating the global impact of this pandemic.

We do so in keeping with the spirit of ICC's creation more than 100 years ago, when the ravages of the First World War brought businesses together in support of peace, prosperity and opportunity for all. As we look ahead with hope to a 'post-COVID-19' future, that driving purpose remains as important as ever.

State of trade: tension, transition, and turning point

Alexander R. Malaket,
President, OPUS Advisory Services International Inc.;
Chair, ICC Finance for Development Market Intelligence

Trade has been a critically important part of the human experience for thousands of years. It has seen periods of tension, transition and tragedy – at the core of war and colonialism, at the heart of impressive progress in economic inclusion and international development, and recently at the centre of a political posturing and policy that can best be described as controversial.

Additionally, and with some justification, trade faces questions today that have never been levelled at this part of commerce before: questions related to its sustainability in its current form and to the carbon footprint of key components of the physical supply chain, such as the global shipping industry. Relatedly, questions about the importance of supply chain visibility and traceability have come to the forefront of commercial and regulatory dialogue, with increasing responsibility placed upon large global buyers, for the behaviours and actions of their suppliers and extended supply chains.

As we develop content for the 2020 edition of the ICC Global Survey on Trade Finance, the world – including global supply chains – grapples with the tragedy and as yet opaque impact of the COVID-19 crisis.

The Bloomberg New Economy newsletter of 7 March 2020 strikes a note of cautious optimism by noting that "Globalization faces a bend-but-won't-break crisis on coronavirus" – a statement that applies equally well to the state of globalisation linked to trade.

We have seen significant 'bending', and incurred material costs around the world from a spate of tariffs and 'trade wars' that no one can or will 'win', yet the fundamental character of the system remains resilient. Multilateral, rules-based trade continues to be central to the governing of trade flows around the world, despite a slowing of global growth to the range of 3% in 2019.

This temporary moment of tension in the dynamics of trade will normalise as a more thoughtful, strategic and informed approach to policy returns to shape the global discourse and the actions that follow.

In the meantime, the forced, now inevitable, search for alternatives – once it succeeds – will set a much more solid, inclusive and sustainable foundation for the global architecture for trade.

ICC participated in the annual Trade Finance Experts' Group Meeting hosted by the WTO in Geneva in March of this year. This meeting of senior trade leaders from around the world, chaired by WTO Counsellor Marc Auboin and hosted by Deputy Director General Yi, provides a unique forum for a far-reaching update on key initiatives and issues across the industry, as well as substantive dialogue on policy and advocacy priorities.

It was in this context that an underappreciated but important reality of trade today was highlighted: the level of zero-tariff trade concluded on the basis of the WTO's 'Most Favoured Nation' status has never been higher (Figure 1).

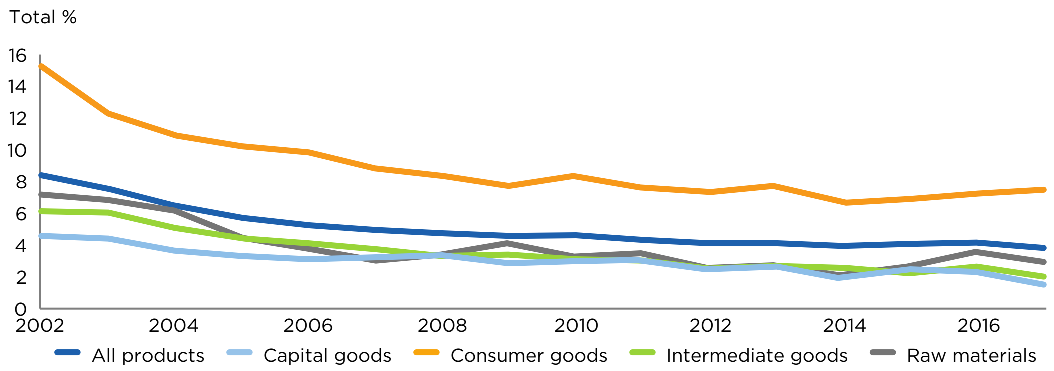
Put another way, despite active, misguided efforts to dismantle a system that has contributed to global growth and prosperity since the post-world war era, the reality is that the core purpose of the multilateral system continues to advance.

Trade works and is continuing to work despite an onslaught of poor decisions, poor policy and absent leadership from those best positioned to advance and magnify its positive effects for the world.

The prevailing geopolitical and policy environment forces a search for alternatives in leadership, in policy and in options for achieving a more balanced, inclusive reality, with trade making an important contribution.

Figure 1

Tariffs applied to the value of imports, by processing stage, world average (2002–2017)



Note: trade-weighted average for effectively applied tariffs.
Source: World Bank, WITS (World Integrated Trade Solution)

We will soon see a period of transition to a 'new normal' in international economics and trade. Just as the G20 occupies a growing position of influence globally as a direct result of its rightly more inclusive nature, this 'new normal' will be characterised by a growing appreciation for the interconnected nature of prosperity, inclusion and security, and will refocus on the necessary growth of multilateral engagement.

As the ICC starts its second century under new leadership, and as the Banking Commission finds its roots in the new Finance for Development Knowledge Centre, we will continue to advocate – clearly, unequivocally and consistently – in support of multilateral engagement, and inclusive, rules-based trade.

This means we will continue to focus on understanding and addressing the global gap in trade financing, while continuing to engage in advocacy through partners like the WTO, the B20/ G20, the United Nations, the Financial Stability Board, the Financial Action Task Force, and the Wolfsberg Group among others.

This includes our traditional areas of work, shaping industry practice, standards and guidance, as well as emerging areas of contribution such as digitisation of trade, supply chain finance (with important partners like BAFT, the ITFA, FCI and EBA among others) regulatory and compliance issues in financial crime, advancing the development of trade finance as an increasingly investable asset class, and a wide range of other important topics.

Business, and trade, can and should be powerful forces for good in the communities and societies in which we thrive. Even the most commercially disciplined, profit-oriented organisations in the world are beginning to recognise that the sands are shifting, with questions around sustainability increasingly at the core of commercial dialogue, and the emerging framework of Economic, Social and Governance (ESG) likewise is increasingly an imperative. Our work around enabling access to trade finance as an element of financial and economic inclusion progresses through critical partnerships with multilateral development banks, including ADB, EBRD and IFC among others, as well as with the Berne Union and its members around the world.

ICC, with our network of National Committees, our more than 45 million members worldwide, and our ecosystem of partners, is uniquely positioned to be a thoughtful voice and a constructive force as we shift from tension to transition to turning point.

Introduction to the Global Survey

The 11th edition of the ICC Global Survey on Trade Finance took place over eight weeks, from February to March 2020, gathering insights from 346 respondents in 85 countries. The Global Survey was conducted by the ICC Banking Commission, in partnership with Boston Consulting Group (BCG), TXF, SWIFT and the Asian Development Bank (ADB). BCG supported with the data collection, aggregation of results and analysis of the survey data. Given the rapidly advancing COVID-19 pandemic, a supplementary survey was conducted to begin to understand the impacts of the pandemic on global trade and trade finance.

The profile of the 346 respondents varies widely, from large multinational banks serving customers around the globe to small local banks with few customers and low trade flows. The diversity of respondents reflects the structure of the trade finance market. The most represented regions in the survey are Western Europe at 32% and Asia Pacific (APAC) at 30% (Figure 3).

Figure 2
What type of bank is your bank?

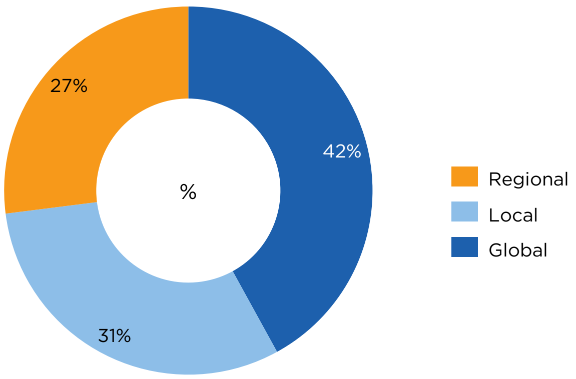
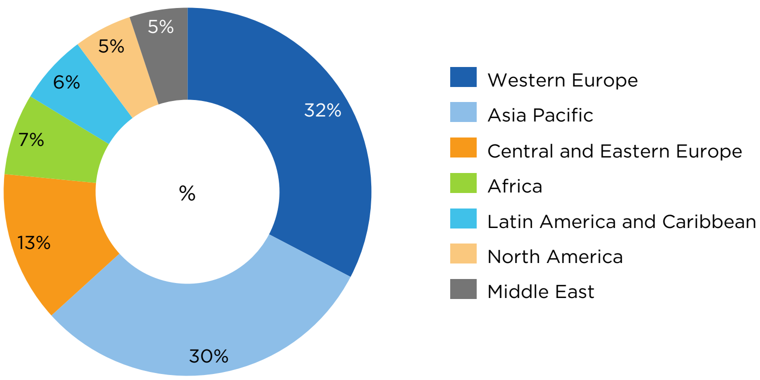
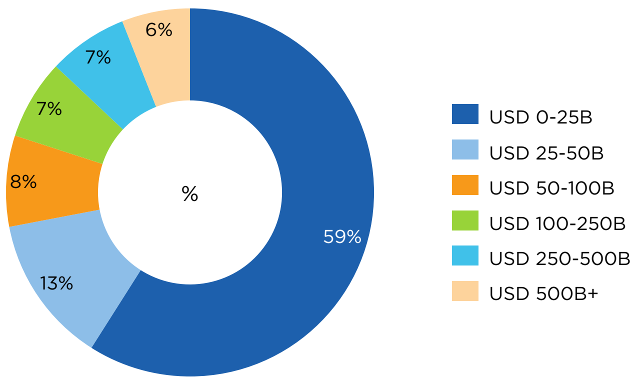


Figure 3
Where is your bank headquartered?



We asked participants to estimate the USD value of all trade finance applications that their banks received last year. The majority (59%) indicated a small-to-medium sized trade finance business of up to USD 25 billion (Figure 4), which is broadly reflective of the dispersed trade finance market around the world. However, respondents also included some large players, with 27% indicating they received at least USD 100 billion in trade finance applications in 2019. This diversity in size and scope provides a rich set of answers and data to draw upon, once again clearly illustrating the representativeness, importance, and reach of the Global Survey.

Figure 4
What was the total USD value of all trade finance applications your bank received in 2019?



Key findings of the Global Survey and the COVID-19 Survey

This year's Global Survey has again provided insights into the trends shaping trade finance, and a fact-based, data-driven view of some of the trade industry's hypotheses on trade. In addition, the short supplementary COVID-19 Survey has allowed us to understand some of the emerging challenges and responses arising from the crisis across the globe.

In summary, the two surveys have provided insights across the following themes:

1. Market outlook on trade finance

- Banks around the world are looking to expand their trade finance business – for our purposes this includes traditional trade finance (TTF) and the various techniques of supply chain finance (SCF) – through various means, including gaining new clients, offering new products, expanding geographically, and increasing digital offerings. In particular, 86% of respondents said that supply chain finance was either an immediate or near-future priority, while 84% answered the same for digital.

- However, concern persists about regulatory and compliance-related obstacles to growing trade finance businesses. These include anti-money laundering (AML) and Know Your Customer (KYC) requirements, and the challenges arising from requirements linked to countering the financing of terrorism (CFT), as well as those related to international sanction regulations.

- Industry practitioners and leaders fully support the policy and regulatory objectives, as well as the overarching need to protect the global financial system from abuse. The issues flagged, however, relate to consequences of regulation that are believed to be unintended, and that directly affect access to trade financing – thus inevitably curtailing trade and impacting economic inclusion and international development.

2. The impact of COVID-19 on trade and trade finance

- Banks from all geographies are already noticing the impact of COVID-19 on trade flows, with most reporting a 0-10% decrease in Q1 2020. Banks expect an even more significant decline in trade flows for the full year, with the majority expecting at least a 20–30% decline from original forecasts, which broadly aligns with both WTO and BCG scenarios.

- Encouragingly, the majority of banks are helping their customers who have been affected by COVID-19, using various measures including extending financing terms and providing more convenient digital (or partly digital) solutions. Some banks have also relaxed their internal policies on original documentation rules, which hopefully is a sign of things to come as the current crisis catalyses and accelerates a significant reduction (perhaps ultimately the elimination) of paper in trade and trade finance transactions. Leading trade banks have

What has ICC done...?

- Leading trade banks have come together under the auspices of the Banking Commission Digitalisation Working Group to **issue a paper** sharing practices adopted in order to enable trade to flow despite pandemic-related difficulties in accessing hard-copies of trade documentation

- The ICC has **issued a call** for governments to quickly enact legislation and measures aimed at advancing digital trade.

come together under the auspices of the Banking Commission Digitalisation Working Group to issue a paper sharing practices adopted in order to enable trade to flow despite pandemic-related difficulties in accessing hard-copies of trade documentation.

- Most banks have not yet seen meaningful support from local authorities to facilitate ongoing trade on digital terms. Requirements persist for original documentation in trade transactions, perhaps unsurprisingly given the speed with which COVID-19 has transformed the commercial landscape.

- The early part of the COVID-19 crisis did not have a systemic impact on the availability of trade financing which, by all reports, remained consistent. However, careful market monitoring by ICC, the WTO, and other key players now suggests emerging system-wide difficulties with USD liquidity, targeted deployment and far tighter controls on trade financing. Deteriorations in credit quality linked to coming bankruptcies are expected to generate a wave of adverse consequences for trade and trade financing. Encouragingly, according to the vast majority of reports, industry standards and practice around the financing of trade have been robust and respected through the crisis to date.

3. Supply chain finance

- Trade banks, particularly those serving global customers, are broadly adopting supply chain finance platforms and expect further growth in this space. However, there is an ongoing divide between global and non-global banks, with 64% of global banks offering SCF platforms, compared to just 13% of local banks and 38% of regional banks.

- This divide is set to continue: global banks expect significant growth in the next five years from SCF, with one-third expecting over 50% growth. In contrast, the majority of local banks expect only 0–15% growth over the same period, which is notable given clear market trends that continue to reflect growth in open account trade as well as in SCF techniques such as payables finance. This significant difference in expected growth rates may reflect differing views around the evolution of the market, or they may be an illustration of limited appetite, expertise or capacity among local banks to significantly advance their SCF propositions.

- Respondents indicate lingering concerns regarding regulation and the ability of smaller banks to enter SCF due to challenges with technology build (e.g. high costs and lack of internal capabilities), although smaller players have overcome these through partnerships and white labelling solutions.

4. Sustainability

- All banks are increasingly recognising the imperative to develop a sustainability strategy, with 67% of respondents stating that they have one. This urgency has primarily been fuelled by concerns related to reputational risk and by fast-growing client expectations.

- There is strong agreement that the environment and climate change should be priorities, with the majority of banks already integrating sustainability risks into credit risk management procedures for clients and conducting sustainability-related due diligence.

- There is a clear desire, however, for more formal guidelines for banks in this area, with 84% of respondents saying they would welcome ICC support in providing sustainability guidelines. The nascent state of these matters, coupled with the wide range of levels of progress on sustainability issues across jurisdictions, including among central banks, adds complexity and urgency to efforts to advance a sustainability agenda globally.

5. Regulation and compliance

- Survey respondents continue to express concern regarding the impacts of existing regulation and compliance policies, with

56% indicating 'significant concern' regarding regulatory requirements.

- The majority of banks expect customer risk due diligence (including sustainability risks) and increased minimum capital requirements to become areas of increased regulatory focus in the coming years.

- Industry stakeholders have reacted positively to the visibility of the BIS in terms of capital requirements as a short-term response to COVID-19; the imperative to balance regulatory efficacy with risk-aligned treatment of trade finance continues to be an area of focus.

6. Digitisation

- While digitisation is widely seen as one of the most important trends to shape trade and trade finance in the coming years, there is a clear divide: while 83% of global banks have a digital strategy, only 46% of local banks report having one.

- This divide exists not only in technology adoption, but also in whether digitisation is considered useful and can reduce costs. While 59% of global banks indicate that digitisation would provide a significant benefit to their operations, just 25% of local and 32% regional banks indicate the same. Furthermore, 90% of global banks expect a reduction in their cost base from the implementation of digital solutions, but only 55% of non-global banks say the same.

- The sharp contrast in expected benefits from digitisation between global banks and regional/ local institutions is instructive, as is the significant difference in benefits expected through cost reduction versus more general, positive business impact. The chasm between global banks and others in recognising a compelling business case tied to digitisation risks driving further consolidation and concentration in trade financing among banks.

7. Financial inclusion

- 73% of survey respondents feel that there is a shortage in servicing the needs of the global market, and the majority believe that there is a role for governments and export credit/ multilateral agencies to help close this gap.

- Most banks reject only a small percentage of trade finance applications, with 62% rejecting between 0–10% of applications in 2019. Micro, small and medium-sized enterprises (MSMEs), and those from Africa and Central/ Eastern Europe, are disproportionately rejected – consistent with the findings from the previous three editions of the Global Survey. The most common reasons cited for rejection are KYC concerns and low-quality applications.

- Digital trade is widely seen as a key enabler to help banks close the trade finance gap, with 55% of survey respondents positioning themselves to service more MSMEs using technology solutions. The challenge is to ensure enough local banks – that often serve these MSMEs – are sufficiently digitally enabled to make it commercially viable to serve the MSME client segment.

MARKET OUTLOOK ON TRADE FINANCE: COVID-19 AND BEYOND

Survey analysis

Since 2000, global trade flows have trebled from USD 6.2 trillion to USD 18.1 trillion in 2019 – growth now widely acknowledged as having been enabled by trade financing, which provides liquidity and risk mitigation solutions for importers and exporters, allowing them to transact with confidence across borders.

The strong growth in trade finance over the past two decades looks set to continue as we enter the 2020s. The 2020 Global Survey indicates that banks continue to see trade finance as a growth area. Across the board, respondents indicated their ambitions to expand their trade finance arrangements to new clients, products and geographies.

The importance of this activity was brought sharply into focus at the peak of the global financial crisis and in the intervening years, where 'real economy' activity like international trade moved to the forefront of the recovery. The priority assigned to transaction banking, including trade financing, within financial institutions was raised in consequence.

Respondents were asked to identify which options they are considering in growing their business (Figure 5). 77% included "transitioning to digital" in their selections (Figure 6). Encouragingly, 61% indicated that they were planning to "expand product offerings", whilst 54% indicated that they will be "expanding their market participation".

Only 3% of respondents answered that their banks were planning to either reduce their product offering or their market participation – demonstrating the optimism many banks have in their trade finance business.

These results are significant for the industry and reiterate the point that trade finance is continuing to evolve. Although the transition to digital has been slower than for other banking products for well-documented reasons, over the coming years this digitisation will materially shape how trade finance works and the types of solutions offered.

Financial Technology firms or Fintechs will continue to expand their involvement in trade financing – likely focused on SCF – over the medium term. This will likely evolve through a combination of direct funding to SMEs and/ or the formation of white-labelled technology partnerships. Continued growth in open account trade and SCF will encourage non-banks to enter the market. The growth trajectory and capacity of non-banks will bear watching over the coming years, particularly in terms of these entities' ability to bring balance sheet capacity to market.

54% of banks mentioned, pre-COVID-19, that they will be expanding their market

Figure 5
Is your bank reconsidering its trade finance business model?

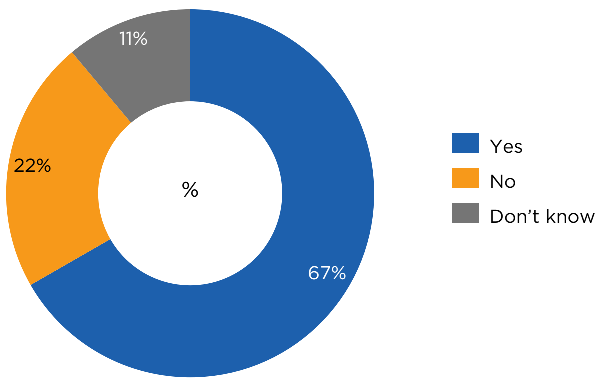
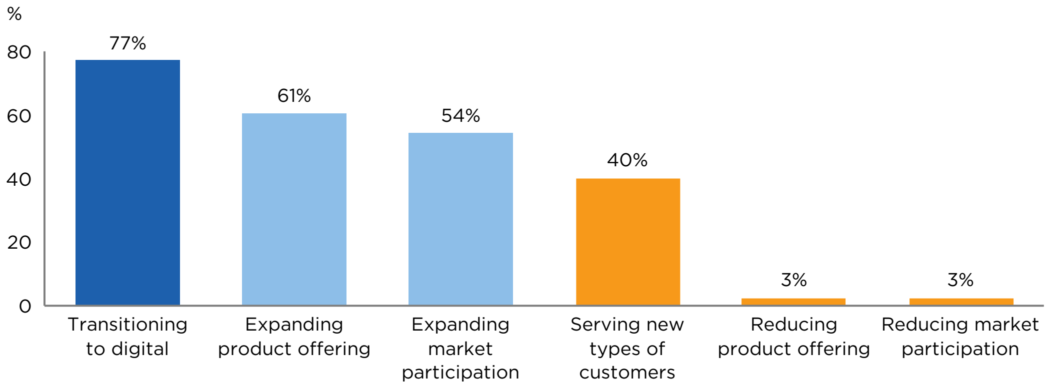


Figure 6
What options are your bank considering for its trade finance model?

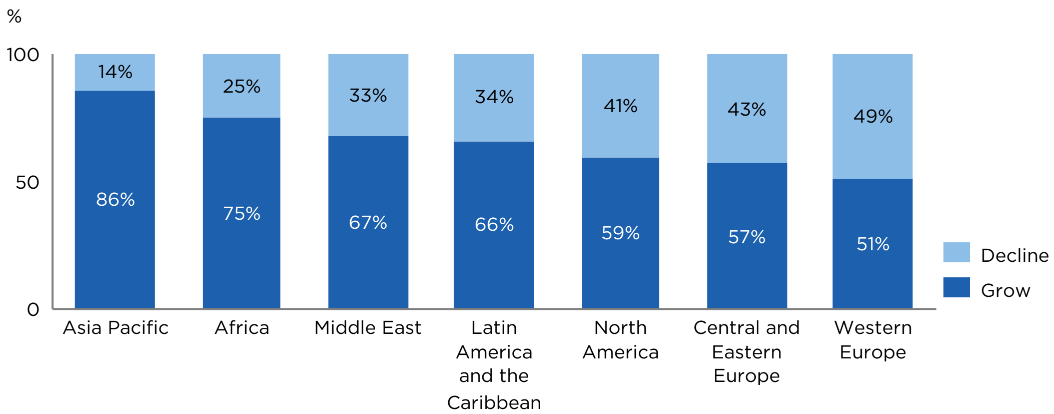


participation despite recent geographical retrenchment and the ongoing reconfiguration of trade corridors. Whether this speaks to a growing desire to target the MSME client segment, or the intention to create net new capacity to underwrite business by distributing trade assets to interested investors, remains to be seen.

When asked about the growth prospects for trade finance by geography, respondents overwhelmingly predicted growth over the coming two years. Growth expectations were positive across the board, with 86% indicating that the demand for trade finance will grow in Asia Pacific (Figure 7), while 75% said the same for Africa. Western Europe saw the biggest split in the survey, with 51% expecting trade finance to grow, and 49% expecting it to decline in the coming years.

Such expectations have been reported despite ongoing and arguably worsening geopolitical and 'trade war' dynamics, at a time when trade has finally, post the 2008 global financial crisis, regained its familiar position as an engine of economic growth. The exact nature and duration of the impact from COVID-19 remains unclear; in particular, the devastating human and economic impact of the virus on the most vulnerable but until now highest-growth markets will demand careful monitoring and has already required crisis-level response from authorities around the globe. There is serious risk that the USD 1.5 trillion annual trade finance gap will be exacerbated by the COVID-19

Figure 7
Will demand for trade financing grow or decline over the next two years (by region)?



crisis. Significant mitigation measures by multilateral development banks, export credit agencies and others are already in progress, but there is much work still to be done.

Asked what they consider to be the priority elements to develop in their trade finance businesses, the vast majority of respondents indicated that traditional trade finance was still an immediate priority for their bank (Figure 8).

While traditional trade finance is the largest source of revenue today, its lead is now only marginal versus open account trade: a shift that is expected to continue over the next few years, even if a short-term, COVID-induced return to traditional mechanisms does materialise.

Despite ongoing market shifts away from traditional trade and trade financing mechanisms, only 53% of respondents indicated that SCF is an immediate priority.

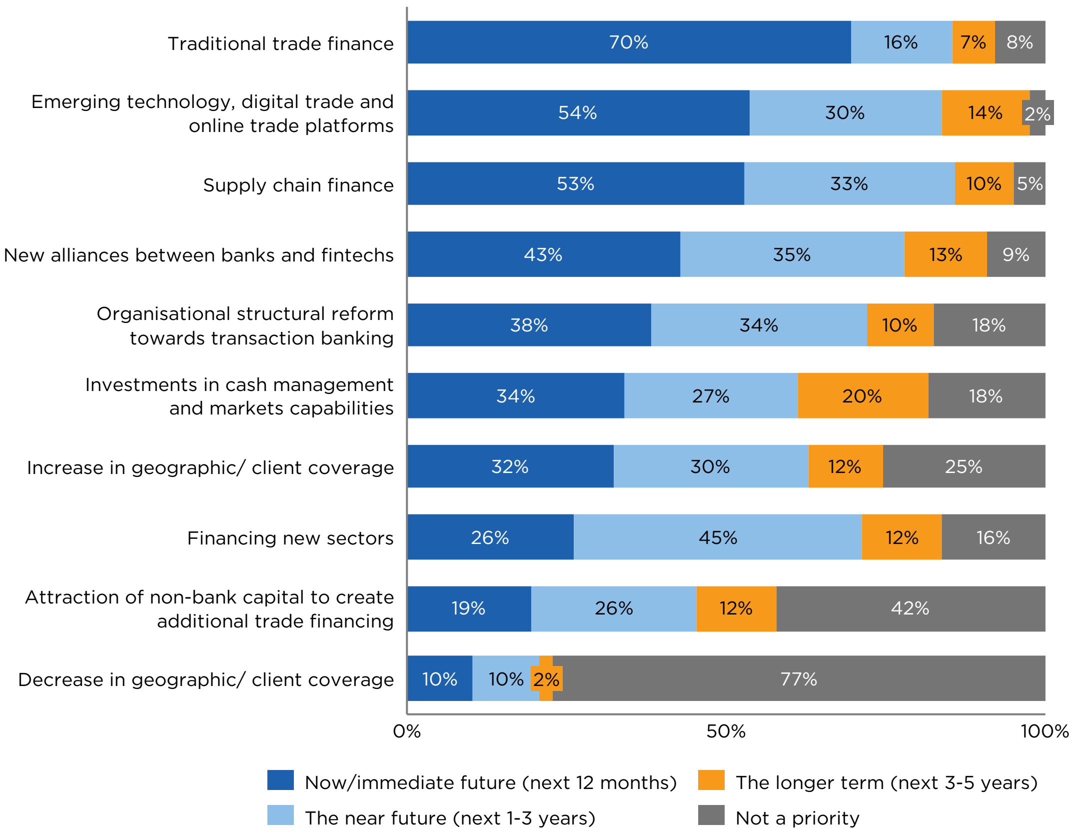
This suggests a disconnect between where banks are focusing and where the market is moving. Whether the gap is bridged by banks shifting their priorities to align with emerging client expectations, or by the entry of more non-banks into the trade financing market, remains to be seen.

84% of participants responded that digital solutions and platforms were either an immediate or near-future priority, confirming the widespread view that trade banks see digitisation as a key market force that will help drive further investment and participation in global trade.

Only 45% of respondents saw attraction of non-bank capital (i.e. asset distribution to third party investors) as a priority area for development. This is worth highlighting given the prevailing interest rate environment, the clear search among asset managers and other capital markets players for attractive investment alternatives, and the ongoing

Figure 8

Please indicate what you consider to be the priority areas of development and strategic focus for your bank



capital cost challenges faced by bank intermediated trade finance. The 'originate to hold' business model persists, as does the interbank asset distribution practice. However, indications are that there is an undercurrent of interest in exploring asset distribution alternatives, enabling technologies and the role of non-bank capital in increasing global trade financing capacity. The ICC has launched a Working Group – Institutional Investors in Trade Finance – to further explore and advance this aspect of the market.

A transition to digital is one of the most prominent themes seen in trade finance over the past few years and was a significant focus of this year's survey. Indeed, 36% of respondents expect either moderate or significant growth in the share of their trade finance business provided through digital ecosystems (Figure 10), rising to 55% for respondents from global banks.

While the vast majority of respondents (92%) indicated that only a minimal proportion of their trade finance business is conducted through Distributed Ledger Technology (DLT) or blockchain (Figure 9), there are indications that the market perceives opportunity in the application of DLT to trade and trade financing, as reflected in several DLT-based multibank consortia in the market. Other commentators, such as the World Economic Forum, have identified trade finance as an area where compelling DLT use cases can and should be developed.

This disparity in expectations and priorities linked to digital trade between global and other banks could be driven by the scale of investments that larger banks have been

Figure 9
What value of trade finance through DLT/ blockchain/ digital ecosystems has your bank provided in 2019?

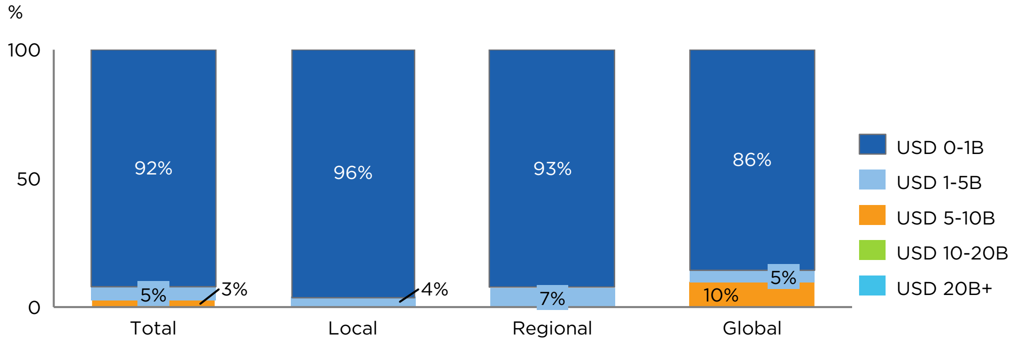
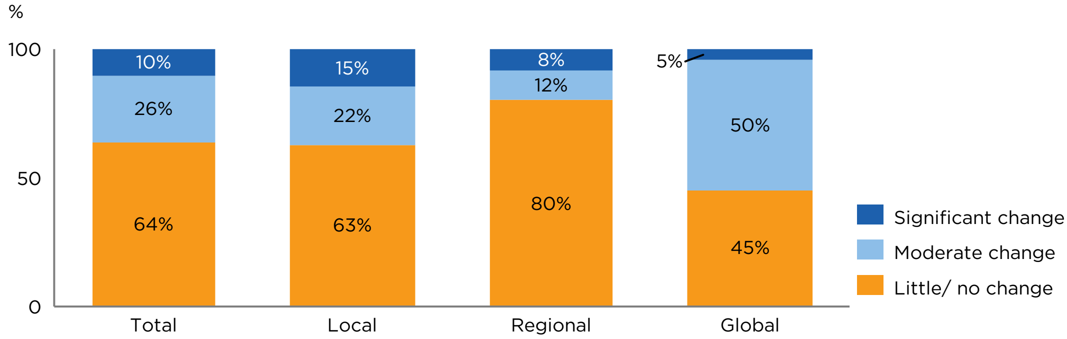


Figure 10
How do you expect this to change for 2020?



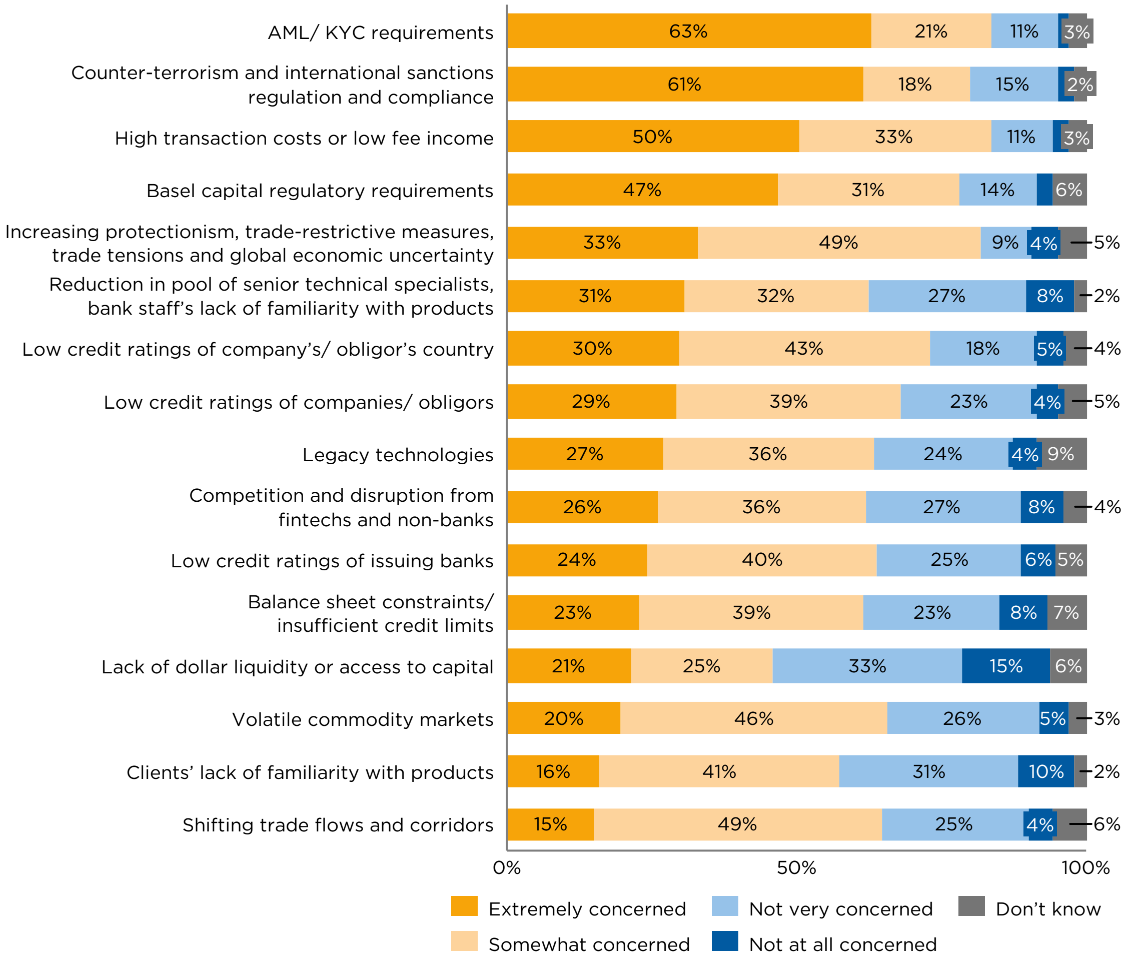
able to make in DLT, blockchain and digital ecosystems, and in turn the commitment to making these technologies a key part of the future of trade finance. The evolving imbalance in digital capabilities between global banks and others may lead to further consolidation and concentration in the trade finance market, unless regional and local institutions actively seek to retain their place in the financing of trade. It may also evolve that the rising tide of digitisation lifts all trade banks (and fintechs), as it combines with notions of open networks and complementary partnerships to reorient the landscape in trade financing.

Despite the survey pointing towards future growth and investment in trade finance, concerns persist about ongoing obstacles to expanding the trade finance arrangements of financial institutions. Of particular concern to banks is an increasingly complex and burdensome regulatory regime.

When asked about potential barriers to the growth of trade finance, participating banks overwhelmingly indicated concern about AML/ KYC requirements (with 63% extremely concerned) (Figure 11) and countering the financing of terrorism/ international sanction regulations (with 61% extremely concerned). In past editions of the Global Survey, AML/ KYC requirements have similarly been cited as the top growth-impeding concern of trade banks.

Regulatory and compliance expectations continue to be an overwhelming concern of banks in terms of growth prospects and the ability to generate additional trade financing capacity. The concern is not driven by any fundamental disagreement around

Figure 11
How concerned is your bank about the following potential obstacles?



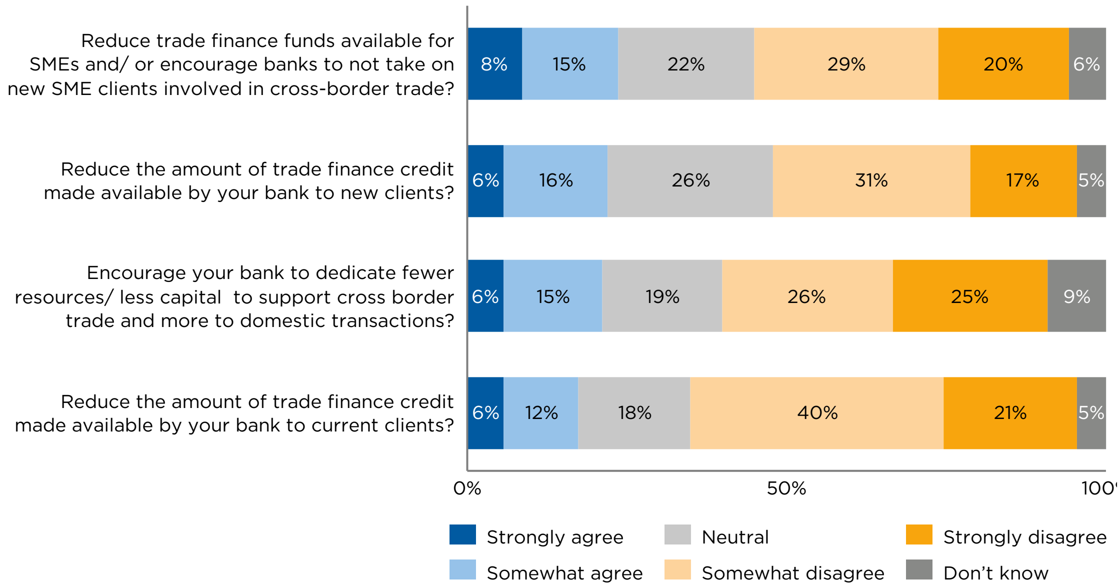
the objectives of regulatory and compliance expectations, but rather around the nature and scope of the role of banks in areas like AML/ CFT and around issues like cross-border inconsistency in regulation, as well as what are believed to be unintended adverse consequences on trade finance through regulation and compliance.

A combination of factors, such as increased feedback from financial intelligence units (FIUs) to industry, the use of enabling technology (Regulatory Technology or RegTech) and, where feasible, greater collaboration between industry and regulatory bodies can help achieve the shared objective of balancing effective regulation with access to trade finance.

Industry collaboration and government support, such as introducing shared KYC libraries and using Legal Entity Identifiers (LEIs) in AML, KYC, and other types of screening, can further help banks manage regulatory requirements. These solutions reduce duplication of effort and the degree of subjectivity in decision making, and they bring validated, verified data into the equation. In addition, projects such as the ADB's Trade Finance Scorecard: Regulation and Market Feedback can help stakeholders better navigate regulatory requirements in different jurisdictions, which have been shown to be a barrier contributing to the trade finance gap.

Looking beyond risk and regulation, 82% of respondents indicated that they were at least somewhat concerned by trade tensions and protectionism (Figure 11), likely driven by an escalation in trade tensions between the US and several jurisdictions, including China. Respondents appeared less concerned by the specific impacts this would have on trade finance (Figure 12). While this may appear counterintuitive given the adverse impact trade tensions have had on actual flows, the view of practitioners may be that tensions will lead to a restructuring of the architecture for trade – including global supply chains and trade corridors – but that trade will ultimately continue and will need to be financed.

Figure 12
To what extent do you agree/ disagree that existing or anticipated trade tensions will:



Talent Management

Over 50% of banks are finding it more challenging to attract trade finance talent in 2019 than in 2018 (Figure 13). The vast majority of banks are recruiting internally (Figure 14), with external sponsorships and initiatives proving less popular.

Attracting and developing the next generation of trade finance practitioners is a challenge that has been the subject of industry discussion for a decade or longer; while consolidation of the trade finance business helped redistribute capacity for a time, the issue is now systemic, it has spawned several industry initiatives including by BAFT, ITFA and the ICC through the Successors in Trade program to attract, train and retain transaction banking and trade finance specialists.

The changing nature of trade finance, and the availability of increasingly robust technology to effect compliance checks, document verification and other operational activities, will inevitably change the skill profile, demographic and character of human resources required to sustain trade financing capabilities in banks and in the wider market. It is also increasingly clear that long-term, incremental 'learn by doing' approaches favoured in trade operations units will not keep pace with the needs of the market, or with the career aspirations and expectations of the next generation of the global labour force.

Figure 13

Compared to 2018, how easy does your bank find it to attract trade finance talent?

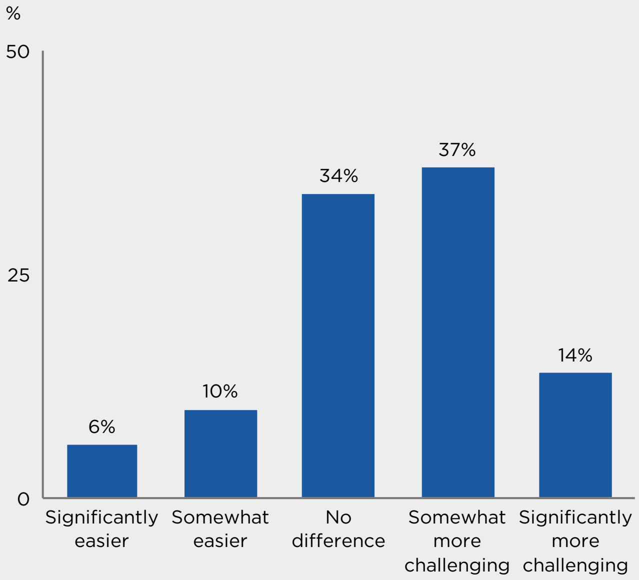
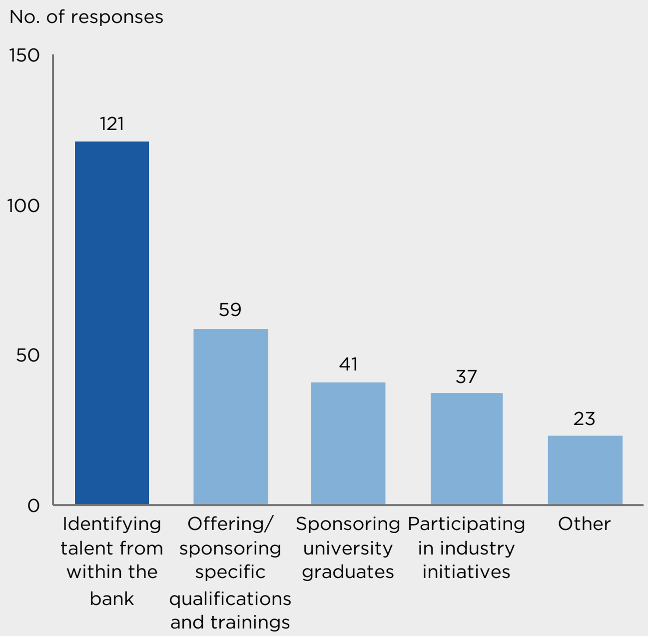


Figure 14

How is your bank attracting a new generation of trade finance staff?



FEATURE

Scenario analysis on the impact of COVID-19 on trade finance

Sukand Ramachandran, Managing Director and Senior Partner, Boston Consulting Group
Ravi Hanspal, Principal, Boston Consulting Group
Noah Mayerson, Associate, Boston Consulting Group

What does COVID-19 mean for international trade and trade finance?

While global trade remained at a near-record high of USD 18.1 trillion in 2019, the onset of the COVID-19 crisis is expected to dramatically impact both the world economy and global trade in the short-to-medium term. The headline-grabbing developments in recent weeks and months – tens of millions unemployed, record falls in stock indices, and unprecedented government intervention – speak to both how profoundly and quickly the virus has challenged the presumed strength of the global economy. And indeed, the positive growth trajectory in global trade over the past decade will doubtlessly be disrupted, as well.

The ultimate impact of COVID-19 on international trade will depend on the scale and duration of the pandemic itself and on the various governmental and policy interventions intended to mitigate the economic crisis. While difficult to predict the precise economic impact of the pandemic, we believe that three scenarios for economic output are plausible, each with different implications for international trade (Figure 15) and trade finance revenues (Figure 16).

Scenario 1: We assume a moderate 3-to-6-month downturn, with a V-shaped recovery into 2021 that sees the global economy quickly return to its pre-crisis growth path. This more optimistic scenario would only likely have been achieved if COVID-19 were brought under control by most major economies by the middle of 2020; given the progress of the pandemic at the time of publishing, this unfortunately no longer seems to be a realistic outcome. In this scenario, we estimate that the fall in global trade for 2020 will be around 11%, and that it will return to its 2019 value by 2021, going on to reach nearly USD 27 trillion by 2028. We would also expect trade finance revenues to drop from USD 46 billion in 2019 to USD 40 billion in 2020 – growing on average at 4.1% per year until 2028.

Scenario 2: We assume a deeper 6-to-9-month downturn with a slower V-shaped recovery (approaching a U shape) into 2021. This implies that by end of Q4 2020, most major economies will have reopened and some form of economic business-as-usual will have returned. We consider this scenario the most likely. In this scenario, we estimate that global trade will decline by 21% in 2020 and only return to its pre-crisis levels in 2024. Given this less bullish scenario, we would expect trade finance revenues to decrease to USD 36 billion – the lowest level in over a decade – subsequently growing by 1.5% per year until 2028.

Scenario 3: In this scenario, we assume a deep widespread shock lasting more than a year with an L-shaped recovery that leaves economic growth at a lower trajectory over the long run. This would become a distinct possibility if COVID-19 (and the associated lockdowns and declines in economic output) persist throughout 2020 and/ or if the virus returns in the winter of 2020/ 2021. If this were the case, we project that international trade will decline by 30% in 2020, rising to just USD 15 trillion by 2028 – far below its pre-crisis value, and approaching levels comparable to those seen at the peak of the 2008 global financial crisis, which was arguably less severe than COVID-19 yet still required over a decade of recovery time.

At the time of publication, the likelihood of second and third waves of COVID-19 is increasingly part of the medical and economic discourse, as is the probability of additional mutations, linked directly to the loosening of restrictions, even controlled degrees of return to work, and the gradual return of travel across local and international borders. The behaviour of pockets of population flaunting physical distancing and limitations on large-group gatherings presents a serious concern. Taken together, these factors present a significant risk that may increase the likelihood of Scenario 3 developing.

This independent analysis largely mirrors the April 2020 projections of the World Trade Organization, which estimated global trade to decline by anywhere from 13% to 32% in 2020.

Implications for trade finance

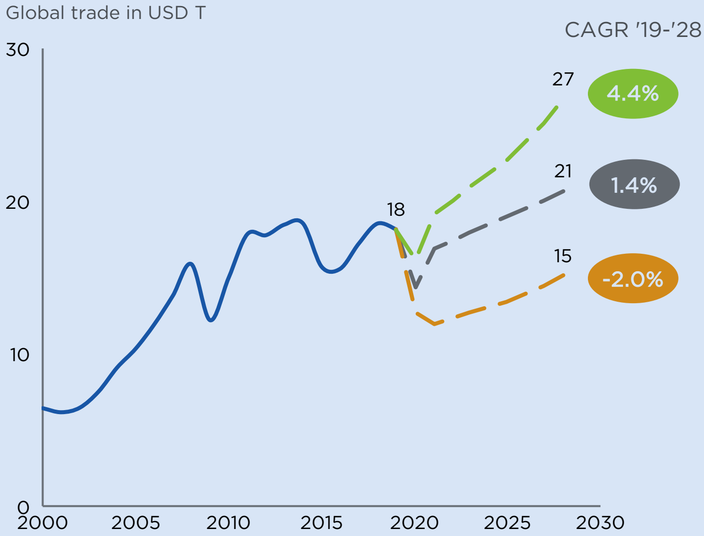
The declines in trade finance revenues projected across the three scenarios are clearly driven in part by a wider slowdown in global trade, which will consequently reduce the demand for trade finance products. However, declines in trade finance revenues will not necessarily directly correlate to declines in the world economy or global trade. Trade finance earnings, particularly from the usage of documentary trade products, have a small element of counter-cyclicality that soften the impact of economic and financial downturns.

As credit quality declines and the global risk environment worsens, it is normal to find that the cost of risk mitigation solutions rises; this will in part counter the anticipated reduction in transaction volumes and will contribute to offsetting declines in trade finance-related revenue.

Products like letters of credit and bank guarantees, which

Figure 15

BCG Trade Finance Model, estimated global trade flows, 2000-2028



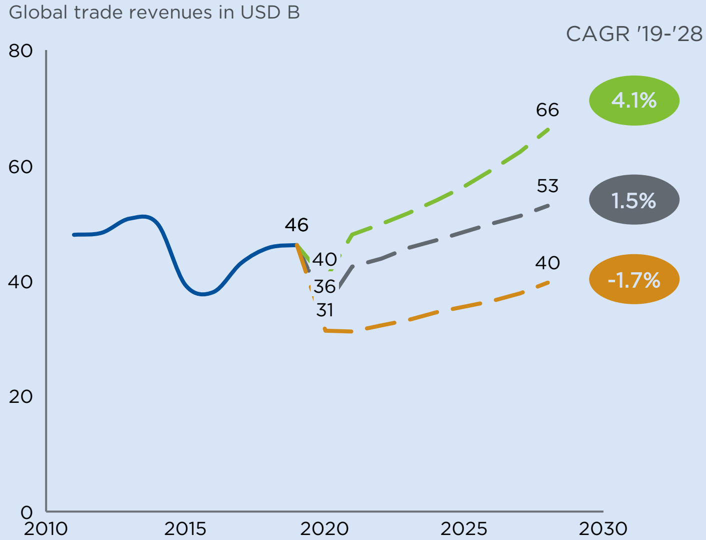
Source: BCG Omnia Global Trade Finance Model 2020

These analyses represent only potential scenarios based on discrete data from one point in time (06 April 2020).

They are not intended as a prediction or forecast, and the situation is changing daily.

Figure 16

BCG Trade Finance Model, estimated global trade finance revenues, 2011-2028

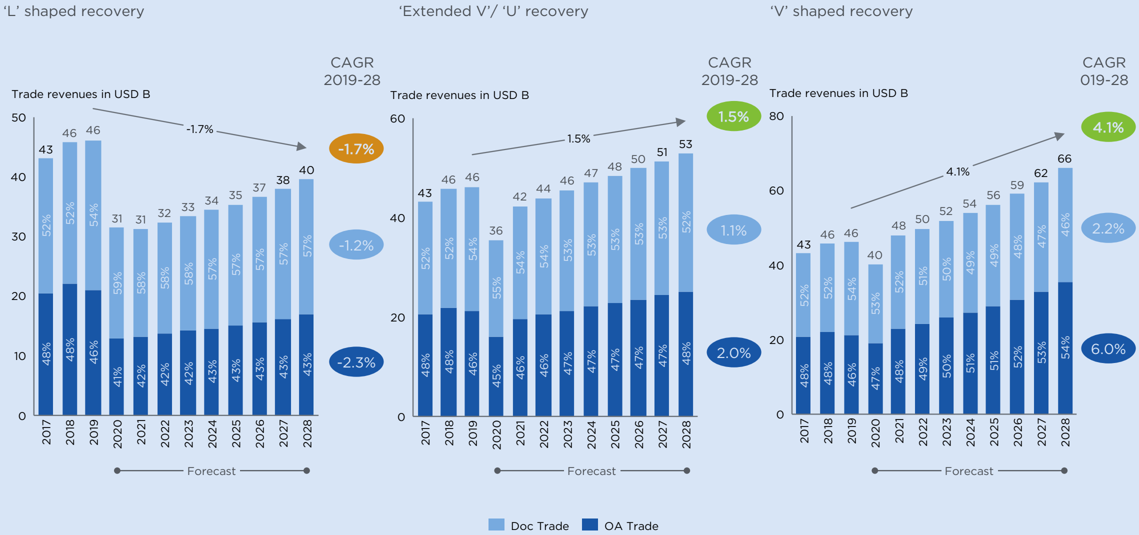


Source: BCG Omnia Global Trade Finance Model 2020

These analyses represent only potential scenarios based on discrete data from one point in time (06 April 2020).

They are not intended as a prediction or forecast, and the situation is changing daily.

Figure 17
BCG Trade Finance Model, estimated share of documentary trade vs. open account, 2011-2028



Source: BCG Omnia Global Trade Finance Model 2020

These analyses represent only potential scenarios based on discrete data from one point in time (06 April 2020). They are not intended as a prediction or forecast, and the situation is changing daily.

command higher margins than open account trade products, will likely grow in popularity given their reputation for risk mitigation. As such, we expect a temporary shift toward documentary trade across the three scenarios, with the shift increasing as the scenarios worsen (Figure 17).

A decline in trade finance revenues and the reduced usage of open account trade products are not the only expected impacts of the pandemic on trade finance. Given the widescale economic disruption we expect a sharp rise in trade finance defaults, especially among SMEs (though we also anticipate that despite this rise, relative to other banking products, trade finance will still be seen as low risk).

Optimistically, the crisis may also help to hasten the shift toward digital solutions in trade. As discussed later in the survey, banks have struggled to navigate a system reliant in part on paper-based documentation in a world under lockdown. Industry and regulators may emerge from the crisis determined to do away with the anachronistic and inefficient system of paper-based trade.

For more information, please see the extended article 'State of the Market' in the ICC Trade Register.

The COVID-19 situation is rapidly evolving, on a daily basis. This article represents a number of scenarios based on discrete data from one point in time (early April 2020). It is not intended as a prediction or forecast about the duration of lockdown, peak of viral infections, efficacy of government or health care responses to the virus, or other health or societal impacts, and it does not represent an 'official' BCG view. It also does not constitute medical, legal or safety advice, and is not a critique, endorsement or recommendation of a particular response. As such, you are advised to use this document as general guidance only in making your own continued assessments as to the appropriate course of action, taking into account local laws, rules, regulations, and orders.

FEATURE

The economic impact of COVID-19 on supply chains

Krishnan Ramadurai, Chair, ICC Trade Register
Ravi Hanspal, Principal, Boston Consulting Group

We would like to acknowledge Zoltan Pozsar and James Sweeney for their original publication 'Covid-19 and Global Dollar Funding', that introduced some of the concepts discussed in this article in the context of COVID-19

As COVID-19 spreads globally and we begin to manage the immediate-term health crisis (ventilator supply, ICU capacity, access to PPE and the like), our attention has increasingly shifted to the economic crisis at hand. Given the global reach of the pandemic, a common topic for thoughtful commercial and policy consideration is the impact on global supply chains, pressured from both 'supply' and 'demand' side challenges.

What will the shutdown of industrial production and services mean for output? What will billions being placed into self-isolation and banned from working, socialising, travelling and, in many ways, spending, do to demand? And, what impact will such shocks have on financial markets, bank lending and global liquidity?

What do we mean by supply chain?

A supply chain is the interconnected transfer of value from one party to another as part of an end-to-end manufacturing process, often across multiple geographical borders, and commonly involving an ecosystem of hundreds, perhaps multiple thousands, of commercial enterprises – domestic or international. At each stage of the supply chain, there is an input, a 'value add', and an output, with the distribution of these varying materials across stages. A prime example is in the electronics industry: the supply chain may start in Asia with intermediate producers in South Korea and Chinese Taipei supplying goods to China, where the final assemblers add their value to the goods and ship them to various destinations such as the US, Europe, South America, or elsewhere in Asia.

Supply chains are increasingly viewed as being composed of at least three concurrent and complementary layers:

- A physical supply chain, involving the production and movement of goods and services
- A financial supply chain, involving the movement of money, financing and risk mitigation as well as related transfers of ownership, plus the aforementioned value-add
- A data and information supply chain, increasingly powered by technology, such as remote sensors, complex financial and logistics systems and others that can provide extensive, near real-time insight into the state of a transaction and a shipment

To help visualise the transfer of value – which relates directly to payment flows – along the electronics supply chain, we have used a sequential chain (Figure 18), but supply chains can be highly complex in reality, with components commonly crossing the same borders multiple times over the course of a production process.

Fundamentally, goods move from seller to buyer and payments from buyer to seller. If one link 'breaks' – through a stall in output or a stall in payment – the supply chain no longer works, and all players face consequences. As value is added at each stage of the production process, the health of the financial supply chain becomes increasingly critical to completion and delivery, driving demand for a range of trade financing solutions aimed at mitigating risk and ensuring adequate cash flow and working capital in the supply chain. Trade finance is, in this way, the oil in the engine of global commerce.

Figure 18
Sample electronics supply chain

Stage 1 Producer 1	Stage 2 Producer 2	Stage 3 Final assembly	Stage 4 End destination
South Korea	Chinese Taipei	China	USA

	Stage 1	Stage 2	Stage 3	Stage 4
Input	5	10	20	30
+ Value add	5	10	10	10
= Output	10	20	30	40

Value add decreases as proportion of input value from **immediate suppliers to final assembly to end destination**

What is the impact of COVID-19 on supply?

On the supply side, COVID-19 first truly hit supply chains by the mandated shutdown of production capacity in China, which was soon replicated across the world.

As production shuts down and disables critical components of the supply chain, gaps turn into problems. Inventories of raw materials and finished goods build up, and staff are laid off. Transport and logistics start to seize-up, compounding the problem by slowing down any limited remaining production and delivery capacity.

Soon, with no goods coming in or out, payments are delayed and missed along the supply chain. Delayed or missed payments will mean that intermediate suppliers will need to meet wages, fixed overheads such as rent, and debt servicing costs from either internal cash reserves or by drawing-down on bank credit lines. Alternatively, they may be able to extend payment terms to their suppliers, but this effectively means transferring the risks down the supply chain. The ability to extend payment terms is a function of the bargaining power the buyer can exercise over the seller. Suppliers down the supply chain will typically be squeezed the most. The impact will be disproportionate, as small and medium enterprises far down the supply chain will have the least bargaining power or external funding options and will also feel the cash flow strains quicker than large corporates.

Although trade finance practitioners are increasingly working to solve the ‘last mile’ financing challenge in international supply chains, and although payables finance programs can offset some of the adverse cash flow impact of extended payment terms, such programs are most commonly available to larger suppliers collectively representing the most significant 'spend' by the buyer. Small suppliers that are considered strategic to the smooth functioning of a supply chain may be the exception, as well those with unique product characteristics or intellectual property that cannot be easily replaced. This dynamic contributes to the reasons why payables finance programs must be appropriately structured, managed and reported upon, and must be thoughtfully deployed across international supply chains. The COVID-19 crisis has provided stark illustrations of supply chain vulnerability in medical equipment and agri-food, among others, with multilateral institutions having to step in quickly and decisively to shore up critical supply chains.

The susceptibility of a specific supply chain will vary depending on five key factors:

- **Industry:** The complexity of supply chains varies materially by industry. The automotive, electronics and telecommunication industries rely on many different component manufacturers, and their end production is dependent on all of these coming together seamlessly. In addition, these industries often are geographically concentrated, with a large proportion of manufacturing in China. The combination of China as an anchor to many global supply chains, and the same country being the source (though no longer the epicentre) of the pandemic outbreak, has directly shaped the impact of COVID-19 on trade flows, and has amplified calls for more agile (and in some cases, reconfigured) supply chains that had been loudly heard in the context of pre-COVID-19 trade war rhetoric. Certain firms are known to actively counter the trend in automotive supply chains: fewer but more intelligent parts, and fewer suppliers, mean that the overall supply chain is simpler and easier to manage.

- **Terms of trade:** The greater the disparity in bargaining power between buyers and sellers, and the smaller the concentration of buyers to suppliers (or vice versa), the less resilient the supply chain will be. The Japanese earthquake and tsunami in 2011 exposed the dependence of Japanese car manufacturers on OEM suppliers to their factories located in the US, as well as the critical importance of a particular Japanese supplier to a US technology giant's supply chain and production capability.

- **Value addition:** Supply chains characterised by higher value addition at each stage will be impacted more than supply chains where value addition is modest or incremental, as the risk is less concentrated in the latter scenario. The garment sector will typically experience a more muted impact than sectors such as electronics and automotive. This is because intermediates depend more heavily on payments flowing through these high value-added supply chains, and therefore experience more immediate and adverse impact in the event of a disruption in payment flows.

- **Supply chain strategy:** As supply chains have become leaner and leaner, there has been less and less slack in the system: fewer resources on standby, less contingency stock, no more buffers in delivery timelines. While this can cut costs, it also means that at times of disruption, impacts are seen immediately and may become more difficult to address, as has been observed during the COVID-19 crisis. As a result, some of the most tightly operated supply chains may be the first to face trouble.

- **Leverage:** As supply chain finance (specifically payables finance) has grown in popularity, supply chains have become increasingly leveraged. As a result, individual firms within the ecosystem have become less disciplined in maintaining their own healthy working capital, resulting in potentially smaller cash reserves at a time of crisis.

What will happen to demand?

Inevitably, supply-side shocks are being accompanied by demand-side shocks caused by widespread production and service sector shutdowns, coupled with lockdowns restricting the movement – and ability to work – of billions of people, goods, and services. Consequently, discretionary consumer spending is likely to collapse.

This will be further exacerbated by the fall in financial markets and the 'dash for cash' as reflected in the indiscriminate selling of financial assets, which results in declining household wealth and falling consumption. Even households not directly impacted will become cautious – with growing uncertainty over jobs, investments, and pensions – translating into less spending.

Understandably, the decline in demand will be felt most acutely in sectors such as travel, and in some areas of the services sector, due to the direct impact of forced shutdowns and border closures. Given the increasing importance of the services sector and its contribution to country GDPs, the fall in demand will have an adverse knock-on impact on reported GDP numbers.

This will no doubt be accompanied by a decrease in demand for goods as the drop in the service and travel sectors ripple across supply chains such as those for food and beverages for bars, restaurants, and hotels, fuel for aviation, and many others. This will be amplified as consumers delay major purchases and travel, local commutes reduce drastically due to lockdown, and businesses – even entire sectors – face a difficult recovery post-lockdown.

At an institutional level, this decline in demand can quickly translate into falling revenues and forced extension of payment terms for suppliers. When coupled with the need to meet fixed costs, pay wages, and service debt, internal cash flows can come under strain, resulting in drawdowns of credit lines at banks – just as we are seeing from the shutdown in supply.

The devastating demand-side and supply-side impacts of COVID-19 build upon each other and reinforce a cycle of crisis as each side of the market wrestles with existential risk in an environment with perhaps no parallel from which to draw helpful lessons and insight.

What does this mean for businesses financially?

As discussed, at an institutional level a shock in supply and demand will translate into missed and delayed payments. If these missed and delayed payments accumulate, and are overlaid with a need to meet salaries, fixed costs and debt payments, then internal cash flows are likely to come under substantial strain. Institutions will have two choices: either they extend payment terms to their suppliers, or draw down available credit lines from banks.

While drawdown of bank credit lines is essentially a function of a bank's assessment of an institution's ability and willingness to repay loans and the bank's appetite to take on more risk exposure, the ability to extend payment terms is a function of the terms of trade and the bargaining power the corporate has over its suppliers.

Looking back at our example from the electronics industry, intermediate suppliers in Korea, Chinese Taipei and final assemblers in China could lean on big technology companies with large cash surpluses for early payment or direct cash funding. We are already seeing some firms accelerating payments to European suppliers, paying them within 15 days. While this will provide some back-stop relief for suppliers, this is not a permanent solution.

With capital markets in a swoon, accessing the commercial paper, bond and equity markets would no longer be a viable option for large and medium-sized corporates under normal circumstances. In addition, SMEs that are typically wholly reliant on banks would also find themselves in a 'no win' situation, assuming banks would want to limit exposures. As such, the crisis calls for extraordinary measures and government intervention to ensure that credit continues to flow and support real economic activity – which is exactly what is happening.

Indeed, in the US the Treasury Department and Federal Reserve have launched a series of financing programmes under the new CARES Act (Coronavirus Aid, Relief, and Economic Security Act), including the Primary Market Corporate Credit Facility and Main Street Business Lending Program. Similar programmes are seen elsewhere, including CBILS (Coronavirus Interruption Business Loans Scheme) in the UK to provide government-backed lending to small businesses.

What does this mean for the banking system?

A key obvious risk for the banking system in such a crisis is the likelihood of increased defaults, as the health of corporates and small businesses starts to deteriorate, and they can no longer service their debt. While this may be, in part, softened by government intervention, the majority of government programmes are focused around providing and backing new lending – but not necessarily preventing default on existing facilities.

However, an additional key risk to consider – particularly around the theme of supply chains – is liquidity. As USD is the major invoicing currency for global trade in goods and services, the risks at a bank level are essentially related to USD funding and the ability for banks to provide this funding.

As supply-side shocks intertwine with demand-side shocks, corporates will draw down internal cash surpluses in the first instance, and credit lines in local currency (LCY) and foreign currency (FCY). While LCY funding should not be a major issue (central banks can print local currency to meet any sharp increase in demand), banks will need to fund USD loans from their stock of USD deposits. For banks that are structurally short on USD, they will need to borrow in the inter-bank market from USD surplus banks which often tend to be the US banks. In addition, countries under US sanctions will face amplified issues due to restricted access to USD funding.

As corporate USD cash surpluses in banks gets drawn down there is a knock-on impact for banks, which puts pressure on their Liquidity Coverage Ratios (LCR), as these withdrawals raise the denominator of the LCR ratio, forcing banks to increase their stock of high-quality liquid assets (HQLA), the numerator of the LCR ratio. The ability to reduce outflows for banks in this situation is limited.

The inter-bank market is a source of liquidity in good times. However, as liquidity is fragile in a crisis, it can act only as a temporary backstop, and banks needing USD funding on a continuous basis will need to get their funding from alternative sources. These alternatives, using our stylised example of the electronics industry, will be the local Taiwanese and South Korean banks, that will fill the gap left by the Japanese banks, which are the traditional lenders of USD in the electronics supply chain.

This switch in funding sources has the potential to redistribute cross-currency funding pressures from a USD/ Yen basis, USD/ Korean Won basis or USD/ Taiwanese Dollar basis. The knock-on impact of these pressures will flow through in the earnings of these banks, as banks in South Korea and Chinese Taipei cannot raise USD as cheaply as the Japanese banks.

Given that Japan, South Korea and Chinese Taipei dominate the 'value add' share of the electronics supply chain that runs through China, USD liquidity will be more at risk in these geographies than in China. If the cascade of requests to draw down credit lines and in particular USD loans becomes a systemic issue, then it can translate into a depletion of USD reserves at local central banks and in turn drain excess reserves at the US Federal Reserve.

Using China as an example, in the case that local banks are swamped with a drawdown of USD deposits their natural port of call will be the People's Bank of China. In turn, the Chinese central bank – as it keeps a part of its FX reserves in FX swaps where they lend USD in exchange for Euros and Yen – will now need to flip this around and unwind these swaps, effectively becoming USD borrowers rather than lenders. This means dealers in London and Hong Kong will need to find alternative sources of USD to match their books. As in normal times most of these dollars were used to fund carry trades, this switch has the potential to transmit local imbalances globally.

In the unlikely event the Chinese central bank exhausts its dollar liquidity in cash markets like the FX market described above, then the bank will either repo or sell its treasury portfolio to fund the dollars required. The central bank will, however, not approach the US Federal Reserve to tap swap lines as, unlike several other central banks (e.g. Japan, UK, Europe and Switzerland), the Chinese central bank does not have swap lines with them.

In essence, a cascade of USD drawdowns has the potential to create stress in USD liquidity:

- In peripheral cross-currency markets (e.g. TWD/ USD) as missed payments grow
- In EUR/ USD and USD/ Yen currency markets as reserve managers stop lending in the FX swap market to help their local banks and the banking system deal with USD outflows in their jurisdictions
- Insofar as USD Libor-OIS spreads grow, as banks start to remedy their LCR ratios to counter the outflow of operational deposits and the drawdown of credit lines

Concluding thoughts – selected policy considerations

This brings to mind a number of considerations for potential policy interventions:

- Expand USD swap lines to countries currently with no access to these swap lines. This effectively means going beyond the 14 countries that currently have access to these swap lines.
- Multilateral Banks raise USD funding from Global Capital Markets which can then be used as a source of liquidity to fund Trade Transactions through targeted lending programmes.
- Relax LCR and Net Stable Funding Ratio (NSFR) with a view toward channelling USD liquidity to where it is needed most.

COVID-19 Survey analysis

The optimistic results from the Global Survey demonstrate a clear desire by banks to grow their trade finance businesses, reflecting an underlying confidence in commercial prospects, trade flows, and general geopolitical stability. However, many respondents completed the survey before COVID-19 moved from a localised threat in China and South East Asia to a global pandemic. As a result, we expect sentiment toward trade finance to be more cautious in the short-to-medium term.

To supplement the Global Survey, the ICC Banking Commission launched a short additional survey specifically aimed at understanding the initial impact of COVID-19 on trade finance. The findings reflect market views as at early April 2020.

The COVID-19 Survey had 233 respondents, and the participating bank profile was somewhat different from that of the Global Survey, with 49% from local, 28% from regional, and 23% from global banks (Figure 19). The largest number of responses were received from banks headquartered in Central and Eastern Europe (39%), Western Europe (20%) and Asia Pacific (17%) (Figure 20).

Responses across geographies and bank types were broadly similar, except where highlighted otherwise.

Overall, banks from all geographies are already noticing the impact of COVID-19 on trade flows, with 34% suffering a 0-10% drop in trade flows versus expectations in Q1 (Figure 21). A further 37% indicated that their trade flows declined from 10-30% in Q1. Only 16% of banks suffered greater than a 30%

Figure 19
What type of bank is your bank?

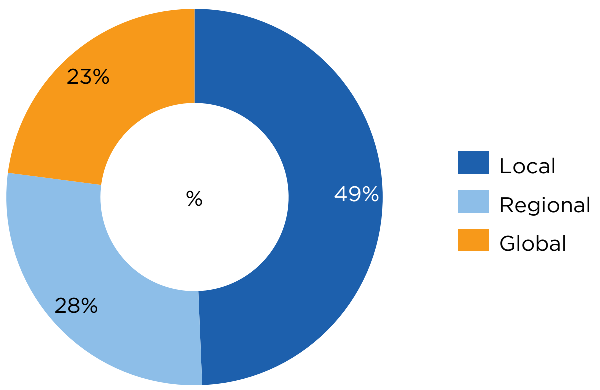
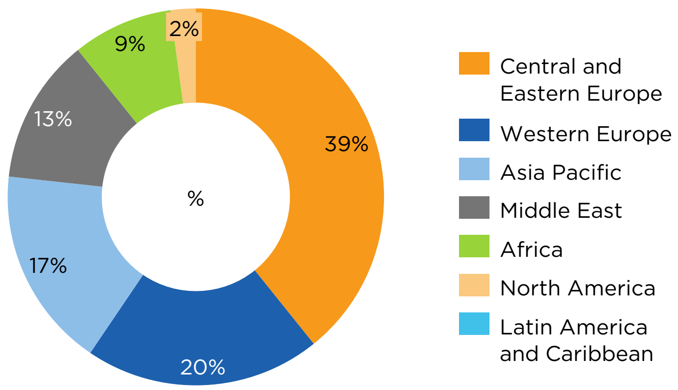


Figure 20
Where is your bank headquartered?



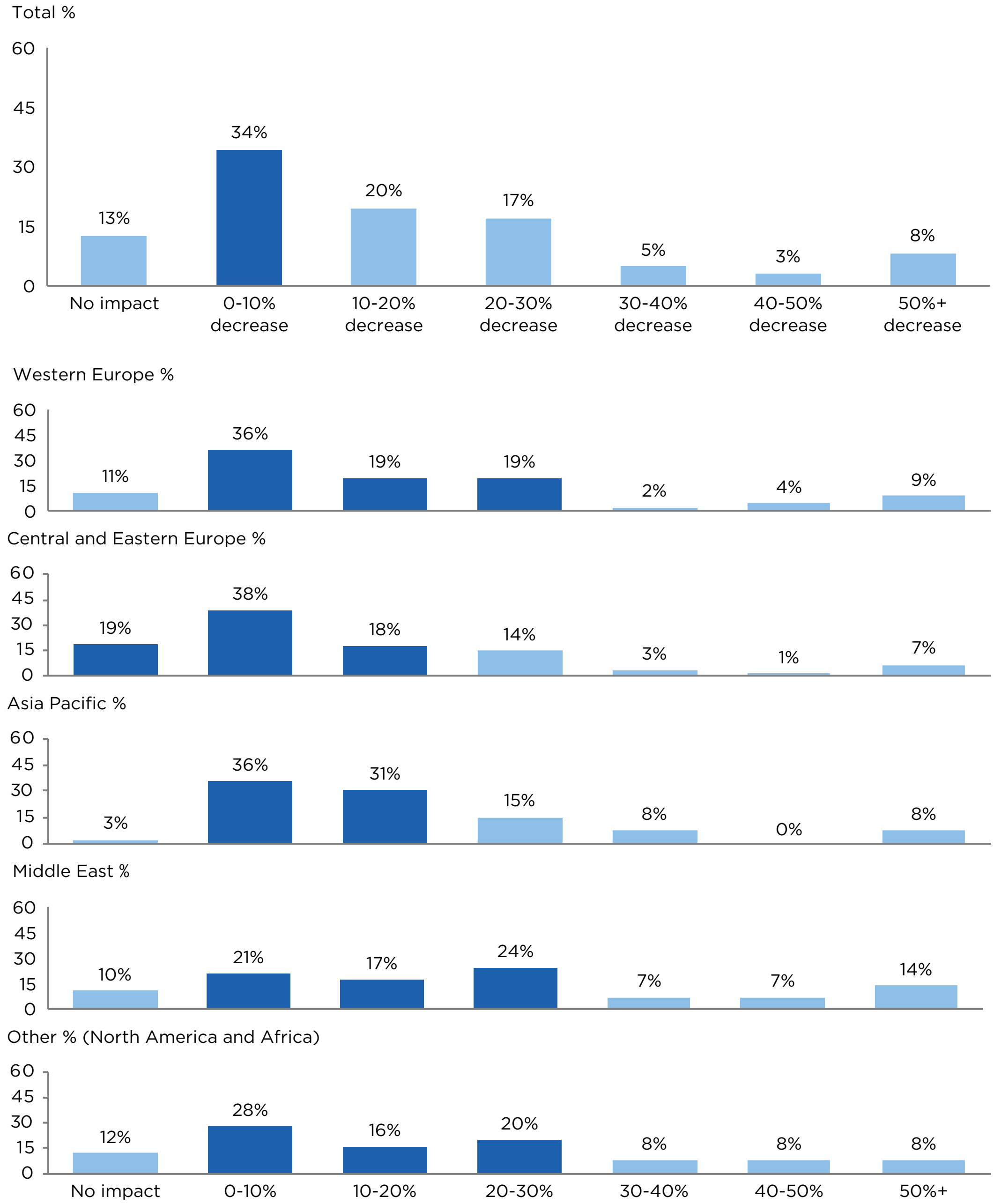
decrease, although this may be because the impact on trade in most markets was more subtle towards the beginning of the quarter.

Results did not diverge materially across markets or categories of banks responding to the survey. Even in APAC, where the impact on trade flows might reasonably have been expected to be worse given proximity to China, 36% reported only a 0-10% decrease in Q1 trade flows.

Looking ahead to the rest of 2020, banks expect a more significant impact on trade flows as COVID-19 continues to shut down economies, reduce consumer spending, and bring businesses of all sizes to the brink. In 2020, 28% of banks expect a 20-30% hit to the trade flows they support (Figure 22), a further 25% anticipate a 10-20% reduction, and 15% expect a 30-40% decrease. This largely dovetails with the projected impact on global trade flows outlined above (Figure

Figure 21

How has COVID-19 impacted your Q1 trade flows versus expectations?



15) from BCG's Trade Finance Model, which estimated an 11-30% decrease in global trade flows as a result of COVID-19 across three different scenarios. Assessment from the WTO (April 2020) suggests a COVID-related reduction of trade flows in the range of 13-32%.

Across regions, the results are largely similar, except for the Middle East where 24% of respondents expect a decrease of 50% or more in 2020 trade flows (and a further 20% expect a 30-50% reduction). The view from the Middle East is likely influenced by the state of oil prices and petroleum exports, as a region heavily dependent on oil exports is seeing oil prices and volumes drop to some of the lowest levels in recent memory, for reasons only partly related to COVID-19.

Respondents indicated that a range of geographies and commodities are expected

Figure 22
What does your bank anticipate to be the COVID-19 impact on 2020 trade flows?

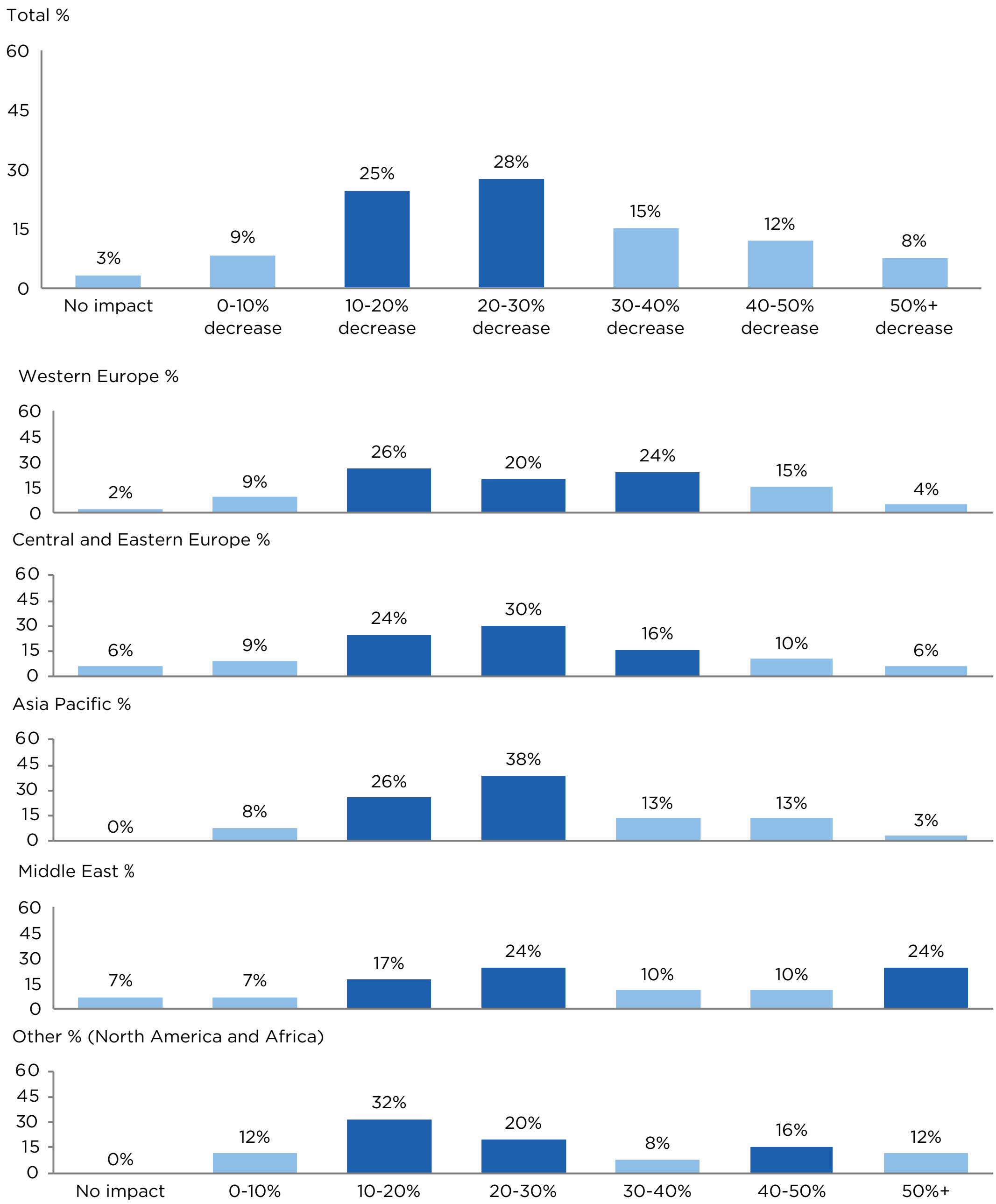
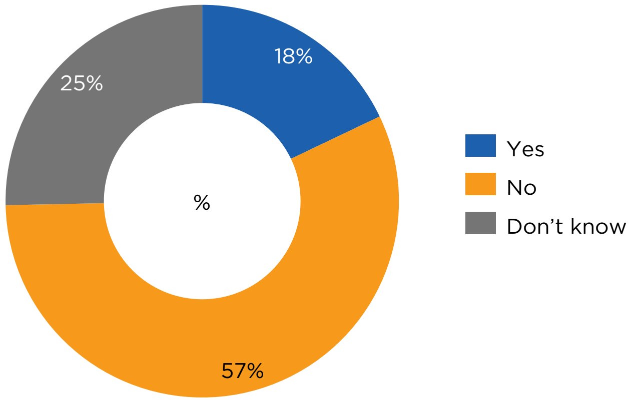


Figure 23
Have you seen any noticeable rise in trade finance defaults owing to COVID-19?



to be impacted by COVID-19. However, retail, travel and tourism (including airlines and hotels), automotive, and, in particular, oil, were cited by many respondents as the most likely sectors to see significant disruption.

We also asked banks if they have seen any noticeable rise in trade finance defaults as a result of COVID-19. As of early April, 57% of respondents had not witnessed an increase in defaults, while only 18% reported that they had observed an increase in defaults (Figure 23).

It is, however, too early in the crisis to properly assess the resulting default situation. Several factors must be taken into account:

- The tenor of traditional trade finance, as well as the maturity timeframes for techniques like payables finance, often exceed 90 days; instances of default, if they arise, would not yet have been discovered.

- Default status may be reached by crossing a timeframe defined by regulatory standards and may therefore be reached as a 'technical' default without reflecting commercial or transactional reality.

- Measures aimed at mitigating the adverse effects of the COVID-19 crisis are under assessment and consideration, and may include, as a matter of government and public policy, the creation of temporary loan extension or forgiveness measures.

- Trade obligations, particularly those related to strategically important flows like agri-food, commodities, defence spending and others, have tended to be given priority in settlement. Such action may prevent technical or even probable defaults from occurring in the end.

Industry leaders and ICC will carefully monitor the evolving state of trade obligations as a critical element of managing the COVID-19 crisis and will work to proactively devise mitigation strategies with authorities where appropriate. It will be difficult to avoid a global, systemic liquidity crisis. The key will be the nature, decisiveness and speed of a coordinated response across jurisdictions, and in this context, multilateralism will again demonstrate its value despite its acknowledged imperfections. Further, the ICC Trade Register will play an important role in providing robust data, analysis and advocacy as the default picture takes shape.

Given the sharp decline in trade flows anticipated by the responding banks, it is more important than ever that both financial institutions and public bodies think creatively to help facilitate global trade and mitigate any barriers created by COVID-19. However, the Survey reveals mixed perceptions in this area, with individual banks taking the lead on implementing new measures and solutions to support their customers, while other key players in the trade ecosystem may need to accelerate their response to the crisis.

As with the global financial crisis of 2008, international bodies, multilateral development banks, and some export credit agencies have responded quickly. Equally encouragingly, the Basel Committee promptly provided direction aimed at reducing capital pressure. Other agencies of public and international policy are understandably preoccupied with urgent health and public safety priorities; the ICC and industry partners are working judiciously to ensure that messages related to the importance of trade and trade finance, the imperative to support SMEs, and the urgent need to safely reopen the global economy are thoughtfully communicated.

When we asked responding banks if they have implemented any measures to support their customers through the COVID-19 crisis, 72% – across the various bank profiles – indicated that their banks have done so (Figure 24). Dozens of respondents indicated that they were extending financing terms such as loan maturity dates and repayment schedules.

Many also indicated that their banks had stopped collecting interest on their trade finance facilities for periods extending out to nine months and had stopped charging customers bank fees. A few respondents credited their central banks with the deployment of new policies and programs aimed at supporting business, with such measures seen as providing important additional impetus to the initiatives taken by the banking sector.

In terms of customer uptake of these measures, many respondents noted that, while early, customers have responded quite positively. One respondent noted that the "demand to structure loans was high," while another said that "customers have responded very favourably and with appreciation" to the new measures. However, one bank respondent mentioned that they had seen "more requests for Confirmation of L/Cs from exporters who normally didn't [request them] before the crisis". This is not unexpected, and reflects the reality that risk is a function of both objective fact and perception. Such an observation also highlights why trade finance techniques and mechanisms have proven their mettle over hundreds of years, enabling trade to flow securely even under the most challenging conditions.

A key question, however, is to what extent will these measures suffice in the medium term? Trade banks are accustomed to trade finance being a low-risk product. However, should the risk dynamics of trade be completely overturned as importers' and exporters' cash reserves are depleted amid the COVID-19 crisis, more substantial intervention will be required, including government grants and growth in government-backed export credit agency funding. Should a worse-case crisis scenario develop, concerns will reach across jurisdictions and the global financial and economic system and will demand coordinated mitigation measures. In such an eventuality, the advocacy dimension of ICC's work, and ICC's unique, trusted, and authoritative position with organisations like

Figure 24
Has your bank put in place any measures to support customers impacted by COVID-19?

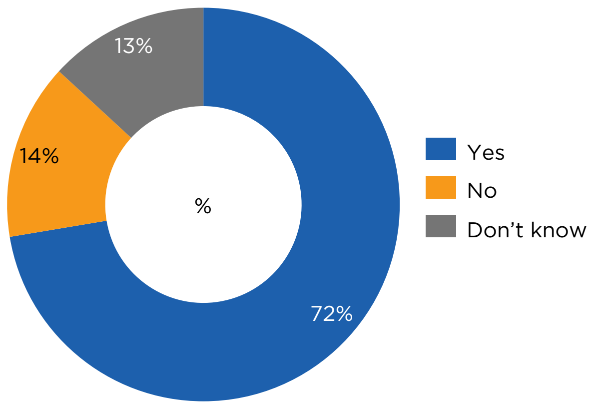


Figure 25

Has your bank rolled out any new digital solutions specifically to mitigate the disruption caused by COVID-19?

the UN, the WTO, the G20 and others will be brought sharply into focus.

ICC has already responded with unprecedented speed in developing communications, tools and program recommendations in the context of COVID-19 and continues to work on such initiatives, including in support of trade and trade financing.

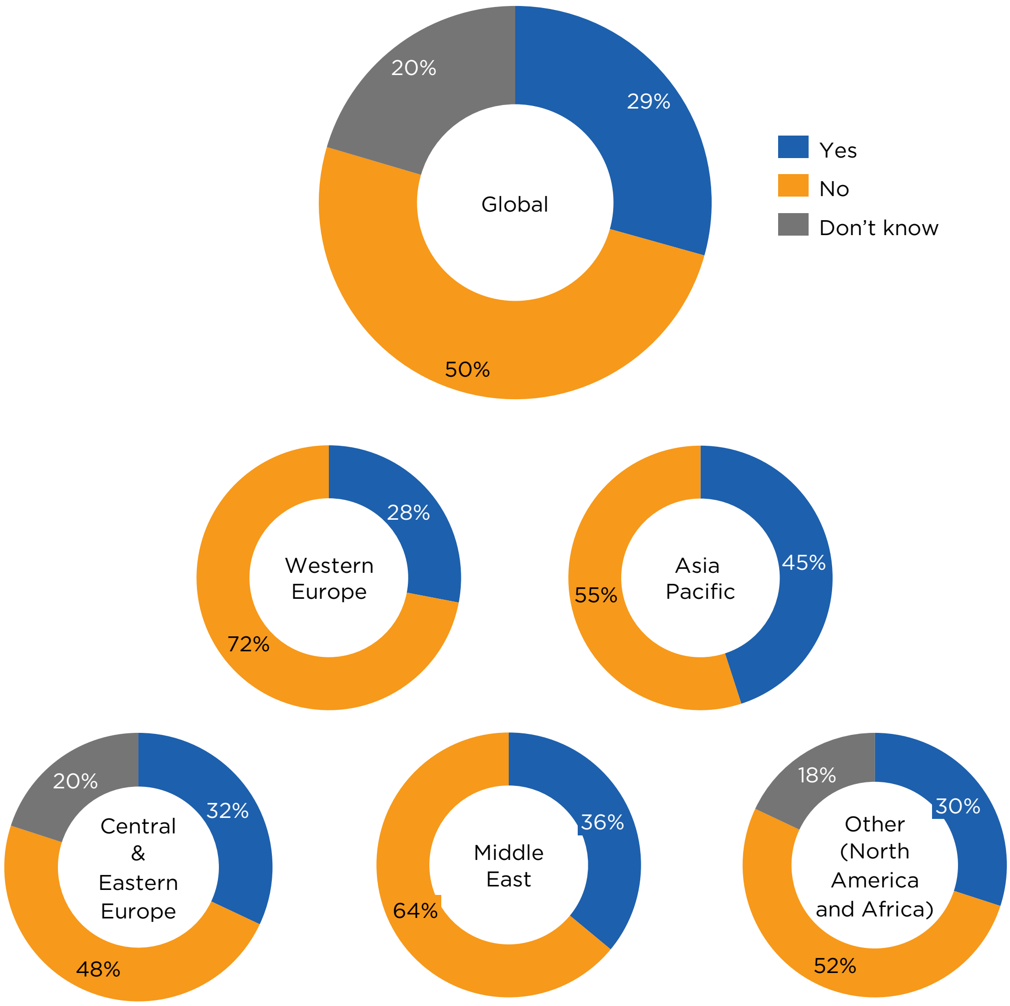
Concerns around the impact of COVID-19 on trade finance are not limited to credit risk, but also operational feasibility, for example the transfer of critical legal documents. To this point, we are aware of various cases where goods are ready to export but securing a letter of credit has not been possible due to 'lockdown' restrictions impacting carriers, bank branches, and the like.

In light of this, 54% of respondents said that their banks had introduced new digital solutions to mitigate any disruption caused by COVID-19 (Figure 25). Notably, in Asia Pacific, the original epicentre for COVID-19, 62% of respondents indicated that their banks have not introduced any digital solutions, the lowest of all regions surveyed.

Taken holistically, the cases where operational and transactional challenges in trade finance have impeded the flow of trade have been limited in number, again illustrating the

Figure 26

Has your local authority/ government provided any regulatory support to your bank to facilitate ongoing trade?



ability of trade finance providers to respond relatively well in times of crisis. Whether this remains the case as COVID-19 evolves is to be determined. Technology and digitisation will play a crucial part in ensuring access to timely and sufficient trade finance at this time.

In addition to more general usage of online platforms and services for day-to-day tasks, many respondents indicated that their banks have relaxed existing rules on the need for original documentation, for example by allowing scanned documents and other e-documents, and have rolled out new rules and platforms to enable the use of e-signatures for legal documents. The importance of global correspondent networks and interbank relationships in trade financing is clearly illustrated under current conditions; concretely, one survey respondent shared that their bank was launching "agreements with [other] banks that in case they are unable to send original documents, they can instead send scanned documents via email as a temporary solution".

29% of respondents said that their local authority has provided regulatory support to help facilitate ongoing trade (Figure 26). In contrast, Asia Pacific seems to be leading the way in the public sector response to COVID-19, with 45% of respondents indicating at least some public action to support trade (the highest of any region in the survey). As observed earlier, this is likely a function of life and death priorities faced by authorities around the globe, coupled with resource and capacity constraints: it will be important to ensure that trade and trade finance are prominent in the economic and commercial policy dialogue that is developing in parallel to the public health priorities.

Specific measures introduced by governments cited by respondents included stimulus packages and support for many small businesses that have been introduced by parliaments and central banks around the world. But they also included more trade-specific measures. Many respondents indicated that regulators had relaxed the need for physical documentation. Other respondents also indicated that a reduction in capital requirements and a relaxation of KYC have been introduced to help support the ongoing flow of global trade.

Notably, 50% of respondents indicated they did not know whether their governments had provided regulatory support to help facilitate trade flows. This finding surely reflects in part the urgency of focusing on other matters, but also hints at the need for improved communication flows and enhanced understanding of available support options.

The redefinition of the commercial, legal, and policy landscape around trade may prove to be a powerful force in advancing long-delayed aspirations to digitise trade and trade finance. The ICC Digital Trade Roadmap will be an important contribution to the development of new modes of digital trade.

The impact of COVID-19 on trade comes not only from supply and demand shocks, but also from logistical challenges. Quarantines and closed borders, coupled with reduced global capacity to move cargo, will naturally reduce global trade flows. In unprecedented and unpredictable moments like these, new and creative solutions emerge – first as temporary fixes and ultimately as new industry norms. The difficulty many banks have found in respect of original documentation serves to highlight the urgency of digitisation in trade finance.

One respondent wrote that in the short term "the ICC should push banks to agree on amending pending L/Cs where original documents cannot be produced anymore or delivered". However, with an eye on the longer term, one respondent said, "The fact that original documents have to be examined and delivered is a significant problem. Technical issues become credit risks. I hope that based on the experience with COVID-19 we can continue to move toward digitisation [in trade]".

FEATURE

SWIFT Trade Traffic: the year in review

Huny Garg, Head of Trade – EMEA, Business Development, SWIFT

This section of the report provides a data-driven commentary on global trade finance traffic, based on data from SWIFT. While SWIFT trade finance traffic represents only a modest portion of global trade by volume, it is a good barometer of trends for L/C use, since about 90% of L/C transactions go via SWIFT.

SWIFT Terms Explained

Traffic: Live messages sent over SWIFT

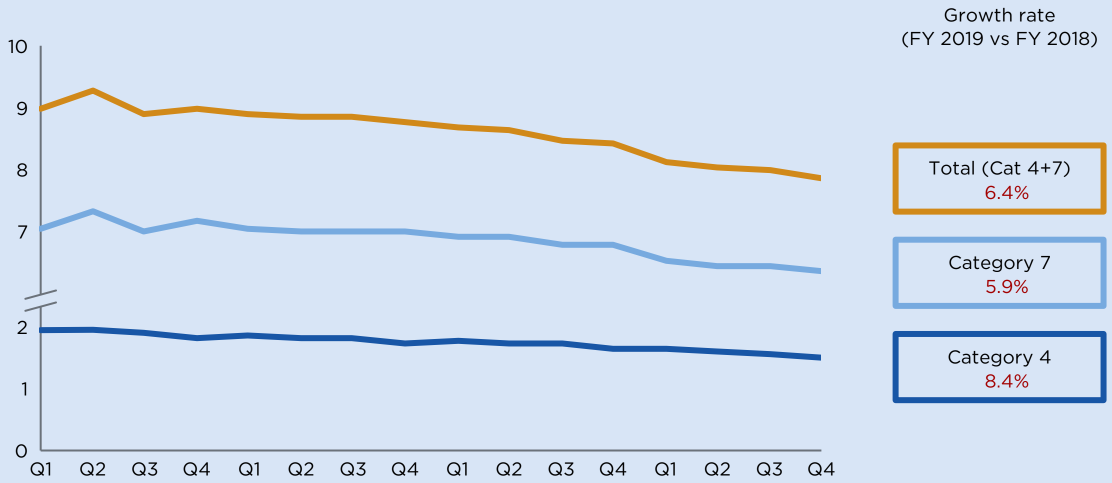
Category 4 messages/ MT400s: Flows for documentary collections, except the three least used cash letter messages

Category 7 messages/ MT700s: Flows for commercial and standby L/Cs and guarantees

Analysis of SWIFT Trade Traffic: Highlights in 2019

- SWIFT trade finance volume fell 6.4% in 2019 from the year before, in large part due to a 5.9% drop in category 7 and a 8.4% drop in category 4 traffic. The decline for MT700 traffic at 3.9% was less pronounced than the overall decline that was driven by an 8.4% decline in MT799 messages.
- Asia-Pacific continued to register much higher volumes of MT 700, garnering a 76.0% share for imports and a 78.1% share for exports. Countries using SWIFT L/Cs the most for imports were: Bangladesh, South Korea, China, India and Pakistan.
- Country/ region using SWIFT L/Cs the most for exports were: China, Bangladesh, India, Hong Kong and Singapore.
- Imports rose sharpest in Ethiopia and Nepal, up 10.4%, and exports rose fastest in Portugal, up 9.6%.
- Imports fell the most steeply in Sri Lanka, down 15.8%, and exports fell sharpest from Saudi Arabia, down 18.6%.

Figure 27
SWIFT global trade finance traffic, FY2016-FY2019



Trade finance traffic continues to slide

SWIFT trade finance volumes in 2019 were down 6.4%, falling more sharply than last year's drop of 2.35%, pushed down by the decline in category 7 documentary credits and guarantees of 5.9%, and an 8.4% fall in category 4 documentary collections.

L/C volumes and values – the slump continues

The volume of L/Cs on SWIFT fell again last year, off 3.9%. Interestingly, Q4 2019 showed an upward trend after many quarters of decline. There was a decline of 8.13% in MT799 (the free format message type that accounts for the largest portion of category 7 volumes) possibly due to improvements in structured messages during standards release in 2018 by SWIFT.

Figure 28
Import traffic vs. average value in FY2019, split by region, based on SWIFT MT700 traffic

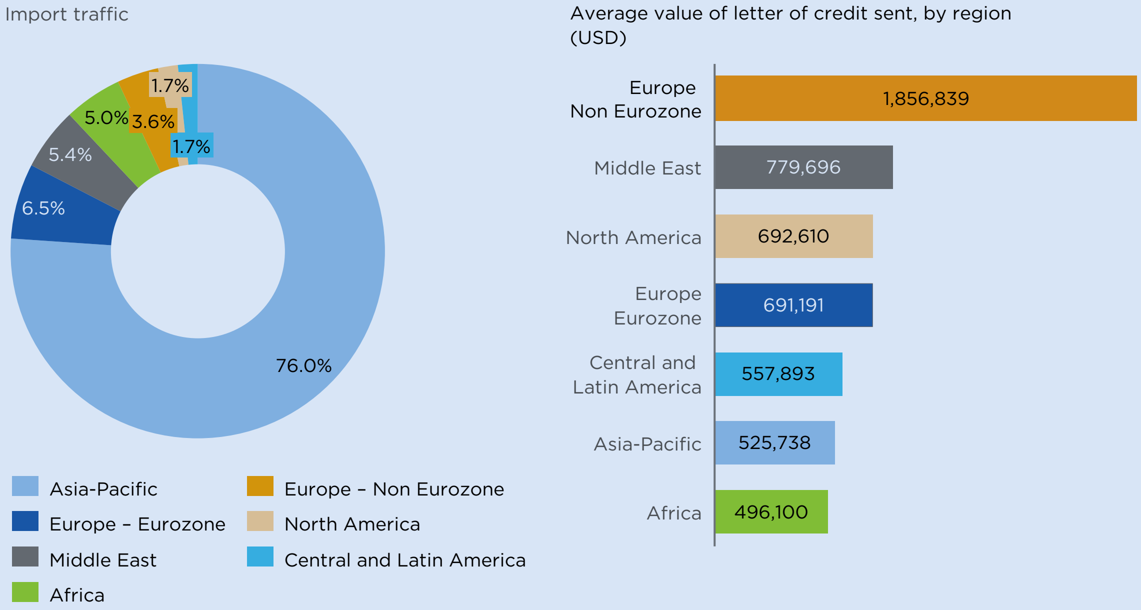
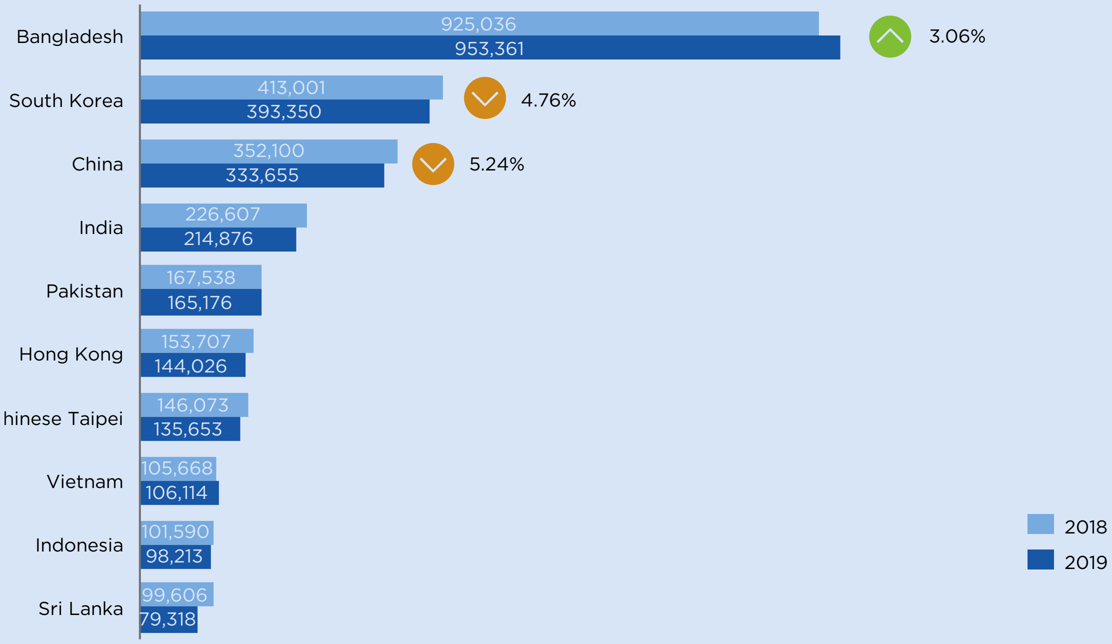


Figure 29

SWIFT MT700 import L/C volumes by country/ region (# messages)



Asia-Pacific received the most L/Cs, around 3.1 million MT700s, much more than any region. But the average value of an L/C received in Asia-Pacific was lowest at USD 430Kv.

Regional analysis: Import L/Cs[1]

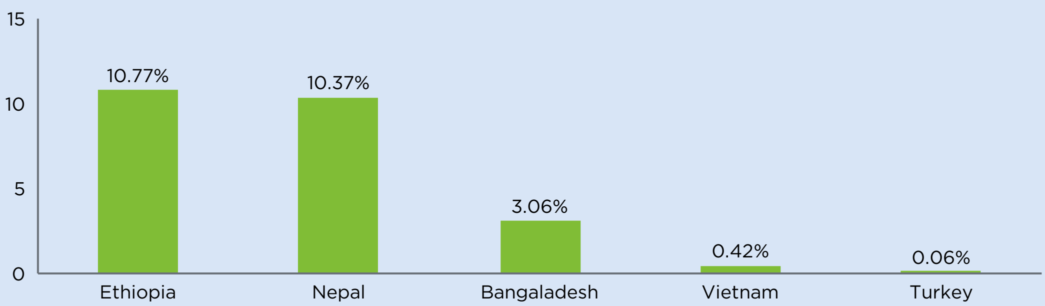
Asia-Pacific continued to register the largest volume for import L/Cs sent using MT 700s, making up 76.0% of world traffic in 2019, followed by the Eurozone 6.5% and the Middle East 5.4%.

The average value of import L/Cs was the highest in non-Eurozone European countries, whereas Africa had the lowest value import L/Cs.

Looking at the cross-border volume of MT700 traffic, excluding domestic flows, the countries importing the most using L/Cs are shown in Figure 29.

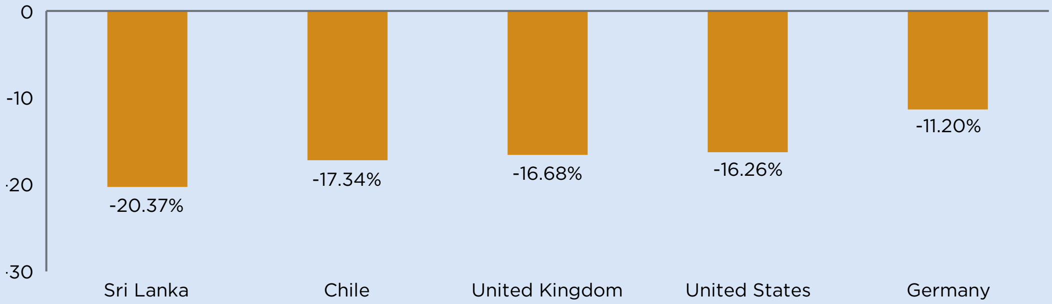
Figure 30

Fastest-growing importers, based on SWIFT MT700 traffic



1 Data includes both domestic and international traffic, as commercial letters of credit can be utilised in domestic transactions

Figure 31
Importers with the sharpest declines in imports, based on SWIFT MT700 traffic



Bangladesh was the only country among the top 5 that experienced growth in import L/C volumes. Countries like South Korea and China saw a decline of 4.76% and 5.24% respectively.

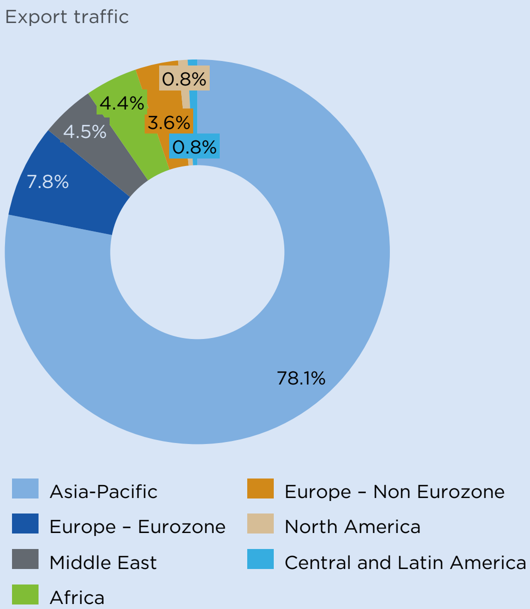
Looking at annual volume over 20,000 MT700s sent internationally, the countries with the highest year-on-year growth in this category in 2019 are shown in Figure 30 above.

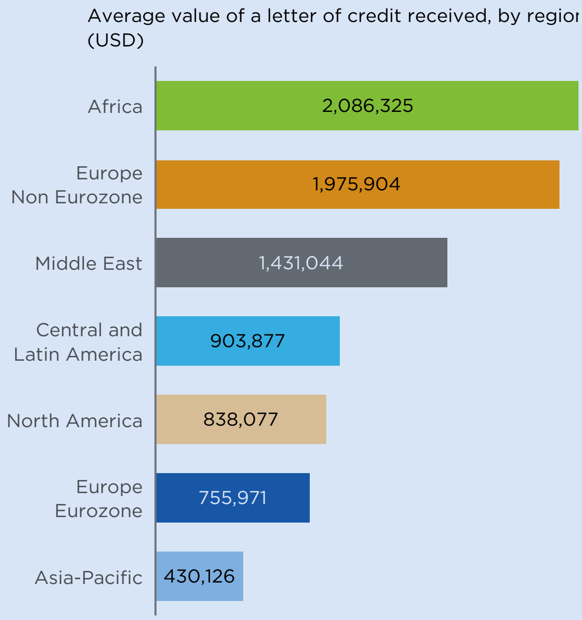
With a yearly volume higher than 20,000 MT700s sent internationally as a gauge, the countries showing the largest declines in imports using L/Cs are shown in Figure 31.

Regional analysis: Export L/Cs[1]

Asia-Pacific continued to register much higher volume for received MT 700s, (exports) accounting for 78.1% of world traffic in 2019, followed by the eurozone (7.8%) and non-eurozone Europe (4.5%).

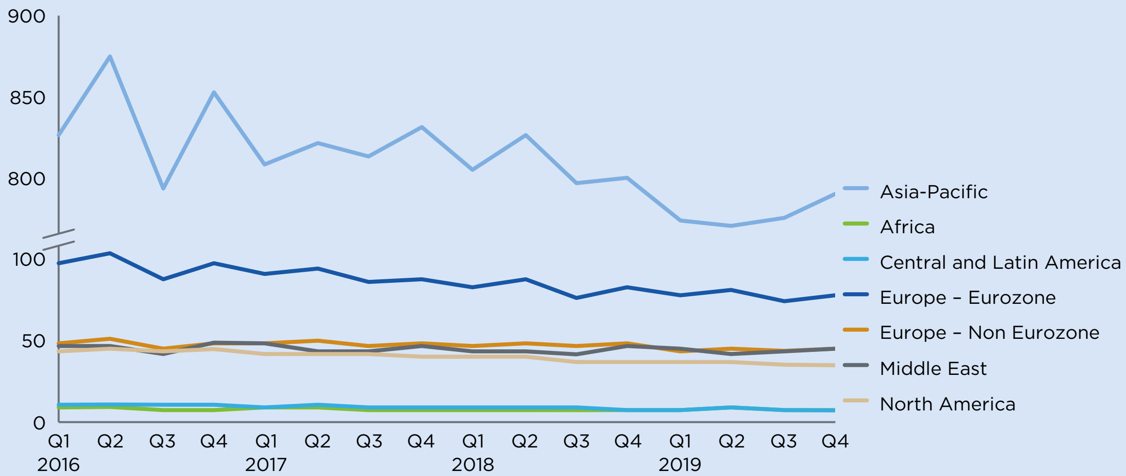
Figure 32
Export traffic vs. average value in FY2019, split by region, based on SWIFT MT700 traffic





1 Data includes both domestic and international traffic, as commercial letters of credit can be utilised in domestic transactions

Figure 33
SWIFT MT700 messages received to non-Eurozone Europe



Export-related message traffic was down across the board in 2019 compared with the previous year. The region that showed the steepest drop was the Eurozone, where export traffic trailed off 6.92%, followed by North America, where traffic contracted 6.54% and Africa, where traffic fell 5.80%.

Looking at the cross border (excluding domestic flows) volume of MT700s received, the countries that exported the most using L/Cs are shown in Figure 34.

Figure 34
SWIFT MT700 export L/C volumes by country/ region (# messages)

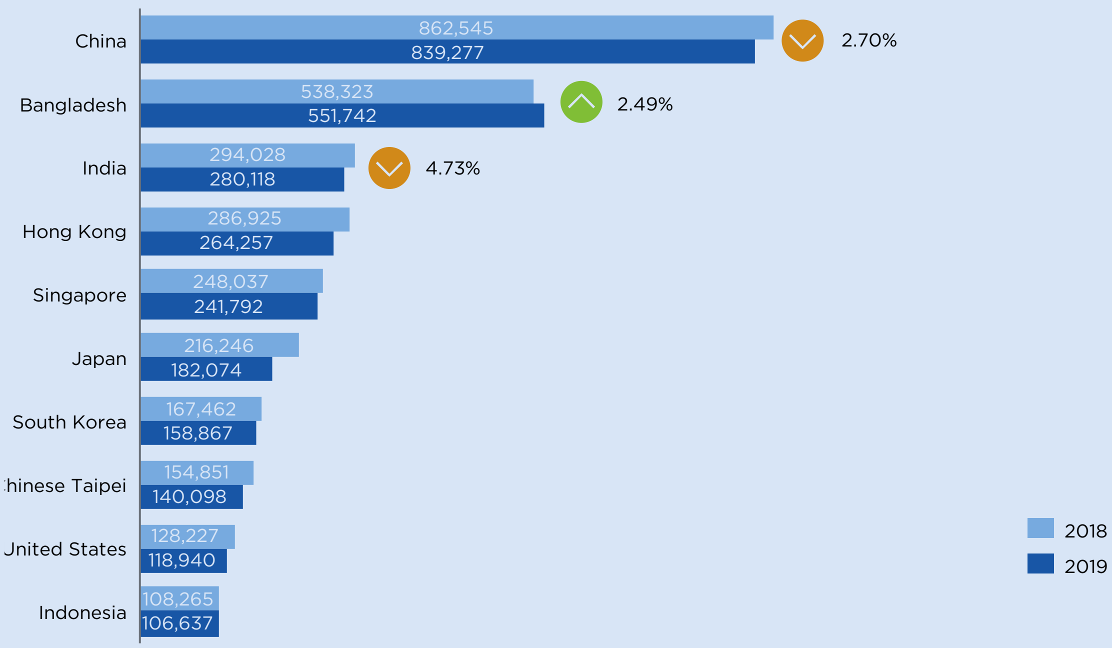
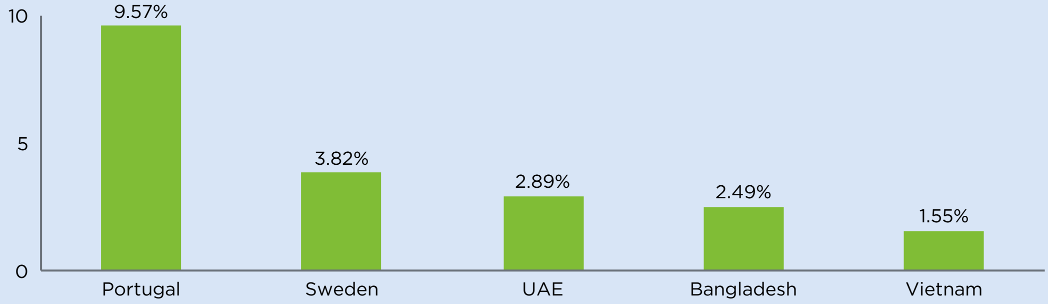


Figure 35
Fastest-growing exporters in 2019, based on SWIFT MT700 traffic

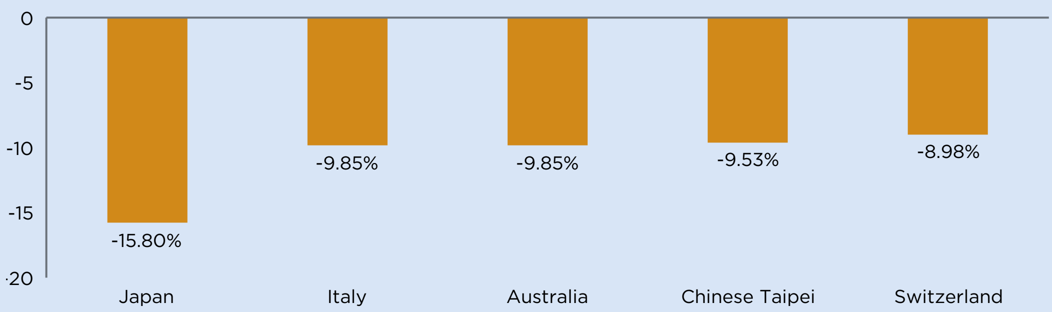


It was noted that Bangladesh continues to see growth in L/C volumes despite most top markets seeing a decline in 2019.

Using a yearly volume of more than 20,000 MT 700s received internationally as a gauge, the countries with the fastest growth in 2019 compared to 2018 and shown in Figure 35

The countries registering the largest drop in annual volumes in 2019, in the category over 20,000 MT 700s sent internationally, are shown in Figure 36.

Figure 36
Exporters with the sharpest declines in exports, based on SWIFT MT700 traffic



Deep-dive on confirmed L/Cs

The share of confirmed L/Cs rose slightly, up 0.3% in 2019 from the previous year. Africa continued to receive the highest percent of confirmed L/Cs, and Asia-Pacific the lowest.

Figure 37
Confirmed export L/C volume, based on SWIFT MT700 traffic in 2019 vs. 2018

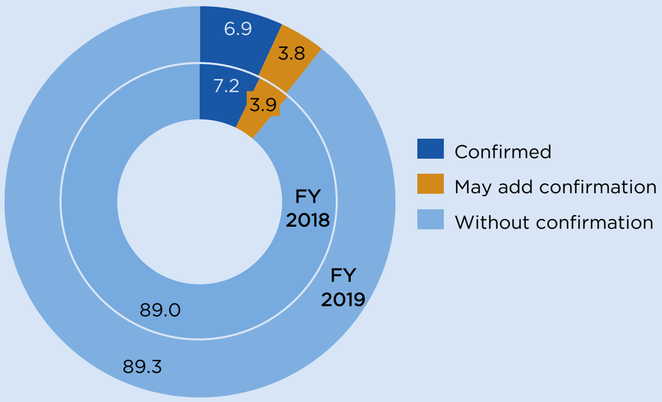
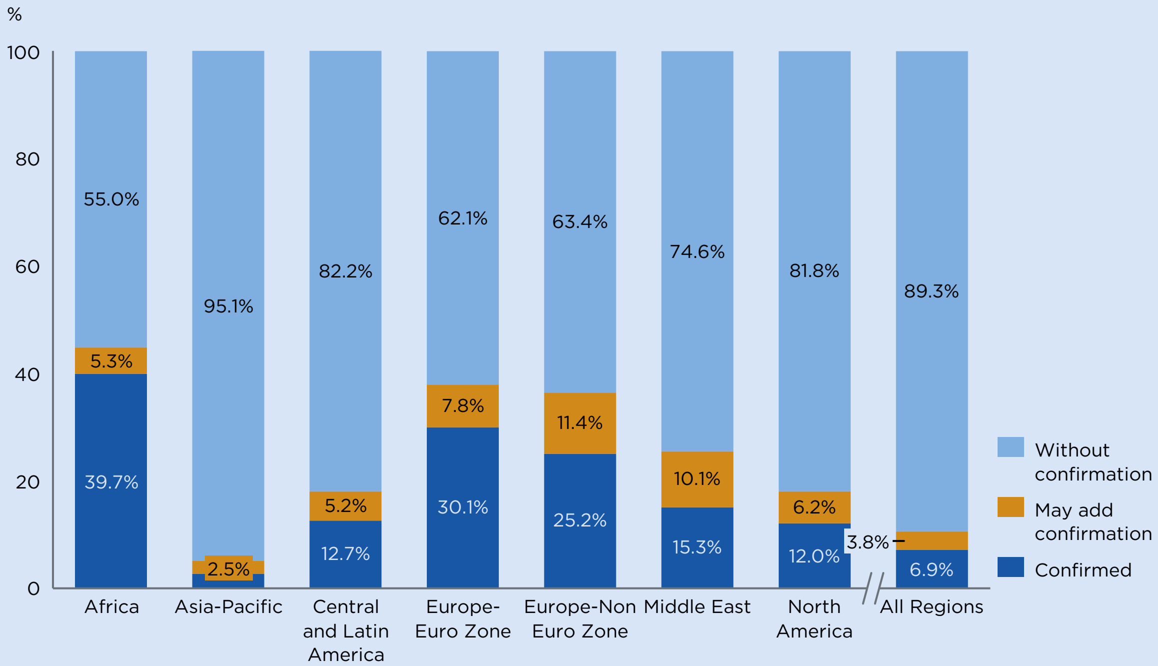


Figure 38
Distribution of confirmed export LC volumes by region in 2019, based on SWIFT MT700 traffic



Deep-dive on L/Cs available by negotiation

The broad preference for using L/Cs available by negotiation as defined under ICC UCP rules continues to be in evidence in SWIFT message data.

In most cases, L/Cs available by negotiation are issued. Based on SWIFT traffic, the share was slightly higher at 74.1% in 2019 with the previous year at 73.6%. Regionally, L/Cs available by negotiation accounted for 80.9% of L/Cs in North America and 78.6% in Asia Pacific. All other regions except Africa (where Payment is most common) mostly used L/Cs available by Negotiation.

For purposes of this section and the graphics that follow, SWIFT has used the term 'Credit Rule' to identify the ways in which an L/C may be made available, as reflected in the ICC's Uniform Customs and Practice (UCP) for Documentary Credits. L/Cs available by Negotiation represent one among multiple credit rule options, but by far the most common and preferred globally.

Figure 39
Export volume by credit rule combination, based on SWIFT MT700 traffic

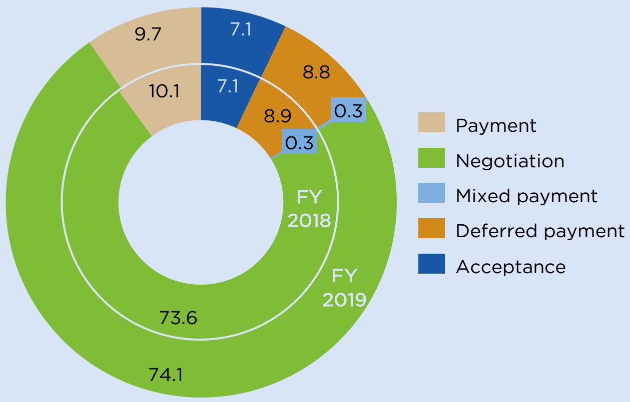
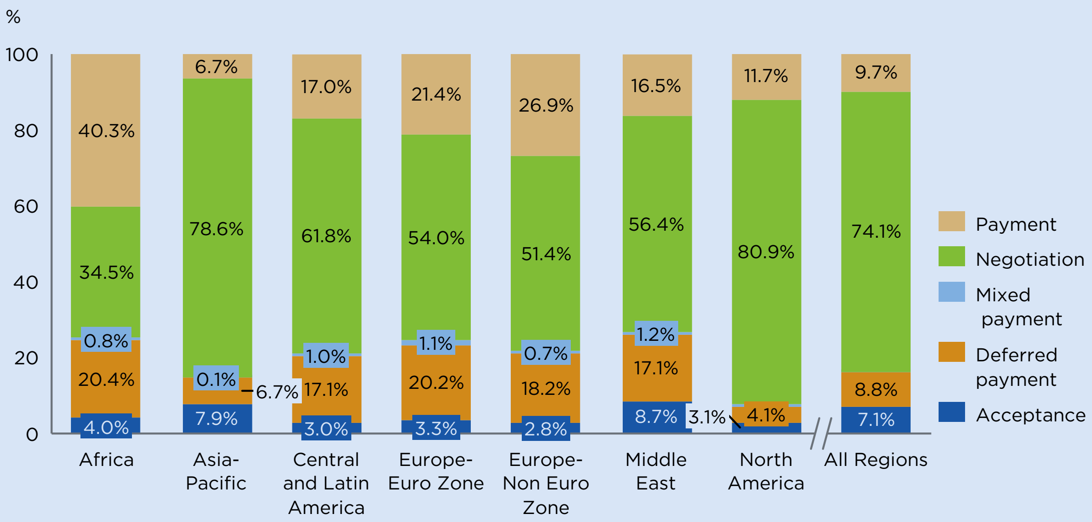


Figure 40
Distribution of confirmed export LC volumes by negotiation in 2019, based on SWIFT MT700 traffic



Deep-dive on L/C validity

L/C validity – or the time between the issuance of the L/C and its expiry – remains short. A total of 38.9% of L/Cs were extended from 31 to 60 days, and 35.4% from 61 to 90 days in line with the short-term nature of a significant portion of global trade.

Validity of L/Cs are generally longer in the Eurozone (33% up to 60 days) and Africa (34.3% up to 60 days) compared to Asia-Pacific where validity is shorter on average (52.9% up to 60 days).

Figure 41:
Volume of L/Cs split by validity, 2019, based on SWIFT MT700 traffic

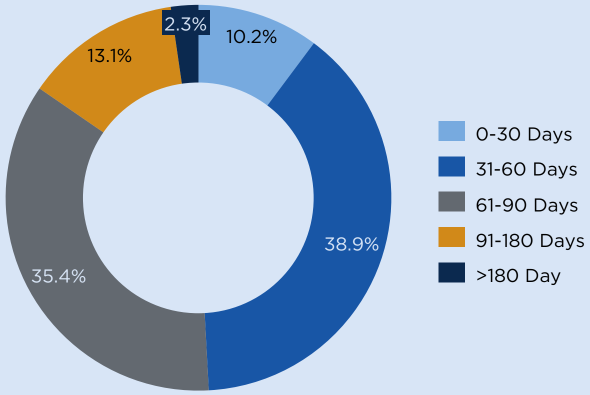
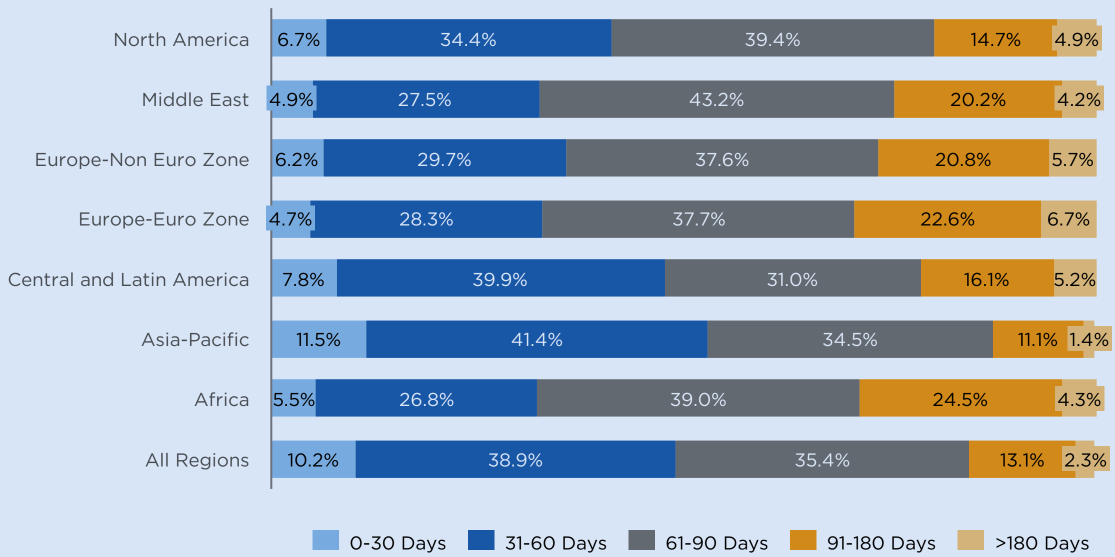
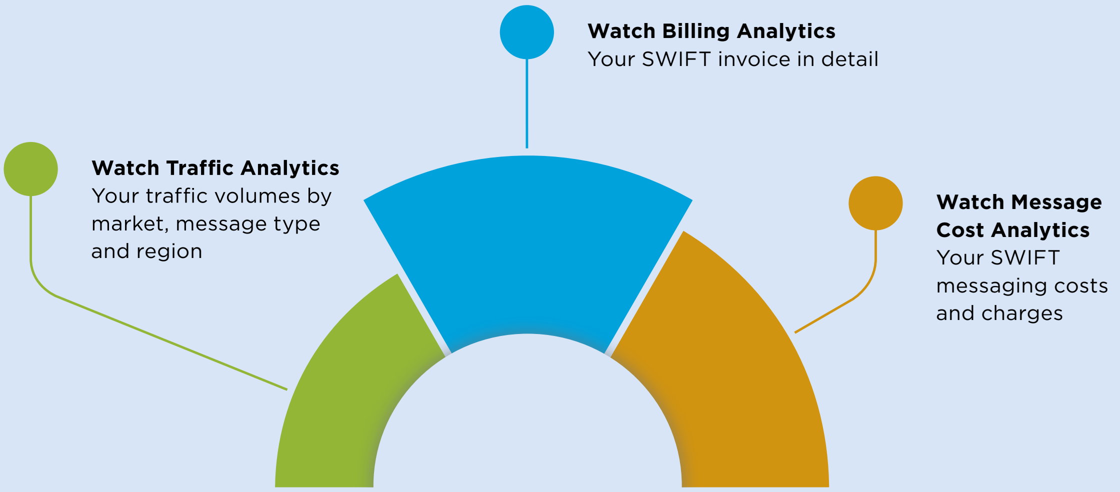


Figure 42
Region-by-region export volume by validity, based on SWIFT MT700 traffic



Watch Traffic

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



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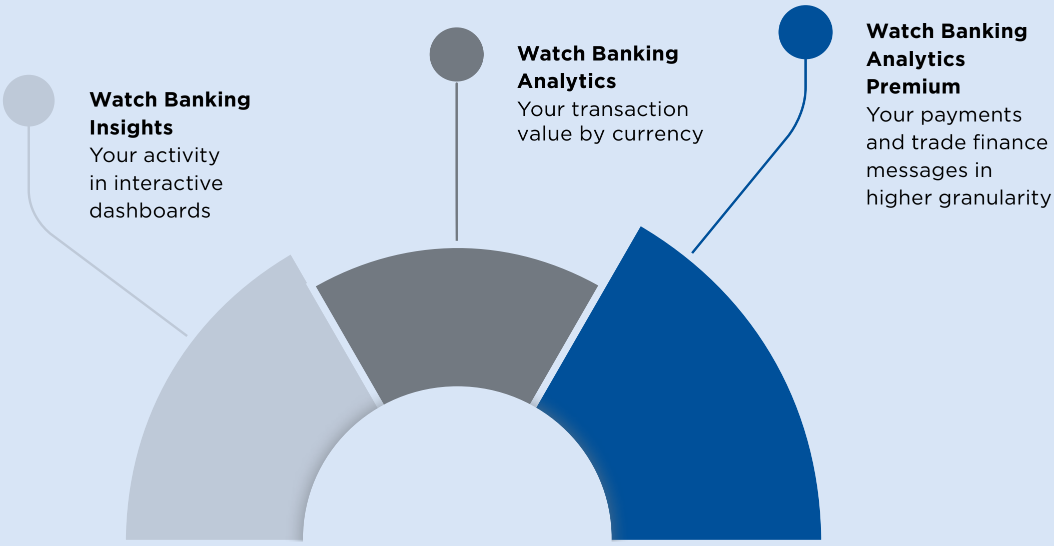
Unique analysis and insights into your correspondent banking business through volume, value and currency analysis. Compare and monitor your performance against the market.



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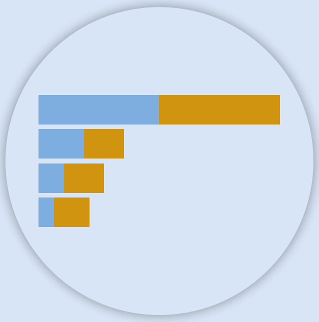
Develop footprint and portfolio for Payments and Cash Management



Your top cash management reporting messages sent and received YTD

Manage correspondent network for Payments and Trade finance

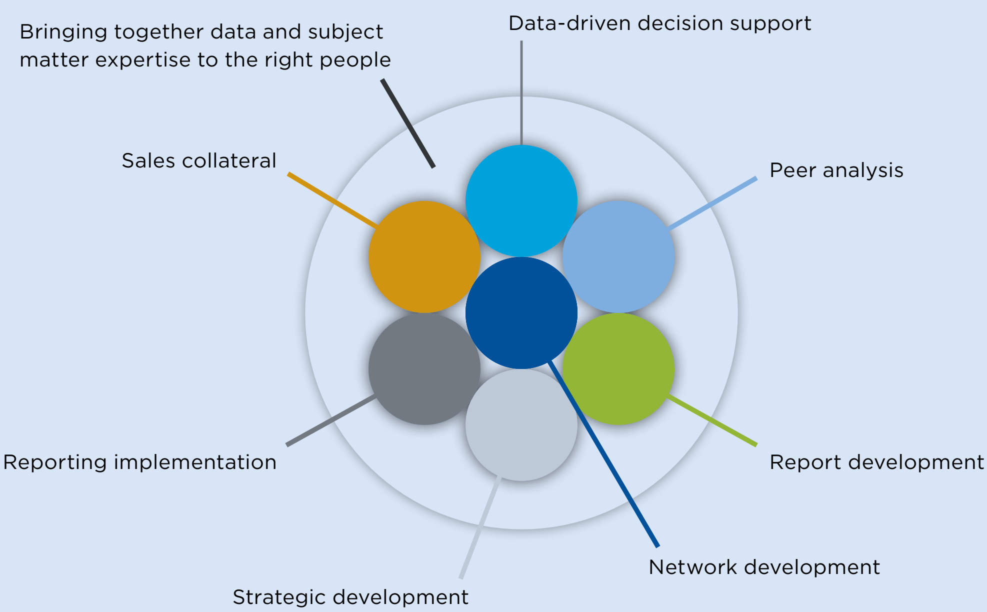
The evolution of the number of counterparties and countries you have activities with

Develop footprint and portfolio for Trade finance

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

BI services

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



FEATURE

TXF on Export Finance

Dr Tom Parkman, Head of Research, TXF

This feature is based on market sentiment data collected from TXF Research's global Export Finance Industry Report 2020, scheduled for release at TXF Global in 2020, and closed deal data from TXF Data. The primary aim of this feature is to provide a comprehensive overview of the state of the export finance market in 2019.

It is important to note that this feature was produced prior to the COVID-19 outbreak. While it is discussed in some detail, the data in this feature highlights the state of the export finance industry before the outbreak.

Methodology

TXF Research

TXF Research's Export Finance Industry Report 2020 uses a mixed methodology that combines quantitative and a qualitative component. The quantitative data was collected using an online survey platform (SurveyMonkey) with banks, export credit agencies (ECAs), exporters, importers (borrowers), law firms and private insurers (brokers and underwriters) all taking part. The qualitative data was collected via telephone interviews with consenting individuals. This mixed methods approach enables the report to identify the latest trends in the market with in-depth and thought-provoking commentary to understand how and why these market trends are occurring.

At the time of writing (March 2020), the data collection was still ongoing, meaning that the data presented in this feature is based on a cross section of the final dataset. A total of 246 individual respondents from the above-mentioned institutions make up the survey data.

TXF Data

TXF Data is the leading source of transaction data in the export finance market, used as the main reference by all the market leaders. The information is collected through three sources:

(i) Deal information submitted through Tagmydeals and directly to TXF

(ii) News articles obtained through TXF's editorial team

(iii) Corporate press releases found online using machine learning.

Findings

Before this feature delves into the state of the export finance market, it would be remiss to not start by mentioning COVID-19. In financial parlance, a black swan event is an extremely rare and damaging event that is almost impossible to predict. It is safe to say that the global COVID-19 pandemic is a 'black swan' event.

To supplement TXF Research's Export Finance Industry Report 2020, an addendum survey looking specifically at the impact of COVID-19 on the industry was conducted. One area the survey explored was force majeure.

Our survey data found that nearly 35% of the sample do not know, or do not have, a force majeure clause built into the legal part of their export finance loans. Further, of those that did have a force majeure clause built into their legal work, a combined 75% of the sample did not know, or do not have, a global pandemic scenario inbuilt, and, finally, **just 15% of the sample with a force majeure clause that covers global pandemics have invoked it**. It remains to be seen how damaging COVID-19 is to the export finance industry but the uncertainty surrounding force majeure could have serious financial, operational and reputational repercussions for institutions.

The ICC has been tracking whether force majeur clauses have been (disproportionately or inappropriately) triggered in the context of the COVID-19 pandemic and has found no systemic evidence of abuse – highlighting that trade continued to be conduced on a good faith basis and in line with industry standards and practice. It has also issued a Guidance Paper on force majeur which builds upon past ICC publications and industry practice.

The market at a glance

In 2019, total deal volume reached USD 108 billion across 341 deals, down USD 30 billion from 2018's USD 138 billion total volume across 412 deals. Looking in more detail at 2019, it was a fairly turbulent year with three clear peaks in export finance activity in February, May and December corresponding to deals closed by Australia Pacific LNG for USD 6.9 billion, the Bahrain Petroleum Company (BAPCO) for USD 4.1 billion, and Gazprom's massive Amur gas processing plant for USD 12.8 billion, heavily backed by a number of European ECAs, respectively (Figure 43).

Interestingly, if these three deals are removed, the export finance landscape looks quite different. The total deal volume drops to USD 84 billion with an average deal size across the year of USD 7 billion (compared to USD 9 billion in Figure 44). Figure 44 also shows that the largest deal volume in the top performing month drops to just over USD 12 billion (down from USD 25 billion in the same month in Figure 44) which suggests that 2019 was a fairly flat year for export finance. This is particularly true when compared to 2018.

TXF Research supports this finding with the level of activity being rated as three out of five over the past 12 months. One lawyer explained why: "Export finance activity seems to be a little bit less busy than in recent times. I think this is probably driven by the China-US trade war. There has just been a general softening of things. I also think Brexit has had a detrimental effect too. I also think the Coronavirus will have a very damaging effect on activity."

At the time of the interview, the COVID-19 pandemic had not taken full hold of the global economy, but it is clear now that that was an accurate prediction. When survey respondents were asked about the impact of the pandemic on the global economy, nearly 80% posited that it will lead to a global recession comparable with the 2008 financial crash.

Figure 43
An overview of the export finance market in 2019

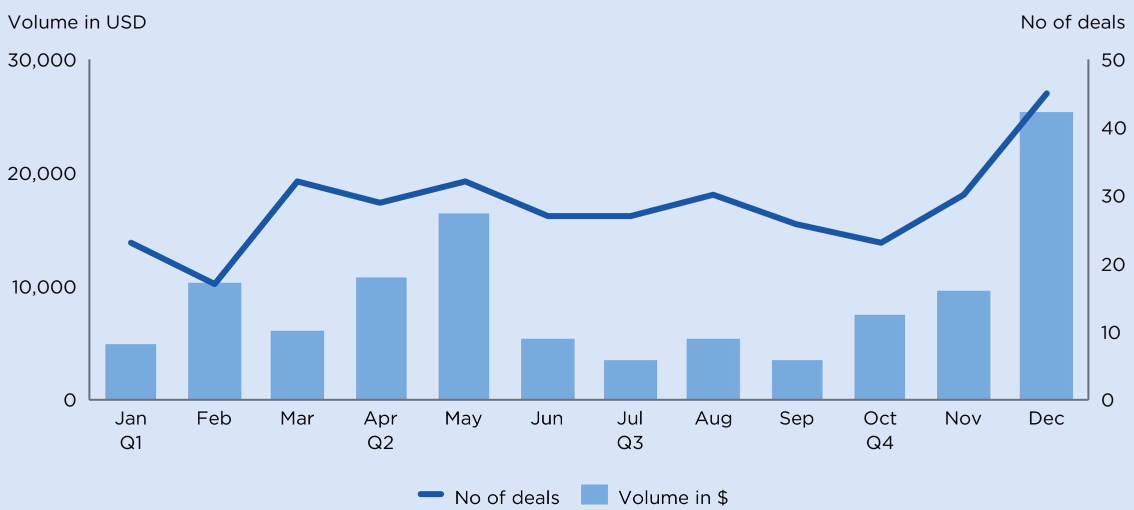
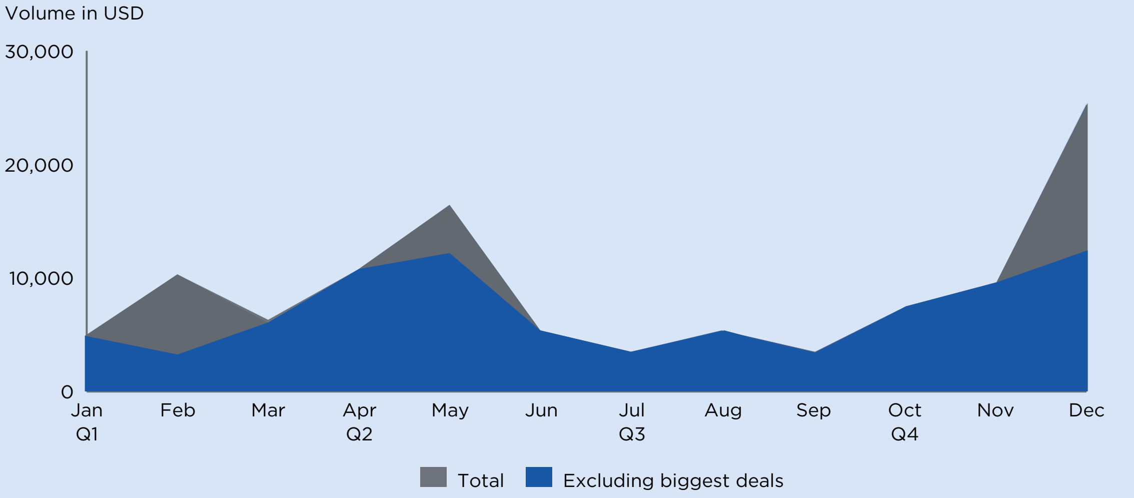


Figure 44

An overview of the export finance market in 2019, without the three largest deals included



A regional view

Looking at closed deal data, Figure 45 shows that Asia Pacific was the most active region for export finance in 2019, with deal volume totalling USD 17.4 billion across 51 deals, followed by the Middle East (USD 6.9 billion across 27 deals) and Russia (USD 16 billion across 40 deals). However, the Middle East had an average deal size of USD 629 million, nearly double that of Asia Pacific (USD 341 million). Europe had the smallest average deal size of USD 201 million, a finding driven by a smaller total volume (USD 14 billion), but it did have the greatest number of closed deals (n=71).

TXF Research suggests that this trend will continue over the next 12 months, with 49% of respondents suggesting that they will do more export finance business in Asia Pacific, followed by the Middle East (31%) and Europe (30%). One exporter currently active in Asia Pacific, and looking to do more, explains why Asia Pacific is attractive: "China is not just the only place to do business with anymore [in Asia Pacific]. We are doing more in Bangladesh, Vietnam, Myanmar, Chinese Taipei and many others. We are looking to cover as many markets as possible not just in terms of quantity, but quality also."

Figure 45

2019 regional breakdown

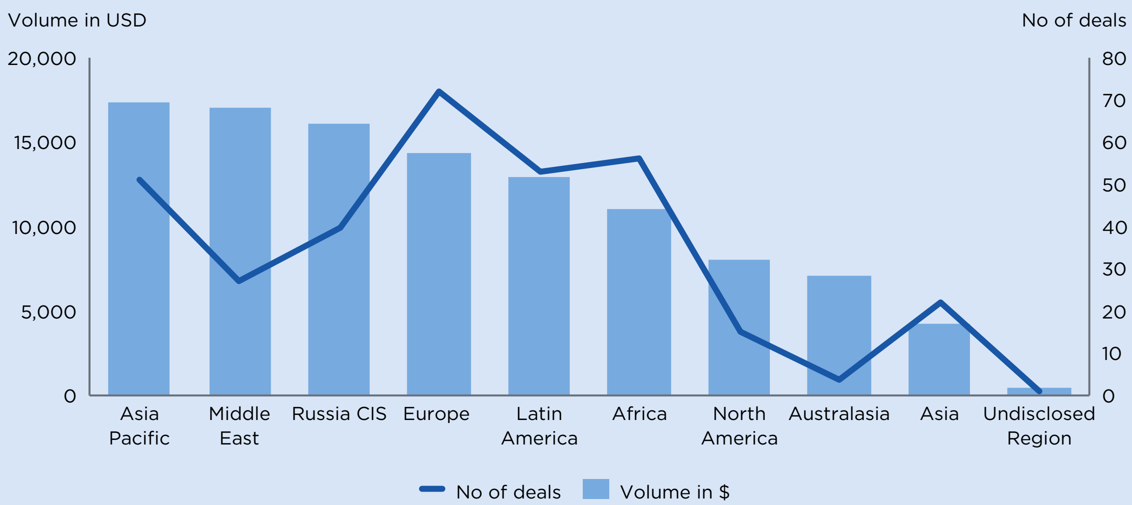


Figure 46
Respondents' level of activity over the past 12 months

	More active	About the same	Less active
Asia-Pacific	49%	45%	6%
Central and South America	27%	62%	10%
Europe (including Russia and Turkey)	30%	65%	5%
Middle East	31%	58%	11%
North America	19%	68%	13%

A deeper look at sector breakdown

Figure 47 shows that oil and gas continued to dominate the export finance market in terms of volume with USD 36.7 billion being closed across 21 deals in 2019, followed by power (USD 22.4 billion across 51 deals) and transport (USD 15.9 billion across 62 deals). With the average deal size of oil and gas standing at a sizeable USD 1.7 billion, it is more than four times larger than the average deal size in power (USD 438 million) and nearly seven times larger than transport (USD 257 million). This closed deal data shows why oil and gas remains the dominant sector to invest in. Figure 48 too suggests that oil and gas may continue to dominate, as it has grown year-on-year since TXF Data started collecting closed deal data.

Figure 47
A breakdown of export finance activity, by sector in 2019

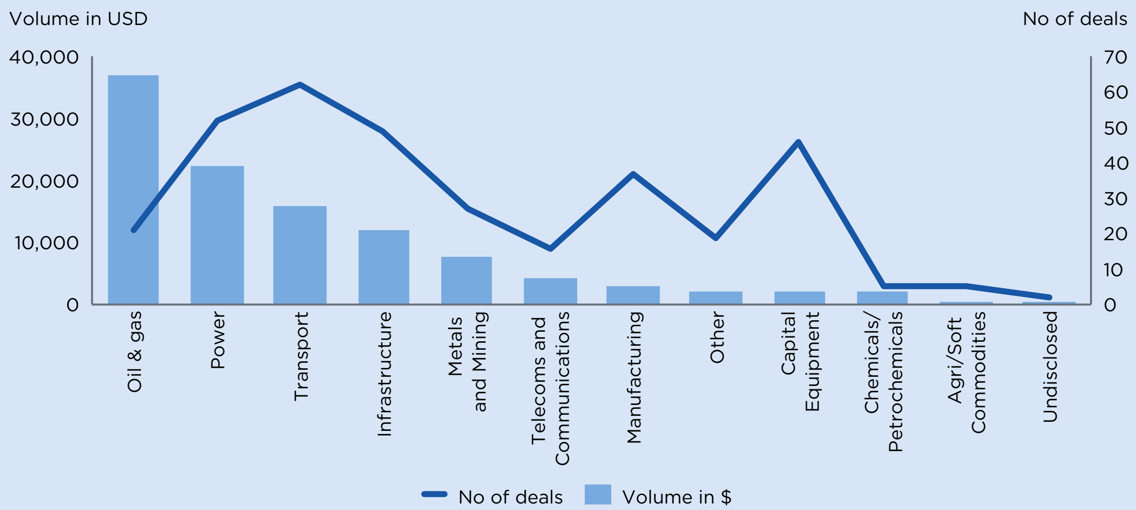


Figure 48
Activity levels across the sectors, 2017-2019

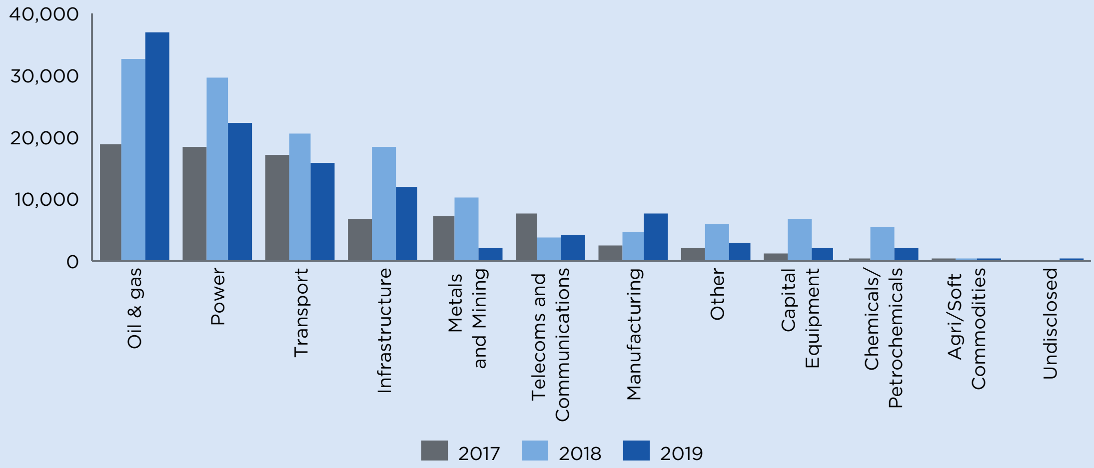


Figure 49
Export finance activity over the next 12 months, by sector

	More active	About the same	Less active
Defence	22%	70%	8%
Infrastructure	46%	50%	4%
Manufacturing	17%	74%	8%
Metals and mining	15%	71%	14%
Oil and gas	25%	64%	12%
Petrochemicals	19%	73%	8%
Power	26%	71%	3%
Renewable energy	53%	47%	0%
Telecommunications	19%	73%	8%
Transport	36%	60%	4%

However, preliminary projections in TXF Research's Export Finance Industry Report 2020 provide some optimism for the renewable energy sector, with 53% of the survey sample stating that they plan to become more active in this space, double that of those looking to do more in oil and gas (25%) (Figure 49).

Perhaps encouragingly for the export finance industry too is that 59% of the survey sample believe that sustainability is a way of life that must be adopted by every institution involved in export finance. Given the strong relationship between sustainability and renewable energy, there is cautious optimism to be had for the future, as one banker pointed out: "We don't finance anything in coal, defence or petrochemicals anymore. We are also reviewing nuclear and our involvement in mining. It will take time as many of these deals have long tenors, but I see a positive future for export finance."

Figure 50
ECA involvement over the past three years

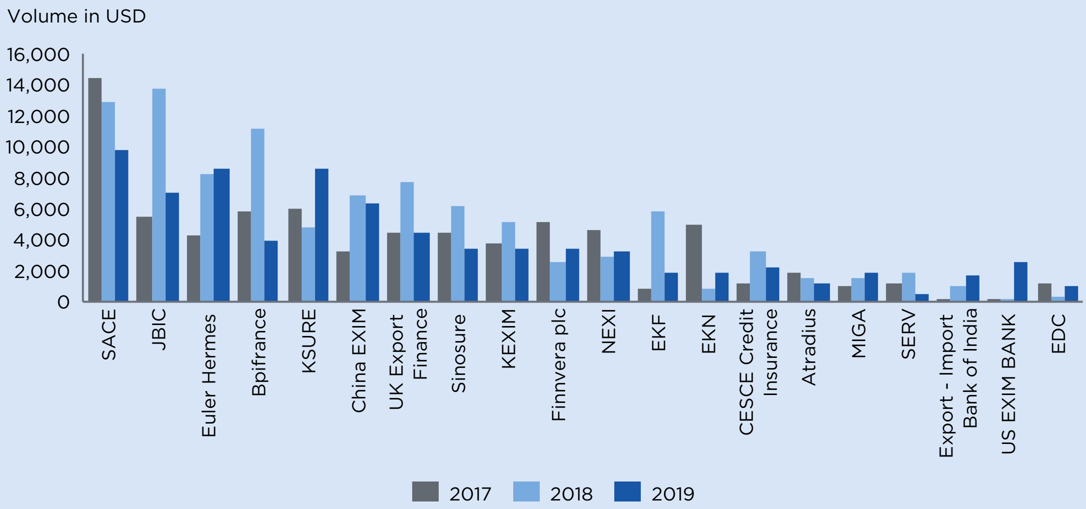
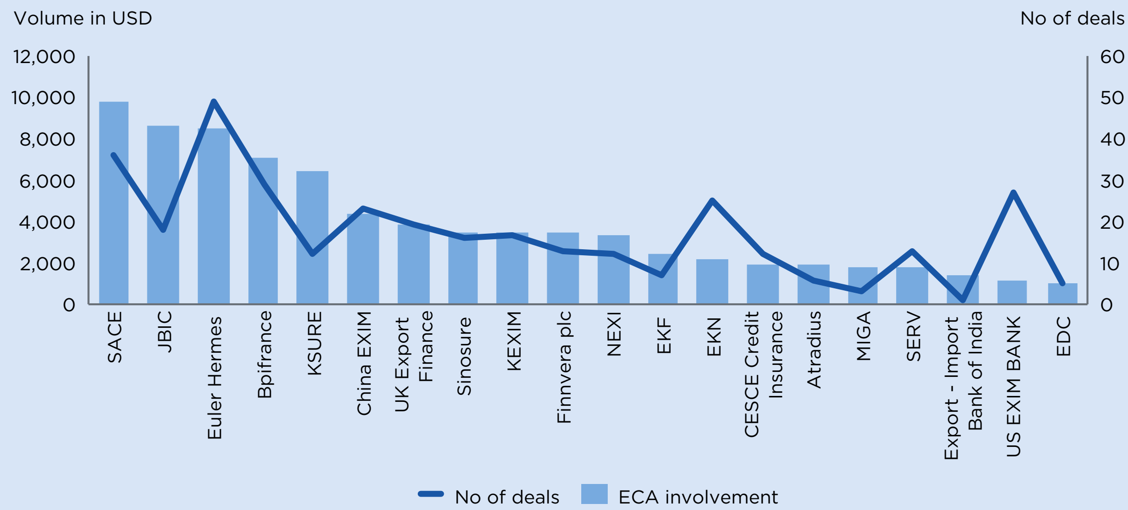


Figure 51
ECA involvement over the past 12 months



ECA involvement

Figure 50 shows that compared to 2017 and 2018, ECA involvement in 2019 has been significantly lower. Looking more closely at the past 12 months, SACE has led the way, guaranteeing USD 9.8 billion worth of deals, followed by KSURE (USD 8.6 billion) and Euler Hermes (USD 8.5 billion) (Figure 51), all of which were involved in the two largest export finance deals in 2019 the Amur gas power processing plant (SACE and Euler Hermes) and the Bahrain Petroleum Company deal (KSURE).

The future of export finance

When the survey respondents were asked about how optimistic they were about the future of export finance, it was a fairly muted response, with an average overall score of two out of five. The main reason for this, as Figure 52 shows, is because of a global recession. It is important to note that respondents noted a global recession as the greatest threat prior to the COVID-19 pandemic.

Since the outbreak, an addendum survey asking the export finance industry about the impact of COVID-19 has been released to the market to better understand its impact. Of a separate sample of 72 respondents (at the time of writing), the reported likelihood of a global recession, comparable to that of 2008, is four out of five. While it is unclear what the final cost of the outbreak will be, it is safe to say that the future of the export finance industry is very uncertain.

Conclusion

2019 proved to be a fairly flat year for export finance, with oil and gas continuing to dominate above any other sector. While Asia Pacific did look set for a fairly optimistic future, the COVID-19 outbreak will almost certainly curtail that optimism. While TXF Data suggested that 2020 might see a resurgence in export finance activity, the black swan event that is COVID-19 looks set to have serious and long-lasting consequences for trade finance.

Figure 52

Greatest disrupters to the export finance industry

Global recession	53%
Geopolitical tensions in borrowing countries	48%
Increasing regulation and compliance	42%
The ongoing US-China trade war	38%
Climate change/ rising environmental problems	30%
Increasingly stringent KYC (‘know your customer) requirements	26%
Involvement of development banks	23%
Increased direct lending from ECAs	16%
Lower funding/ fees from new entrants into the export market	15%

SUPPLY CHAIN FINANCE

Survey analysis

Supply chain finance is one of the fastest growing trade finance products and is responsible for the majority of market growth. Incumbents and disruptors who have succeeded in this market have done so with material technology investment that has allowed the product to work at scale with some of the world's largest supply chains. The Global Survey, however, reveals a stark divide in how trade banks are planning to engage with SCF – if at all. Global banks are adopting SCF platforms broadly and expect further growth in the coming years.

The survey found that 64% of global banks already offer an SCF platform (Figure 53), largely in the form of proprietary systems (Figure 54). This is compared to just 38% of regional banks, and 13% of local banks. Given that open account trade and SCF are responsible for the vast majority of growth in trade and trade finance, the disparity between global, regional, and local banks here is concerning: the lack of SCF capabilities may marginalise smaller players, potentially driving further consolidation in a strategically important market that is already highly concentrated.

Notably, while 65% of respondents report having built a proprietary SCF platform, over a third of respondents purchased an open network platform, use a hybrid platform, or insource their SCF platform from a provider. This highlights a potential strategy for smaller players to stand their ground in the market without the need for capital-intensive technology builds, and hence effectively compete in their markets. Indeed, even some of the world's largest banks offering SCF solutions are today leveraging third-party platforms to accelerate bringing leading solutions to customers.

This is the case for payables finance programs, and increasingly for the next wave of evolving SCF techniques, as described in the Standard Definitions for Techniques of Supply Chain Finance, co-authored by the ICC and several industry associations.

Figure 53
Does your bank currently offer a supply chain finance platform?

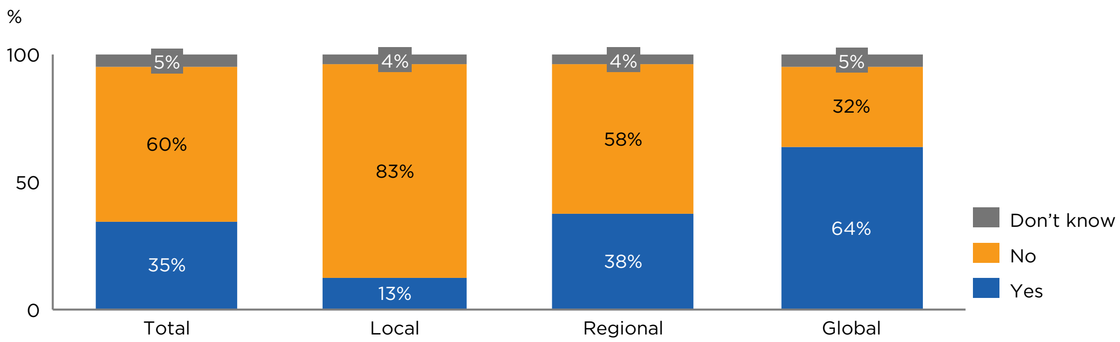
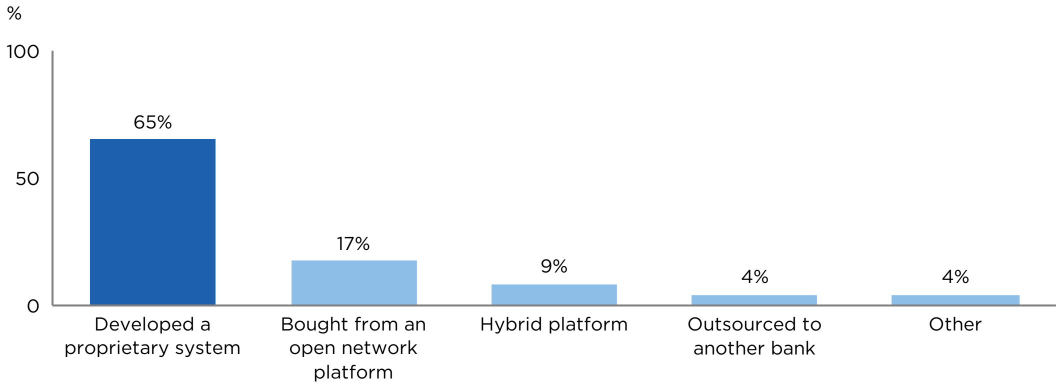


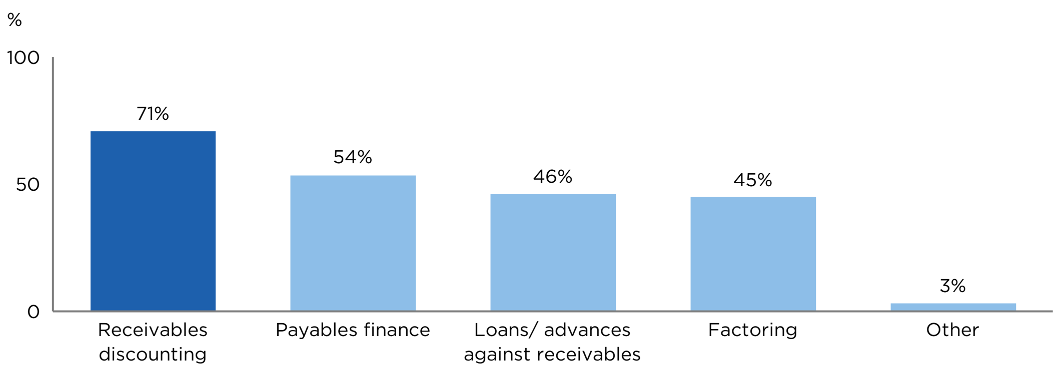
Figure 54
Which of the below best describes your bank's SCF platform(s)?



In terms of the different SCF products, receivables discounting is seen as the most in-demand SCF technique from a client perspective (Figure 55), followed closely by payables finance, loans/ advances against receivables, and factoring. While not necessarily evident from the survey data, there is substantial variation in the customer profiles of these different products. Historically, receivables financing and factoring have been skewed to the micro, small, and medium enterprises (MSME) market, with payables financing more commonly used by larger corporates. Such programs typically involve large buyers extending payment terms to their suppliers, while concurrently inviting suppliers to access funds early on the basis of a discount.

Current market patterns are starting to change with increased demand for receivables finance among lower-margin but high-revenue large corporates, as a means to manage cash flow and liquidity. On the other end, as technology has developed and become more scalable, and non-bank players and third-party investors have grown their presence in the market, we are beginning to see more and more mid-market SCF programs.

Figure 55
What, if any, of the following SCF techniques are most frequently cited as a priority for your bank's clients?



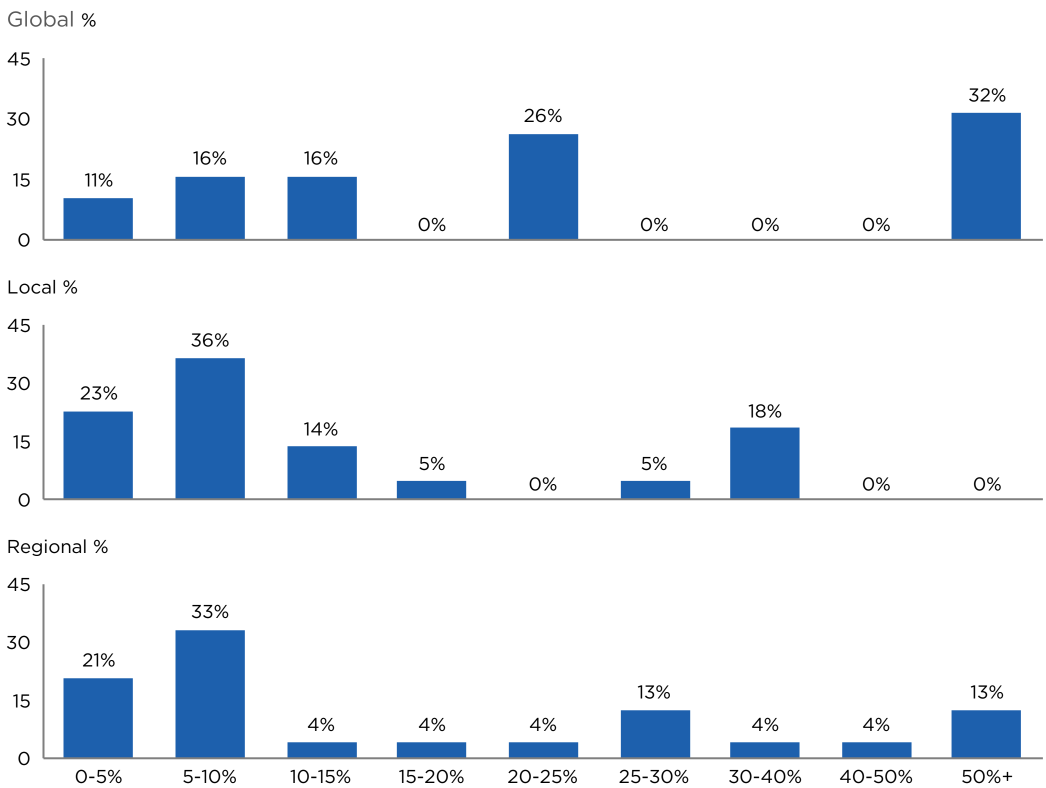
In line with market forecasts, global banks reported that they expect to see a significant increase in the usage of SCF over the next five years – with one-third expecting over 50% growth (Figure 56). By contrast, the majority of local banks expect only 0–15% growth over the same time period, again highlighting the divergence in perspectives between different types of banks. This raises strategic concerns for smaller regional and local banks. If their growth will not come from SCF and open account trade, where will it come from in a market where traditional trade is flat to downward-tending, as reflected in the analysis of SWIFT data earlier in this report?

This is exacerbated by the fact that as larger banks continue to invest in technology to drive automation in trade, it will be increasingly difficult for smaller players to compete on cost-to-serve, putting them in a challenging position in the market. As such, now is an important time for regional and local players to understand how they can access technology in a cost-effective way in order to build a resilient, future-ready trade and supply chain business. The increased availability of banking-as-a-service, software-as-a-service, and infrastructure-as-a-service (including cloud) solutions are likely to play a key role.

Perhaps equally important, the lessons learned by large global banks – and fintechs – around supplier onboarding and payables finance program design and deployment can prove invaluable to regional and local banks in charting a way forward. Industry practitioners in leading SCF banks will likely acknowledge that the core challenge is not necessarily a technology challenge. Multi-bank, consortium-based initiatives may offer a compelling path for non-global banks to participate in the open account market through SCF solutions targeted at their unique client base. Relatedly, finance executives in mid-cap and smaller enterprises may not be as conversant with SCF techniques and may not therefore express a demand for such support from their financial institutions.

Figure 56

What are your growth expectations for SCF within your bank for the next five years?

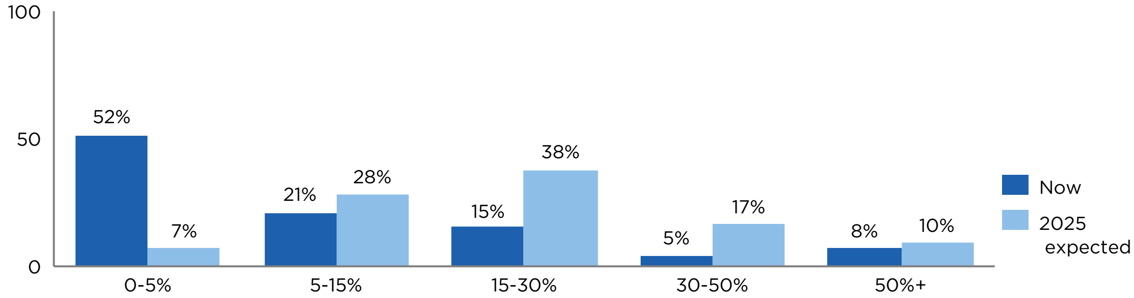


While a majority of respondents indicate that SCF represents only 0–5% of the trade financing made available today, only 7% think that this will be the same in 2025 – highlighting the expectation in the market of the growth in popularity of SCF relative to documentary trade and TTF (Figure 57).

It is worth noting that the findings of this survey will likely understate bank activity levels in SCF, since certain techniques – such as factoring – reside and are delivered in areas outside of a typical trade finance business, in some cases even outside a bank through a related affiliate entity.

However, despite the enthusiasm that global banks have for SCF, the survey reveals a number of challenges in delivering SCF solutions to customers.

Figure 57
What is the proportion today of SCF against TTF provided by your bank? By 2025, what do you expect to be the proportion of SCF against TTF provided by your bank?



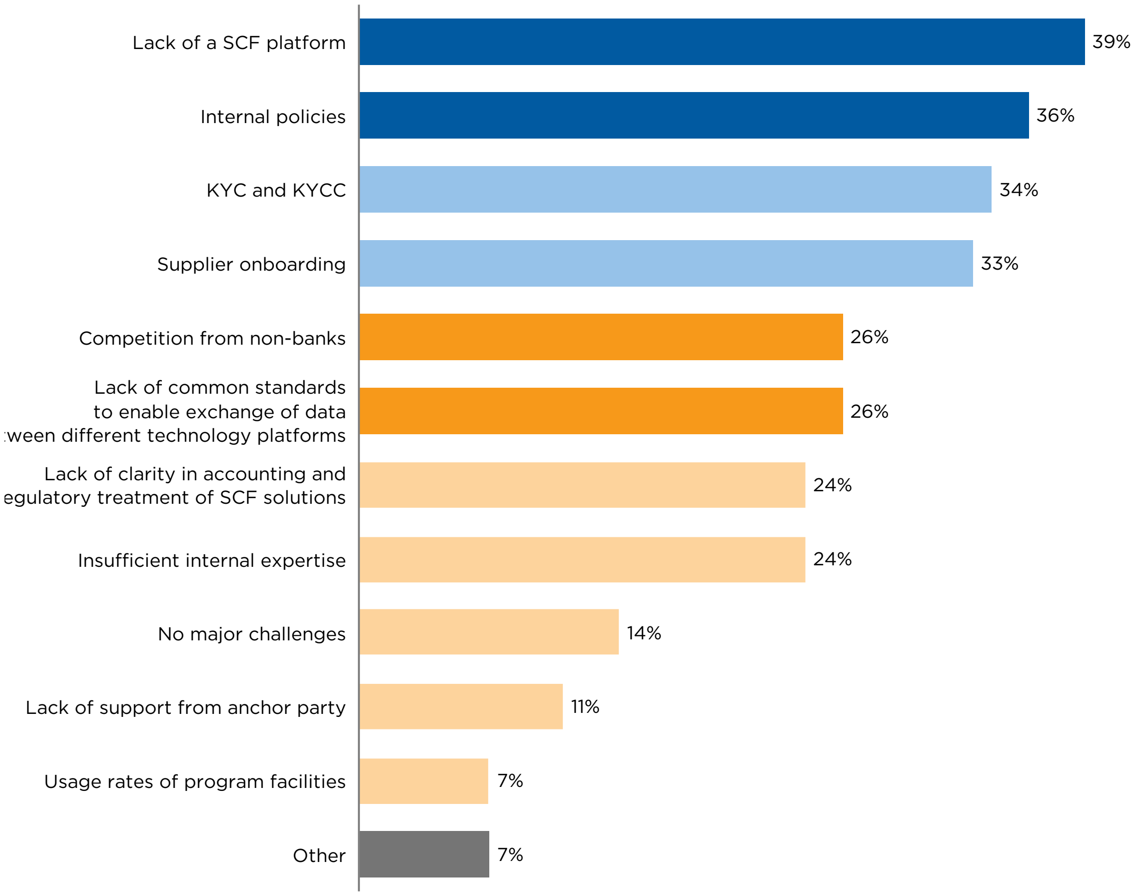
Lack of an SCF platform and aligning internal policies to SCF are the primary concerns of respondents (Figure 58). As referenced above in Figure 55, the majority of respondents who offer an SCF platform have developed their own system; it seems the development of a system is highly prohibitive to banks not yet offering SCF solutions.

KYC and supplier onboarding are concerns, with one in three respondents citing these as major challenges. Further, a quarter of banks surveyed were concerned about competition from non-banks and lack of common standards to enable the exchange of data.

Ensuring that banks of all types are provided with guidelines and support to understand and implement SCF solutions should be an industry priority in the coming years. Indeed, the barriers to the adoption of SCF solutions cited by many banks in our survey are highly solvable – with the right tools. Fortunately, as SCF has grown in popularity, it has also grown in maturity; industry bodies such as the ICC, BAFT, the ITFA, FCI and the EBA, through the Global Supply Chain Finance Forum (GSCFF), work to drive the evolution of SCF and to advocate for its appropriate, transparent, and properly reported use in support of domestic and international commerce. Industry leaders and practitioners have a responsibility and an opportunity to advance thoughtful, informed dialogue with corporates, banks, governments and regulators to maximise a common understanding of SCF techniques and to begin setting the necessary standards globally.

Figure 58

What are the major challenges, if any, your bank faces in delivering SCF solutions to your customers?



FEATURE

Supply chain finance: evolution or implosion?

ICC Global Survey Editorial Committee

Supply chain finance is increasingly recognised as an important and growing solution set in the financing of international trade – high-value, strategically important economic activity worth about USD 25 trillion per year if we count merchandise and service sector trade. Up to 80%, or about USD 16 trillion, of merchandise trade is said to depend upon some form of trade finance, with the fast-growing service sector inexorably developing an increasing need for trade finance.

SCF, an umbrella term that covers multiple techniques, aims to address the vast majority of trade today that takes place on open account terms, with the remaining 10% or so on the merchandise trade side enabled through more traditional trade finance mechanisms such as documentary letters of credit and documentary collections.

SCF has been showing promising signs of growth and wider adoption, with one of its variations or techniques, payables finance, providing a viable mechanism for enhancing the cash flow of both the buyer and the seller in a cross-border supply chain. Such programs, where a buyer extends terms to improve its own financial health while simultaneously offering discount options to suppliers, are even encouraged in a couple of key jurisdictions as a means of addressing systemic liquidity issues and SME finance challenges.

A nascent proposition in the market, SCF as a whole (though not all techniques under that umbrella term) is beset by a lack of common understanding and clarity around what is deemed ‘appropriate practice’, and by the absence of definitive guidance on accounting treatment and reporting requirements.

This reality creates a context in which innovation can thrive. However, it also indirectly enables boundary-pushing practices, some of which should be welcomed and supported, and others which are questionable at best, or even outright abuses aimed at obscuring commercial and financial realities.

The evolving nature and thus far limted development of of clear and agreed industry standards and accepted practice, to say nothing of the absence of ICC rules, opinions, and guidance which have provided critical parameters in traditional trade finance since 1933, amplifies the situation. Though this is natural given the early stage in which SCF exists at the moment, those very same characteristics, coupled with the entry of unregulated fintechs and non-bank financiers into SCF, create a perfect storm of innovation plus potential abuse.

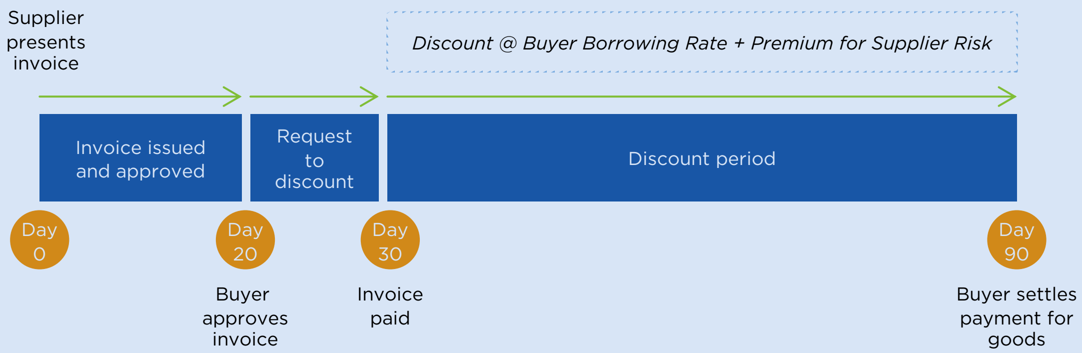
Trade finance and more specifically SCF have been the subject of unaccustomed levels of attention from the press, ratings agencies and regulatory authorities, partly off the back of a very few, but highly visible commercial failures linked to payables finance and partly as a result of market activities that trigger reactions across a range of stakeholders.

Thoughtful and well-informed questions are important and welcome, as are genuine efforts to shine the light of truth on SCF practices around the globe. Sensationalist postures by writers or by others seeking to earn political points are less constructive and should be countered by more rigorous discourse.

Unbalanced postures pose an existential threat to a set of financing solutions that could prove powerfully effective in advancing economic inclusion and trade-based growth.

Contrary to some of the coverage, which highlights the extension of terms as an abuse of SMEs through payables finance, the complete picture on this technique is

Figure 59
Payables finance in action



that terms are extended to benefit the large buyers, while participating SMEs have the option to secure immediate payment at a discount to the face value of invoices, at rates linked to the credit quality and (often lower) borrowing cost of the large buyer.

Are there alternatives, like mandated accelerated payment standards? Possibly, but these could arguably represent a market-distorting policy option as opposed to a commercial practice. Their use becomes a matter of political choice. Could the cashflow situation of MSME suppliers be improved by reducing transaction timeframes through technology or enhanced processes? Probably.

The specific characteristics of a payables finance program can vary – from the scope of coverage of suppliers, to the cost of discount and the degree of extension of terms. It is in the detail of program structure that definitions of accepted practice and the value of industry guidance plus regulatory and standards body direction can be critically important.

Should the option to extend payment terms through payables finance be open-ended, for example? In the absence of guidance and direction, some very credible and legitimate practitioners are happy to structure programs that extend out beyond 24 months, whereas others are developing an argument that term extensions ought to be guided by the typical working capital cycle of an industry sector. Other questions arise around the types of invoicing (and therefore underlying commercial or trade activity) that should be considered in-scope for payables finance.

In the end, payables finance presents a significant opportunity to enable the flow of liquidity across domestic and international supply chains, down into the so-called ‘long tail’ where MSMEs occupy an important space. Its appropriate use and structuring ought to be determined through a thoughtful, coordinated, and decisive set of steps involving press and ratings agencies, accountancy bodies and firms, regulators, trade industry bodies, finance providers, and corporates as well as MSMEs.

Whether or not boundary-testing practices (including financial and regulatory reporting) or structures will be tolerated by authorities, it is clear at this moment that some form of accepted framing of payables finance is necessary and important. Anything outside of those agreed boundaries may well be a valuable addition but should be clearly distinguished from SCF and payables finance.

SUSTAINABILITY

Survey analysis

Global trade has no way of hiding from the climate change challenge: its business-as-usual operations have long been susceptible to disruption from extreme weather events, and it is increasingly being forced to adapt to new regulations targeting carbon-heavy industries that directly impact their viability. It is imperative for banks to not only nominally support sustainable trade, but to integrate sustainability into their trade finance policies and day-to-day activities (such as supply chain finance). At the same time, sustainability should not just be viewed solely or exclusively through the lens of climate change, but rather, by reference to the widest definitions of sustainability which include environmental, social and governance (ESG) issues among others.

In the survey, 66% of respondents say that they have a sustainability strategy that applies to trade finance and SCF (Figure 60); we would expect – and hope – for this to climb to much closer to 100% in the future editions of the Global Survey, perhaps emulating the rapid shift in focus on ESG which has now become central to investment management and strategy, physical supply chain management, public procurement and a host of other areas. Indeed, as enablers of international trade, trade banks have a critical role and influential opportunity to drive changes in business practices and behaviours globally for the better.

Western European banks are leading the way in this area, with three-quarters having a sustainability strategy. More broadly, these strategies were primarily adopted due to credit and reputational risk (38%), as well as client expectations (35%) (Figure 61). These are likely also influenced by banks' group-wide policies and initiatives towards sustainability. Regulatory requirements are less of a driver across all geographies. However, this is likely to change in the coming years as new regulations come into force.

Figure 60
Does your bank have a sustainability strategy that applies to trade finance and supply chain finance?

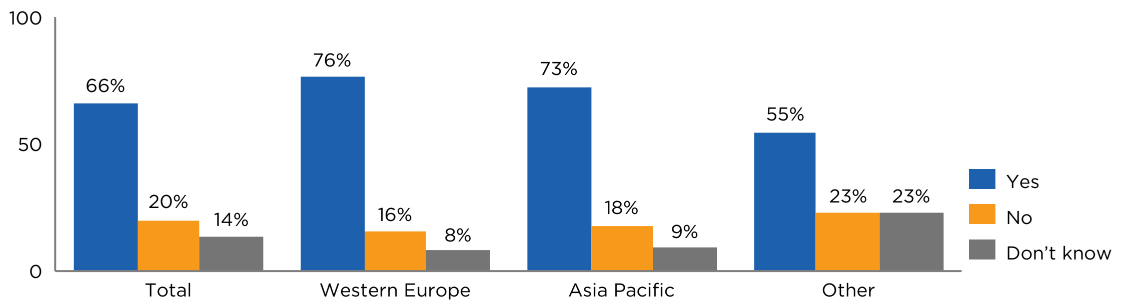
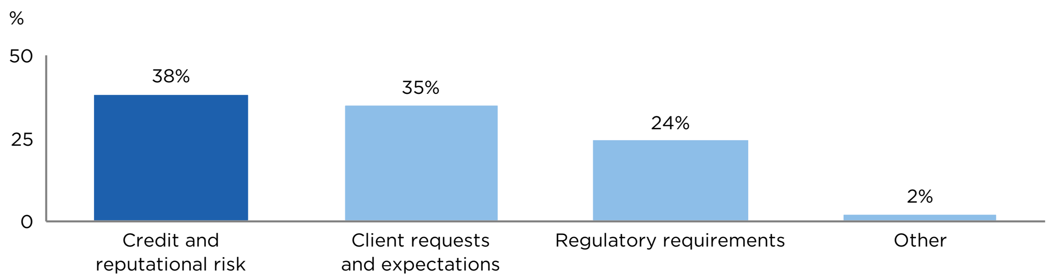


Figure 61
What, if any of the following, is the primary reason your bank has adopted a sustainability strategy?



The survey demonstrates that banks of all types are increasingly coming to terms with the need for a sustainability strategy in trade. The available evidence points to the integration of sustainability policies now – not just as a longer-term goal. Indeed, 76% of respondents indicated that they are already integrating sustainability-related due diligence in respect of KYC and other credit risk adjudication and management policies (Figure 62 and Figure 63). Further, 61% of respondents said that their bank has rejected trade finance applications in the past year as they didn't meet their bank's internal policies on ESG risks (Figure 63).

Figure 62
Is your bank integrating sustainability risks into credit risk management procedures for clients using trade finance/ supply chain finance instruments?

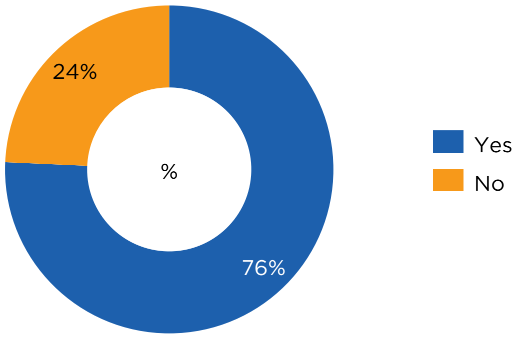


Figure 63
Is your bank conducting sustainability-related due diligence in its trade finance operations as part of KYC procedures?

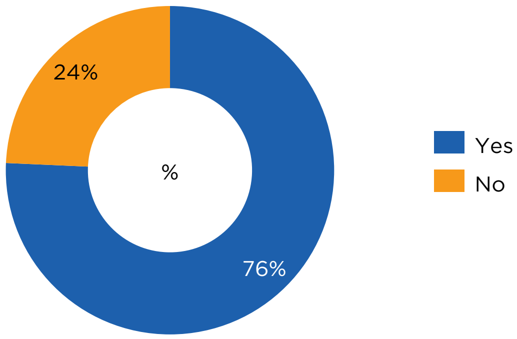
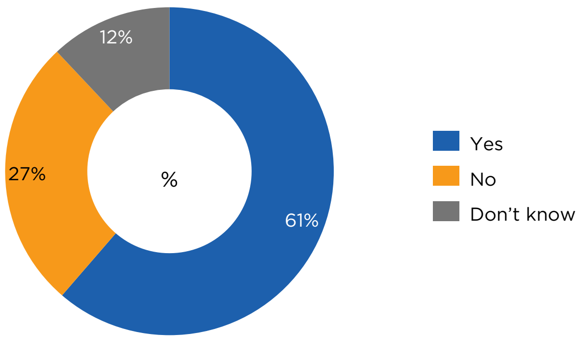


Figure 64
Did your bank reject any trade finance applications due to ESG risks with clients?



From a demand perspective, almost half of banks feel their clients are requesting innovative finance mechanisms to help them implement more sustainable strategies and operations (Figure 65), highlighting a clear expectation for trade banks to play their part in driving sustainability and advancing ESG considerations in trade. Customers want their banks to be proactive, and not just reactive.

There is strong agreement that climate change and the environment should be priorities for banks, with survey respondents ranking these areas as their key sustainability priorities (Figure 66). Banks continue to interpret sustainability as climate-related. At the same time, there is opportunity for banks to recognise the critical role that trade and trade finance provision play in other pressing social issues, such as the eradication of forced child labour, promoting financial inclusion of women, and the broader fight for gender equality, among numerous others. This fast-emerging reality mirrors the increasing responsibility faced by buyers for the actions and behaviours of members of their supply chain – no matter how small or how remotely located they may be. The human cost, and increasingly the regulatory expectations and reputational impact – good or bad – are transforming the way these issues are prioritised and addressed around the globe.

Figure 65

Are your trade finance clients requesting innovative finance mechanisms for implementing more sustainable strategies and operations?

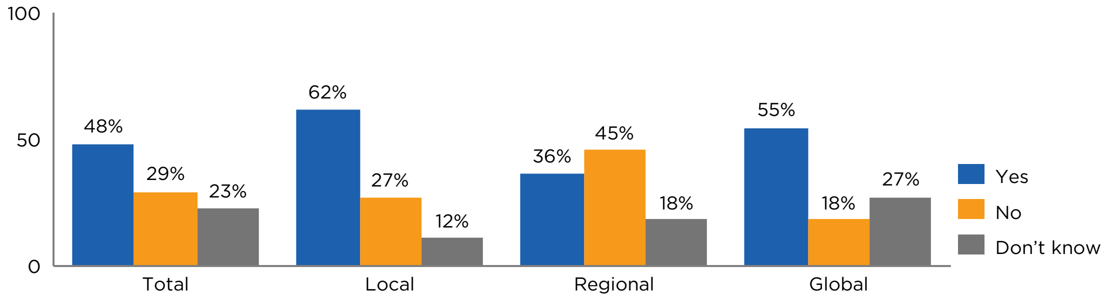
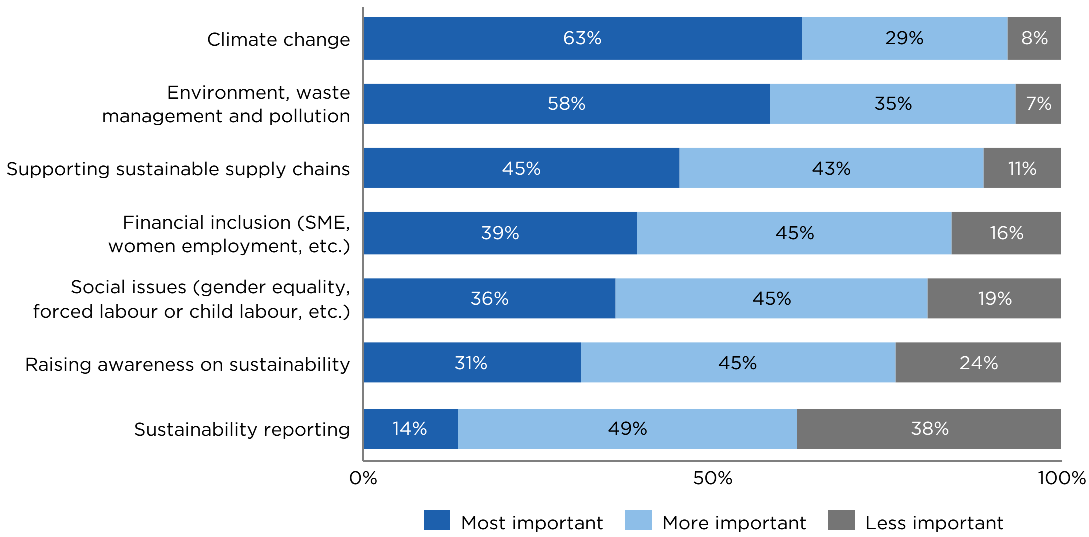


Figure 66

What should be the sustainability priorities for banks in trade finance over the next five years?

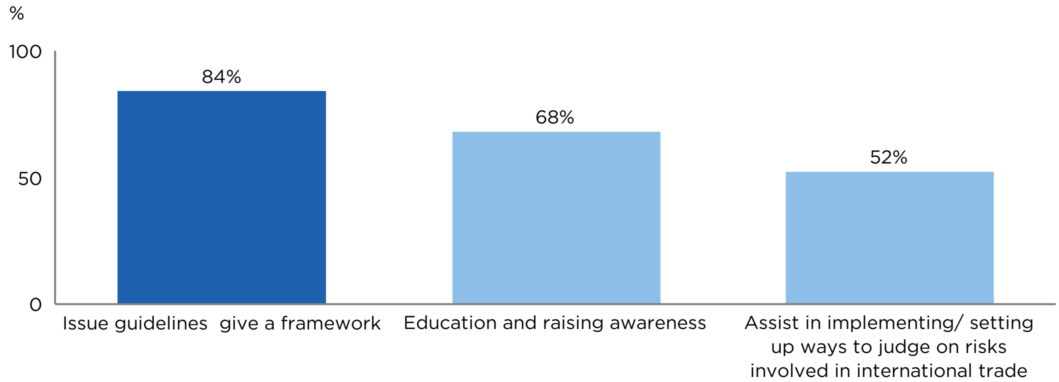


While banks indicate sustainability as a core business priority, there is a clear desire for structured support and formal guidelines to support them in this transition. 84% of survey respondents indicate that the ICC Banking Commission could add value by providing these tools (Figure 67).

The ICC is active at the highest levels of advocacy around climate change and sustainability, and the ICC Banking Commission has a well-established Working Group on Sustainable Trade Finance. In 2019, for example, ICC organised a series of consultations bringing together high-level business leaders, policy makers, academic experts, economists, and thought leaders to discuss the nexus between international trade and climate change. However, there is clearly room to continue and expand our contributions in this area: an opportunity that will rise in priority as more of our members adopt sustainability as a key part of their business.

Figure 67

Where/ how can the ICC Banking Commission add value to sustainability in trade finance?



FEATURE

ICC: accelerating progress on sustainable trade finance

Roberto Leva, Trade & Supply Chain Finance Relationship Manager Asian Development Bank; Co-Chair, ICC Sustainability Working Group
Harriette Resnick, Co-Chair, ICC Sustainability Working Group

Introduction

It is no longer a question whether banks that provide trade finance should allocate their capital in a way that promotes sustainable ESG practices by their customers. The question now is how to get it done at scale within the critical next decade.

The reasons why are evident to anyone following world events; major fires, sea-level rise and coastal erosion, flooding, heat waves and droughts, deforestation and biodiversity loss are all occurring with alarming frequency across the globe. Regulatory authorities, as well as customers, investors, and employees, are focusing on whether these global threats pose prudential risks to banks and the extent to which their portfolios are aligned, or out of sync, with sustainable development goals.

In response to these challenges, the ICC Banking Commission's Working Group on Sustainable Trade Finance has developed database tools and guidance that can help banks identify and mitigate their exposure to risks arising from adverse environmental and social effects of customers' operations and supply chains. Through four work streams, members from commercial banks, multilateral development institutions, and other trade experts are exploring how to accelerate the use of trade finance to encourage sustainable business practices.[1] The objectives and achievements of the working group to date, which are consistent with ICC's, ADB's and many member organisations' commitment to climate action and promotion of green and inclusive growth, are described below.

Process and principles

This work stream has created tools and guidelines that enable trade bankers to identify sustainability risks arising from trade finance transactions and to speak to their customers about them. Its objective is to drive integration of these tools and guidelines into operational processes, in line with individual banks' risk management strategies and ESG, reputational, and credit risk policies.

To facilitate trade bankers' access to key ESG information, work stream leaders Nigel Beck and Lindokuhle Ndlangamandla of Standard Bank have collaborated on International Finance Corporation's development of a new version of its Global Map of Environmental and Social Risks in Agro-Commodity Production (GMAP) database.[2] In addition to highlighting such risks arising in over 250 country/ commodity scenarios, GMAP now integrates information from the International Trade Centre's (ITC) Standards Map that specifies which voluntary certification authorities are available for those scenarios and whether their requirements address the high risks identified by GMAP. Targeted next steps are to improve ease of access to GMAP/ ITC data, potentially through developing an interface for an automated feed into user systems, and to cover other country/ soft commodity risk scenarios.

1 The working group, led by Harriette Resnick, independent advisor, and Roberto Leva, Trade and Supply Chain finance specialist at the Asian Development Bank, has also benefitted from the input of talented young professionals participating in the Banking Commission's Successors in Trade program

2 GMAP was created by IFC with the assistance of World Wildlife Fund, drawing on the IFC 2012 Performance Standards on Environmental and Social Sustainability. To get access to the full GMAP data, register without charge through this link: gmaptool.org/register. A webinar on the integrated GMAP tool is available at: youtube.com/watch?v=0HLXlexzJN4&feature=youtu.be)

In addition, inspired by the due diligence process used by banks to comply with KYC requirements, working group co-head Roberto Leva of the Asian Development Bank spearheaded the development of sustainable trade finance Customer Due Diligence Guidelines. The guidelines include a questionnaire that can form part of a client-level review, designed to help relationship bankers identify whether a customer's operations or supply chain pose ESG risks. They also aid them in evaluating customer responses to determine whether the client is taking appropriate steps to mitigate those risks. To minimise customer workload from duplicative information requests, SWIFT is currently working to incorporate the questionnaire as an optional feature of its new Corporate KYC Registry.[1]

We are soliciting feedback on these tools, both from banks and corporates, to validate their utility and highlight potential areas for improvement.

Training

This work stream, with Roberto Leva as its leader, aims to develop training materials to raise awareness of the risks faced by banks if they finance customers who fail to manage adverse ESG impacts. In addition to case studies that provide examples of these risks, we aim to spotlight business opportunities that encourage sustainable practices. Training resources will also highlight the tools and guidelines described above. The first step will be the creation of a podcast sponsored by the Asian Development Bank, in collaboration with the ICC Academy, to be widely available to the industry in 2020, to assess further interest in additional content. Following the podcast, the working group, the Asian Development Bank, and the ICC Academy will evaluate the need for the creation of online training to be accessed via the ICC Academy platform.

Regulation, policy and green finance: definitions and taxonomies

The regulatory landscape relating to 'sustainable finance' is evolving quickly. Taxonomies to define that term have been developed by the EU and other jurisdictions for a range of economic activities.[2] Central banks and supervisory authorities recognise, and are taking steps to address, the prudential risk to financial institutions created by climate change and other ESG challenges, and the need to promote sustainable transactions.[3] Banks may soon be required to conduct stress testing through portfolio reviews that assess exposure to climate change impacts.[4] They may also be asked to disclose the extent to which they have financed 'green' transactions, or have exposure to customers whose business results in climate-related physical or transition risks or other adverse environmental or social impacts.[5]

In response to these developments, the working group has initiated two new work streams. The first, led by Merisa Lee Gimpel of Lloyds Bank, will seek to develop support for the proposition that sustainable operations and supply chains reduce default rates for customers' trade finance transactions. As part of this inquiry, they will consider what data is needed to make this case. This stream will also examine the policy ramifications, i.e. whether sustainable trade finance merits capital relief, or should improve a company's credit rating, as well as what other incentives are needed to encourage the funding of 'green' trade transactions.

1 swift.com/news-events/news/enabling-smoother-know-your-customer-kyc_processes-for-corporates
2 See, for example, ec.europa.eu/info/files/200309-sustainable-finance-teg-final-report-taxonomy_en ("Final TEG Report)
3 or information about the Network for Greening the Financial System, see ngfs.net/en; centralbanking.com/awards/4662326/green-initiative-network-for-greening-the-financial-system
4 See, for example, bankofengland.co.uk/paper/2019/biennial-exploratory-scenario-climate-change-discussion-paper
5 See, for example, fsb-tcfd.org/; Final TEG Report at 9

Under the leadership of Simon Connell of Standard Chartered Bank, the other new work stream aims to define 'sustainable trade finance' with greater specificity[1] and in line with regulatory developments. The objective is to help identify which trade transactions will meet the growing demand for sustainable assets that is being encouraged by public policy measures. Focusing initially on the traditional trade and supply chain finance products covered in the ICC Trade Register, work stream participants will review whether current definitions of sustainable investments from ongoing taxonomy initiatives can be leveraged to apply to these trade structures, starting with a few sample business sectors and their related taxonomy criteria.

Conclusion

Throughout its history, the ICC Banking Commission has developed rules and best practice standards that have helped trade finance to flourish, both as critical, trade-enabling commercial activity, and more recently as an asset class. The Sustainable Trade Finance Working Group's ongoing efforts to define the pathway for sustainable trade and expand its positive impact continues that important tradition.

1 To date, our working definition has been the provision of traditional trade and supply chain finance products to support "the business and activities of buying and selling commodities, goods and services that meet environmental, social and economic criteria capable of benefitting all actors involved and minimizing adverse impact while fostering sustainable global development." iccwbo.org/publication/global-survey-2018-securing-future-growth/

REGULATION AND COMPLIANCE

Survey analysis

Over the past few years, the growing use of digital solutions by banks has enhanced their ability to assess risk and combat criminal activity. However, the increasing sophistication of criminal and terrorist organisations has been accompanied by a growing regulatory regime aimed at stamping out criminal activity from the financial system and from global trade. This trend, along with new capital requirements from the Basel Committee, presents significant concern to banks across the world – particularly in respect of the resources needed to meet the increasing complexity of regulation and compliance policies.

56% of survey respondents indicated that their banks were significantly concerned both by understanding and implementing compliance procedures, and with capital and regulatory requirements (Figure 68 and Figure 69).

However, while there was widespread similarity across banks on capital and regulatory requirements, there was a more pronounced divide between different types of banks in respect of compliance. While 74% of global banks and 68% of regional banks indicated that they were extremely concerned by the need to implement compliance procedures, only 35% of local banks said the same. This, unsurprisingly, suggests that navigating the complexity of compliance rules and regulations may have the most pronounced impact on trade banks that operate across multiple countries and jurisdictions.

Figure 68
How concerned is your bank with understanding and implementing compliance procedures?

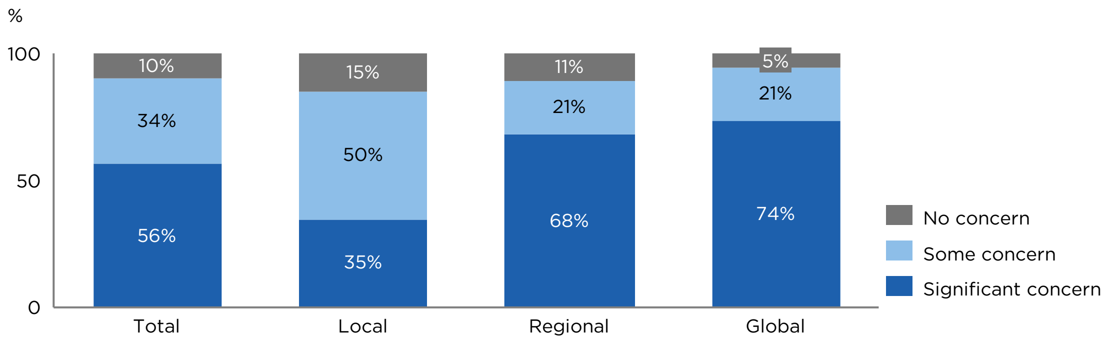
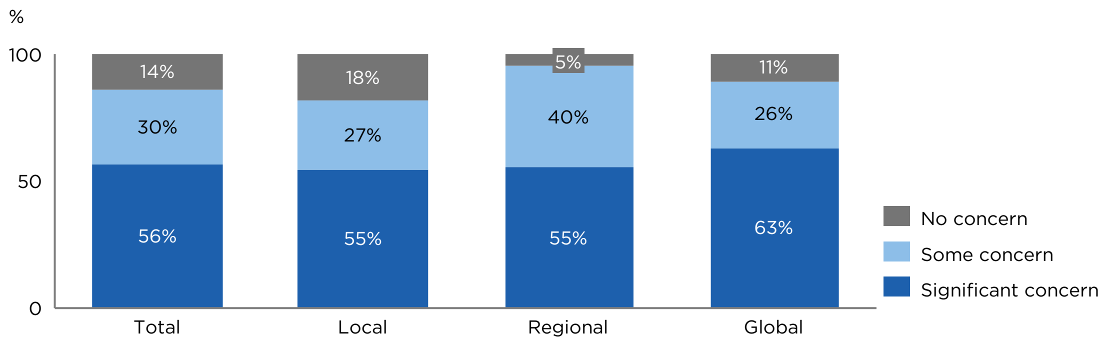


Figure 69
How concerned is your bank with capital and regulatory requirements?



The impact of an increasingly complex regulatory regime has been felt by banks across geographies. We asked banks to give a sense of the FTE increase needed over the past decade to understand and implement new financial crime policies. 40% of respondents said that they have been required to increase their staff by 20% or more (Figure 70); among banks based in Western Europe this number rises to 55%. Furthermore, when asked how due diligence transaction and client monitoring capabilities have evolved in the past year alone, many respondents cited an increase in staff numbers. This clearly has a material impact on operational costs for trade banks – which is likely to be passed on to customers in the form of higher prices or may have the unintended adverse consequence of reducing overall industry capacity to provide trade finance.

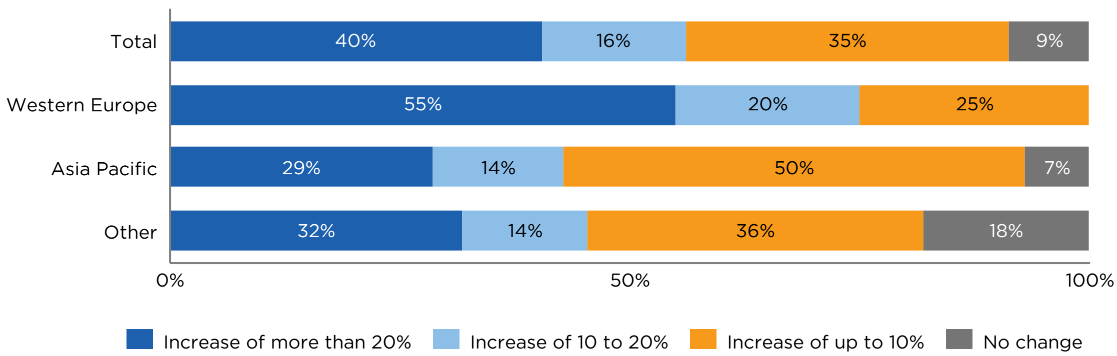
The unintended impact of regulation arising, for example, from cross-border inconsistency or material variations in standards of compliance, can be profound: the complexity and/ or cost of compliance may result in banks being less able to cost-effectively support trade. This is most relevant for MSMEs, who are often seen to be the highest risk and therefore need the most onerous checks but bring in the lowest revenue per transaction.

As such, AML, KYC, and other regulations are alleged to be a key contributor to many banks underserving the SME market. However, at the same time, very few banks would argue against the need for such regulation, and therefore the key question remains: how can regulatory authorities and banks together achieve an optimal balance between regulatory efficacy and assured access to timely and affordable trade finance?

Banks may debate the expectations – implicit and explicit – from authorities that the financial sector ought to become more central to investigative, intelligence, and prosecutorial activity, and regulators may indicate that the commercial impact of compliance costs is irrelevant. In reality, the path forward is one that leverages technology but is built on a foundation of effective collaboration between banks, governments, regulators, and industry bodies.

Figure 70

Compared to ten years ago, can you give an estimation of the increase of FTEs that has been needed to implement financial crime policies in your bank?



Operationally, since 2018, most banks have seen either an increase or no change in the number of alerts of suspicious activity, false positives and trade finance red flags, with only a small minority reporting a decline (Figure 71). For the significant number of respondents who indicated an increase in 2019 across the three measures, it is challenging to ascertain whether this trend is good news (i.e. the numbers are increasing due to improved bank operations and digital solutions to detect criminal activity) or a sign of increasing criminal sophistication and usage of trade channels.

For the trade banks implementing machine learning-based controls, reducing the number of false positives is a critical Key Performance Indicator (KPI) in the cost effectiveness of this technology, and many are pushing to bring false positives to well below 15%.

Financial intelligence units report anecdotally that 'defensive' filings of Suspicious Activity Reports (SARs, also called Suspicious Transaction Reports and Suspicious Matter Reports) generate material volumes of content for authorities to review, with little actionable intelligence arising when such reports are filed based on an overabundance of caution – 'just in case' – by banks. Efforts are underway by the Asian Development Bank, following publication of the ADB's Trade Finance Scorecard: Regulation and Market Feedback, to advance collaboration and to advocate for the inclusion of selected common (and

Figure 71
Please indicate for each of the following if the number has increased, decreased, or remained the same when compared to 2018

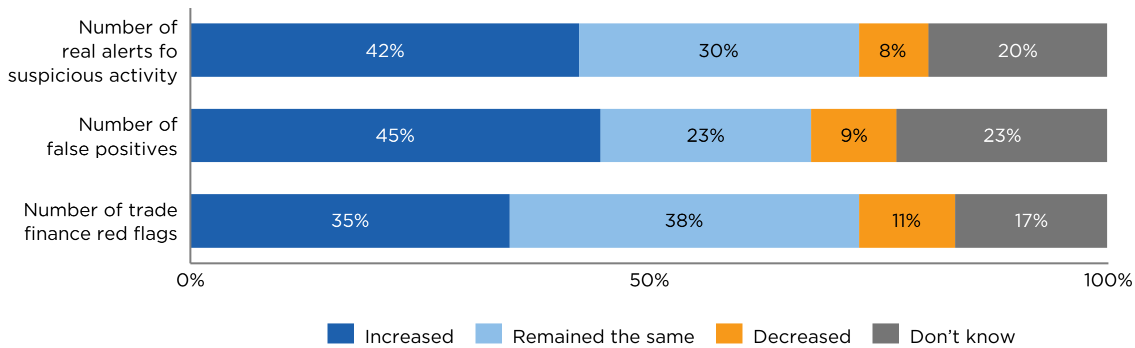
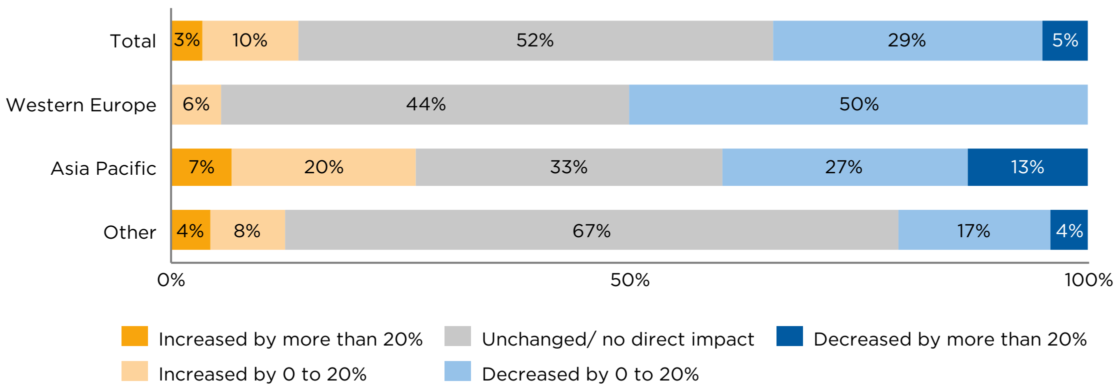


Figure 72
To what extent has the regulation implementation measures relating to financial crime and AML impacted your trade finance business (in transaction volumes)?



structured) data elements in SARs, and to enable cross-jurisdiction investigations and follow-ups between intelligence and investigative agencies and others. This is with the direct intent of reducing the adverse impact on trade finance while concurrently helping to improve the value of SARs in generating actionable intelligence.

We also asked banks to estimate the impact on their trade finance volumes as a result of AML and financial crime policies. Over half of respondents said that these regulations had no direct impact on transaction volumes (Figure 72), and a further 34% indicated a decrease. However, there are relatively sharp divergences across different geographies.

In Western Europe, 50% of respondents said such policies had a negative impact on transaction volumes, with 44% indicating no direct impact. While we may have expected a greater proportion of respondents to indicate a reduction in flows as a result of financial crime regulation, it is encouraging to see how banks have been able to adapt.

KYC regulation and AML policies have increased the regulatory imperatives faced by trade banks in recent years. Manual data provision by customers and slow verification processes can delay or even prevent banks from supporting transactions in a commercially timely manner, impeding the building of new customer relationships.

Figure 73
Please indicate which, if any, of the following KYC utilities your bank is using?

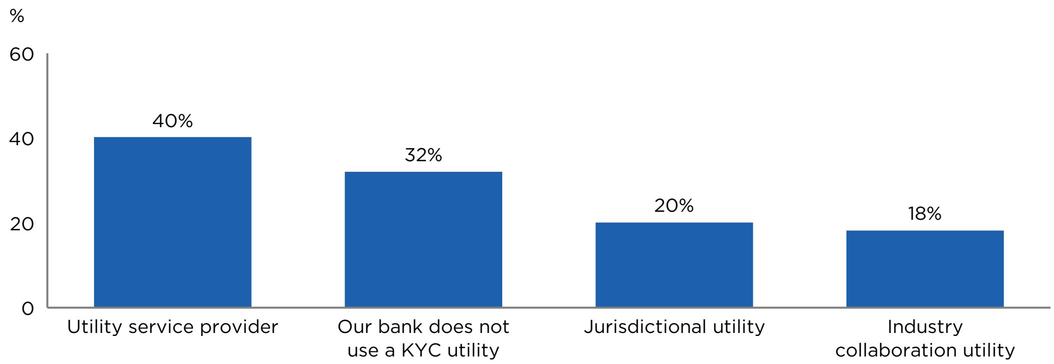
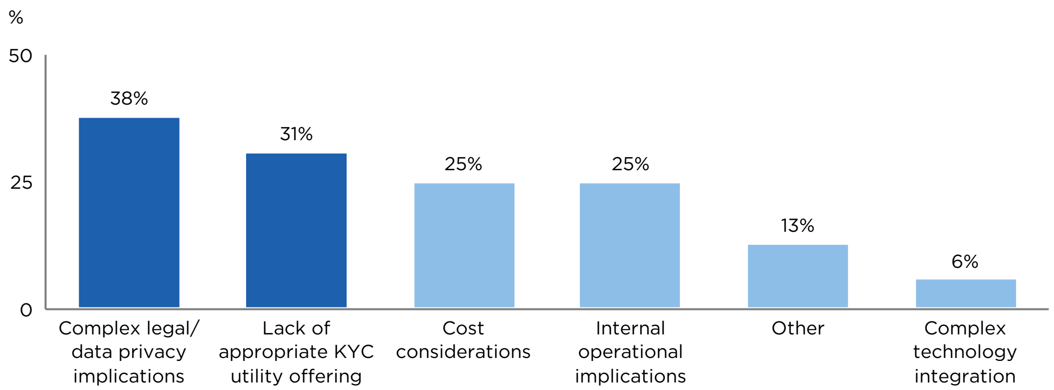


Figure 74
For what reasons does your bank not use a KYC utility?



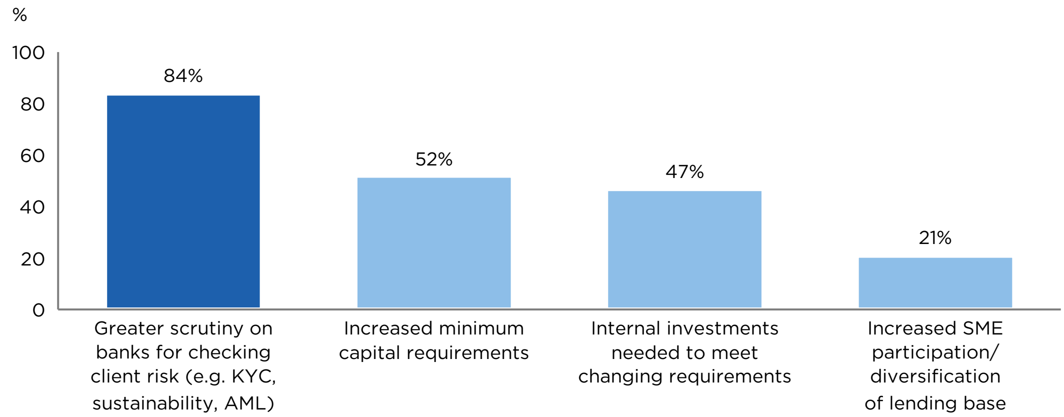
KYC utilities aim to ease this process for trade banks by standardising data and risk operations and enabling industry collaboration. However, when asked which KYC utilities banks were using, 32% indicated that they were not using one at all (Figure 73). Of the remaining respondents, 40% indicated that they were using a utility service provider to manage their KYC risk monitoring and operations, 20% were using a jurisdictional utility, and 18% were using an industry collaboration utility. Of the one-third of respondents not using a KYC utility, 38% indicated legal and privacy implications as the main reason (Figure 74) A further 31% said that there was no satisfactory utility offering available. Only 6% were discouraged by the cost and complexity of technology integration.

Looking ahead, the survey indicates that banks do not expect regulatory scrutiny to abate. 84% of respondents anticipate added pressure to check client risks (Figure 75) from KYC and AML policies to sustainability requirements. In line with this, digitised KYC and AML processes were the most frequent single change that respondents believe would improve efficacy in compliance activities. Other respondents would like to see increased guidance from regulators. One respondent voicing a common view across the industry stated that they would like to see "clearer and more consistent direction from regulators on compliance requirements".

52% of respondents anticipate an increase in minimum capital requirements, while 47% expect that their banks will need to

Figure 75

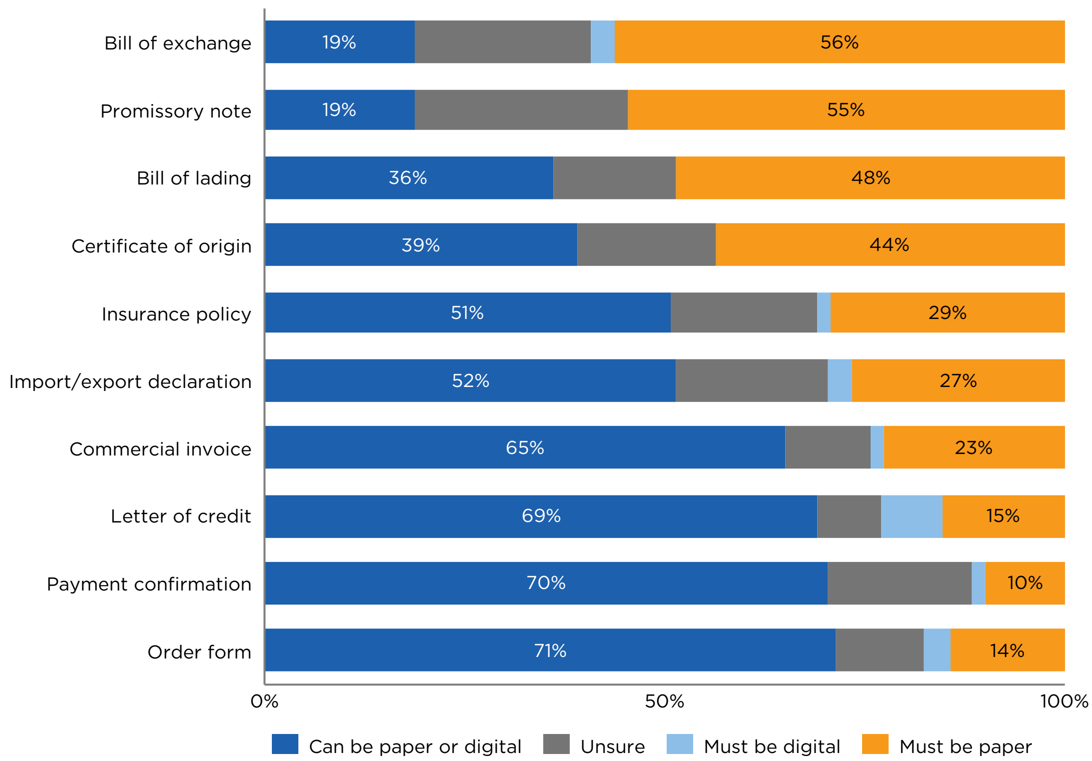
As regulation becomes stricter, what challenges/ requirements do you see being imposed on banks going forward?



make further investments in their internal operations to meet this expectation. There is a strong sense that knowledge sharing and collaboration across the industry would improve the ability to adhere to regulatory and compliance requirements, suggesting a wider adoption of KYC utilities in the future. The growing receptiveness of regulatory authorities to engage with industry through public-private partnerships such as the UK's Joint Money Laundering Intelligence Task Force or AUSTRAC's Fintel Alliance is a constructive development with promising potential. Progress on compliance-related data-sharing across borders would be an important complement, and should be achievable while respecting local and regional privacy law.

While regulation has become more complex in some areas, it appears to be starting to modernise to enable more digitised trade. For most trade documentation, over 50% of respondents mentioned that documentation was no longer mandated to be paper-based in the context of trade financing (Figure 76). The challenge, however, is that for trade to truly digitise, all end-to-end documentation – including bills of lading and certificates of origin, which in many markets still need to be physical – must be able to be digitised. Digital documents or digital data extracts must be more widely recognised as having legal standing. Digital documentation would also be required in both the importer's and exporter's jurisdictions. This makes it clear that local regulations and requirements remain a barrier to paperless trade. Digital trade is explored in more detail in the next section.

Figure 76
Which of these documents are legally required to be paper in your home jurisdiction?



FEATURE

Regulations in a digital world

Felix Prevost, Senior Capital Manager, GTRF, HSBC

When horse-drawn carts became prevalent and streets crowded, France introduced rules mandating that they stay on the right to reduce accidents and improve traffic flow. The UK chose the left. Whatever their reasons, be it to free coach drivers to manipulate whip or sword, a system of codified rules emerged to support ever faster and larger coaches. When the first motorised vehicles appeared, some states required a footman to precede the automobile to announce its presence and ensure clear passage. The rules of the road continued to evolve, and today self-driving cars are on the streets of multiple cities around the world.

Over the past two centuries, international trade has rocketed. Innovations in technology support ever more goods to move around the world in complex global supply chains. The advent of steam-powered ships allowed bigger and faster ships. Containerised shipping allowed faster loading and unloading of ships with fewer breakages. Finance of international trade, though, has barely changed since the invention of paper money: a letter of credit is a commercial bank's promise to pay, just like currency notes today are simply a note issuer's promise to pay the bearer on demand.

Digital innovations in the space of communication, computing and banking promise to change trade finance. The question we ask is whether regulations can evolve to support these digital innovations? To answer this, we must turn to the risks that the current regulatory regimes seek to address.

Communication

The world communicates electronically. We send emails, text, call, and videoconference around the world. Why do we still sign and mail physical contracts? Regulations around physical documents assume that physical presence ensures uniqueness (there is only one contract and no other false copy), acceptance (the signature proves that the counterparty has seen and accepted the terms of the contract), and legality (how else can I show this is legal unless I have a physical record?).

Until distributed ledger encryption (Blockchain) provides a suitably acceptable ecosystem for record-keeping of contracts (fix the terms in perpetuity for future record review, record who viewed and accepted the terms, etc.), electronic signatures and digital contracts provide an intermediate step which can achieve similar purposes as those of a physical contract. The European Union Electronic Identification, Authentication and Trust Services (eIDAS) regulation goes a long way in showing how regulation can support this digital solution to physical records.

In international trade, documents have multiple uses; however, at its core trade finance intermediated by banks helps build trust between buyers and sellers by ensuring, for example, that bills of lading, which enable the holder to claim and collect goods, are only released by the seller to the buyer once payment is ensured. As of now, most of these documents remain paper-based as they are not yet widely accepted electronically. Paper documents require manual processing and time-consuming and costly air freight delivery from the seller to their bank to the buyer's bank and onwards to the buyer. Digitising the paperwork could save on operating costs for each party in the chain (e.g. no postage), reduce operational risk (e.g. lost documents, incorrectly read documents), improve carbon footprint (e.g. no post by air), enable governments to enhance and accelerate their customs controls (e.g. automated submission of documents for customs pre-checks while goods are in transit) and ensure no tax evasion (e.g. one electronic submission to both exporting and importing customs offices preventing mislabelling or mis-valuing of shipment).

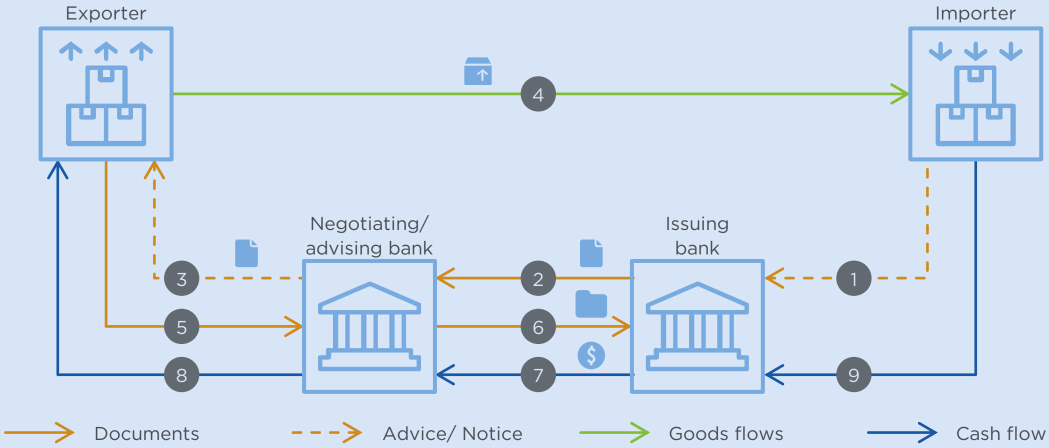
Evidently, all interested parties will need to move jointly together to support digitisation of trade documentation. If any one party, such as a customs officer or a freight forwarder, still requires a paper document by law or practice, then that document will need to be created and posted between the other actors. According to the World Economic Forum and the United Nations, a supportive regulatory framework covering banking, insurance, contract law, and customs as set out by the UN Economic and Social Commission for the Asia-Pacific (UNESCAP) could reduce annual trading costs by up to USD 7 billion and increase exports by USD 257 billion in Asia alone.

Computing

In the second half of the twentieth century, banks were among the first to adopt computers widely. Notwithstanding the tens of billions of dollars spent on bank IT each year, their core systems remain stuck in the days of green screens. As banks worldwide wrestle with creaking mainframes, two computing developments offer potential solutions.

Cloud computing could ensure that banks have access to enough computing capacity to run and grow their operations and optimise their vast pools of data to manage risks arising from intermediating such things as international trade. Many regulators around the world, however, remain hesitant as to the prospect of banks uploading their data stores into the cloud. Although borne of an understandable desire to protect individual consumer data, newly enacted data protection laws can act as a brake on banks upgrading their IT infrastructure. Outsourcing and operational resilience rules set by regulators such as the United Kingdom's Financial Conduct Authority (FCA) and the European Banking Authority (EBA) codify some of the expectations on banks in this regard. Regulatory sandboxes worldwide provide a useful mechanism for banks and cloud service providers to demonstrate the viability of their proposed operating model, and we can expect regulators to more fully embrace the use of cloud computing

Figure 77[1]
Typical documentary credit transaction



1 DC application
2 DC issued
3 DC advised
4 Goods are shipped
5 Documents presented. If any discrepancy exists the Exporter is notified
6 Document sent to issuing bank
7 Issuing bank will effect payment or accept for a future payment
8 Payment to Exporter
9 Documents received and import bill settled

Note the separate flow of documents on top of payments and goods

1 Step 8 can also take place before Step 9

in the banking industry. In the context of international trade finance, regulators may wish to consider balancing privacy and data sovereignty considerations against the positive impact of data-sharing and data storage across borders, with appropriate safeguards in place.

Cloud computing could unlock great value through its potential to power artificial intelligence (AI) and machine learning. Such tools could simplify and automate documentary processing for trade loans, credit approvals and risk management, including anti-money laundering and sanctions controls. A comprehensive regulatory framework for AI is still outstanding, with the European Union spearheading efforts to codify expectations that AI rules be auditable and explainable at the forefront.

Banking

Regulators are leading the charge on at least one area: around the world, they are beginning to force banks to open their doors to new financial technology providers (fintechs) through Open Banking Application Programme Interfaces (APIs). In the United Kingdom the FCA and the competition authority are mandating banks to allow their clients to share their data with other providers. Open Banking offers the promise of financial innovation with the aim of providing enhanced solution to clients. If they do not adapt and evolve, banks risk disintermediation as fintechs encroach on their business, or they risk being left to run the plumbing as utilities while fintechs reap the benefit of higher value-add service relationships with clients.

Open Banking can also help with building the infrastructure for a truly integrated framework to fight financial crime. Today banks are mostly left to their own devices to identify and report suspicious transactions based on their limited view of the end-to-end transaction and payment flow. In 2020 the UK government announced a new bank and financial services levy to tackle money laundering. Through Open Banking tools the Financial Intelligence Unit (FIU) or another authority could tap into a wider dataset to run its own anti-money laundering and sanctions screening. This could even be further enhanced by implementing the recommended rollout of Legal Entity Identifiers (LEI) and public company registries.

While most regulators are still exploring the relative risks and merits of Blockchain technology, some are taking the lead and establishing supportive frameworks to develop useful Blockchain solutions to trade finance. The Bank of Thailand has spearheaded the development of the Thailand Blockchain Community Initiative within its regulatory sandbox. This initiative aims to digitise and eliminate paper guarantees from the Thai government procurement system. Such digitisation promises to simplify the guarantee amendment and cancellation process. With governments in South Asia and the Middle East still often requiring the issuance of de jure or de facto open-ended guarantees, such simplification through a central repository of guarantees could see banks improve their capital allocation by more easily engaging with beneficiaries to cancel dud guarantees. Elsewhere in Asia, the Hong Kong Monetary Authority is partnering with banks to find a way to digitise trade documents. These are clear examples of a well-defined problem being road-tested to develop a solution in partnership with industry.

Regulators from Mexico to India have supported the development electronic platforms allowing companies to auction off their receivables in a bid to simplify access to working capital. Whereas certain jurisdictions make it prohibitive for companies to assign receivables, here is an example of regulators trying to bring together industry participants to create an arm's-length market for receivables. Likewise, recent progress in the ratification of the UN Convention on the Assignment of Receivables in International Trade suggests further potential in this area.[1]

1 www.mayerbrown.com/-/media/files/perspectives-events/publications/2020/05/the-un-convention-on-the-assignment-of-receivables.pdf

Developing rules

Laypersons can easily identify producers as suppliers and consumers as buyers, and most also understand that buyers can in turn be producers themselves. Practitioners also know that surrounding this supply chain there lies a complex ecosystem of freight forwarders, shipping agents, insurers, financiers, quality inspectors, customs agents, and regulators. Digitisation of trade finance has been a long time coming, but roadblocks remain on this transformation. Some jurisdictions still do not accept electronic bills of lading, while others require paper documents to support cross-border payments as part of capital controls. Change can only happen if all parties in the trade ecosystem move together in line with regulation.

Pax Romana gave the world one of the first systems of long-distance international trade. Over centuries, the Silk Road facilitated exchanges between China and Europe. European empires thrived from trade with the New World. The Industrial Revolution gave rise to specialisation of production on a global scale, with cotton from British colonies feeding mills in Northern England. Along the way, how legislators regulate market activity has evolved to reflect changing legal, cultural and technological realities. Like cars learning to drive themselves, trade finance is subject to digitisation and will require a supportive regulatory framework to ensure it can fulfil its potential, and the Digital Trade Roadmap set by the ICC establishes a helpful guide for regulators and industry to develop this framework.

FEATURE

Stronger together: combatting trade-based money laundering

Richard Bunting, Principal Specialist, Intelligence Partnerships, AUSTRAC
(Australian Transaction Reports and Analysis Centre)

International trade has increasingly become a target for criminal exploitation, and government and industry must join forces to combat trade-based money laundering.

In simpler times, a business front would suffice to make illegally acquired money appear legitimate. A chain of laundromats did the job for Al Capone and is the origin of the term 'money laundering'. Over time, criminals have turned to increasingly sophisticated methods to disguise the origins of dirty money and integrate it into the mainstream economy.

In trade-based money laundering (TBML), criminals take advantage of the size and complexity of international trade to transfer money between parties and evade authorities. Techniques include mismatching the value of the goods and payment (over- or under-pricing relative to market value, quantity or quality), issuing multiple invoices for a single shipment, or sending no goods at all. Money launderers may also seek to obscure their crime through constructing a network of highly complex trade processes that mingle legitimately with illicit funds and take advantage of governance gaps across jurisdictions.

TBML is big business. The profits of international organised crime have been estimated as 1.5% of global GDP, with more than half of these profits laundered through the global financial system.[1] Developing countries are particularly vulnerable, where value gaps in reported international trade have been estimated as USD 8.7 trillion over 2008-17, and USD 817.6 billion in 2017 alone.[2] The human consequences are grave, including 40.3 million people forced into slavery worldwide, a quarter of whom are children[3].

For authorities and the trade financing industry, TBML can be difficult to detect amid the many processes, parties, transactions and jurisdictions. As with any disruption approach, anti-TBML efforts need to be constantly refined to keep up with new and emerging risks posed by criminals seeking to harm the community and profit from their crimes.

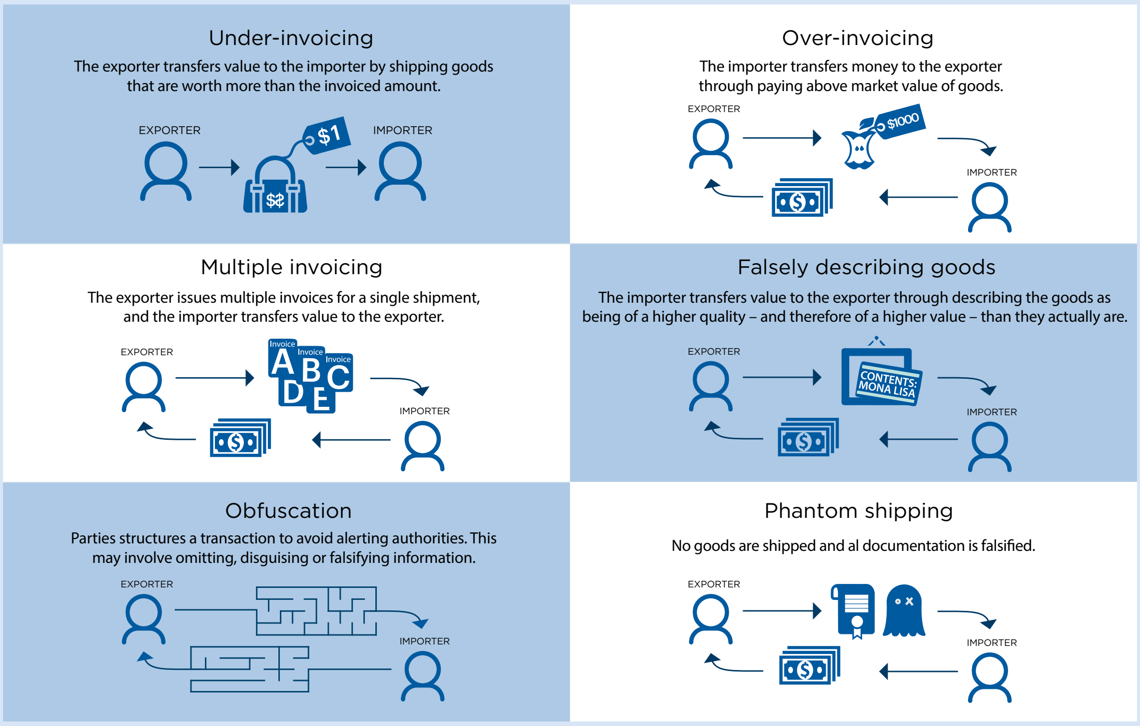
Collaboration is key

Acknowledging that no single body can tackle such challenges, the Australian Government's anti-money laundering/ counter-terrorism financing regulator and financial intelligence unit, AUSTRAC, takes a collaborative approach.

AUSTRAC is the Australian government agency responsible for preventing, detecting, and responding to criminal abuse of the financial system to protect the community from serious and organised crime. AUSTRAC regulates more than 15,000 businesses to protect them, and the financial sector, from criminal abuse. These regulated or 'reporting' entities are at the front line in combating financial crime. They submit reports about financial transactions and suspicious matters to AUSTRAC which become the building blocks of actionable intelligence. Each report contributes a piece of the jigsaw puzzle that, when put together, allows a more detailed picture to emerge.

1 OECD (2016), Illicit Trade: Converging Criminal Networks, OECD Reviews of Risk Management Policies, OECD Publishing, Paris. dx.doi.org/10.1787/9789264251847-en
2 GFI (2020), Trade-Related Illicit Financial Flows in 135 Developing Countries: 2008-2017, Global Financial Integrity, Washington DC. gfintegrity.org/report/trade-related-illicit-financial-flows-in-135-developing-countries-2008-2017/
3 ILO (2017), Global Estimates of Modern Slavery, International Labour Organization and Walk Free Foundation, Geneva. ilo.org/global/topics/forced-labour/statistics/lang--en/index.htm

Figure 78
Trade-based money laundering techniques



Such information realises its greatest potential when understood within a larger context. Suspicious matter reports and financial information received by AUSTRAC are available to more than 5,000 designated users within partner agencies to support national security and law enforcement investigations. AUSTRAC's analysts also use this information to identify new and emerging risks and to develop sophisticated in-depth intelligence reports on priority law enforcement and national security matters. AUSTRAC then provides indicators and trends back to the businesses it regulates to help them further mitigate risks and respond to emerging threats. As the quality of reports increases, so does the intelligence that leads to the detection and apprehension of criminals.

To further boost the benefits of collaboration, AUSTRAC established the Fintel Alliance in 2017, the world's first private-public partnership of its kind. Fintel Alliance's 28 members include experts from financial industry, intelligence agencies, law enforcement, and academic and research institutions. Along with improved operational outcomes, members' capability increases as partners learn from one another and synthesise knowledge. Fintel Alliance has now formed a TBML working group that includes front-line experts from industry and law enforcement to develop indicators and typologies that can be broadened to other jurisdictions and trade types.

The value of this interconnected approach is becoming clear. Better intelligence and information-sharing regarding child sexual exploitation resulted in a 643% increase in suspicious matter reports to AUSTRAC. This supported the detention or arrest of 73 persons and the protection or rescue of 35 victims in 2018-2019.

To combat TBML, as with other serious and organised crimes, we need to continue to monitor and prepare for shifts in the risks that criminals may pose to the financial system and community. Timely and quality contributions from industry are crucial for success. As financial crime becomes more complex across the globe, collaboration is a critical foundation to overcome criminal exploitation of our interconnected trade, financial systems and global communities.

FEATURE

Combating money laundering: improving systems, enabling trade

Can Sutken, Relationship Manager, Asian Development Bank, Trade Finance Program
Catherine Daza Estrada, Workshop Secretariat, Asian Development Bank, Trade Finance Program

Increased trade helps bring developing countries into the global financial system. But financing that trade can be difficult when the process is sometimes stymied by systems aimed to combat money laundering.

Trade helps build inclusive growth and reduces poverty. Trade finance helps facilitate international trade and commerce by making it easier for importers and exporters to transact business using financial instruments and products.

Greater access to the global financial system would narrow the gaps between developed and developing countries. Without proper financing, developing countries cannot benefit from trade because they do not have the money to build supply-side capacity and trade-related infrastructure. Greater financial inclusion is key to achieving the UN's Sustainable Development Goals (SDGs).

In the latest study by the Asian Development Bank, the global trade finance gap was estimated to be USD 1.5 trillion. This persistently large market gap impedes the full potential of trade to deliver growth, jobs, and poverty reduction. The ADB study identified AML and KYC requirements as one of the key reasons why trade finance proposals get rejected.

The United Nations Office on Drugs and Crime estimates only about 1% of crime proceeds laundered via the global financial system are seized and frozen. Around 80–90% of the reports of suspicious financing are of no immediate value to active law enforcement investigations, based on a poll conducted by the Royal United Services Institute.

To be clear, this isn't a choice between fighting financial crimes and improving financial access. Illicit money transfers cannot be allowed to compromise the integrity and security of the global financial system.

It is worth studying, however, whether the regulatory regimes designed for KYC, AML, and countering the financing of terrorism (CFT) could be streamlined so that the bad guys get caught but the good guys still get financed.

In terms of trade and trade finance, 'following the money' is thought to be more challenging given that trade finance involves complex transactions involving multiple parties, including correspondent banking relationships that are thought to be of higher risk from an AML perspective.

To address trade-based money laundering (TBML), the Asia/Pacific Group on Money Laundering Trade Based Money Laundering Typologies Report 2012 recommended the adoption of common formatting to record and maintain trade-relevant statistics. That way, data could be analysed to identify trends related to trade-based money laundering, instead of that data being lumped in with other forms of money laundering, as they are now.

For its part, the ADB Trade Finance Program has convened multiple stakeholders from international organisations, regulators, and major global banks to brainstorm on these issues and present practical solutions.

ADB is encouraging standard setters to consider adopting common trade data points in suspicious transaction reports to produce higher quality, actionable intelligence from those submissions. It has highlighted the need for a feedback loop between and among regulated banks, financial intelligence units, law enforcement, and other relevant agencies such as customs authorities.

To help address issues relating to non-customer due diligence in trade finance, and a perceived misalignment in trade finance examinations by bank examiners, the ADB has published "Trade and the Legal Entity Identifier", a paper discussing the Legal Entity Identifier as a unique and secure system to facilitate business transactions, risk evaluation, and money lending; and "Effective Practices in Trade Finance Examinations", which provides bank examiners and regulators a better understanding of trade finance, how departments involved work, and how to align expectations on appropriate compliance related to trade and trade finance.

Actively engaging the private sector in creating solutions to address money laundering, not just in trade and trade finance, could be the missing piece in the fight against financial crimes. The ADB is leveraging its neutral position to enable the parties involved to discuss and move forward with more clever solutions that are effective and support clean business.

This doesn't need to be a choice between fighting financial crimes or improving financial access. Systems can be designed to be better at spotting illicit transactions while streamlining the process so that the developing economies are not left behind.

DIGITISATION

Survey analysis

The Global Survey has already touched on several aspects of digitisation, from supply chain finance to SME inclusion to regulation. Digitisation is not simply a trend in trade finance, but a singularly disrupting change to the way trade finance operates. Given the difficulty that many banks have had in accessing original documentation during COVID-19 (due to lockdowns and quarantines), we expect the push to fully digitise global trade and trade finance to gather further momentum. While digitisation is widely seen as one of the most important – and promising – developments to shape trade finance in the coming years, the survey shows a clear divide between banks that have the vision, capacity and commitment to advance digital capabilities and those that currently do not.

Of the banks surveyed, 64% indicated that they have a digital strategy for trade finance (Figure 79). However, this number differs significantly by bank type. While 83% of global banks have a digital strategy, only 46% of local banks have one – a stark reminder of the challenges many banks face in integrating digital solutions into their existing offerings. Indeed, only 17% of respondents have successfully implemented digital solutions (Figure 80), with a surprising one in five not yet seeing any tangible benefits. 22% of banks said that they have tried to implement technology solutions but that it has been

Figure 79
Does your bank have a digital strategy for trade finance?

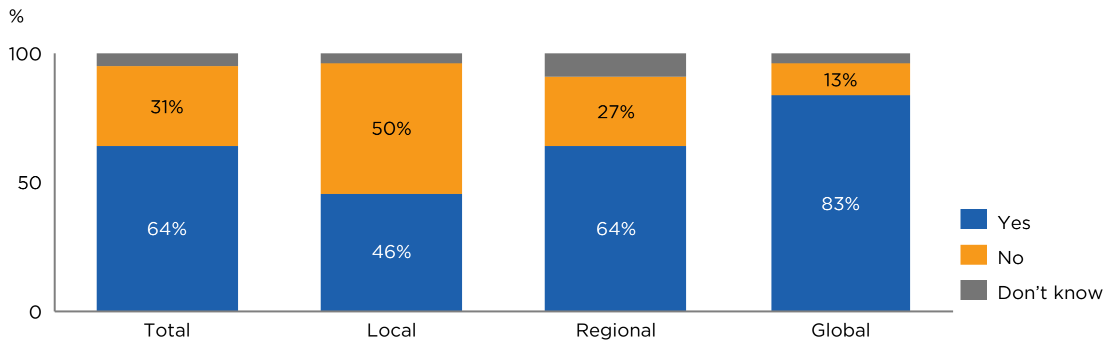
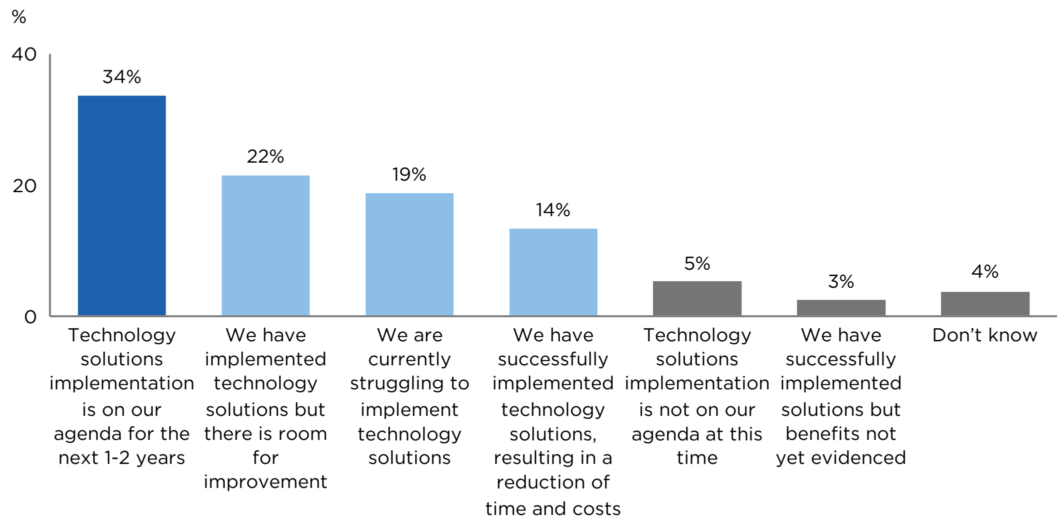


Figure 80
Please indicate the maturity of your bank in using technology solutions



imperfect, while a further 19% are currently struggling to even match that. This clearly highlights that the effort and expense of upgrading bank technology continues to be a key hurdle in digitising trade, and indeed for some organisations runs into hundreds of millions USD when calculated in US Dollars..

Of the various digital trade technologies looked at in the survey, the most common implemented by banks is an online platform for trade finance (55%) (Figure 81). This is unsurprising, and largely considered to be 'table stakes', given that channels represent the 'customer gateway' to digital trade. High-quality

Figure 81

What instruments and solutions are your bank using for digitised trade finance?

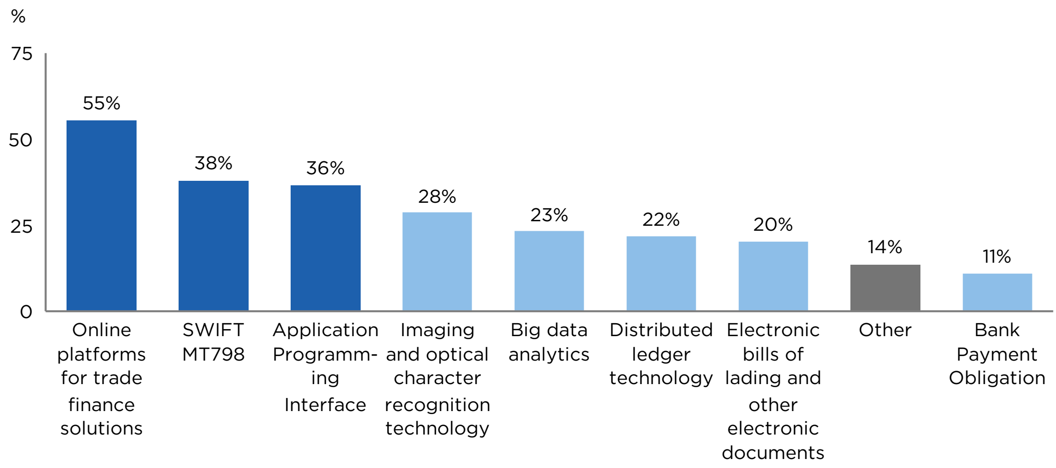
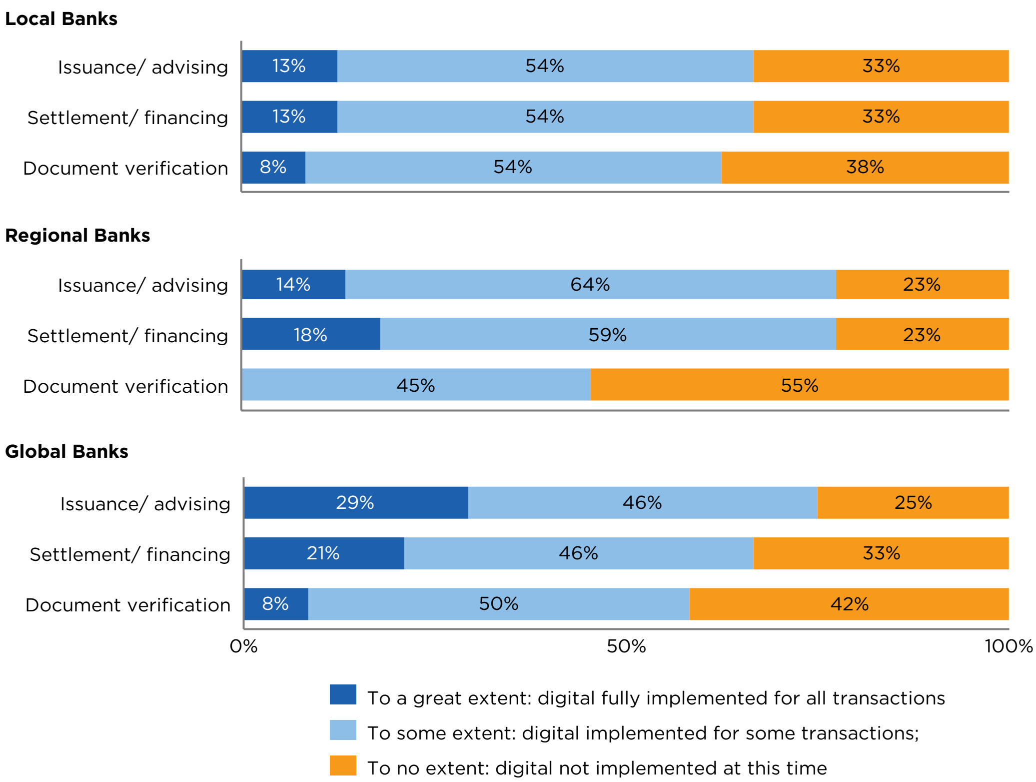


Figure 82

To what extent has your bank removed the use of physical paper for documentary transactions?



digital channels are often a substantial value differentiator, particularly in the MSME space where host-to-host connectivity is largely non-existent.

SWIFT MT798 (38%) and APIs (36%) were also frequently cited by respondents as digital solutions offered by their banks. Only 22% of respondents indicated that their banks were integrating DLT-based solutions in their trade finance operations; while this may be surprising given the attention DLT continues to receive, it likely represents the fact that DLT is still often applied largely to pilot transactions and proofs of concept, with practitioners seeking to better understand the scalability of DLT-based solutions and the differentiated proposition around DLT-based technical architectures versus other options.

Digital is clearly an important topic for banks, and particularly for global banks, but there is limited end-to-end adoption of digital solutions in trade finance. This is consistent

Figure 83
What is the level of client usage of digital channels in each of the following areas?

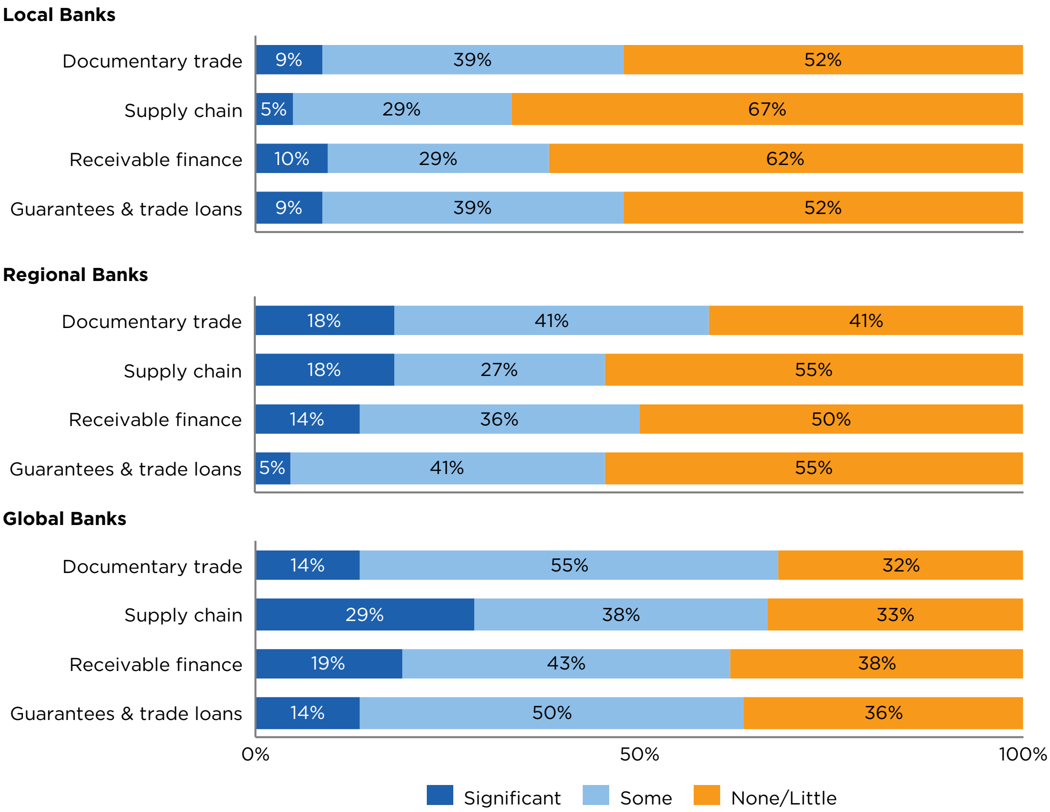
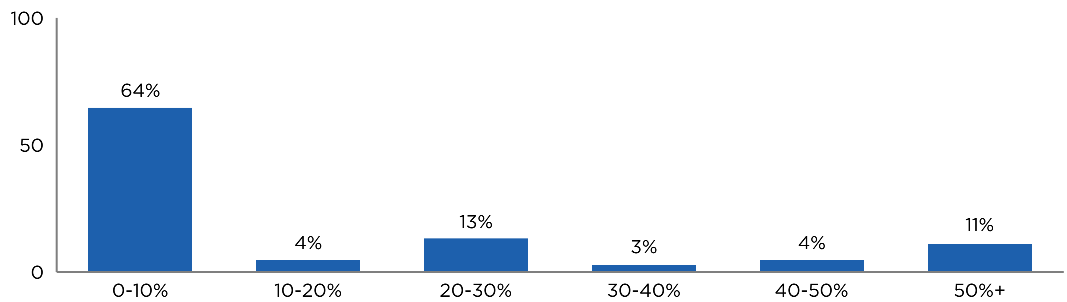


Figure 84
What percentage of documentary trade transactions do you receive digitally?



across bank types, although adoption is more limited among local and regional banks than global banks. While most banks have removed the use of physical paper for documentary transactions to some extent (Figure 82), it is more common among global banks. However, between half and two-thirds of local banks indicated that client usage of digital channels across trade finance products is either minimal or non-existent (Figure 83). For global banks the number is closer to one-third.

Further, most banks receive only a small amount (0–10%) of documentary trade (Figure 84) and open account trade (Figure 85) transactions digitally. This is rather surprising given the prevalence of digital channels for transaction origination.

The same trend emerges for zero-touch processing transactions (i.e. no human intervention from start to finish), with an average of only 6–9% across the four products surveyed (Figure 86). This is less surprising and a known challenge for banks – while many components of trade finance operations are being digitised (e.g. data capture, sanctions screening), very few players, if any, have managed to create a fully digital ‘zero touch’ end-to-end process (e.g. to include document checking).

In terms of achieved benefits of digitisation, 83% of respondents indicated only a minimal reduction in costs over the past five years due to digitisation (Figure 87). Given the prominent focus that digitisation has had in

Figure 85
What percentage of open account trade transactions do you receive digitally?

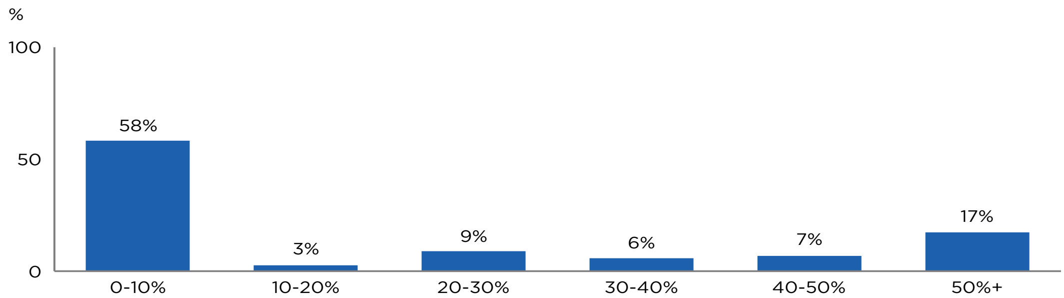
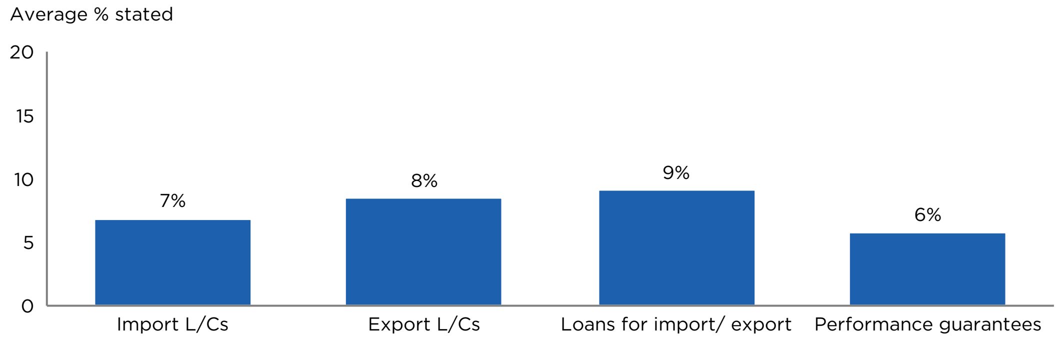


Figure 86
What percentage of your transactions have zero-touch processing for the following products?



the industry over the past decade, it may be surprising that so few banks report much benefit (at least from a cost perspective). This may be due to the fact that we are still far off from system-wide paperless trade, and hence there is still a long way to go in terms of cost reduction from digitisation. Alternatively, these findings may speak to the challenge and cost of implementing technological solutions – reducing returns on investment.

Looking ahead, 66% of respondents expect at least 10% in cost savings from digitisation over the next five years. However, again this differs by bank type, with 91% of global banks expecting a meaningful reduction to their cost base from digital solutions (Figure 88), but only 55% of non-global banks expecting the same.

Of banks surveyed, 80% spent only USD 0–10 million in 2019 on developing or acquiring digital solutions for trade finance (Figure 89). This may be because the limited reduction in costs that most banks have experienced over the past five years has reduced their appetite for investment, or conversely the lack of adequate investment may be limiting cost reductions.

The differences between bank types in the survey go beyond technology adoption to how they view the fundamental utility of digitisation. Looking beyond cost savings, digitisation can bring improved product propositions, more advanced channels, enhanced customer experience and retention, and superior risk mitigation - amongst other benefits. This could shape the future of trade finance, with banks that can build and implement digital solutions taking greater market share, and banks that are unable to do so entering partnerships or withdrawing from the market.

Respondents from banks with successful digital trade finance solutions said that the solutions with the most benefits were online

Figure 87
Over the past five years what % cost savings has digitisation of trade provided?

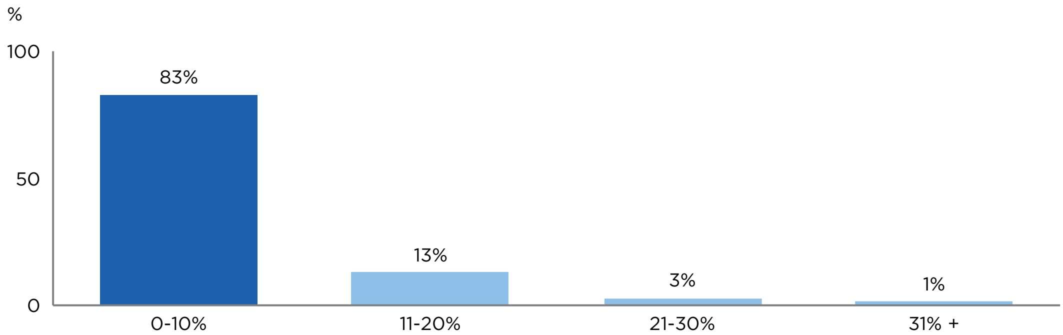
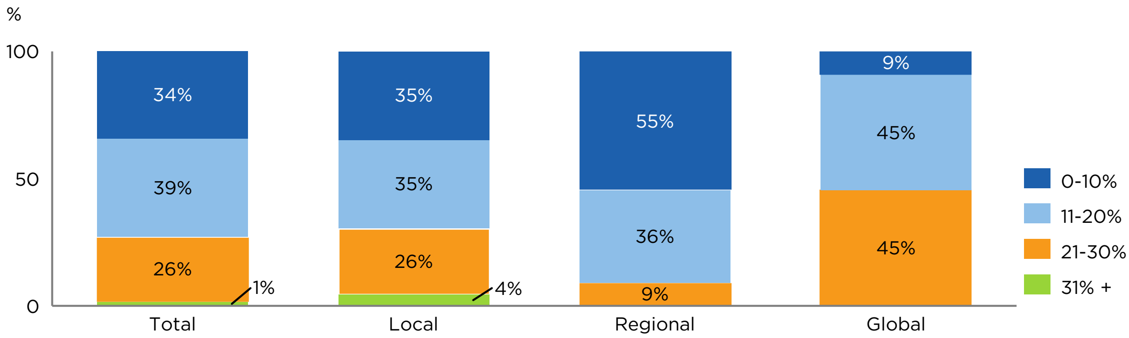


Figure 88
Over the next five years what % cost savings do you expect digitisation of trade to provide?



platform offerings to customers, digital processing and approval processes, and automation of operations. One respondent cited “use of machine learning/ artificial intelligence to automate processing in operations” as an example of how their bank has integrated digital solutions into their offerings. Another respondent noted that “[digital products] do not replace people, but help people operate more efficiently”.

The cost reduction impact of digital solutions suggests strongly that the case for investing in these technologies must be built upon a wider foundation – a combination of factors such as client expectation and satisfaction, reductions in operational and fraud risk, and the ability to refocus trade finance specialists from mundane, lower-value tasks that can be addressed through technology to activities that generate business or client relationship value.

For banks that are finding it hard to implement technological and digital solutions, 61% cite the challenges (financial, logistical, and technical) of building internal capabilities (Figure 90). A further 51% answered that both regulation and client needs were hampering wide-scale adoption of digital solutions.

When asked to evaluate the benefits of digitisation, answers vary again across bank types. While 57% of global bank respondents agreed that digitisation will enable banks to serve their customers significantly better (Figure 91), only 42% of local bank respondents felt the same way. The divide was even starker when respondents were asked if digitisation would benefit their trade finance operations – 59% of global banks agreed, while only 32% of regional banks and 25% of local banks agreed (Figure 92).

Despite these responses, global banks expect that it will take longer for digital trade finance to replace current models and practices

Figure 89
How much has your bank spent in 2019 on developing/ acquiring digital solutions for trade finance, including future spends (3-5 years ahead)?

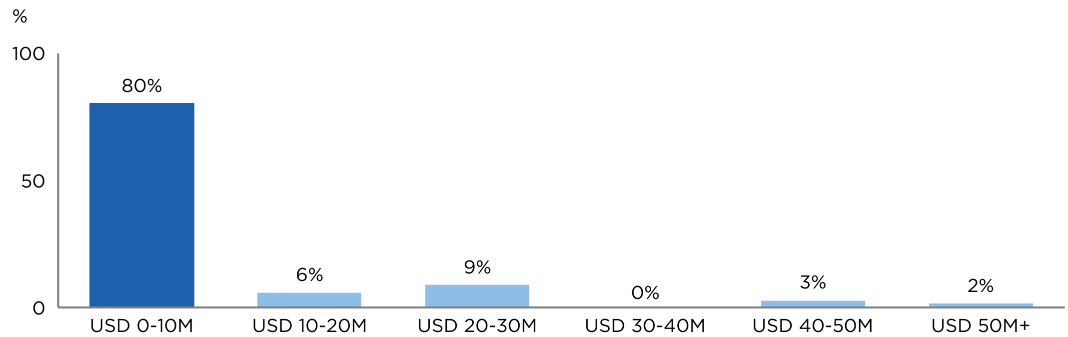
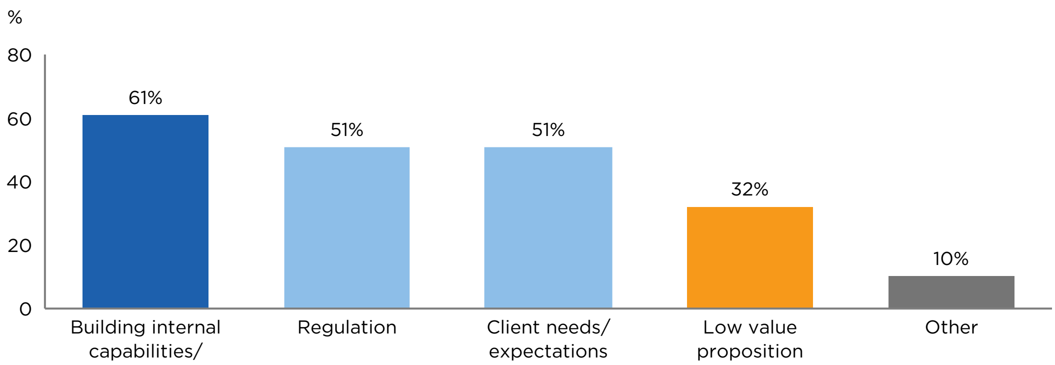


Figure 90
What are the main barriers that are preventing a wider adoption of digital solutions?



than do other banks. Only 43% of global banks expect this to happen before 2030, compared to 59% of local banks (Figure 93). Further, 13% of global banks expect that pure digital trade finance will never fully supplant traditional trade finance. This could be driven by global banks' first-hand knowledge of how challenging, expensive, and time-consuming it is to modernise legacy systems and associated processes across multiple jurisdictions.

The disparity in sentiment towards digitisation between global, regional, and local banks is somewhat concerning. It is clear that smaller banks have had less success in reaping the benefits of digital solutions, particularly when we consider the reality that benefits of digital solutions must be understood to encompass more than cost reduction.

Limited investment capacity, local regulations, a small customer base, and the inherent scale challenges of technology are all particularly acute for smaller trade banks. If these smaller banks fail to capture the advantages of technology, there is a material risk of their being disadvantaged in a two-speed market. However, in today's market there are emerging alternatives to the prohibitive costs of technology solutions, from forming partnerships with non-bank players to adopting white-label digital platforms that will give smaller banks the opportunity to keep up with the changing world of trade finance.

Figure 91
To what extent, if any, do you think that digitisation will enable your bank to better serve its existing clients and attract new clients?

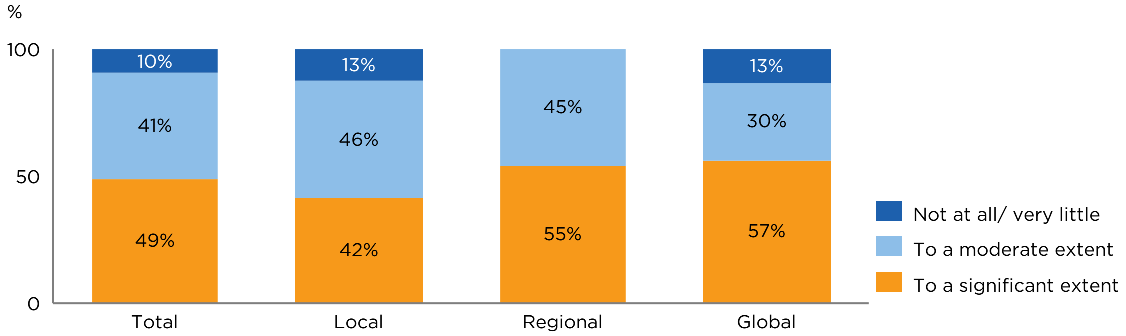


Figure 92
How would you rate the benefits of digitisation to your bank's trade finance operations?

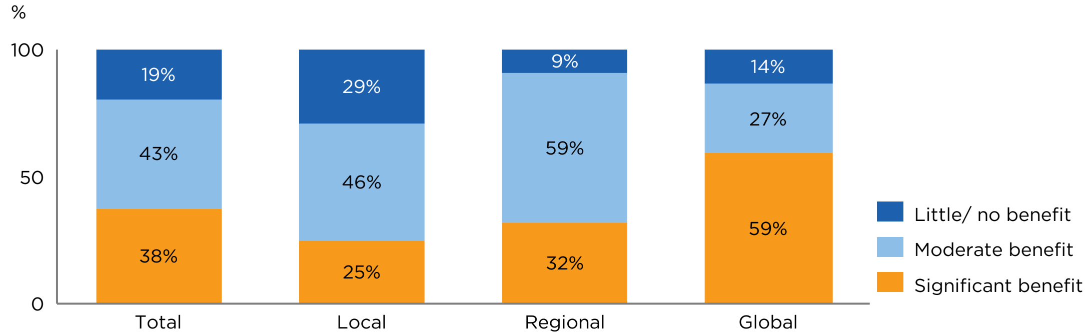
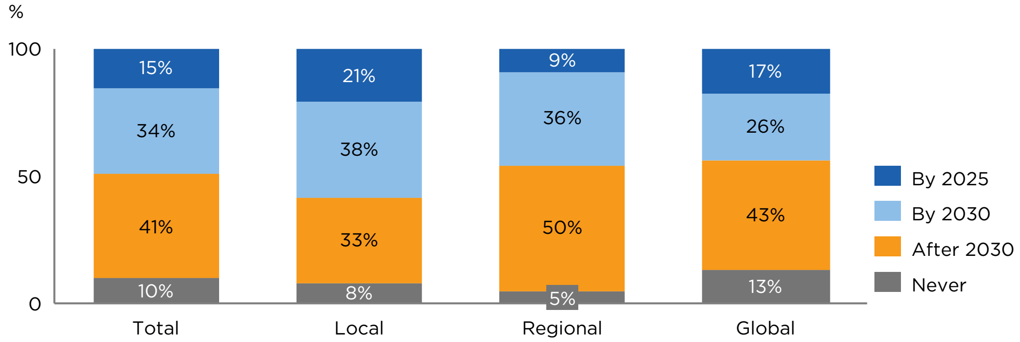


Figure 93
When would you predict pure digital trade finance to completely replace traditional trade finance as known today?



FEATURE

Digital trade and COVID-19: maintaining the crisis-driven momentum

Alisa DiCaprio, Head of Trade and Supply Chain, R3
Chris Southworth, Secretary General, ICC UK

Introduction

By April 2020, most banks across the globe had implemented Business Continuity Plans (BCPs) in response to local quarantines and lockdowns. Common to many of these BCPs was the scaling up of existing digital solutions. Indeed, 55% of respondents to the supplementary ICC COVID-19 Survey report rolling out new digital solutions during the pandemic. None of this was easy or without significant adjustment challenges. But many are asking what is going to happen to this progress when we return to business as usual?

This is where the ICC can play a role. The ICC Digital Trade Roadmap is a tool to continue the digital gains made during COVID-19. We need this because we can expect the digital strides we have made to regress back to paper when the crisis eases. The reason why is the same reason that digitisation hadn't progressed this far earlier: the stubborn persistence of paper-pushing norms and regulations.

What is the roadmap?

The ICC Digital Trade Roadmap is a simple framework for governments, institutions and industry. It presents a list of specific policies and actions that would progress the digital agenda over time. It does this by advocating action in three pillars:

1. Modernising outdated laws and regulations,
2. Supporting standards that enable interoperability of digital platforms, and
3. Changing industry behaviours and norms around paper

Harmonisation of action across digital advocates will be key in 2020. Few believe that we should be using paper originals and handwritten signatures in 2020. But moving to digital is an enormous task that requires coordination from the private sector and government. It isn't that no one wants to do it, it's that there is so much to do, no obvious way to prioritise, and no single global institution tasked with coordinating the agenda. The roadmap can provide this coordination on both a local and global level.

What does the roadmap tell us about digitisation in different jurisdictions?

In addition to guiding actions, the roadmap also gives us a way to estimate national level digital trade progress.

Digitisation is a global challenge that requires patient and persistent cooperation. At the inter-governmental level, we have a good understanding of what needs to be done to make a difference. But at the national level, the picture is more nuanced because of the different legal frameworks and different makeups of economies. Figure 94 offers a view into 12 ICC member economies. They include a mix of developed and developing economies.

Figure 94 tells us three important things. First, that most countries are doing relatively well in implementing the WTO Trade Facilitation Agreement. Second, that progress on Electronic Single Window initiatives is in evidence, albeit slowly. And third, we learn that the WTO E-commerce negotiations, while broadly inclusive, could benefit from more markets participating. These insights can be used for greater advocacy on these topics.

The roadmap also allows us to see that progress on digitisation isn't only about modernising regulations or establishing standards. Equally important is systems change within the industry. This points to the need for more focus on pillar three in the roadmap: helping industry upskill and modernise systems and processes.

Before we can change practices around paper, we need to understand why paper is used in the first place. We asked ICC respondents to tell us – for their region – which documents were required to be paper and which could be submitted digitally. Figure 95 shows these results.

Of the ten document types included in the survey, there were four where more than 50% of respondents reported that they must be issued in paper form. These are Bills of Exchange, Promissory Notes, Bills of Lading and Certificates of Origin. Ideally, governments need to create the conditions where all documents operate by digital means to prevent a return to paper, but these results are helpful in identifying a specific area of law where governments can make a tangible difference to digitising trade, similar to what is happening in the UK.

Most positively, documents that could be paper or digital with more than 50% of respondents included: Insurance policies (51%), import/ export declarations (52%), commercial invoices (65%), Letters of Credit (69%), payment confirmations (70%) and order forms (71%).

Figure 95 also reveals the inconsistency across different legal jurisdictions. Smaller countries, without legacy systems like Georgia and Singapore, can often act as hotbeds of innovative new practices and be a useful bridge between developed and less developed countries. If mobilised, this group could be a powerful force for change in institutions like the World Trade Organization, in the same way the Friends for Ecommerce for Development were in the lead up to the WTO Ministerial Conference in Buenos Aires in 2018 and the consequent start of ecommerce negotiations.

Figure 94
Digital progress in three areas

	Implementation of the WTO Trade Facilitation Agreement (%)	**Use of Electronic Single Window**	**Participation in WTO Ecommerce negotiations**
Brazil	95.8	operational	yes
China	96.2	in progress	yes
Germany	100	operational	yes
India	72.3	in progress	no
Netherlands	100	in progress	yes
Nigeria	15.1	in progress	yes
Russia	100	in progress	yes
South Africa	100	operational	yes
UAE	90.3	no	no
UK	97.1	operational	yes
US	100	in progress	yes

Sources: TFA database, World Bank, EC database

Figure 95
Which documents are legally required to be paper (by region)

Country	Letter of Credit	Bill of Exchange	Commercial Invoice	Order Form	Insurance Policy	Promissory Note	Bill of Lading	Certificate of Origin	Payment Confirmation	Import/ Export Declaration
APAC										
Australia	Paper or digital	Must be paper	Paper or digital	Paper or digital	Paper or digital	Must be paper	Paper or digital	Paper or digital	Paper or digital	Paper or digital
Bangladesh	Must be paper	Unsure	Unsure	Must be paper	Unsure	Unsure	Must be paper	Must be paper	Must be paper	Must be paper
China	Paper or digital	Must be paper	Paper or digital	Paper or digital	Paper or digital	Must be paper	Paper or digital	Must be paper	Paper or digital	Must be paper
Hong Kong	Paper or digital	Must be paper	Paper or digital	Paper or digital	Unsure	Must be paper	Paper or digital	Paper or digital	Unsure	Paper or digital
India	Paper or digital	Must be paper	Paper or digital	Paper or digital	Paper or digital	Must be paper	Paper or digital	Paper or digital	Paper or digital	Paper or digital
Singapore	Unsure	Paper or digital	Must be paper	Paper or digital	Paper or digital	Paper or digital	Must be paper	Paper or digital	Paper or digital	Paper or digital
Sri Lanka	Paper or digital	Must be paper	Must be paper	Paper or digital	Must be paper	Must be paper	Must be paper	Must be paper	Paper or digital	Paper or digital
Vietnam	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital
Middle East										
Afghanistan	Paper or digital	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper	Paper or digital	Unsure
Qatar	Paper or digital	Must be paper	Must be paper	Paper or digital	Paper or digital	Must be paper	Must be paper	Must be paper	Paper or digital	Paper or digital
Saudi Arabia	Paper or digital	Must be paper	Paper or digital	Paper or digital	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper
UAE	Paper or digital	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper	Paper or digital	Must be paper
LATAM										
Argentina	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital
Brazil	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Must be paper	Must be paper	Must be paper	Paper or digital	Paper or digital
Ecuador	Must be paper	Must be paper	Paper or digital	Paper or digital	Must be paper	Must be paper	Must be paper	Must be paper	Paper or digital	Paper or digital
Mexico	Must be paper	Must be paper	Paper or digital	Paper or digital	Must be paper	Must be paper	Must be paper	Paper or digital	Paper or digital	Paper or digital
Panama	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital
Central & Eastern Europe										
Armenia	Must be paper	Unsure	Paper or digital	Paper or digital	Paper or digital	Unsure	Must be paper	Must be paper	Paper or digital	Must be paper
Belarus	Paper or digital	Must be paper	Unsure	Unsure	Unsure	Must be paper	Unsure	Unsure	Unsure	Unsure
N Macedonia	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper	Unsure
Russia	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper
Turkey	Paper or digital	Must be paper	Must be paper	Paper or digital	Must be paper	Must be paper	Unsure	Must be paper	Paper or digital	Must be paper
Ukraine	Paper or digital	Must be paper	Paper or digital	Paper or digital	Unsure	Must be paper	Must be paper	Unsure	Unsure	Paper or digital
Uzbekistan	Paper or digital	Unsure	Paper or digital	Must be paper	Must be paper	Unsure	Must be paper	Unsure	Paper or digital	Paper or digital
Western Europe										
Belgium	Paper or digital	Must be paper	Paper or digital	Paper or digital	Paper or digital	Must be paper	Must be paper	Must be paper	Unsure	Paper or digital
France	Paper or digital	Must be paper	Paper or digital	Paper or digital	Must be paper	Must be paper	Unsure	Must be paper	Paper or digital	Must be paper
Germany	Must be paper	Must be paper	Must be paper	Paper or digital	Must be paper	Must be paper	Must be paper	Must be paper	Paper or digital	Must be paper
Italy	Paper or digital	Must be paper	Paper or digital	Paper or digital	Paper or digital	Must be paper	Must be paper	Must be paper	Paper or digital	Must be paper
Serbia	Paper or digital	Must be paper	Paper or digital	Paper or digital	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper	Must be paper
Spain	Paper or digital	Must be paper	Paper or digital	Paper or digital	Paper or digital	Must be paper	Must be paper	Must be paper	Paper or digital	Paper or digital
Sweden	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Unsure	Must be paper	Paper or digital	Paper or digital	Paper or digital
UK	Paper or digital	Unsure	Paper or digital	Paper or digital	Paper or digital	Unsure	Paper or digital	Paper or digital	Paper or digital	Paper or digital
Africa										
Egypt	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital
South Africa	Paper or digital	Must be paper	Paper or digital	Must be paper	Paper or digital	Must be paper	Must be paper	Must be paper	Paper or digital	Must be paper
Tunisia	Paper or digital	Must be paper	Must be paper	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital	Paper or digital

Must be paper   Paper or digital   Unsure

Note: The above chart has been developed directly – unedited - from Global Survey responses, and does not represent an official ICC view. Please treat as an indication that requires further validation

How COVID-19 reinforced the need for a roadmap

COVID-19 accelerated the digitisation agenda in ways that were unimaginable a year ago. Companies, governments, and institutions all scrambled to implement ad hoc practices in order to keep trade flowing and teams working while isolated at home. This reinforced the applications for the ICC Digital Trade Roadmap in two important ways.

First, it made it clear that guidance is needed even for temporary measures. Business Continuity Plans (BCPs) were rolled out before most government or regulators had a chance to offer any guidance. And even then, fewer than 30% of ICC's COVID-19 Survey respondents report receiving support from their governments in relaxing requirements for paper (although anecdotally, this appears to have improved over the course of the crisis). However, there are clearly authorities that have issued direct guidance. As an example, both the Indian Bankers Association and the Bank of Algeria suggested that electronic or scanned documentation was acceptable where presentation or transmission was not feasible.

Today's environment – as we saw in Figure 92 and Figure 93 – isn't yet conducive to fully digital trade flows. To have the confidence to try untested solutions, banks need regulators and governments to show their support. The roadmap can be used to identify where guidance is most needed.

Second, emergency response measures made it clearer than ever before what is achievable. In some cases, they also illustrated what it will take to get there. The ad hoc digital practices implemented by banks aimed to address five challenges: deal origination and distribution, negotiable instruments, document transmission, authorised signatures, and shipping delays. Banks managed to keep trade flowing despite these hurdles. Now that we know it is possible to go digital, the direct actions promoted by the roadmap can help introduce greater collaboration among trade participants.

Conclusion

We have a framework available in the roadmap, a better grasp of where we need to act to move the agenda forward to digitise trade documentation, and a global crisis on which minds are focused. There is a clear case for action in order to set the conditions for economic recovery – digitisation is a solution.

For the first time in living memory, we have all the tools available at the same time to capture the opportunity if, as industry, we mobilise and cooperate across jurisdictions. ICC has a central role to play as the neutral rallying point but so does the finance industry as a facilitator to help bring all the stakeholders to the table.

USING THE ROADMAP TO MAKE PROGRESS: THE UK EXPERIENCE

The UK is the second-largest services exporter, third-largest ecommerce market, and a global centre for finance, innovation, and international business. It is thus surprising the UK hasn't already taken the opportunity to position itself as a global leader in the digital business environment.

The answer lies in the complexity and age of the UK legal system, coupled with the fact that there is no single point of leadership in government and no trade body singularly focused on making the case for change.

We have identified three specific pieces of legislation that act as a brake on progress.

- The Bills of Exchange Act 1882,
- Carriage of Goods by Sea Act 2002 and,
- The Statute of Frauds Act 1695 (Northern Ireland).

The need to modernise underscores a deeper issue in UK law: how title of ownership is recognised. In trade, title refers to goods. But the legal definition goes much further and covers everything from ownership of assets to pensions and power of attorney. Several attempts have been made to review the UK situation, but all have failed to make significant progress.

The good news is there is genuine alignment and a real appetite to address the issues from across industry and government. ICC has stepped in to act as the neutral convener using the roadmap to rally the different stakeholders. They have included the UK Law Commission, Ministry of Justice, Department for Digital Trade, the Commonwealth, and a host of experts from finance, law, academia, shipping, insurance and trade. All agree the time is right and there is a real opportunity to move the agenda forward.

As the home of English law and the Commonwealth, the general consensus is that if the UK can fully digitise trade documentation, it sets an important precedent across all 54 Commonwealth countries and all contracts that use English law. The UK could also become the first G7 country and lead the way for others to follow.

Multilateral and bilateral trade dialogues are another place that the UK can show leadership. The UK is also an active participant in the WTO Ecommerce negotiations and is in the midst of trade negotiations with the EU and US. Brexit and now COVID-19 have accelerated the agenda and opened up a window of opportunity that has remain unchanged for hundreds of years. It's an enormous opportunity that the UK must take.

Using the roadmap, the ICC can act as a neutral convener for industry, to bring all the parties to the table and to step in as the body that makes the case for change. If we can do this across the ICC network, we will be able to accelerate the digitisation of global trade.

FINANCIAL INCLUSION

Survey analysis

One of the most pressing and challenging issues facing the trade industry today is financial inclusion broadly defined, as well as more specifically in making sure, that trade finance products are available to businesses of all sizes and across geographies, and that by extension, the benefits of trade in terms of enhanced standards of living can be more equitably distributed. Survey respondents overwhelmingly believe there is a shortage in servicing the needs of the global market (Figure 96), and that multilaterals, governments, and export credit agencies have a role in helping to close this gap. Additionally, while public–private partnerships can help banks close the trade finance gap, there is a wider set of tools available, and the onus of expanding access to trade finance is shared by both industry and public bodies.

The majority of banks only rejected a small percentage (0–10%) of trade finance transactions in 2019 (Figure 97), primarily due to KYC concerns, suitability, and low-quality applications (Figure 98). While this rejection rate is low on the whole, there is a discrepancy across geographies, with applications from Africa, and Central and Eastern Europe, receiving a disproportionately high number of rejections relative to their representation in trade finance applications (Figure 99), contributing to the well-documented trade finance gap, which persists at about USD 1.5 trillion annually according to ongoing analysis by the Asian Development Bank.

In addition to these geographical discrepancies, MSMEs are more likely than other customer segments to be rejected for trade finance support (Figure 100). These businesses represent 29% of total trade finance applications and make up 36% of rejections, again highlighting the extent of unmet demand (i.e. the trade finance gap) that exists in the market, and the degree

Figure 96
Do you believe there is a shortage in servicing the trade finance needs of the global market?

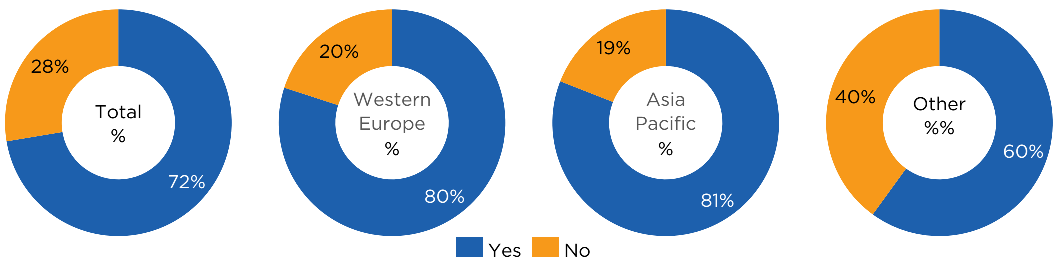


Figure 97
Of the total value of trade finance transactions your bank received in 2019, what percentage did your bank reject/ not support?

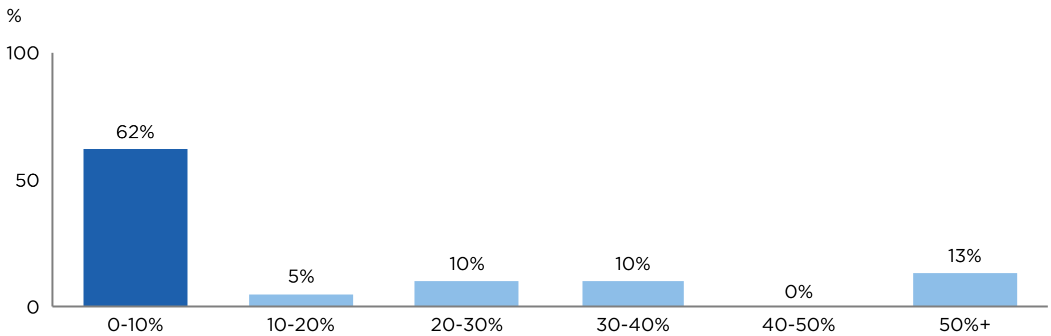
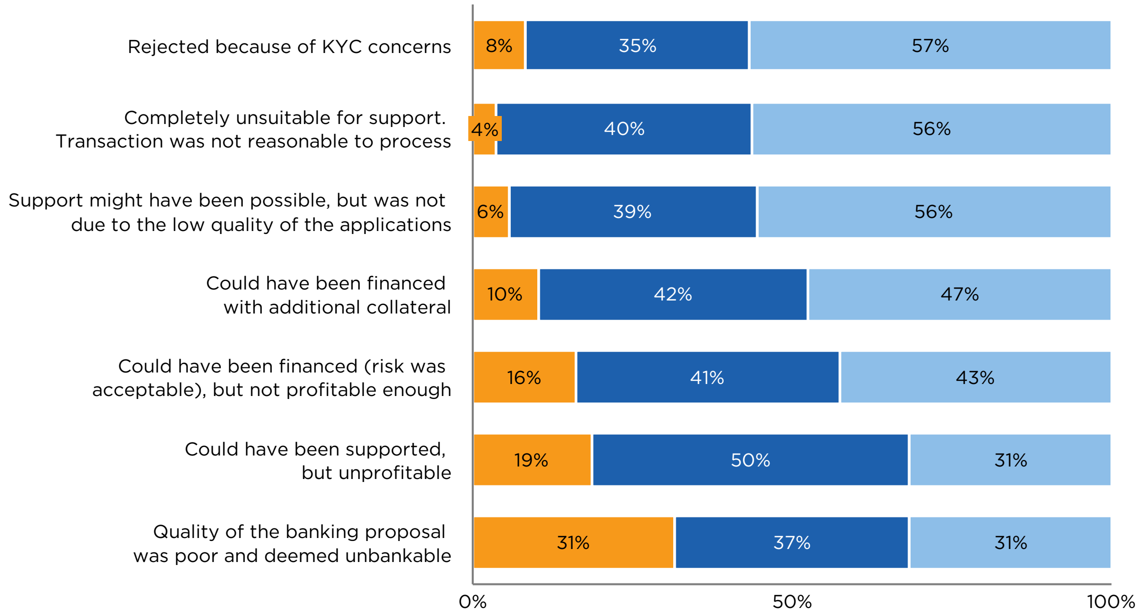


Figure 98

Of the rejected/ not supported transaction applications, please rank the most common reasons that your bank did not support applications in 2019

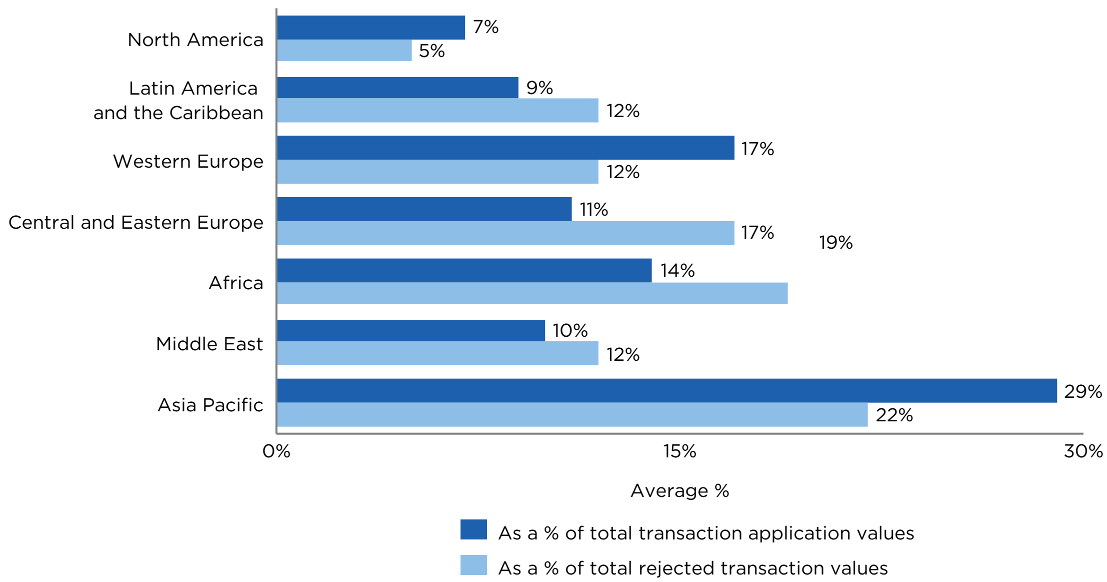


Note: 'Rejected because of KYC concerns' – not that the (potential) client was suspicious, but that the KYC regulatory requirements were too costly and onerous

'Could have been supported, but unprofitable' –regulatory capital on trade finance made supporting the transaction unprofitable

Figure 99

In 2019 what was the percentage breakdown of trade finance applications and rejections per region?



to which MSMEs face a disproportionate challenge in accessing trade financing.

Further, there is little variation in the rejection rate of various trade finance products relative to their share of overall applications (Figure 101), although there are small spikes in rejections for loans or advances against both inventory and receivables.

Banks generally do not receive trade finance support from government or other public institutions to help provide financing to MSMEs (Figure 102). However, Asia Pacific is an exception, with 62% of respondents indicating they receive some public support for MSME financing. In light of this, it is interesting to note that Asia has the lowest rejection rate of all regions relative to the

Figure 100
In 2019 what was the percentage breakdown of trade finance applications and rejections per client segment?

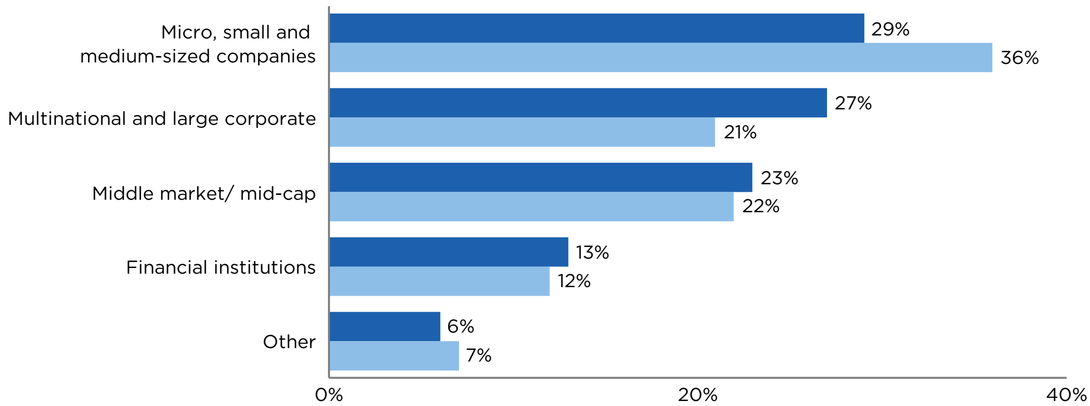
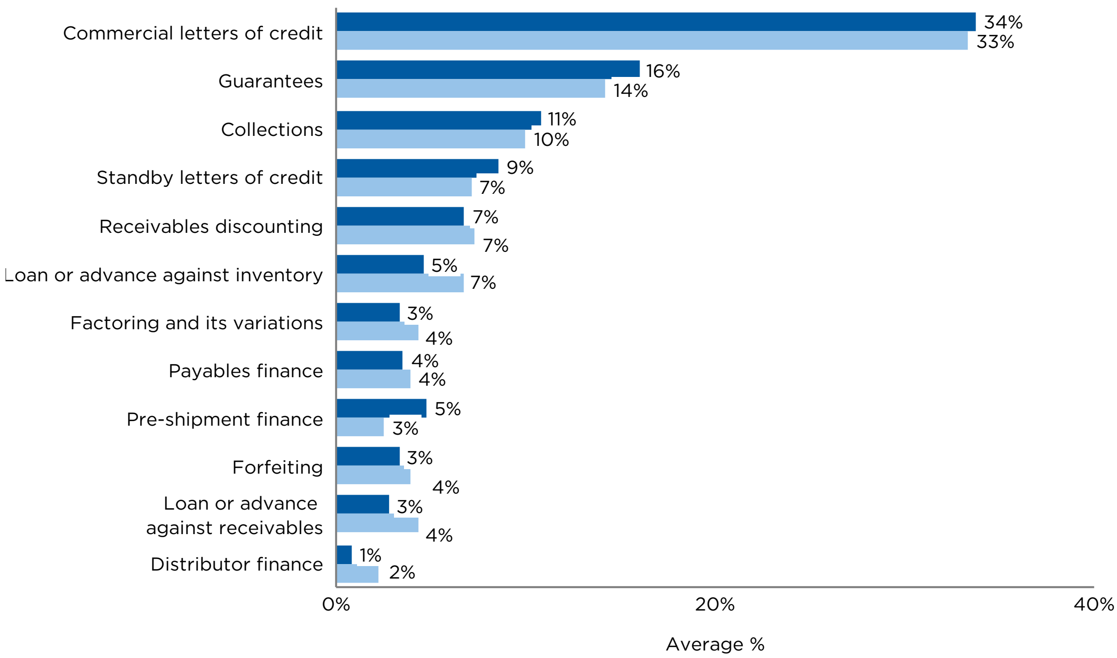


Figure 101
In 2019 what was the percentage breakdown of traditional trade finance applications and rejections per transaction type?



values of their trade finance applications (Figure 100). This may be due in part to the public support offered to MSME financing.

Unsurprisingly, respondents overwhelmingly indicated that government support for MSME financing would help close the trade finance gap (Figure 103), even with multilateral development banks and export credit agencies providing important resources to help banks reduce unmet demand in the trade finance market (Figure 104). The positive reception of these public-private partnerships is encouraging and evidence for further public support to work with industries to close the trade finance gap.

Figure 102
Does your bank receive any type of support for MSME trade financing from the government or other public institutions?

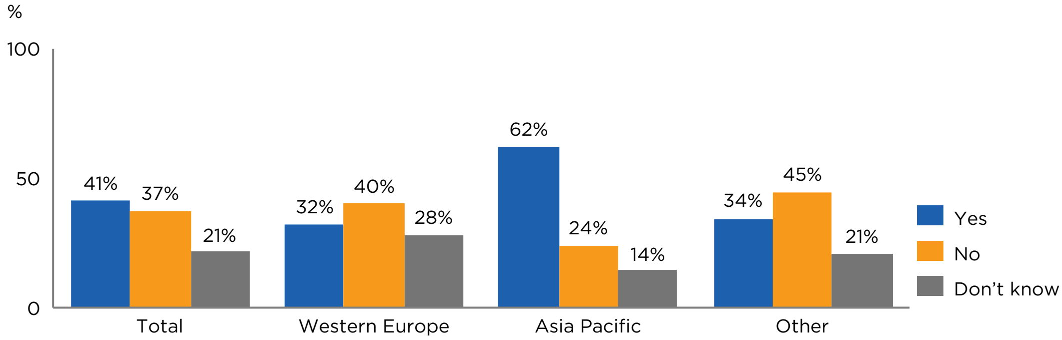
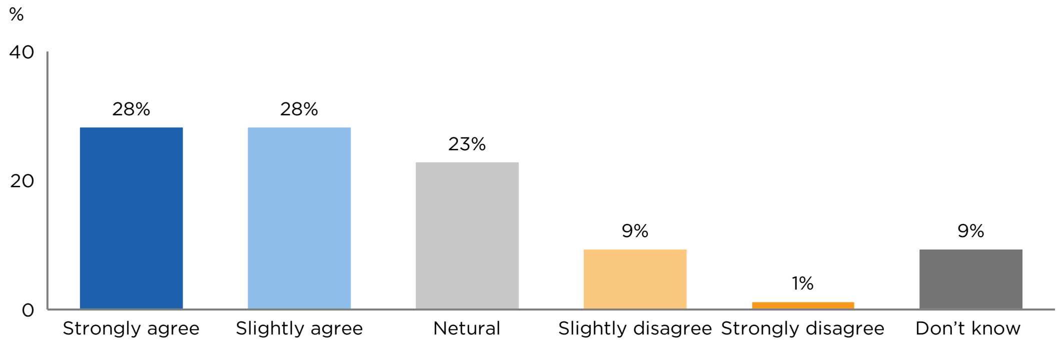


Figure 103
To what extent do you agree that government funding assistance/ partnerships for MSMEs would help in fulfilling demand for their trade finance?



Indeed, amid the COVID-19 crisis, we expect both the need for MSME trade finance and the scale of the trade finance gap to grow, adding to the urgency of government support – both to keep businesses viable today, and to help them recover in a more uncertain future. The ICC has issued an urgent call for decisive action to 'Save Our SMEs', and the Banking Commission has contributed with a specific call for governments to keep trade finance in mind, as they design support programs and mechanisms aimed at dampening the damaging effects of COVID-19.

The digitisation of trade finance and technology solutions are seen as major tools to help banks close the trade finance gap. A significant challenge for trade banks is serving MSMEs profitably. A small ticket letter of credit typically carries a fraction of the fees of a higher value corporate letter of credit, but often has the same – if not higher – operational cost given less publicly available information for KYC, credit assessment,

Figure 104
To what extent do you agree that multilateral development banks and export credit agencies help banks like yours to close market gaps (unmet demand) for trade finance?

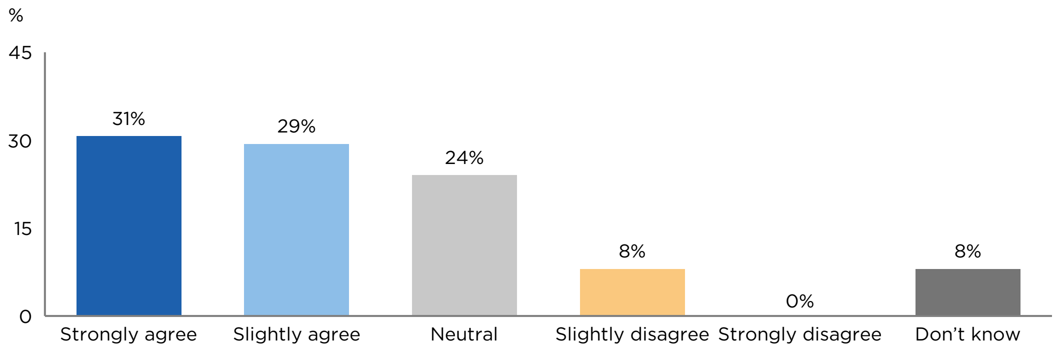
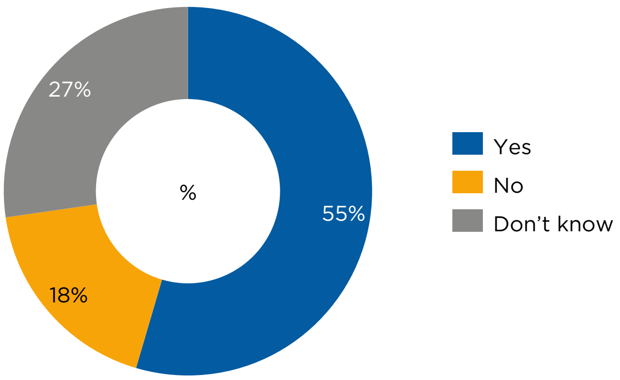


Figure 105
Is your bank positioning itself to maximise the potential to service more MSMEs and close market gaps (unmet demand) through technology?

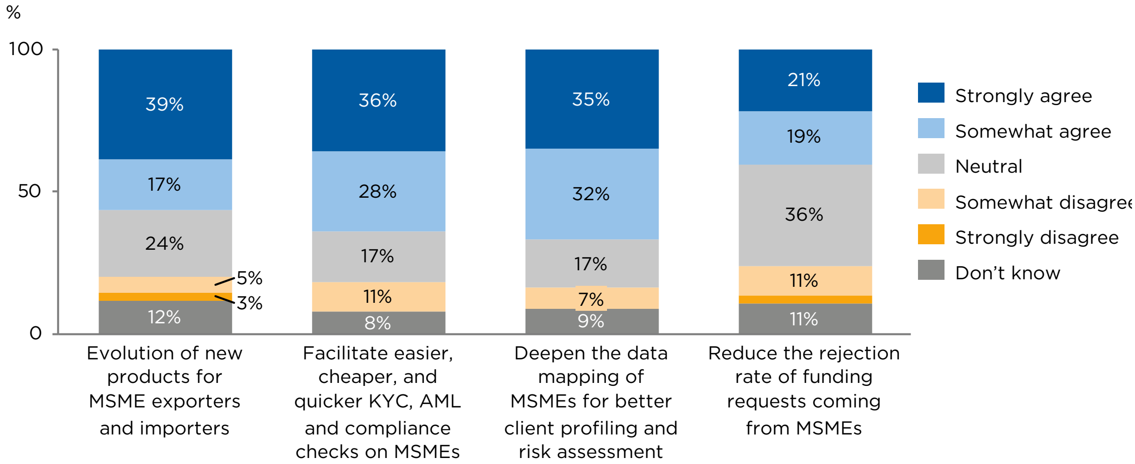


and other due diligence or regulatory requirements.As result, digital trade with self-service sales channels and straight-through-processing operations could open material opportunities.

Survey respondents are positioning themselves to service more MSMEs, with 55% using technology solutions to do so (Figures 105–106). Regional and local banks disproportionality indicated that they are not positioning themselves to do so. This is worrying because it is precisely these types of banks that could have the best reach into the MSME market. This is a further example of how digital trade is not yet sufficiently widespread, and many of the local and regional banks that could serve these MSMEs are behind the curve in its adoption.

Figure 106

To what extent do you agree that technology will enhance your bank's engagement with MSMEs in the following ways?



FEATURE

SMEs and the trade finance gap: it's a data problem...

Catherine Nomura, President and Founder, Kountable

The lack of inclusion of SMEs in global trade is often referenced by the SME trade finance gap, and much has been done to study and try to improve access of SMEs to finance, especially loans, to try to address this gap. Through Kountable's five years of partnering with SMEs in East Africa who struggle to finance trade deals, it has become clear that there is a much larger underlying problem, one which also points the way to practical solutions if we address it head-on. Inclusion shows up and is measured globally as a finance problem, but at its heart, it is a data problem.

The lack of digitisation of SME-involved trade, the lack of access to ERP (Enterprise Resource Planning) capabilities and a system of record capable of capturing the trading activities of sub-enterprise scale businesses, makes trade involving SMEs more difficult to transact and fund on many fronts. Exclusion extends beyond finance to difficulty accessing the best global suppliers and competitive pricing for trade services such as insurance and logistics.

Put simply, capital flows based on the assessment by its owners of risk and return.

The completion of due diligence on trade transactions involving SMEs, and on SMEs themselves, has been notoriously difficult. However, this failure to measure, this lack of reliable data on which to assess the merits of a trade, disguises the fact that much of this business is very investible on commercial terms, especially with data not just for due diligence, but also to manage projects to further mitigate execution and performance risk.

Lack of access to finance is one result of this absence of data and affects even the best SMEs (with outstanding demonstrated execution capabilities) in the presence of high-quality, enforceable contracts with reliable suppliers and investment-grade end payers.

What data is missing in trade involving SMEs?

1. Who the best SMEs are. We need a reliable source of data on which SMEs can execute, not just pay bills. Execution ability is different from and not always correlated with credit-worthiness. KYC data and measures of execution ability are key risk-mitigating data points.

2. Who the end-payers are. KYCC (Know Your Client's Client) is also needed but is often obscured by contract terms set up in tendering processes that require goods to be purchased onshore from SMEs who must first procure them abroad.

3. Is the trade transaction properly constructed to mitigate predictable risks, like those associated with currency fluctuations, contract terms mismatches, inspections, KYC/ KYCC related issues for all parties to the trade, and vetting and verification of contracts and key documents?

4. Real-time project management data, including tracking of milestones and financial flows comparable to what an ERP system integrated with enterprise-grade accounting and treasury management systems provides for larger entities.

With reliable data on all these aspects of an SME-involved trade transaction, capital can flow to this activity at scale because trustable risk profiles can be built and monitored. On the flip side, failing to address the data problems will hobble any attempt to solve financial inclusion at scale. Unmitigated risk will continue to lead to casualties that sink programs. Guarantees can be part of the solution but are not a substitute for de-risking transactions at an operational level through better business practices, validation of data integrity, transparency, and timely and secure data flows between the various stakeholders.

With regard to exclusion from quality supplier relationships, which we have seen have national and even global implications in the face of the current pandemic and governments' reliance on SMEs to procure medical products, data also helps. With data, SME buying activities can be aggregated to increase purchasing power to competitive levels, influence policy and take advantage of economies of scale as the cost of servicing trades skyrockets. Their inclusion at this time is critical to the pandemic response of any country that tenders out healthcare procurement.

Fortunately, the basic technological ability to gather this data now exists through smartphone proliferation and fairly widespread internet connectivity. The trade activity that SMEs are involved in, properly recorded and supported through the use of currently available data collection and management systems and tools, makes for an attractive investment option. It is usually short-duration, often supportive of the UN SDGs and ESG goals, high-margin, and offers tremendous diversity across geographies and sectors to fit the goals of a wide range of investment objectives and mandates. If we can solve the data problem, there is every reason to believe the market will respond at scale to the financial opportunity that is currently hidden.

FEATURE

How to increase the professionalisation of trade finance

Dominic Broom, Member, ICC Banking Commission Executive Committee;
Executive Consultant, The London Institute of Banking and Finance

Training and trust

At some point in the process of international trade, one of the parties involved will have to be trusted to handle someone else's money. But who should be trusted? Even in open account financing, making sure that the paperwork is correct and enforceable requires an objective and expert third party.

It is not always easy for companies that export and import goods and materials to know which third party really brings objectivity and expertise to the table. And companies are not the only stakeholders with an interest in ensuring honest, fair and efficient global trade. Governments, financial regulators, investors and, increasingly, NGOs also pay close attention to how trade is conducted. They want to reach a number of critical goals including: preventing money laundering and the financing of terrorism; ensuring that business is carried out in a fit and proper manner; boosting fair and sustainable trade; and closing the trade finance gap. Those are only a few important goals from a much longer list.

The banks engaged in trade finance have a long-standing tradition of upholding the sector's professional standards. They required their staff to undertake ongoing training and to sit rigorous exams that demonstrated their expertise. The Certificate for Documentary Credit Specialists (CDCS) set by The London Institute of Banking & Finance, for example, is a globally recognised benchmark. Banks and their clients can be confident that someone who has passed the exam knows what they are doing. Qualifications like the CDCS were part of the reason why banks were trusted over many decades to support and advise firms in global trade.

No more easy money

So, what's the problem? Financial services firms were able to make a lot of money in the 1990s and early 2000s with a 'good enough' approach to trade finance. Outsourcing was in full swing and supply chains were lengthening. With plenty of demand, banks did not necessarily seek out, or train, as many technical specialists as in the past. Instead, they outsourced many of their own functions to third parties. Graduate recruits, too, focused on more high-profile jobs in banking. That meant that, as trade finance bankers who had been trained under the old system started to retire, an expertise gap opened up. Arguably, a trust gap also appeared.

Then came the financial crisis and, as a trade finance gap opened up around the world, regulators started to look more closely at how banks were being run. What they saw was sobering. Today, they want to see solid evidence of up-to-date professional standards across the industry.

Those standards can be hard to meet. In trade finance, in particular, there are technical rulebooks – the Uniform Customs & Practice for Documentary Credits (UCP 600) and the Uniform Rules for Demand Guarantees (URDG), agreed by the ICC – that practitioners need to understand and apply in detail.

Trade finance bankers also need sound business judgement. They need to know their customers, their customers' customers, and to be able to gauge whether what is being proposed makes 'good honest sense'. That goes beyond having a level head and personal integrity – important though they are. Trade is multipolar, so assessing trade deals takes experience and expertise, a knowledge of the world economy, and ongoing professional development.

The real costs

What regulators want to see at trade finance banks is good governance, operational stability, environmental sustainability, and excellent compliance. None of those are feasible over any period without professionally trained staff.

Training staff, of course, comes with a cost, which is why it has often been neglected. However, loss of client trust, poor regulatory compliance, increased regulatory oversight, and high staff turnover are ultimately even more expensive. Outsourcing certain functions is not the solution. Regulators now want banks to be able to demonstrate that their systems are fit for purpose and sustainable. For most that means more trade finance professionals in-house.

Staff are your business

Finding those professionals will not be easy in the short term. A generation of bankers largely turned its back on training for a career in trade finance, despite the ever-growing need for trade and supply chain financing. That means expert advisors and mentors can be thin on the ground, which has arguably exacerbated the trade finance gap. However, specialist educators, like The London Institute of Banking & Finance and the ICC Academy in Singapore, can help. Their qualifications are recognised industry benchmarks and their staff and examiners are all longstanding industry practitioners. Both offer online qualifications and classroom-based training programmes that support banks and their employees with flexible ways of studying.

What may help even more is the value that younger employees place on access to training and expert qualifications. They know that they need to demonstrate professional excellence and to constantly update their skills and knowledge. They know that automation will transform banking. Blockchain and smart contracts, for example, are often cited as the future of trade finance.

It is certainly true that, over time, many routine tasks in trade finance will be automated – as they have been in other industries. However, what cannot be automated is trust in expert support and advice. Focusing on that will be imperative in banking – particularly when net interest margins are low.

Professionally trained staff will remain vital to the bottom line for two main reasons. One, regulators are much less intrusive when they know that a bank is carefully and appropriately staffed. That cuts compliance costs. Two, and just as importantly, customers appreciate access to trusted expertise. After all, people will shop around if they are buying a commodity product like broadband access. They quibble about the bill much less if they are having their kidney taken out. All they really want to know then is that they are going to be alright.

FEATURE

Successors in Trade: "Is it time to isolate or time to reach out?"

The Successors in Trade (SIT) programme was established by the Executive Committee of the ICC Banking Commission following a recommendation by Mr. Ruediger Geis of Commerzbank in Frankfurt, a long-serving member of the ExCo. The Program was launched in 2018 as a strategic programme to identify and develop the next generation of specialists to support trade finance and SCF practitioners.

An exciting sub-stream of the SIT programme is the Outreach Initiative. Young, talented trade finance professionals are challenged to devise and implement strategies to attract a new wave of trade professionals as members of the ICC Banking Commission and to reach into countries where the ICC Banking Commission is not represented or connected.

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The Outreach Initiative is guided and mentored by a panel of experienced trade finance professionals, who are either members of the ICC Banking Commission Executive Committee or the Advisory Board. They include Dr. Rudolf Putz of the EBRD, Mr. Vincent O'Brien of the Executive Committee, Ms. Ana Kavtaradze from Bank of Georgia, and Mr. Huny Garg from SWIFT.

In this section, SIT team members currently active in the Outreach Initiative share their experiences and insights and how they can bring new members from new countries into the ICC Banking Commission and the ICC itself.

The team is composed of Ms. Irina Chuvakhina (Priorbank Belarus), Ms. Innesa Amirbekyan (ID Bank Armenia), Ms. Antonija Koceva (Komercijalna Banka, North Macedonia), and Mr. Samuel Ansah (Ecobank, Africa).

Ms. Irina Chuvakhina, Priorbank, Belarus

Like many trade finance professionals around the world, I experience ICC every single day of my working life as so many trade banking transactions are based on the application of ICC rules. However, the possibility of playing a part within the ICC Banking Commission would not be something that I would have considered a real possibility. But with the support of my bank and the EBRD Trade Facilitation Programme (TFP), I was invited to participate as a guest at the ICC Banking Commission Meeting in Jakarta, Indonesia in April 2017. My participation was a small but historic step; this was the first time that a trade finance professional from Belarus was included as a delegate in the history of the ICC Banking Commission.

This amazing event and my knowledge about the keen interest of my colleagues from other Belarusian banks in ICC activity whet my appetite for the engagement. I returned home to Belarus inspired to do something to help trade finance professionals contribute to and benefit from participating in ICC Banking Commission.

Unfortunately, there was no immediate path to help the trade finance professionals in Belarus engage with ICC. We had the idea to establish an informal Trade Finance Club in Belarus among the participants of EBRD TFP, and with the assistance of one of our mentors, it was agreed with ICC Paris that if this informal trade finance club evolved into a more formal association, we could join as direct members of ICC.

With this progress in hand, we had a delegation of five trade finance professionals in attendance at the ICC Banking Commission Meeting in Tbilisi, Georgia in October 2018.

I am pleased to advise that with the guidance of our mentors, the key steps have already been taken to form the Trade Finance Association of Belarus with direct membership in ICC. A well-attended meeting of trade finance professionals from commercial banks and the National Bank of the Republic of Belarus endorsed this approach on 18 February 2020 in Minsk, Belarus.

It is fair to say that COVID-19 has slowed our advance but it will not stop us moving forward, and I hope that we will join the ICC family sooner or later and our delegation will attend the Dubai meeting in Spring 2021 as an ICC member.

Ms. Inessa Amirbekyan, ID Bank, Armeni

The SIT Outreach Initiative has empowered me to do what I have always wanted: to build a local and international network of trade finance professionals so that Armenia can prosper in international trade. For me, having good relations with other technically competent trade finance professionals makes business easier and a lot more rewarding.

ICC Armenia was formed in June 2018 and our Banking Commission took its first steps in October 2018. In fact, I was the first formal representative of ICC Banking Commission Armenia to join Banking Commission Meetings, with the first one in Tbilisi in October 2018, followed by the Annual Meeting in Beijing in 2019, and finally the Paris meeting in October 2019. I was all set and registered to participate fully at the Dubai meeting in April 2020 with a young delegation from Armenia, but COVID-19 put an end to that. This was a disappointment as the Dubai meeting had an amazing agenda and the theme reflected what the SIT Outreach Initiative is all about: Connecting the Trade World – shaping the future!

The challenge in Armenia is probably typical of the challenges facing the ICC Banking Commission all over the world in bringing in young talent. Without a doubt there are lots of interested young trade finance professionals wishing to interact with and be part of the ICC Banking Commission. However, decisions for membership are generally made by senior executives who are not familiar with the workings of the ICC Banking Commission and, in many instances, not familiar with the work of the ICC itself.

This situation creates a barrier for the younger and keenly interested trade finance professionals in Armenia to engage with ICC. However, this challenge was turned into an opportunity and a step towards full membership for young trade professionals as I established the first Trade Finance Club in Armenia. We recently held our first oversubscribed meeting in Yerevan, Armenia at the offices of ICC Armenia.

Given our love of trade finance I felt it appropriate to hold the meeting on 14 February 2020. This 'Valentine's Day' meeting was very successful and led to a delegation being formed to attend the April 2020 meeting in Dubai. While the Dubai meeting may now be temporarily postponed, our activity locally and with the other SIT team members continues by digital means. I can honestly say that being part of the SIT outreach team provides a tremendous opportunity to make positive change and we have already come up with a range of new ideas.

Trade finance professionals in Armenia, as in many countries in the region, are familiar with working with the development banks such as the EBRD, IFC, and the ADB. These development banks are partners of ICC in Market Intelligence and in many other areas of trade development and facilitation. These multilateral development banks can provide a bridge to bring in new young talent to the ICC Banking Commission, and this is one core area of activity on which we intend to focus.

Mr. Samuel Ansah, Ecobank, Africa

Given that I am a trade finance professional working at Ecobank, and responsible for smooth operations and trade technology across 32 countries, I have a keen interest in the integration of a new wave of tech-savvy trade finance professionals into the important work for trade development of the ICC Banking Commission.

However, based on my initial research, the catchy slogan of the ICC, "We make business work for everyone, every day, everywhere", may not yet be an accurate reflection of the reality on the ground in Africa.

However, with the support of my Outreach Initiative team members and mentors I intend to change that. Given that Africa is a continent of 54 countries, all eager for trade expansion, the fact that there are fewer than 10 ICC National Committees on the continent is considered by some to be a major disappointment. However, I see it as a great opportunity for the outreach team and the ICC itself.

The time to act is now. In March 2019, African leaders took a major step forward and now all 54 African nations signed the African Continental Free Trade Area (AfCFTA), the biggest trade agreement signed since the World Trade Organization was established.

With the AfCTFA in place, this challenge has become an opportunity for the SIT outreach team, and even amid the COVID-19 pandemic this is the time to think outside the box. My recommendation is simple but effective. When there is no ICC National Committee within a country, trade finance professionals should be able to join through the multilateral development banks that have been working in partnership with the ICC for many years. Should an ICC National Committee be established in a particular country, the membership would revert back through the more natural channel of the typical local ICC National Committee route.

Just think about what can be achieved if we integrate young trade talent from the African continent into the ICC Banking Commission. The raw numbers speak for themselves.

AfCFTA can create a market with GDP of USD 2.5 trillion and a population of over 1 billion, 60% of whom are below the age of 25. Surely, these figures in themselves are a call to action for the ICC Banking Commission and our SIT outreach team.

I have not yet had the honour of attending an ICC Banking Commission Meeting like my other SIT outreach team members, although I was all set with flights booked for Dubai 2020. However, it is always good to see and hear my team members in the virtual world, which is now becoming our norm and it is working well.

Ms. Antonija Koceva, Komercijalna Bank, North Macedonia

The leading trade finance banks in North Macedonia are members of the EBRD's TFP. Many of these banks have won international recognition for their services by international financial institutions and many of the trade finance professionals themselves have achieved exceptional results under the electronic learning programme of the EBRD. I have also graduated and hold my EBRD trade finance certificates with pride.

In North Macedonia there is an ICC National Committee but until now there has been no active Banking Commission within its framework. Recently there has been tangible progress in forming this commission and we are looking forward to the launch and active participation of the highly motivated trade finance professionals in North Macedonia.

By being part of the SIT Outreach Initiative and actively participating at ICC Banking Commission Meetings in Beijing and Paris, I have learned about the essential activities of the ICC Banking Commission. I have been inspired to mobilise local trade finance talents for an active ICC Banking Commission in North Macedonia.

Through special arrangements facilitated by our mentors and the ICC UAE I had put together a small but highly interested delegation to attend the Dubai 2020 meeting. With the Dubai meeting postponed, I urgently needed an event to maintain the momentum and interest in the ICC Banking Commission within the trade finance community in North Macedonia.

Thankfully the EBRD TFP took the initiative of agreeing to host a trade finance training and information event in our capital city Skopje on 17 March 2020. I am glad to advise that this event was highly successful with the participation of commercial banks, the central bank, and a highlight being a presentation by ICC North Macedonia on the benefits of being part of ICC.

The Dubai meeting being postponed was a major disappointment for my SIT outreach team members and me, and the COVID-19 lockdown and distancing temporarily derailed our momentum in the SIT programme and the Outreach Initiative.

However, we are now re-energised, re-focused and making maximum use of videoconferencing and other communications technology to achieve our objectives.

The next substantive step of the SIT Outreach Initiative will be to host an Outreach Initiative Webinar with participation of the respective ICC National Committees and the soon-to-be-formed Trade Finance Association of Belarus.

With our dynamic mindset and drive to be real Successors in Trade we will take every opportunity to turn the challenges of evolving global isolation into a reality of a dynamic and inclusive ICC Banking Commission global outreach initiative

The mentors for the SIT Outreach Initiative commend the team for their commitment and innovation in the pursuit of their team objectives and believe these young trade finance professionals are showing the way forward for the expansion of the important work of the ICC Banking Commission.

Successors in Trade Outreach Initiative Team

Ms. Irina Chuvakhina, Priorbank Belarus
Ms. Ana Kavtaradze, Bank of Georgia
Ms. Innesa Amirbekyan, ID Bank Armenia
Ms. Antonija Koceva, Komercijalna Banka
Vincent O'Brien, ICC Banking Commission

Final Successors in Trade Outreach Initiative before COVID-19

On 17 March 2020, the Successors in Trade Outreach Initiative with the support of the EBRD held an educational and informational event in Skopje, North Macedonia where ICC presented the benefits of ICC membership.

FEATURE

Mind the gap: why we need to think about small exporters

Dr. Rebecca Harding, CEO, Coriolis Technologies

The World Trade Organization's latest outlook for global trade makes grim reading. The COVID-19 pandemic could cause a drop in world trade of between 13% and 32% in 2020; this largely mirrors BCG's own analysis presented earlier in this report. The trade community has been watching inventory stock plummet since February, and while at the outset of the crisis this was simply a supply chain disruption, the complete global lockdown of our daily lives has caused a drop in global demand for goods and services like no other in recent memory. Even the IMF, which has been one of the more optimistic global forecasters over the last decade, is predicting a drop in global growth of up to 3%.

Within all this mayhem, spare a thought for the smaller businesses that form part of the global supply chains that define the way in which global trade works. These businesses are at the end of the supply chains and reliant on payment of invoices for their finance. They may well have contracts to supply goods or services to players further along the chain, but if the whole trade system grinds to a halt, then these invoices are not paid, and the contracts are not honoured – very simply because the goods at the end are not delivered to the client.

Here is the problem: if I am a small exporting business with a turnover below, say, GBP 5 million, then I probably do not know about export credit agencies, and I almost certainly fall outside of the banks' commercial banking reach. I therefore rely on the contracts I have and the swift payment of invoices to fund my business through cashflow. Even if I am supplying an essential good or service, I will find it difficult to access support schemes because I am too small and reliant on my invoices, not working capital loans or turnover. If the invoices against a contract stop being paid because the goods at the end of the chain aren't being delivered or even demanded any more, then my business runs out of cash very quickly. Because I am looking to have an invoice financed rather than a loan, I may fall outside many of the support structures currently on offer globally.

So, is the solution a digital one? The sector has been talking about the need for big data and artificial intelligence to create compliance and onboarding solutions; blockchain is regarded as one of the most effective ways of moving from manual trade finance processes to secure digital transactions. As a result, there are many fintech solutions out there in the market that have sought to digitise trade finance from the supply side. They streamline transactions and payments securely and generally save banks time and money, making them more efficient and effective.

The COVID-19 pandemic has revealed the importance of the demand side – in other words, the need for trade finance among a group of very small businesses who are currently excluded from existing, largely corporate, solutions. The legacy of the global financial crisis was to push trade finance providers away from these smaller companies because, in an environment where unorthodox monetary policy was keeping yields low, the due diligence and onboarding costs relative to deal size for the smallest businesses were simply unsustainable. Many of the digital solutions that have evolved since then have either directly or indirectly sought to close the SME trade finance gap by offering quicker onboarding and compliance tools to banks so that they can provide money to these businesses more readily.

There is limited evidence that digital solutions are substantially closing the gap, however, and COVID-19 is likely to widen it again. This is because these solutions do not address the demand side. That is, many of the SMEs, according to the OECD , are micro businesses that contribute to value added trade – that is, to critical value-adding parts of supply chains. So, while these businesses may be tiny, they add to global trade in terms of innovation and supplying a very specific part of the supply chain, but do not necessarily even know that trade finance solutions are available to them.

The technology challenge for the sector that emerges from this crisis is to develop digital technologies that are almost akin to trade finance marketplaces – where demand and supply can meet securely and where the SMEs drive the type of finance that they need with full transparency of how they appear to the banks in terms of risk. There are indeed marketplace solutions that are beginning to emerge, but the urgent pressure now is for the SMEs themselves to understand that trade finance is a viable solution in the current global lockdown if they have invoices or contracts. Rather than a supply-side digital marketplace, this is a demand-led Open Trade Finance solution – much as Open Banking has been in the retail sector. Unless this type of solution can be found, the supply in the market will always outstrip the demand.

OUR PARTNERS

We thank our valued partners for their ongoing contributions

Boston Consulting Group

Boston Consulting Group (BCG) plays a central role in the Global Survey by supporting the day-to-day project and the development of the survey and overall report, and by contributing a strategic, value-focused perspective to the core topics.

BCG is a global management consulting firm and the world's leading advisor on business strategy. BCG partners with clients from the private, public and not-for-profit sectors in all regions to identify their highest-value opportunities, address their most critical challenges, and transform their enterprises.

BCG's expertise in the Financial Institutions sector spans all major topic areas to give global, regional and local banks detailed insight, knowledge and analysis across markets. Trade finance is an established and growing topic area for BCG's Wholesale and Transaction Banking practices. BCG has worked on more than 25 recent trade finance-related projects globally on industry questions and challenges such as market entry and growth, pricing, cost reduction, operations, and digital change and transformation.

By partnering with ICC on the Global Survey, BCG aims to bring additional strategic insight, commercial, and technical industry perspectives to the table for maximum value for the reader base.

Beyond the ICC Global Survey, BCG continues to actively support the trade finance community with thought leadership, including releasing a publication with SWIFT ahead of SIBOS last year: Digital Ecosystems in Trade Finance. In addition, BCG once again supported the ICC and its editorial board in co-authoring the 2019 ICC Trade Register.

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TXF

We would also like to thank TXF for their continued contributions, including a feature in this year's report based on market sentiment data collected from TXF Research's global Export Finance Industry Report 2020, scheduled for release at TXF Global in 2020, and closed deal data from TXF Data. Along with TXF Essentials, the market leading platform for in-depth news and stories in the export, trade and commodity industries, these three strands make up TXF Intelligence, TXF'S new business intelligence platform

For more information on the TXF's data used in this feature, please contact:
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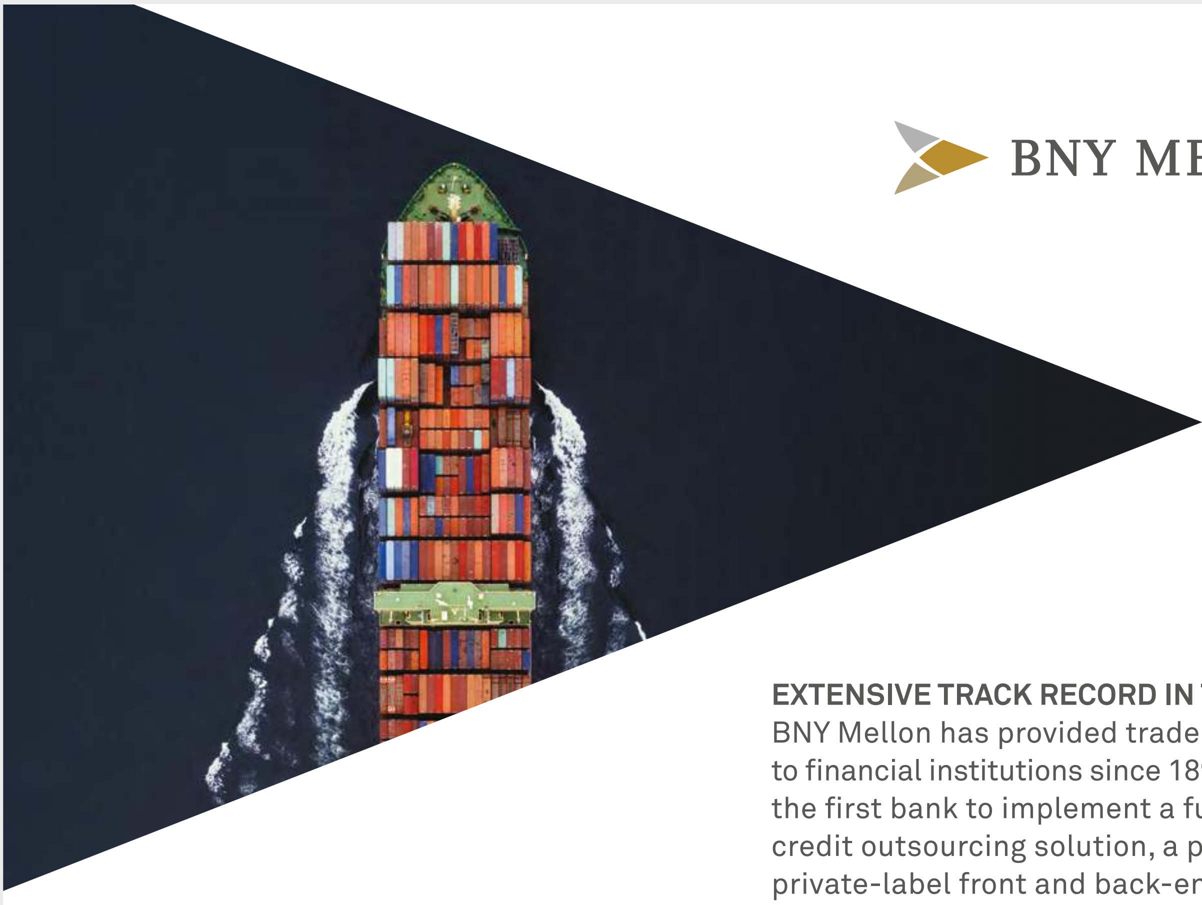

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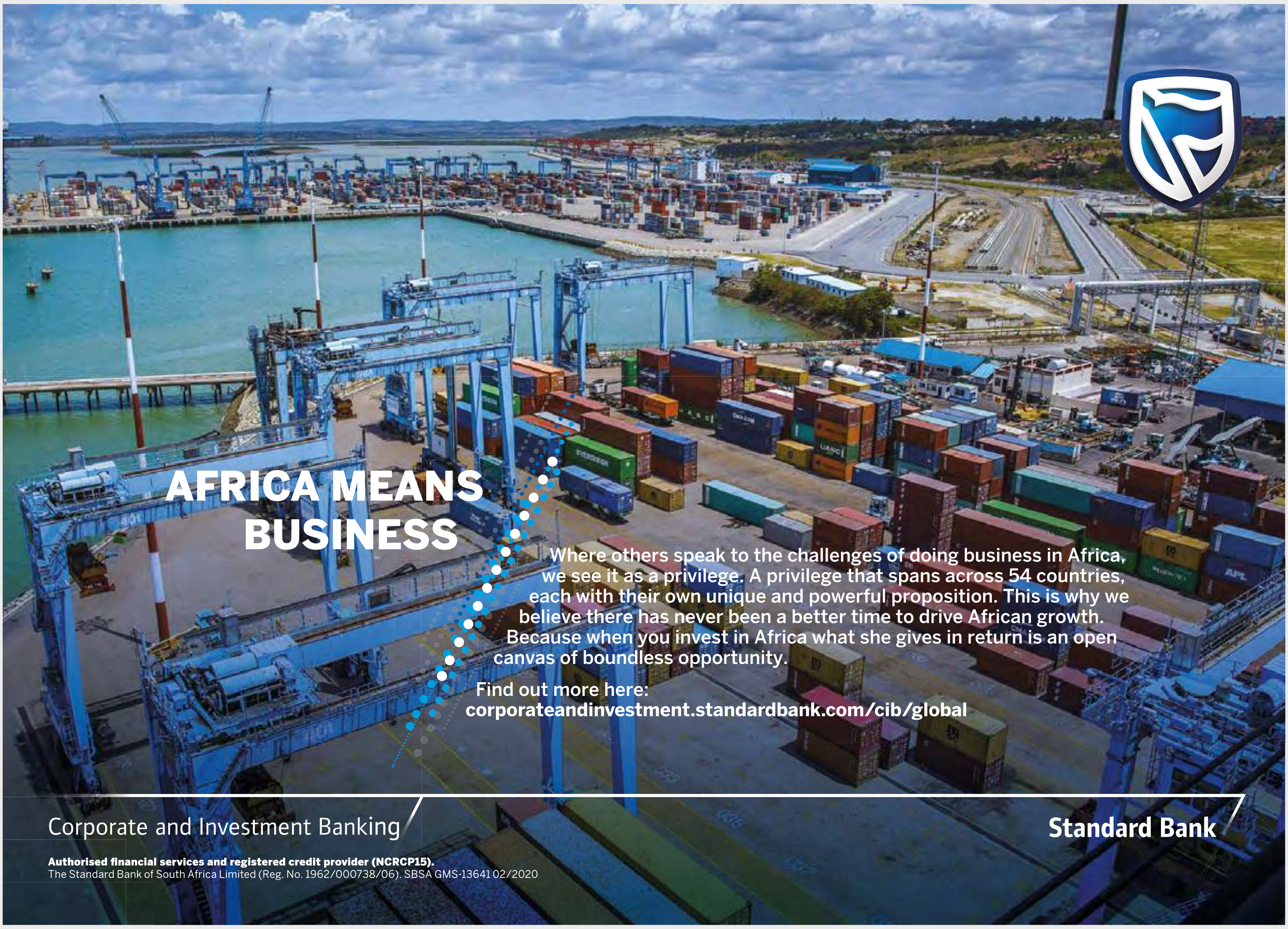
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2019

ICC TRADE REGISTER REPORT

GLOBAL RISKS IN TRADE FINANCE

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IN THIS REPORT

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REFERENCE INFORMATION

ABOUT THE INTERNATIONAL CHAMBER OF COMMERCE

The International Chamber of Commerce (ICC) is the institutional representative of more than 45 million companies in over 100 countries. ICC's core mission is to make business work for everyone, every day, everywhere. Through a unique mix of advocacy, solutions and standard setting, we promote international trade, responsible business conduct and a global approach to regulation, in addition to providing market-leading dispute resolution services. Our members include many of the world's leading companies, SMEs, business associations, and local chambers of commerce.

For more information please visit: www.iccwbo.org

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The ICC Banking Commission is the largest commission of the ICC. It is the authoritative voice for the trade finance industry, setting the standards and benchmarks for industry practices. The Commission is delighted to continue working with its two Trade Register partners: Boston Consulting Group (BCG) and Global Credit Data (GCD).

As always, the ICC Banking Commission extends special thanks to our 22 Member Banks:

ANZ
Bank of America Merrill Lynch
Bank of China
Barclays
BMO Financial Group
BNP Paribas
Crédit Agricole CIB
Deutsche Bank
HSBC
ING
J.P. Morgan Chase
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Rand Merchant Bank
Santander
Société Générale
Standard Bank
Standard Chartered Bank
Sumitomo Mitsui Banking Corp
UniCredit
Wells Fargo

The findings of this report are based on our Member Banks' underlying data sets, and financial and resource contributions. Their continued financial support, investment of time and resources, and uncommon focus on the bigger picture let us collect increasingly robust and meaningful data to produce this report each year.

Finally, the ICC Banking Commission would like to thank the project's leadership: Krishnan Ramadurai, Chair, ICC Trade Register; David Bischof, Project Manager; our team of Project Advisors, Henri d'Ambrières of HDA Conseil in France, Jonathan Joseph-Horne of Sumitomo Mitsui Banking Corporation, Hugo Verschoren of goVer Trade Technologies Ltd in Belgium, and Christian Hausherr of Deutsche Bank AG; the ICC Secretariat; Sukand Ramachandran, Ravi Hanspal, and Noah Mayerson of BCG; and Richard Crecel and Michaël Dhaenens of GCD. The entire team has been instrumental in the design and execution of the 2019 Trade Register Report.

OUR PARTNERS

Global Credit Data

Global Credit Data's objectives, as set out in its Articles of Association, include providing its members with credit data collection, analysis and research, contributing to a better understanding of credit risk and promoting quality standardisation and transparency of data to improve credit risk management. GCD's data-collection and analysis competencies allow the ICC to remain focused on core strategic and advocacy activities.

GCD is a non-profit association owned by over 50 member banks. Its mission is simple – to help banks better understand and model their credit risks through data pooling and benchmarking activities. GCD started collecting data in 2005 as the Pan European Credit Data Consortium (PECDC), with the goal of helping banks to develop Basel II-compliant Loss Given Default (LGD) and Exposure at Default (EAD) models. Member banks have exclusive access to this database and use it to successfully support their IRB Advanced accreditation applications. It now covers over 120,000 non-retail defaulted loan facilities from around the world. In 2009, GCD introduced a Probability of Default (PD) database which now covers more than 10 years of data and helps banks to calibrate and benchmark their PD master scales for Basel II and III Advanced and Foundation models. In 2014, PECDC changed its name to The Global Credit Data Consortium (GCD) to reflect the growth in membership of US and Canadian banks. In 2017 GCD introduced a Benchmarking Platform for member banks to compare their forward-looking PD, EAD and LGD estimates against their peers. The robustness and capacity of GCD's data collection and management infrastructure make GCD databases a leading global standard for credit risk data pooling.

The value of GCD membership extends beyond the data itself, to a deep network of highly experienced credit risk professionals. GCD member banks benefit from exclusive rights and access to credit databases and analytics, and from knowledge and research facilitation via the unique industry association. In a variety of forums, such as workshops, webinars and surveys, GCD facilitates discussion in key strategic areas including LGD modelling, stress testing, Comprehensive Capital Analysis and Review (CCAR) and International Financial Reporting Standards 9 (IFRS9) modelling. Highlights include the North American and European GCD conferences held each year.

GCD members are owners of the association and its data. They have a prominent role in steering the GCD's strategic direction to keep activities member-centric and drive the "by Banks for Banks" credo.

BOSTON CONSULTING GROUP

Boston Consulting Group

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By partnering with the ICC Trade Register, BCG aims to bring additional strategic insight, commercial, and technical industry perspectives to the table for maximum value for the reader base.

Beyond the ICC Trade Register, BCG continues to actively support the trade finance community with thought leadership, including releasing a publication with SWIFT ahead of SIBOS last year: *Digital Ecosystems in Trade Finance*.

In addition, for the first time this year, BCG will be supporting the ICC and its editorial board in co-authoring the ICC Global Survey – looking at more holistic trends and sentiments in the trade finance space.

BCG was founded in 1963. It is a private company with more than 90 offices in 50 countries. For more information, please visit www.bcg.com.

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FOREWORD FROM CHAIR OF THE ICC TRADE REGISTER

Krishnan Ramadurai
Chair, ICC Trade Register

In its 11th year of publication, the ICC's annual Trade Register Report remains a unique source for trade finance and export finance-related credit risk data which is used by:

- Banks as an internal reference point for getting appropriate capital and accounting treatment for trade finance and export finance products
- Banks and the industry in their dialogue with regulators to ensure trade finance products are treated appropriately under various global and national regulations and receive consistent risk-aligned capital treatment, and
- Capital markets participants as a proxy benchmark for investments made in trade assets, even though the Trade Register clearly highlights the limitations in using this data as an investment benchmark.

At the time of writing, the unexpected and unpredictable rise and spread of COVID-19 is disrupting the world around us – and trade is no exception. As we discuss the impacts of the virus on global trade and trade finance later in the report, it behoves us to recognise the precariousness of the international trading system, but also to acknowledge that relative to other banking products we continue to see trade finance as a low-risk asset class – even, or perhaps particularly, in these uncertain times.

In terms of developing the Trade Register Report, this year the project team set itself the task of:

- **Further simplifying and standardising the data collection process within the GCD portal:** I am happy to report progress in improving the data collection process by eliminating the collection of redundant data fields and making changes based on feedback received from banks submitting data to the Trade Register. The quality and robustness of the data has also been enhanced by introducing product and sub-product hierarchies. This enables the Trade Register to measure obligor-level defaults more accurately for short-term trade finance and for export finance by expanding the time period of data collected on recovery and write-off amounts.
- **Refining estimates of Credit Conversion Factors and Loss Given Default for L/Cs and guarantees:** Progress on this front has been mixed; while estimating Loss Given Default for letters of credit (L/Cs) and guarantees remains challenging, given the

practice-based differences in place to deal with defaulted obligors, progress has been made on estimating Credit Conversion Factors (CCF) for L/Cs and guarantees. This is illustrated by the fact that we were able to combine the expertise of GCD in collecting and analysing data and the project team's technical knowledge, to put together a paper which clearly shows that the empirical CCF for performance guarantees and financial guarantees are far below the regulatory stipulated values of 20/50/100%. While this exercise was undertaken in response to proposed changes to CCFs for guarantees in the new Basel III regulations, it can also be used by banks to make a case for empirical CCFs for estimating Expected Losses (ELs) under IFRS and US GAAP accounting rules.

- **Convergence in the use of Trade Register data for estimating LGD and EAD within corporate models:** This is one area where progress has unfortunately been limited. While tentative steps have been taken, including a joint working group meeting of GCD risk professionals and ICC trade professionals, this group has not been able to make progress given the need to address data and other qualitative issues with the trade data set. Given the technical challenges in convergence, one action being explored involves using a common data portal to collect LGD and EAD data for both the Trade Register and the GCD participating banks. This also has the added advantage of potentially increasing the number of banks participating in the report.
- **Expanding the scope of supply chain finance (SCF) techniques and the estimation of LGD:** Given the issues surrounding supply chain finance raised in part by the accounting firms and the rating agencies, the Trade Register has focused on strengthening the data collected on supply chain finance and making a start at embedding the methodology for identifying obligor-level defaults and exposure movements which will help in estimating LGD. Given the limited number of defaults reported and the need to maintain the anonymity of data, estimation of LGD for SCF will commence only from 2020.

The storyline of this year's report reinforces the themes of previous years. Both trade finance and export finance products continue to exhibit low credit risk characteristics. This is driven by a combination of low probability of default and high recovery rates, and in the case of trade finance shorter time to recovery. This year's dataset includes nearly USD 15 trillion of trade finance, export finance, and SCF transactions from over the past decade.

The Trade Register is at a crossroads: while its continuing evolution will require it to expand product scope to include the full range of SCF products and receivables finance, it will need to address issues emanating from the current crisis in a timely and transparent manner. This will enhance the usefulness of the report to a wide range of stakeholders ranging from banks and regulators to capital market investors.

To address these challenges the team will need to focus on:

- The Trade Register data converging with the GCD data as a single source of data for modelling LGD and EAD for trade finance products
- Expanding the scope of the SCF data collected to estimate LGD
- Using the data collected for L/Cs and guarantees to make a case with the regulators to lower the regulatory CCF values, and
- Expanding the number of banks providing data to the Trade Register, and as part of this sufficiently rewarding our participating Member Banks.

We hope you find this to be a useful report, and welcome your comments, feedback, and suggestions for enhancing it further in future years.

Krishnan Ramadurai
Chair of the Trade Register

EXECUTIVE SUMMARY

As we enter a new decade, the trends of the past decade will doubtlessly accelerate and continue to shape both trade and the world around us: growing digitisation, the rise of industry disrupters, the world's march towards increased interconnectedness, the rise in the impact and awareness of climate change, and political tensions disrupting the long-held assumptions of the world order. Indeed, the ways that trade and trade finance operate today look radically different from what they did at the start of the past two decades. Since 2000, global trade flows have trebled from USD 6.2 trillion to USD 18.1 trillion in 2019 – undoubtedly made possible through trade finance products which offer liquidity and risk mitigation solutions for importers and exporters, allowing them to transact with confidence across borders.

The COVID-19 pandemic – and the global economic downturn that has followed – will in the short term likely reverse the growth in global trade over the past decade. As discussed later in the report, various scenarios suggest the 2020 value of global trade could decline by anywhere from 11% to 30%. With supply chains disrupted and consumer demand plummeting at an unprecedented rate, it is understandable that the virus is top of mind for those involved in global trade.

As a result, the risk profile of trade products will likely increase this calendar year – data that is not yet reflected in the bank data utilised by the Trade Register. At the same time, the world will at some point emerge from this crisis. Some variation of business as usual will, slowly, resume – a new normal will take hold. The short-term impacts of COVID-19 aside, the virus will likely disrupt and perhaps accelerate existing industry trends. The risk mitigating properties of documentary trade may grow in popularity (reversing the ongoing shift to open account trade), although this may be less pronounced than in previous crises as more attention has been placed on how to apply risk mitigation to SCF. Further, the challenges in producing original documentation may help speed up the shift to digital in the industry. Importers and exporters, trade banks, and regulators must not only focus on immediate risk mitigation but also on how to incorporate the lessons learned from this crisis into how global trade operates and is governed in the future.

As the banking environment continues to evolve and respond to the changing political, economic, and regulatory milieu, trade finance and export finance will also need to adapt and evolve. This context makes it more critical than ever for banks to understand the risk profiles of their trade finance and export finance products. The ICC Trade Register plays an important role in this with its data-driven, objective and transparent view of the credit-related risk profile of trade finance and export finance.

The 2019 Trade Register Report, which contains data up until the end of 2018, reinforces the themes of previous years; notably, that trade finance and export finance products continue to present low credit risk compared to other banking products. This is driven by a combination of low probability of default, high recovery rates and, in the case of trade finance, shorter times to recovery.

For trade finance products, the latest Trade Register data suggests that default rates have largely remained the same as, or lower than, in 2017. Import L/Cs are a notable exception to this, with an increase in default rates when weighted by exposures and transactions. This rise was driven by the default of a major French retailer, whose impact was felt across its global supply chain. While it is encouraging to note that the rise in import L/C defaults was not driven by an industry-wide issue, it is still revelatory to observe the wide-scale impact of a single corporate default.

Expected Losses, on the other hand, are similar across products when compared to 2017. This is consistent when viewed from either an obligor-weighted or exposure-weighted perspective.

Conversely, export finance has seen increases in default rates in 2018. This growth in default rates is not uniform across asset categories; the corporates asset class had the largest increase while specialised asset class defaults decreased. The regional perspective is mixed, with North America in particular and Europe to a lesser extent seeing increases in default rates while the Middle East saw a decline (even though it retains the highest default rates across the regions). In spite of these increases and the geographic variance, export finance credit risk for banks remains very low, driven in particular by Export Credit Agency (ECA) backing, which is typically at around 95%. As such, recovery rates for defaulting transactions are typically above 95%, resulting in low overall Expected Losses.

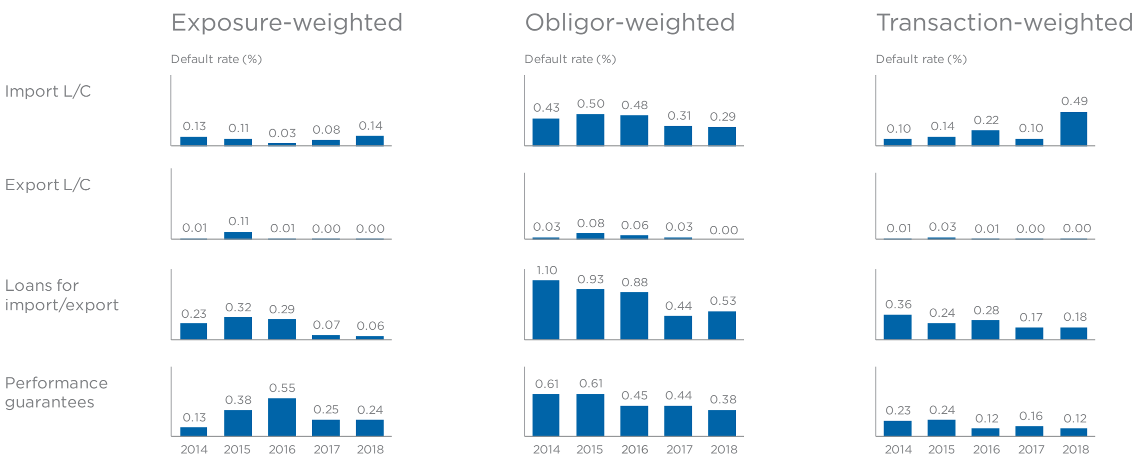
The supply chain finance data set, specifically covering payables finance, is only in its second year of ICC Trade Register coverage and is hence comparatively small; however, initial indications are that the probability of default for SCF is comparable to other short-term trade finance products. Nevertheless, 2018 saw an increase in SCF defaults due to the default of a single UK-based construction firm, which impacted suppliers around the world. Over the coming years, we will collect further data to substantiate and disaggregate these results so that they can be used to inform regulatory, capital, and accounting policies.

The ICC is continuing to enhance the scope, improve the data quality and refine the methodology of the Trade Register. Indeed, the quality of the data included in the Trade Register has continued to improve in recent years. In the longer term, we will explore ways to expand the scope of the Trade Register to include operational and fraud risks. We will also continue to actively expand participation in the Trade Register to grow the underlying data set.

Figure 1:
Products included within trade finance and export finance[1]

Trade finance (short term)	Export finance (medium and long term)
• (Issued) import letters of credit • (Confirmed) export letters of credit • Loans for import/export • Performance guarantees and standby letters of credit • Supply chain finance (payables finance)	• Products (e.g. export credits) for which an ECA has provided a state-backed guarantee or insurance to the trade finance bank

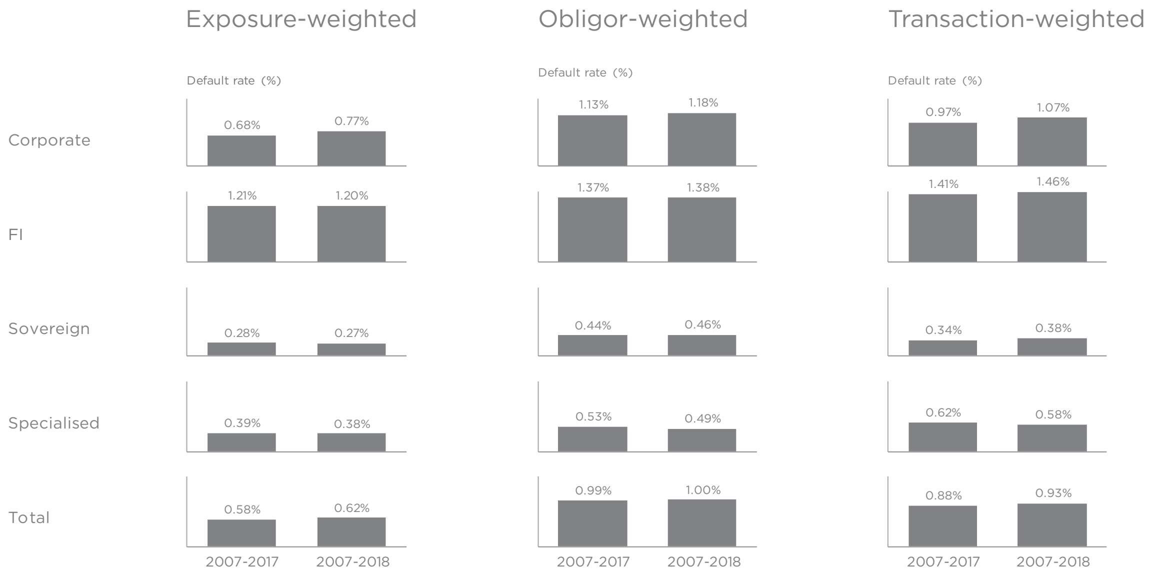
Figure 2:
Summary of default rate trends
Trade finance, 2014–2018



Source: ICC Trade Register 2019

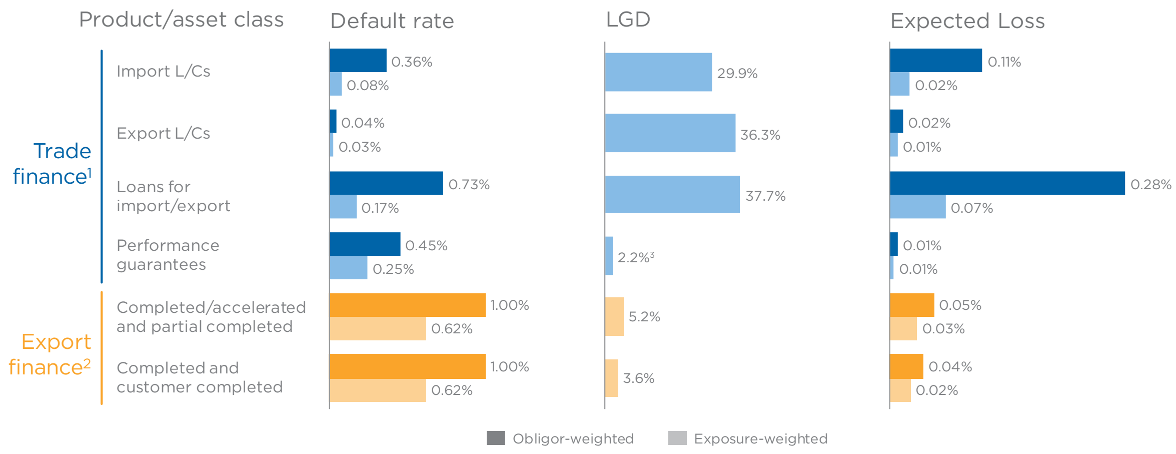
1. See Appendix A for detailed trade finance and export finance product definitions

Export finance, 2007–2018



Source: ICC Trade Register 2019

Figure 3:
Summary of Expected Loss findings for trade finance, 2008-2018, and export finance, 2007-2018



1. 2008-2018 2. 2007-2018 3. Accounts for 4.1% observed 'claim rate' (i.e. applying CCF to Loss Given Defaults)
Source: ICC Trade Register 2019

THE FULL REPORT

INTRODUCTION TO THE ICC TRADE REGISTER REPORT

THE FULL REPORT

Context of the Trade Register Report

The ICC Trade Register Report presents a global view of the credit risk profiles of trade finance, supply chain finance, and export finance transactions. The Trade Register demonstrates the low-risk nature of the transactions that enable global trade and the trillions of dollars in economic value that flow from these commercial activities.

The report draws on data from 25 trade finance and export finance banks[2] – a representative set of global trade finance and export finance transactions that amounts to 32 million transactions in total and nearly USD 15 trillion in exposures. The combination of import letters of credit, export letters of credit, performance guarantees, and supply chain finance exposures in the Trade Register is equal to approximately 28% of global traditional trade finance flows and 11% of all global trade flows (Figure 4).

The data is analysed by GCD, BCG, member bank specialists, and the ICC Banking Commission project team and Project Advisors. The methodology used is consistent with the approach used in past years and, over time, the Trade Register has evolved to increasingly align with the Basel framework, while also providing a practitioner's view of credit risks within trade finance and export finance.

While the report format has varied, the objectives of the Trade Register have stayed the same:

- To provide an objective, transparent view of the credit-related risk profile and characteristics of trade finance and export finance using a rich, data-driven approach with the intention of contributing to relevant informed policy and regulatory decisions
- To progress the understanding of trade finance and export finance, their importance to global trade and their highly effective global risk mitigation capability to a broad range of parties, and
- To promote understanding of the international regulations affecting bank capital requirements for trade finance and export finance, and their history and objectives, in order to create a uniform global view of this industry as part of the ICC Banking Commission's commitment to effective and collaborative advocacy.

This year's report reflects the findings from past years: **trade finance and export finance continue to be a low-risk asset class.**

It should be noted that an increasing number of investors are using the Trade Register and its data in making investment decisions. Given the data limitations that are outlined below, **the ICC can only authorise – and strongly encourages – the usage of the report's data and information for research purposes and not to inform investment decisions.**

Report scope

To continue its relevance and reliability, the scope of the ICC Trade Register is frequently updated; for example, to include expanded geographic reach, number and diversity of contributors, volume and quality of data, and align analytical methods to the Basel framework.

Figure 4:
Estimated coverage of ICC Trade Register in 2018 (products grouped to enable like for like comparison)

Product	2018 exposures in Trade Register (USD T)	Est. share of 2018 trade finance, by product (%)	Est. share of 2018 total global trade flows (%)
L/Cs (including import and export)	0.60	28%	3%
Other trade and SCF	1.36	26%	7%
Total	**1.96**	**28%**	**11%**

Source: BCG Trade Finance Model

2. 22 Member Banks contributed to the report in 2019, but the ICC Trade Register contains data from 25 banks in total across all years

Gathering representative data from a multitude of banks internationally is complex and, as a result, the Trade Register focuses only on credit risk across the following products:

- Issued import letters of credit (referred to as import L/Cs in this report)
- Confirmed export letters of credit (referred to as export L/Cs in this report)
- Loans for import/export
- Performance guarantees and standby letters of credit (referred to as performance guarantees in this report)
- Supply chain finance payables finance (referred to as SCF payables finance in this report)
- Export (finance) credits, backed by an ECA

Definitions of these products are outlined in Appendix A.

The scope of export finance products historically has been limited to products for which an OECD ECA has provided a state-backed guarantee or insurance to the trade finance bank. For 2019, the project team has once again extended data collection to non-OECD Export Credit Agency-backed export finance. Data is thus collected from two different streams: OECD and non-OECD countries.

For the purpose of the report, export finance transactions are split into four asset categories (sovereign, financial institutions, corporate and specialised), with definitions outlined in Appendix A.

The risk scope is currently restricted to credit risk.

Overview of methodology

An important methodological imperative for the Trade Register has been to align the analysis and calculations to a Basel-compliant view, as the Basel regulations provide a uniform methodology to assess and manage credit-related risk.

An ongoing, multi-year effort is underway to align the Trade Register's data structure, methodology detail and calculations more closely with the Basel approach. Specific explanations of the methodology and calculations are mentioned in the relevant sections, and a full discussion on export finance calculations is included in Appendix A.

As in previous years, the report includes three different weighting methodologies to measure default rates – exposure, obligor, and transaction. While data is collected at a granular level to ensure as consistent a methodology as possible, several limitations exist and are explored in detail in Appendix A. However, it is worth noting three points here:

(1) An element of judgement remains in the definition of default. The definitions prescribed require banks to identify not only borrowers with overdue payments of 90 days or more, but also other borrowers judged by the bank as "unlikely to pay". This element of judgement will always result in a difference between banks.

(2) The definition of a technical default varies widely between regulators. For example, one bank may be required to briefly declare that an otherwise sound borrower is in default due to a mistaken mis-booking of a payment, overlooked for 90 days, while another regulator may allow a similar event to be ignored for default counting purposes.

(3) As is the Basel approach, the obligor-weighted default rate for a product is calculated as the number of obligors (holding the product in question) who default on any financial product that they hold with the bank, divided by the total obligors holding the product in question. While this is the definition used in the report, there is ongoing discussion with contributing banks to apply this consistently in the data provided – a topic we will look to address in future editions.

Care is needed when comparing the different weighting methods of obligor, transaction, and exposure. While exposure-weighted data gives a good insight into the effects of defaults and losses on the banking industry, the most common default and LGD rates used and reported by banks are based on obligor or transaction weightings. In the case of

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obligor and transaction-weighted data, equal weight is given to small and large borrowers and transactions, meaning this data is more representative of smaller borrowers and transactions.

Representativeness of Pooled Data

Over the last year discussion has continued about the need for users of pooled data to prove that the data represents the portfolios to which it is being compared. The degree of representativeness will depend on the use of the data. For example, to calculate the overall industry average default rate for import L/C applicants, the average of the total data set may need to be adjusted to take account of regional data concentrations. To use the data to benchmark the modelling of a particular portfolio, the user would need to take into account the borrower countries, facility types, borrower types, industries and sizes. **This year the Trade Register will share anonymised data with contributors to allow them to create customised reference data sets for their own purposes.**

The Trade Register is based on data pooled voluntarily by banks active in trade finance. Given that these banks represent a large proportion of the global trade finance business, the data sets are globally representative, but may not fully capture country-level or regional nuances, as the depth of data sets does vary by market.

TRADE FINANCE: STATE OF THE MARKET

Market Trends in Trade Finance: From COVID-19 and Beyond

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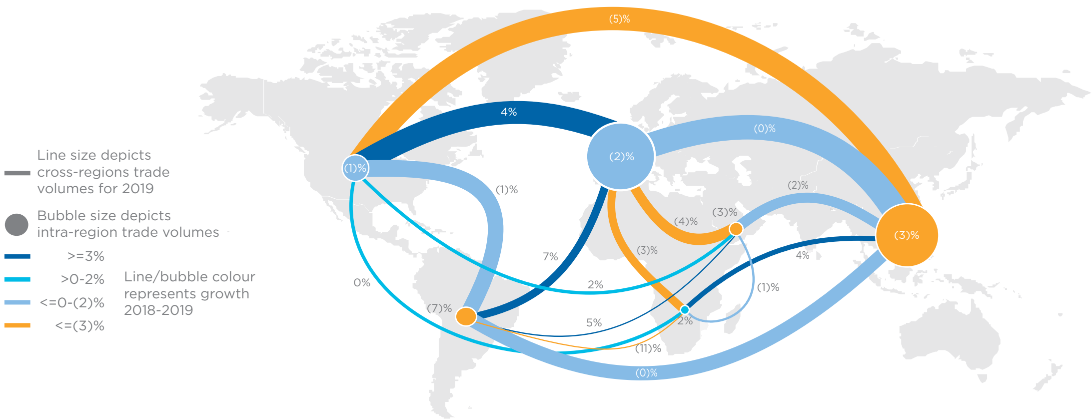
State of the market: An unprecedented time for global trade

International trade continued to grow over the last decade despite the after-effects of the 2008 financial crisis and the return of protectionist policies in many countries, including the US. But it now faces an even greater challenge from the COVID-19 pandemic.

Global trade volumes are sure to fall in 2020 and, with them, the revenues of the trade finance industry. The effect on volumes over the next few years will depend on the scale and duration of the pandemic, and on the immediate governmental responses to it. And, even after the pandemic and emergency measures have passed, international trade may still be constrained by long-term changes in commercial behaviour and public policy. Not since WWII have the prospects for international trade been so uncertain.

Figure 5:
BCG Trade Finance Model, change in 2019 global trade corridors from 2018



Source: BCG Omnia Global Trade Finance Model 2020

Review of 2019: Setting the scene before COVID-19 struck global trade

The value of international trade in 2019 showed a slight decline to USD 18.1 trillion, 2% down from its historic peak in 2018 of USD 18.5 trillion, but was nonetheless showing strong signs of recovery versus its 2015/16 dip. Indeed, the underlying volume of trade increased by 2%.

The fall in the value of global trade was largely the result of US Dollar appreciation (the local currencies of 18 of the top 20 trading countries depreciated against the US Dollar). Further, trade tensions between the US and China continued in 2019 – also dampening the rise in trade values seen in recent years. Trade between US and China fell by 12%, driving an overall 5% reduction in trade between the US and Asia. Trade in most other corridors was more or less flat, with Africa the only region to have shown positive growth (Figure 5).

Despite the slight decrease in global trade values, trade finance revenues ticked up by 1% to USD 46 billion in 2019. This was due to a 6% growth in documentary trade revenues. Open account revenues, by contrast, were down 4%. This reversed the trend of recent years in which revenues have shifted from documentary to open account trade. The most likely explanation is that trade tensions between the US and China have increased uncertainty in supply chains and, hence, the demand for the risk mitigation supplied by documentary trade products. Shifting from familiar suppliers in China to new suppliers in Vietnam or Thailand is also likely to increase demand for documentary trade, at least until the new relationships are well established.

We expect the uncertainties created by the COVID-19 pandemic to sustain increased demand for documentary trade over the short-to-medium term (as demand for these trade products tends to be countercyclical). Indeed, we expect this effect to be greater than it was in the 2008 financial crisis because COVID-19 is more far reaching, with grave economic consequences in all regions of the world.

What does COVID-19 mean for international trade?

The relatively benign outlook for international trade in 2019 has been abruptly impacted by the onset of the COVID-19 crisis. As of the end of April 2020, the pandemic shows no signs of abating. Confirmed infections have reached over three million globally, and the number of deaths attributed to COVID-19 is 200,000. More and more countries are being hit by the virus, with the US now an epicentre.

Governments are imposing ever more stringent lockdowns, banning people not only from entering the country but from travelling domestically. In many countries the entire population is confined to their homes, except those working in industries deemed essential, such as food supply and healthcare.

With large sections of many economies effectively shut down, stock indices have fallen dramatically and claims for unemployment benefits have exploded. Governments are offering unprecedented sums of aid to businesses and their employees, while central banks are cutting interest rates and injecting masses of liquidity into the financial markets.

Figure 6:

Web traffic, compared to baseline (BCG Demand Sentinel)
Change in normalised visits for the periods 31 March to 6 April 2020 vs. 27 January to 2 February 2020

Sector	AE	AU	BR	CA	DE	ES	FR	IN	IT	JP	MX	MY	SG	TH	UK	US	VN
Accommodation & Hotels	-71%	-79%	-81%	-78%	-83%	-84%	-80%	-74%	-85%	-48%	-68%	-84%	-55%	-63%	-82%	-74%	-77%
Air travel	-71%	-68%	-59%	-69%	-61%	-74%	-67%	-60%	-78%	-54%	-55%	-73%	-63%	-56%	-65%	-61%	-70%
Automotive Industry	-50%	-33%	-37%	-28%	-7%	-68%	-61%	-30%	-60%	-12%	-14%	-65%	-7%	-28%	-51%	-22%	54%
Banking Credit & Lending	-15%	-4%	-6%	-8%	-11%	-29%	-23%	-11%	-19%	-13%	5%	44%	3%	21%	-14%	-10%	15%
Beauty & Cosmetics	8%	11%	-28%	-11%	1%	-13%	-25%	-43%	-23%	-10%	-6%	-36%	-21%	-21%	-3%	-8%	-13%
Beverages	53%	9%	-25%	7%	16%	8%	-14%	22%	15%	-16%	-12%	-22%	4%	-9%	30%	32%	-3%
Car Rentals	-66%	-69%	-63%	-67%	-66%	-82%	-79%	-67%	-84%	-26%	-41%	-65%	-57%	-44%	-71%	-70%	-24%
Consumer Electronics	-25%	8%	-1%	-5%	-4%	-8%	-15%	-16%	5%	6%	-8%	-27%	-3%	-7%	-3%	-3%	-14%
Fashion & Apparel	-18%	-5%	-15%	-17%	-6%	-43%	-38%	-66%	-40%	-10%	-20%	-47%	-24%	-15%	-23%	-18%	-31%
Furniture	-19%	4%	-22%	-16%	-3%	-37%	-31%	-46%	-46%	27%	13%	-36%	5%	79%	-17%	-15%	-6%
Groceries	66%	9%	314%	60%	34%	-1%	96%	-15%	24%	-8%	6%	-13%	64%	22%	117%	81%	41%
Insurance	-19%	-37%	-29%	-27%	-23%	-35%	-33%	-19%	-23%	-3%	4%	-31%	10%	0%	-39%	-21%	-3%
Jewelry & Luxury	-37%	-24%	-22%	-41%	-10%	-59%	-15%	-57%	-49%	-25%	-29%	-32%	-36%	-10%	-29%	-29%	-34%
Marketplace	-29%	1%	-12%	-3%	1%	-19%	-16%	-54%	-16%	-2%	-20%	-13%	-17%	2%	-1%	3%	5%
Medicine	16%	27%	17%	-7%	-14%	-12%	7%	5%	22%	2%	3%	-11%	-27%	-28%	-3%	-4%	-22%
Restaurants & Delivery	-27%	-26%	19%	-13%	-5%	-54%	-61%	-53%	-24%	-12%	-8%	-16%	-4%	-17%	-32%	0%	-27%
Telecommunication	-5%	-5%	-6%	-21%	-2%	-21%	-12%	19%	-2%	-5%	-1%	-9%	-12%	-6%	-8%	-11%	21%

Source: SimilarWeb data (www.similarweb.com); BCG Demand Sentinel

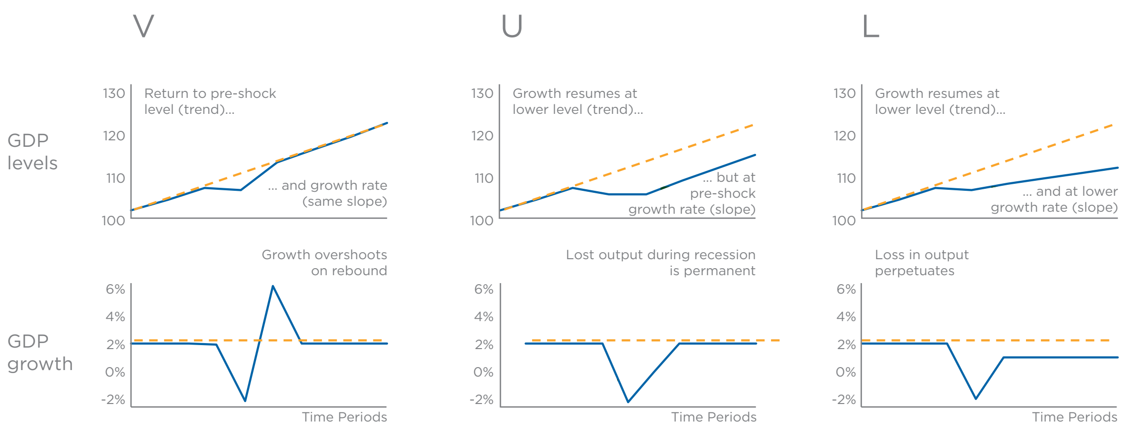
The immediate effects on international trade are best understood by noting that the COVID-19 crisis is simultaneously a demand shock and a supply shock. The demand effect is most acute for sectors where consumers have effectively been banned from making purchases – travel, sports, restaurants, high-street retail, and so on. But a general decline in demand is also being caused by the loss of income among those who have lost their jobs (perhaps temporarily), the reduced wealth of consumers with stock market exposures and increased saving in response to financial uncertainty. The exceptions are those sectors that the lockdowns directly benefit, such as supermarkets and online entertainment (Figure 6).

The reduction in demand and supply means that the movement of goods will slow down, and in turn global trade will fall. However, if the pandemic does not last significantly longer than now expected, the effect is likely to be less sustained than it was following the 2008 financial crisis (however, in the near term the impact may be deeper). In addition, some of the very sharpest impacts are likely to be on service industries (e.g. restaurants, travel and leisure), rather than the import and export of physical goods – the focus of this report – although the ramifications will ripple across their supply chains (e.g. equipment, aviation fuel, etc.).

On the supply side, factory closures caused by staff sickness or governmental edicts are disrupting supply chains and causing downstream shortages of retail goods and components for manufacturers. The problem is exacerbated by the direct effects of the COVID-19 crisis on shipping. Port closures, sickness among crew, and the prioritisation of medical supplies are resulting in a reduction in route options, congestion at ports and long delays in the receipt of goods. Where possible, buyers will likely seek to avoid these problems by finding domestic substitutes for imported final goods or components, thereby reconstituting supply chains in the near future to build resilience into their business models.

The ultimate impact of the crisis on economic output and international trade will depend on the geographic scope, scale, and duration over which the pandemic plays itself out. The longer it goes on, the greater the strain on companies' liquidity, the greater the job losses, and the greater the number of

Figure 7:
COVID-19 shock and recovery scenarios



Source: BCG analysis

insolvencies. But the economic outcome will also depend on the effects of the immediate governmental interventions and on potential longer-term changes in policy, some of which may rein in the globalisation that has characterised the last 40 years. It is, therefore, difficult to predict. However, we believe three scenarios for economic output are plausible:

1. A moderate 3-to-6-month downturn, with a **V-shaped recovery** into 2021 that returns the global economy to its pre-crisis growth path. This will occur only if COVID-19 has been brought under control in most major economies by Q3 2020.

2. A deeper 6-to-9-month downturn with a slower **V-shaped recovery** (approaching U-shaped) in 2021 (our current view as the most likely outcome).

3. A deep widespread shock lasting more than a year with an **L-shaped recovery** that leaves economic growth at a lower rate over the long run. This scenario becomes possible if COVID-19 cannot be brought under control within the next 6 months or returns in the winter of 2020/21.

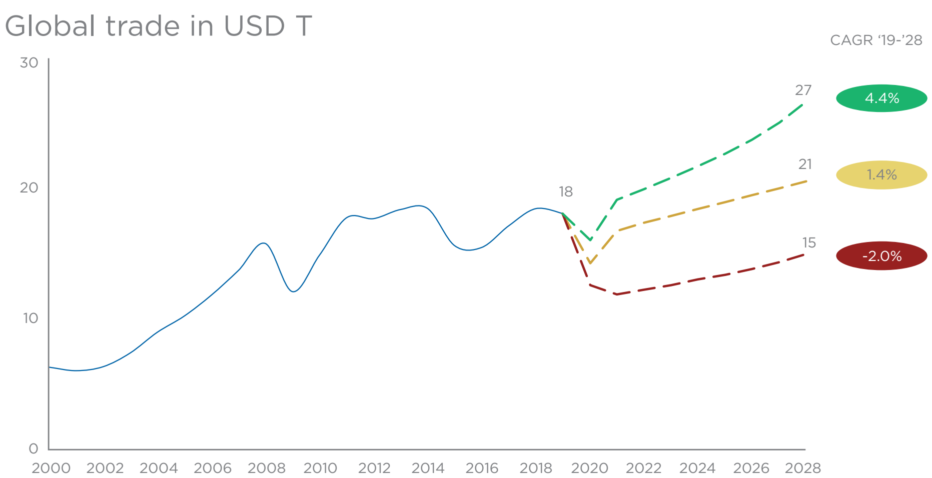
These output scenarios have dramatically different implications for international trade (Figure 8). On the moderate V-shaped scenario, we estimate that the fall in global trade for 2020 will be no greater than 11%, and that it will return to its 2019 value of USD 18 trillion by 2021, going on to reach nearly USD 27 trillion by 2028.

On our slower V-shaped scenario (approaching a U-shaped recovery) – the one we currently consider most likely – international trade makes a slow return to normality from Q3 2020. Global trade falls by 21% in 2020 and does not return to its 2019 value until 2024, reaching USD 21 trillion in 2028.

The severe L-shaped scenario entails a sustained setback for international trade. We estimate that global trade would decline by 30% in 2020 and not return to its 2019 value in the foreseeable future, rising to only USD 15 trillion by 2028.

This independent analysis largely mirrors the April 2020 projections of the World Trade Organization, which estimated global trade to decline by anywhere from 13% to 32% in 2020.

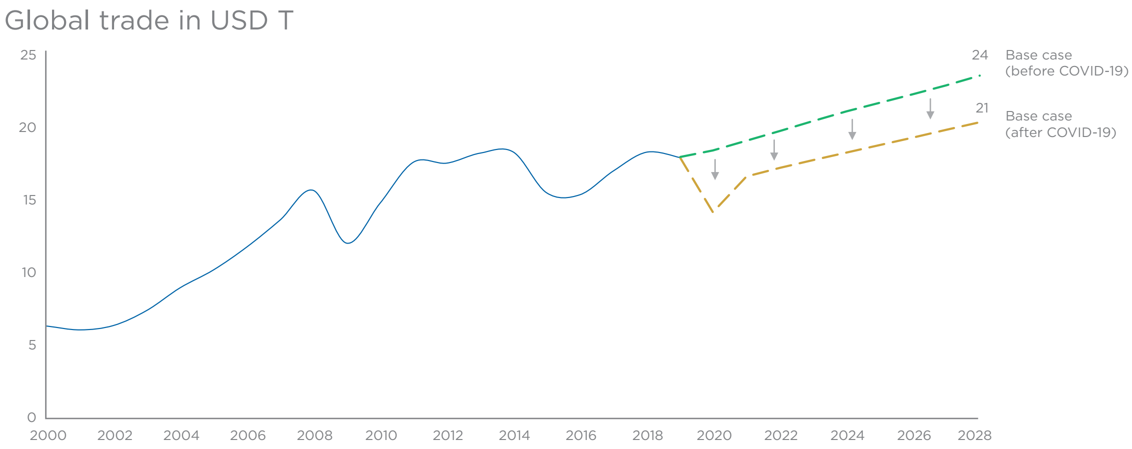
Figure 8:
BCG Trade Finance Model, estimated global trade flows, 2000-2028



Source: BCG Omnia Global Trade Finance Model 2020
These analyses represent only potential scenarios based on discrete data from one point in time (06 April 2020). They are not intended as a prediction or forecast, and the situation is changing daily.

Figure 9:

BCG Trade Finance Model, estimated global trade flows before and after COVID-19, 2000-2028



Source: BCG Omnia Global Trade Finance Model 2020
These analyses represent only potential scenarios based on discrete data from one point in time (06 April 2020). They are not intended as a prediction or forecast, and the situation is changing daily.

To put these scenario-based projections in context, we have also estimated future global trade flows in the absence of the COVID-19 crisis: our pre-COVID-19 base case. Under this now-impossible scenario, global trade would have been forecast to reach USD 24 trillion by 2028 rather than the USD 21 trillion of the slow V-shaped scenario.

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FEATURE

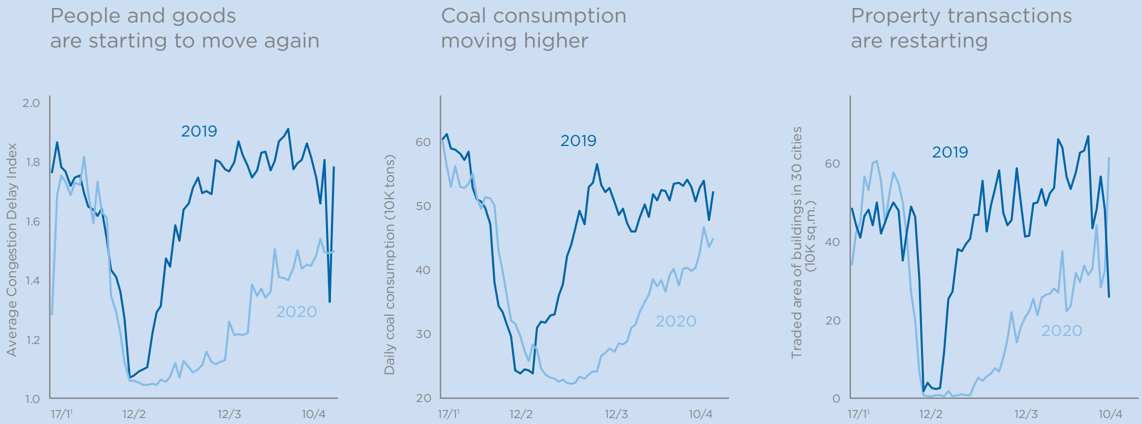
Progression of the COVID-19 crisis in China

The Chinese government locked down Wuhan on 23 January 2020, and subsequently most other cities in the Hubei province. In other parts of the country, people were encouraged to work from home and places where people gather in large numbers, such as cinemas and sports venues, were closed. The consequent lost output disrupted international supply chains, providing the initial supply shock of the COVID-19 crisis.

As of early April, the number of new COVID-19 cases in China is close to zero, as is the number of new deaths. Production has resumed in many industries, people and goods are moving again and the resumption of the real estate market suggests that a degree of economic confidence has returned (Figure 10). Overall the virus's economic impact in Asia appears less material than in Europe and North America (Figure 11). However, the speed with which the Chinese government lifted the lockdown means there is a material risk of another outbreak of the virus in the coming months.

All eyes are now on China to understand its recovery in the medium term – as this is currently the best indicator to other markets as to what recovery may truly look like.

Figure 10:
China COVID-19 recovery data



1. In DD/MM format
Note: As of 07 April 2020; China data re-based for weekdays excl. weekends relative to start of Chinese New Year. Congestion delay index average include Beijing, Shanghai, Guangzhou, Shenzhen, and Wuhan; Daily coal consumption of major power plants = sum of daily average coal consumption of Jerdin Electric, Guangdon Yudean Group, Datang International Power Generation, and Huaneng Power International, Inc.
Source: Wind, www.cqcoal.com, and BCG Center for Macroeconomics

Figure 11:

COVID-19 crisis and sector impacts by Total Shareholder Return (TSR) (as of 2 April 2020)

TSR performance (21 February - 2 April 2020)[1]

		Americas	Europe	Asia
Healthier sectors	Food/staples Retail	-9%	-8%	-10%
	Household Products	-11%	-13%	-2%
	Pharma	-13%	-13%	-12%
	Telecom	-14%	-15%	-10%
	Food & Beverage	-17%	-23%	-8%
Pressured sectors	Semiconductors	-21%	-34%	-21%
	Utilities	-22%	-27%	-4%
	Health Equipment	-22%	-23%	-4%
	Software	-25%	-27%	-23%
	Prof. Services	-26%	-26%	-24%
	Capital Goods	-28%	-32%	-25%
	Transport	-28%	-43%	-14%
	Financials	-28%	-31%	-24%
	Tech Hardware	-28%	-17%	-20%
	Materials	-28%	-25%	-24%
Vulnerable sectors	Media	-31%	-42%	-6%
	Retailing	-35%	-35%	-16%
	Insurance	-36%	-33%	-21%
	Banks	-39%	-48%	-23%
	Real Estate	-41%	-30%	-20%
	Auto	-45%	-42%	-30%
	Hospitality	-47%	-43%	-25%
	Durable Goods	-47%	-32%	-17%
	Energy	-47%	-26%	-28%

Note: As of 02 April 2020; Based on top S&P Global 1200 companies; Industries are based on Global Industry Classification Standard definitions.

1. Performance is tracked for the period 21 February 2020 (before international acceleration of outbreak), through 02 April 2020.

Source: S&P Capital IQ; BCG Henderson Institute; BCG analysis

Implications for trade finance

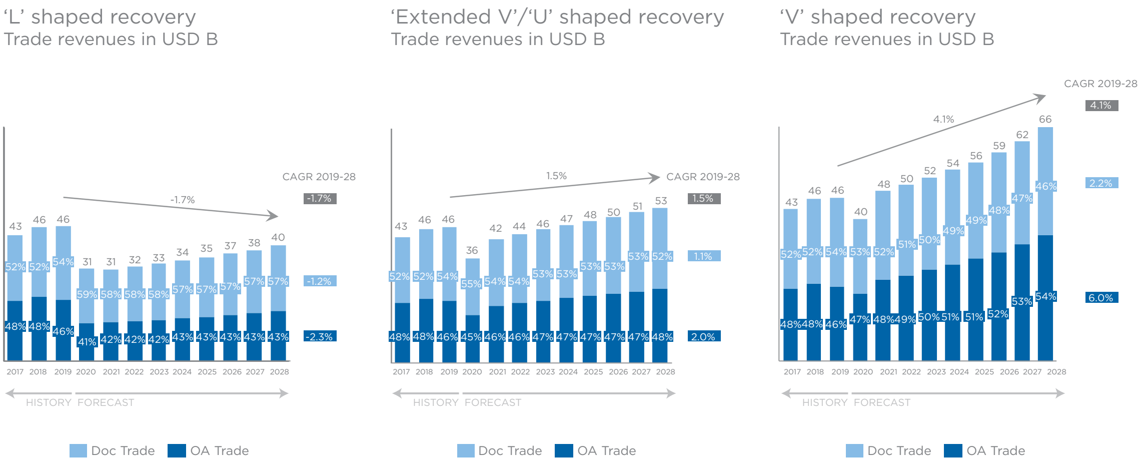
A slowdown in global trade, whether from COVID-19 or any other cause, will always reduce the use of trade finance and, hence, the revenues of its suppliers. However, the decline in trade finance revenues is unlikely to be strictly proportional to the fall in trade. This is because trade finance earnings as a percentage of total trade tends to be counter-cyclical. The uncertainties attendant on a difficult economic environment make importers and exporters more willing to pay for risk mitigation provided by letters of credit and bank guarantees – which are generally higher margin than open account trade.

We have factored this temporary shift away from open account trade and back to documentary trade into our estimates of future trade finance revenues under the three scenarios, with the shift increasing as the scenarios worsen (Figure 12). In the most severe scenario, we would expect documentary trade to jump from 54% of the total in 2019 to 59% in 2020. This will soften the blow, but it will not suffice to avoid an absolute decline in trade finance revenues (Figure 13). Even in the best scenario, revenues may fall from USD 46 billion in 2019 to USD 40 billion this year.

Reduced revenues are unlikely to be the only effect of COVID-19 on trade finance. In the short term, declining consumer demand and the disruption of supply chains will likely cause the default rate to spike (something that we look to explore in detail in future versions of the Trade Register, once the data is available). And banks will face calls for leniency, especially towards SMEs, which are expected to be hardest hit.

Figure 12:

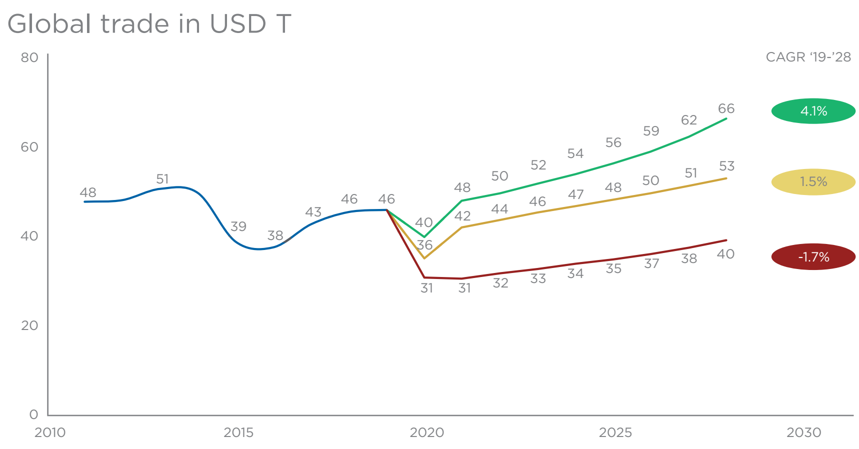
BCG Trade Finance Model, estimated share of documentary trade vs. open account trade, 2011-2028



Source: BCG Omnia Global Trade Finance Model 2020
These analyses represent only potential scenarios based on discrete data from one point in time (06 April 2020). They are not intended as a prediction or forecast, and the situation is changing daily.

Figure 13:

BCG Trade Finance Model, estimated global trade finance revenues, 2011-2028



Source: BCG Omnia Global Trade Finance Model 2020
These analyses represent only potential scenarios based on discrete data from one point in time (06 April 2020). They are not intended as a prediction or forecast, and the situation is changing daily.

The prices banks charge for documentary trade products are also likely to rise along with the demand for them and the risk of supplying them. Or banks may restrict supply to clients that they can be confident remain viable. Trade banks with deep customer relationships and, hence, the data required to detect early signs of trouble, will be at an advantage in knowing when to extend credit and when to take remedial action.

On a more optimistic note, the crisis may help catalyse the shift to digital trade. Flight bans and lockdowns are making processing of paper-based trade documents even more challenging and inefficient than usual, and organisations are working to find alternatives – such as replacing physical document presentation with sending SWIFT confirmations. In this regard, ICC released in April 2020 a guidance paper providing technical guidance to the market during COVID-19, including sharing different options for document delivery in a world in lockdown. The COVID-19 environment may have finally convinced everyone that paper-based trade is outdated and unsustainable, accelerating the move to digitisation.

From a risk perspective, it is unlikely that at the time of writing (April 2020) there has been a significant increase in trade defaults as a result of COVID-19. Many businesses have at least some form of cash reserves, and the tenor of a trade finance transaction is often 90+ days. However, as companies face further liquidity challenges and struggle to repay their trade finance facilities, we expect a notable increase in defaults during the crisis – particularly among SMEs. It will be important to understand not only the scale of trade finance defaults, but also how they compare to other asset classes. Will they, relatively speaking, continue to be low risk, even throughout this crisis? With these important considerations in mind, the Trade Register intends to expedite 2020 data collection to present a comprehensive view as early as possible, in 2021, of how COVID-19 impacted the risk profile of trade finance products.

FEATURE

Tackling COVID-19 with trade policy

Simon Evenett
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The COVID-19 pandemic has massively increased demand for ventilators, protective clothing, disinfectant, and testing kits in countries hit by it. Trade is crucial to meeting this demand, allowing such medical supplies to move rapidly from producer countries to the countries where they are needed. Any anti-globalisation sentiments that have been produced by the crisis would be seriously counter-productive if translated into barriers to the trade of medical supplies. Governments should take the opposite approach and free-up trade in medical supplies to the greatest extent possible. Measures could include:

- Removing import tariffs and quotas on all relevant medical equipment, medicines, disinfectant, and soap
- Eliminating all non-tariff regulatory barriers to importing relevant medical supplies, except those with the demonstrated purpose of ensuring safety
- Publicly refusing to ban or limit exports of relevant medical supplies, and reversing any such restrictions that already apply, and
- Strengthening incentives to ramp up domestic production by offering generous minimum prices for medical supplies sold to the state.

At the time of writing, the UK is starting to show progress here. The Chancellor of the Exchequer has waived customs duty and import VAT on medical equipment to be used in COVID-19 treatment. Similar actions by other governments would encourage much-needed global collaboration in dealing with the crisis.

Beyond COVID-19: the changing face of risk in trade

In the thick of the COVID-19 crisis, it is easy to think that nothing else is a priority. Even if that is almost true for now, it won't remain true. The trends that are reshaping the risks involved in trade finance will reassert themselves once the COVID-19 crisis has passed. We discuss three here: new digital technology, the ongoing trade tensions between the US and China, and climate risk.

Technology

Advances in digital technology have helped banks reduce the risks involved in supplying trade finance. Most obviously, they have greatly increased the data available for making credit assessments; they improve speed and accuracy when screening for criminal activity (in AML and KYC procedures); and they reduce the potential for human error. Technology also offers the opportunity to change how trade finance operates, from blockchain to electronic documents and signatures.

However, this technology also creates new kinds of operational risk. Systems failures can bring operations to a halt and cause significant reputational damage, as witnessed across multiple financial institutions when online banking or payments systems are down. In trade finance, such failures can have knock-on effects through a supply chain spanning several countries. And, of course, digital operations create opportunities for ever more sophisticated cyber-criminals. Furthermore, the greater the amount of subjective judgement given to machine learning models, the higher the risk that the models themselves make human-like errors, such as 'false negatives' in sanctions screening. The repercussions of this can be material in terms of operational losses and regulatory fines.

The shift to digital is thus changing the nature of the risks faced by trade banks and creating a second-order operational risk of not adapting risk management practices quickly enough. When technology works as it is intended, it serves to reduce operational risk by mitigating human error. However, when it doesn't work, technology can create a host of new risks for banks. Uncharted territory is often more perilous than familiar ground.

Trade tensions between the US and China

In 2018 the US government imposed import tariffs on a range of consumer and industrial goods. A like-for-like response from the Chinese government contributed to a hit on the value of global trade in 2019 – with a host of sectors suffering a 20%+ decrease in the value of goods imported between China and the United States. Given that these are the two largest economies in the world, this reduction in trade between them is materially subduing the aggregate value of global trade.

2019 saw encouraging signs of a potential rapprochement with the signing of a Phase 1 deal. However, this deal did not cancel the USD 370 billion in US tariffs on Chinese goods; it simply delayed the planned imposition of a further USD 60 billion of tariffs on Chinese consumer electronics. And any serious reduction in US-China trade tensions seems unlikely in the near future because they result from economic and geopolitical concerns that are shared across the political divide in the US.

Climate risk

Public and political concern about climate change has been mounting in recent years. Companies whose activities contribute to greenhouse gas emissions are increasingly likely to fall from favour with consumers and be subject to governmental interventions. The European Commission, for example, is considering a carbon border tax aimed at making European importers pay for the CO_2 emissions resulting from the foreign production of the goods they buy. Its planned implementation in 2021 may be delayed, but some measure along these lines is likely in the coming years.

Such a tax would encourage European importers to seek low-emission alternatives to current high-emission suppliers, thereby changing global supply chains and international trade flows. And it would reduce international trade, because the tax will not apply to companies within the EU, who would therefore become favoured suppliers. Insofar as other countries adopt measures with a similar green motivation or retaliate against what they see as a discriminatory trade barrier, the reduction in global trade will be exacerbated. The tax may also be applied to shipping itself, since this contributes to the emissions arising from imported goods. This would drive up its price and again favour domestic or "near-shore" suppliers.

The financial performance of high-emission companies is likely to deteriorate in this new environment, and trade banks will need to factor this into credit assessments. They will also need to take account of the green credentials of their clients due to regulatory and reputational risks. Regulators, shareholders and consumers increasingly disapprove not only of environmentally unfriendly companies but of the firms that finance them.

Recovery from COVID-19 will give companies an opportunity to reinvent themselves as more socially responsible enterprises. Though COVID-19 is not a consequence of climate change, it is likely to make the public and politicians even more conscious of global threats to our welfare. Indeed, banks and corporate leaders must look beyond just climate and environmental policies to advance a sustainability agenda. With its ability to shape economies and societies, global trade must also incorporate wider social causes in its sustainability principles, from child labour to women's inclusion and diversity to human rights. Many companies will be well-advised to "go green" and to more generally advance an ESG agenda. And the banks that finance these companies will be well-advised to make the same move.

The COVID-19 situation is rapidly evolving, on a daily basis. This article represents *a number of scenarios* based on discrete data from one point in time (early April 2020). It is not intended as a prediction or forecast about the duration of lockdown, peak of viral infections, efficacy of government or health care responses to the virus, or other health or societal impacts, and it does not represent an "official" BCG or ICC view. It also does not constitute medical, legal or safety advice, and is not an endorsement or recommendation of a particular response. As such, you are advised to use this document as general guidance only in making your own continued assessments as to the appropriate course of action, taking into account local laws, rules, regulations, and orders.

FEATURE

The 'Ins' and 'Outs' of Supply Chain Finance

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Introduction to supply chain finance

The financing of global trade continues to be in a state of flux. Traditionally, documentary trade products such as letters of credit or documentary collection are the anchor of trade finance, offering financing, liquidity, and risk mitigation. In recent years, open account trade finance, most notably supply chain finance (SCF), has emerged as an increasingly popular and fast-growing alternative. With flexible and cost-effective techniques and mechanisms, SCF has become a cornerstone of global trade.

Growth in SCF is particularly material when compared to documentary trade, which has experienced relatively flat volumes in the last few years. Virtually all long-term growth in international trade finance is predicted to be driven by open account products. BCG's Trade Finance Model estimates that cross-border open account trade finance drives USD 21 billion of trade finance revenues today, representing 46% of the overall trade finance market, up from 42% five years ago. We expect this to grow at 2% CAGR over the coming decade, dependent on macroeconomic factors, including industry recovery from COVID-19. When including cross-border and domestic SCF transactions, we estimate that the global revenue pool for working capital and supply chain finance solutions today falls anywhere between USD 50 and 75 billion.

One of the fastest-growing and most frequently discussed open account products is payables finance, whereby sellers in the buyer's supply chain are able to access finance with the option of receiving the discounted value of receivables prior to their actual due date and, typically, at a financing cost aligned with the credit risk of the buyer.

But SCF exists in several other forms beyond payables finance. Receivables discounting, whereby corporates sell individual or multiple receivables (represented by outstanding invoices) to a finance provider at a discount, is one of the most popular SCF techniques, particularly among SMEs. Loans or advances against receivables are also growing in usage: financing is made available to a party in a supply chain on the expectation of repayment from funds generated from current or future trade receivables.

SCF's industry body – the Global Supply Chain Finance Forum (GSCFF) – defines eight techniques within its definition of SCF (receivables discounting, forfaiting, factoring, payables finance, loan or advance against receivables, distributor finance, loan or advance against inventory, and pre-shipment finance). For the purpose of the Trade Register's credit default risk analysis, only payables finance is considered in the report at this stage – as discussed below.

Drivers of growth in supply chain finance

But what is the appeal of supply chain finance techniques? Why are they all the rage in trade finance today?

The drivers behind the growth in SCF in recent years are related both to the changing nature of trade finance and to the inherent characteristics of SCF solutions that make them attractive to both buyers and suppliers. For suppliers, SCF allows companies to unlock supply chain liquidity and optimise their cash positions. Crucially, SCF provides suppliers with access to a range of financing options, often on the back of their buyer's credit and hence at much more affordable rates than they would typically be offered otherwise. This is particularly valuable for suppliers such as SMEs with weaker credit histories. As such, SCF has helped to close the 'trade finance gap' for the SME segment, although there is still room for materially greater penetration, and many supply chains are yet to be readily served by large banks or other providers.

For buyers, the appeal of SCF is simple: in a symbiotic trading relationship, what is good for the supplier is ultimately good for the buyer. Indeed, SCF solutions help to safeguard supply chains from being disrupted by the lack of cash liquidity. Buyers can also utilise their own credit rating to get better borrowing terms from suppliers. The mutually beneficial solutions offered by SCF to both buyers and suppliers are just one explanation for its rise – but why is SCF on the rise now?

Improved technology and digitisation solutions, such as e-invoicing and automated reconciliations, have helped facilitate substantial adoption of SCF by making it more operationally viable and thereby scalable. SCF transactions are often originated at the level of an individual order, with much lower average values than a traditional L/C. As such, using technology to minimise the operational effort and cost per transaction is a critical success factor.

In addition, as the global economy has become more digitised and interconnected, trading partners have begun to operate with increased trust. Consequently, trading partners are increasingly willing to trade on open account terms without relying on the security and risk mitigation of documentary trade. For this reason, at times of economic stress there may be a reversal in SCF growth as businesses shift back to documentary trade. We expect this to be one of the many potential impacts of COVID-19 on global trade (more on the effects of COVID-19 on SCF is detailed below).

How the market is changing – and how incumbents need to react

More recent technological developments in SCF have largely been driven by non-bank players (e.g. fintechs). In recent years, many non-bank players have captured a large portion of the new SCF business, especially from SMEs that many incumbent banks find difficult to serve profitably. Fintech offerings often provide more usable channel capabilities (e.g. that allow companies to integrate procurement and accounts payable activities) or access to an ecosystem of related businesses through a single platform. It is important to note that while non-bank players may be able to provide easy-to-use and compelling online propositions, they often lack the credit controls or balance sheet capacity of incumbent banks. Skills, both institutional knowledge and human capital, are still required to manage risks across the cycle – areas of particular strength for incumbent banks.

Indeed, incumbents continue to have a number of built-in advantages over the disrupters that, if used correctly, can protect their primacy in the SCF market. Incumbents have much larger customer bases, more diverse and wide-reaching distribution channels, and balance sheets that give them far greater lending capacity. Further, while many of the disrupters provide channels and means to facilitate SCF techniques, they usually do not provide the actual lending – credit typically is provided by third-party investors. Incumbent banks therefore have a further advantage in having more advanced credit capabilities and a deeper understanding of and expertise in credit risk.

To make the most of these advantages, incumbents must respond to the challenge posed by the non-bank players. This means catching up with fintechs through platform functionality and integration with ERP and accounting systems. Banks can build their own, adopt a white-labelled platform, or form a partnership with a non-bank provider. Whichever approach they take, incumbents will need to make sure that platforms and related processes are standardised across countries and branches. And to reduce operating costs and risks, SCF products should also be standardised as far as possible, while providing tailored solutions for large and mid-corporate customers.

Incumbents will also need to make better use of the rich data about customers, transactions, and networks that SCF products and platforms can provide. This requires strong data architecture and capabilities, potentially using artificial intelligence to support faster and more nuanced decision-making. Many global and regional banks will need to either recruit people (e.g. data scientists) with these skills or form partnerships with specialist firms.

However this increased competition in SCF plays out, it will lead to further investment in new solutions for businesses of all sizes across global supply chains. This will benefit SCF customers and the global economy, by reducing the costs of international trade and helping to offset opposing forces such as increased tariffs.

Supply chain finance in the context of the Trade Register

Given the rapid growth of SCF, it was only a matter of time before it made its way onto the ICC Trade Register. This began in the 2018 report, with the publication of data about cross-border payables finance transactions. This welcome development allows interested parties to understand both the growth in SCF volumes around the world and the risks to service providers and investors.

The ICC Trade Register uses the definition of payables finance that was standardised by the Global Supply Chain Finance Forum in 2016. However, the data available for last year's publication was not fully representative of the market. Banks under-reported because, being relatively new, payables finance is not yet always captured in the data systems from which banks report to the ICC Trade Register. Further, some of the new providers of payables finance do not report to the ICC Trade Register. We expect that these problems will be remedied over the coming years and that the ICC Trade Register will provide a richer and more precise representation of the cross-border payables finance market.

Risks in supply chain finance

Including payables finance in the ICC Trade Register has helped to provide a sense of its risk profile for service providers who offer payables finance and for investors who are interested in this technique. Although the data analysis is still in its early phase, the Trade Register's analysis supports the view that payables finance is low risk – in line with the risk profile of other trade finance products.

Still, low risk does not mean no risk, and it is important for the involved parties to appropriately manage the risks associated with payables finance (and SCF techniques more broadly). Typical risks in payables finance include credit, operational, and classification risks. Understanding how these risks factor into these facilities is crucial to developing appropriate risk-mitigation policies.

For credit risk (e.g. buyer default), service providers need to develop and implement a credit model that suits their risk appetite. This may include the type and size of clients they want to approach, regional aspects, legal documentation to use, and the diligence they want to spend on their clients and adjacent counterparties.

For operational risk (e.g. fraud or inability to deliver the product by the supplier), similar to a credit model, service providers need to implement sound procedures to manage their ongoing business. Payables finance today is a mostly large-scale business that is processed automatically rather than handled manually on an individual transaction level. Protection measures against operational risk include appropriate understanding of risk tied to supply chain logistics, credit checks, legal action to ensure a valid assignment of the purchased receivable where required, and experienced operational staff who manage the ongoing business. In addition, the use of more subjective automation such as machine intelligence and artificial intelligence can also give rise to new operational risks: Are the models performing correctly? Are they biased? Are they as accurate as humans?

Finally, there is the risk of reclassification from trade payable to bank debt. While this is primarily a risk that the party using payables finance faces, it is similarly relevant for a service provider. Payables finance offers corporates the option to retain the classification of financed transactions as trade payables, rather than debt; in turn, trade payables do not affect the corporate's debt ratio. This is a key driver in making payables finance so attractive.

More generally, questions around how to reflect payables finance on a corporate's balance sheet have triggered increased attention, as accounting firms grapple with how to characterise payables finance and rating firms scrutinise a perceived lack of transparency. This is after a number of recent corporate collapses put SCF, and particularly payables finance, in the spotlight. In all known cases, payables finance may not necessarily have been the cause of these collapses but would have added to the leverage of the companies that later collapsed.

Payables finance is a useful tool to optimise the working capital of both buyers and sellers – when implemented correctly. The corporate collapses may have been inevitable, but the use of payables finance could have been avoided with appropriate risk-protection measures.

The GSCFF, in partnership with the ICC, provides guidance on how payables finance should be structured and implemented, and is actively engaging with accounting associations on this important point.

Supply chain finance and Carillion

Public scrutiny of SCF peaked with the collapse of Carillion in 2018. Carillion, a UK-based construction firm, was forced into compulsory liquidation in 2018 with liabilities of around GBP 7 billion – a shock to British industry and front-page news in the UK.

Carillion utilised SCF in its dealings with many of its suppliers. When the company went into administration in January 2018, it owed GBP 500 million to banks through SCF facilities, although this was not immediately clear from its balance sheet: as per common practice, SCF debts were listed as money "owed to creditors" (i.e. "trade receivables") rather than bank debt.

SCF was not the cause of Carillion's collapse: it was a financing tool that the company used to improve its cash flow, but it also somewhat masked some of the firm's financial challenges. While the incident by no means suggests SCF products are high risk, it highlights the need for all parties in SCF to fully understand its risks and how to best reflect and treat them. Given the rapid growth in SCF and open account trade witnessed over the past decade – a trend expected to only increase in the coming years – it is imperative that industry bodies including the GSCFF, accountants, and regulators work together to adapt and clarify their rules and standards to a rapidly shifting industry.

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What does COVID-19 mean for supply chain finance?

COVID-19's impacts on global trade are myriad, sparing no industry sector or geography. This report's *Market Trends in Trade Finance* feature discusses how trade and trade finance may be affected by the virus. But what might be the direct impacts on supply chain finance? Will COVID-19 halt its growth and momentum? There are multiple factors to consider.

First, COVID-19 has not only led to a global health crisis followed by an exogenous demand and supply shock to the worldwide economy, but it has also triggered a significant reduction in foreign trade and a breakdown in global supply chains. Consequently, de-risking supply chains and improving cash and liquidity management within the supply chains will become an even more important topic for multinationals and SMEs alike in the economic downturn initiated by COVID-19.

Second, there may be the risk of a slowdown of SCF, in particular relative to traditional documentary trade finance products which offer stronger risk mitigation. In the past, particularly in times of macroeconomic risk and uncertainty, documentary trade has benefitted from its less risky reputation.

Third, we expect increased demand from suppliers for buyer-led financing arrangements (like SCF) due to supply chain disruptions, factory closures, and the inability of many workers to do their day-to-day jobs. Cash-strapped suppliers in need of rapid liquidity will seek favourable financing arrangements through the (often) higher credit-worthiness of their buyers. Although the origination and set-up of SCF typically take a few months including educating and onboarding the supplier base, increased use of supply chain finance may be part of the solution to fight the adverse effects of the economic downturn.

Fourth, buyers are likely to resist extending this credit to their suppliers because, if the supplier is unable to meet its obligations, the buyer may be liable for the debts if they have recourse. Buyers will want to push recourse to the banks who will themselves be liable in the event of a supplier default – though banks may still not want to take on the added risk.

Fifth, a further driving force of the growth in SCF – third-party investors – may abate in the coming months because of COVID-19. In recent years, third-party investors have purchased securitised trade finance assets from banks and other providers, who tend to see SCF products as a low-risk asset class. However, these third-party investors have limited experience in SCF securities across a full credit cycle and cannot be certain the risks will pay off as market uncertainty rises. They may prefer to invest in more established asset classes. As a result, SCF supply may fall and, with that, prices may increase.

In any scenario, the (unexpected) breakdown of global supply chains will lead to a stronger emphasis on risk management around supply chains both physical and financial. Large buyers will think about de-risking their physical supply chains by, for example, increasing the number of suppliers, ensuring strategic suppliers come from different regions of the world, or focusing more on local proximity rather than price for strategic suppliers. At the same time, banks have to ensure that sophisticated risk management practices are in place to be able to offer supply chain finance in the future – and to position themselves as part of the solution to fight the economic downturn initiated by COVID-19.

ANALYSIS OF TRADE FINANCE

Overview of findings

The ICC Trade Register's filtered data set contains nearly USD 15 trillion of exposures (Figure 14), and 24 million transactions (Figure 16) from 2008–2018 across four trade finance products: import L/Cs; export L/Cs; (short-term) loans for import/export; and performance guarantees (including standby L/Cs). The data set is used to carry out detailed analysis of the credit risk characteristics of these products.

The findings of the 2019 ICC Trade Register reinforce those of previous years: that trade finance products present banks with low levels of credit risk. Indeed, the ICC's data set from 2008–2018 clearly demonstrates the low levels of default for trade finance products across all geographies and product types. Weighted by obligors, default rates over the past ten years are 0.36% for import L/Cs, 0.04% for export L/Cs, 0.73% for loans for import/export, and 0.45% for performance guarantees (Figure 15). Across export L/Cs, loans for import/export, and performance guarantees, 2018 default rates were largely in line with the previous year. Import L/Cs saw a marked rise in the transaction-weighted default rate in 2018, driven primarily by a large obligor default, mostly affecting Asia Pacific (APAC). Import L/Cs are discussed later in this report.

While obligor-weighted default rates are the official means of measuring default rates as per the Basel methodology, in the Trade Register we also consider exposure- and transaction-weighted default rates, which in this context may be more appropriate to gauge the credit risk profile of trade and export finance. Obligor-weighted default rates are best examined at a client-level. At a whole portfolio level, however, obligor-weighted default rates typically become skewed towards the risk profile of SMEs, as a balanced portfolio – such as the one examined in the Trade Register – will likely have many more SMEs (high volume, low value) than large corporates (low number, high value). The same applies for transactions, whereby some SMEs may have a larger number of lower value transactions compared to a large corporate. For this reason, exposure-weighted default rates can be the most balanced way of looking at the overall portfolio: here default rates are effectively weighted by the total dollar value of defaulting transactions, removing any particular 'skew'.

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Figure 14:

Total exposures and default rate by exposure, by product, 2008–2018

	Total exposure (USD M)	Defaulting exposure (USD M)	Exposure-weighted default rate (%)
Import L/C	3,202,070	2,544	0.08%
Export L/C	1,901,356	496	0.03%
Loans for import/export	6,645,580	11,546	0.17%
Performance guarantees	2,559,444	6,275	0.25%

Source: ICC Trade Register 2019

Figure 15:

Total obligors and default rate by obligor, by product, 2008–2018

Note: the "double counting" of obligor defaults is addressed in Appendix A.

	Total obligors	Defaulting obligors	Obligor-weighted default rate (%)
Import L/C	250,377	910	0.36%
Export L/C	170,404	70	0.04%
Loans for import/export	331,684	2,420	0.73%
Performance guarantees	402,357	1,827	0.45%

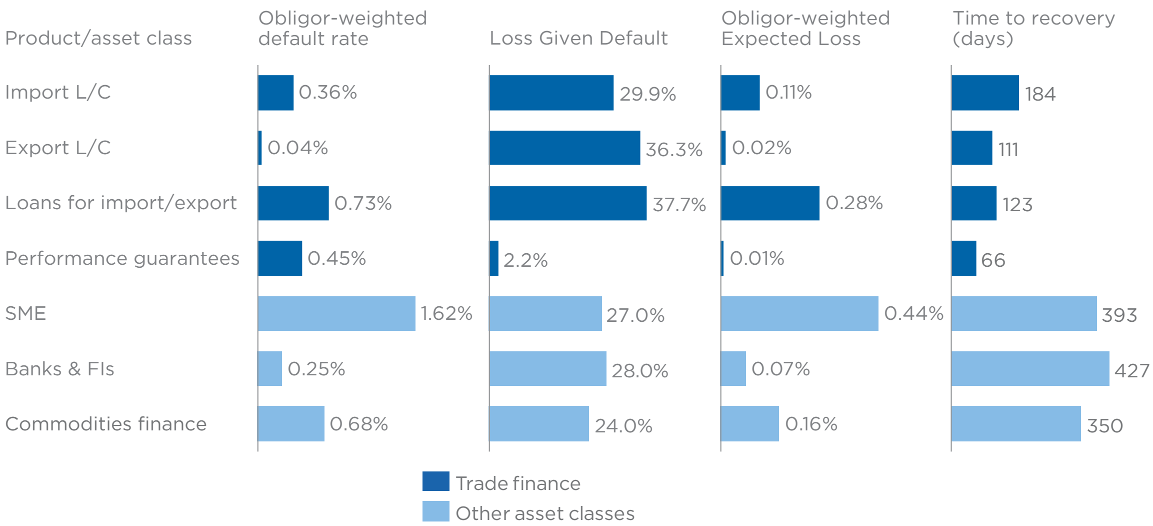
Source: ICC Trade Register 2019

Figure 16:
Total transactions and default rate by transaction, by product, 2008–2018

	Total transactions	Defaulting transactions	Transaction-weighted default rate (%)
Import L/C	6,634,572	10,351	0.16%
Export L/C	2,699,070	217	0.01%
Loans for import/export	13,649,945	30,131	0.22%
Performance guarantees	4,172,725	6,729	0.16%

Source: ICC Trade Register 2019

Figure 17:
Comparison of trade finance to other asset classes, 2008–2018



Source: ICC Trade Register 2019

For 2008–2018, Loss Given Default rates are 29.9% for import L/Cs, 36.3% for export L/Cs, and 37.7% for loans for import/export. For performance guarantees the LGD is 52.3%, but in practice this is 2.2% when factoring in the low call rate (i.e. number of successful times a performance guarantee facility was called upon) and negligible losses (see Figure 18 below).

Time to recovery is much shorter for trade finance products versus other asset classes. For example, time to recovery is, on average, six months for import L/Cs and only two months for performance guarantees, compared to over one year for other asset classes such as term lending.

When comparing trade finance products and other asset classes, some care is needed. While the comparison across the various products in the 2019 Trade Register is done at an obligor level, the data for other asset classes comes from a separate pool (e.g. GCD data pool for corporates) and the underlying methodology varies slightly (see Appendix A).

Low LGD and default rates result in low exposure-weighted Expected Losses for trade finance products: 0.02% for import L/Cs, 0.01% for export L/Cs, 0.07% for loans for import/export, and 0.01% for performance guarantees (Figure 18). These levels are similar to results seen in 2017.

Figure 18:

Overview of exposure-weighted default rate, LGD, and Expected Loss, by product, 2008–2018

	Exposure-weighted default rate	Exposure at default	LGD	Expected Loss
Import L/C	0.08%	100.0%	29.9%	0.02%
Export L/C	0.03%	100.0%	36.3%	0.01%
Loans for import/export	0.17%	100.0%	37.7%	0.07%
Performance guarantees (Applying CCF to EAD)	0.25%	4.1%	52.3%	0.01%
Performance guarantees (Applying CCF to LGD)	0.25%	100.0%	2.2%	0.01%

Source: ICC Trade Register 2019

Figure 19:

Overview of obligor-weighted default rate, LGD, and Expected Loss, by product, 2008–2018

	Obligor-weighted default rate	Exposure at default	LGD	Expected Loss
Import L/C	0.36%	100.0%	29.9%	0.11%
Export L/C	0.04%	100.0%	36.3%	0.02%
Loans for import/export	0.73%	100.0%	37.7%	0.28%
Performance guarantees (Applying CCF to EAD)	0.45%	4.1%	52.3%	0.01%
Performance guarantees (Applying CCF to LGD)	0.45%	100.0%	2.2%	0.01%

Source: ICC Trade Register 2019

Similarly, obligor-weighted Expected Losses mirror the figures from previous years. ELs are 0.11% for import L/Cs, 0.02% for export L/Cs, 0.28% for loans for import/export, and 0.01% for performance guarantees (Figure 19). These compare favourably to obligor-weighted ELs of 0.44% for SME lending, 0.07% for banks and financial institutions, and 0.16% for commodities finance.

As discussed in last year's report, the CCF for letters of credit and performance guarantees is set at 20% and 50% under the Standardised and IRB-Foundation Approaches, with the percentages reflecting the likelihood of these off-balance sheet products becoming on-balance sheet assets. In practice, for an L/C and a guarantee of USD 100 each, the Standardised and IRB-Foundation approaches expect, on average, a loss of USD 20 and USD 50 respectively upon default, but before any recovery (e.g. sale of collateral). While the LGD of 29.9% is in line with (or marginally higher than) the 20% CCF applicable to L/Cs, the 2.2% LGD reported for performance guarantees is significantly lower than the 50% CCF that banks are required to apply under current regulations. As such, historical data demonstrates that there is a strong case for revisiting and lowering the CCF to better match the risk profile of the product.

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Observed average maturity

In general, the longer the maturity of a bank's credit exposure, the higher the credit risk; more can go wrong over a longer period, and a bank may be unable to reduce its exposure to a failing obligor.

Trade finance products typically have short contractual maturities and are typically issued on a transaction-by-transaction basis. This provides banks with the ability to actively manage their risk by ceasing to underwrite trade business for customers with deteriorating credit quality.

The Trade Register shows that the average contractual maturity for trade finance products is 111 days for import L/Cs, 129 days for export L/Cs, 133 days for loans for import/export, and 625 days for performance guarantees. However, there is significant variation in the maturities within products, highlighting that banks are willing to underwrite a wide variety of businesses with varying working capital cycles, even within individual products (Figure 20).

As seen in previous years, performance guarantees stand out with a significantly longer average maturity than other trade finance products, as they are often used for long-term projects or long-term contractual obligations. Despite this difference, clients use performance guarantees to execute tangible economic projects that could involve trade activity, and the banks manage their risk similar to other short-term trade finance products. For these reasons, performance guarantees are included in the Trade Register.

Figure 20:
Average maturity by trade finance products, 2008–2018 (days)

	Average maturity	10th percentile	90th percentile
Import L/C	111.0	74.8	183.4
Export L/C	129.0	74.8	297.4
Loans for import/export	132.7	78.4	257.0
Performance guarantees	624.6	395.4	1055.5

Source: ICC Trade Register 2019

Trends in Default Rates

Default rates in 2018 were largely in line with the positive trends seen in 2017 (Figure 21), demonstrating the low-risk nature of many trade finance products. For example, for most trade finance products, exposure-weighted default rates decreased to some of the lowest levels seen in recent years. However, import L/Cs saw a marked rise in default rates when weighted by both exposure and transactions, bucking the trend in other trade finance products. As discussed later in the report, this rise was driven almost exclusively by the default of a single global corporate in France (referred to in this report as CorpX), highlighting the interconnectedness of supply chains and the impacts of a single default on connected companies.

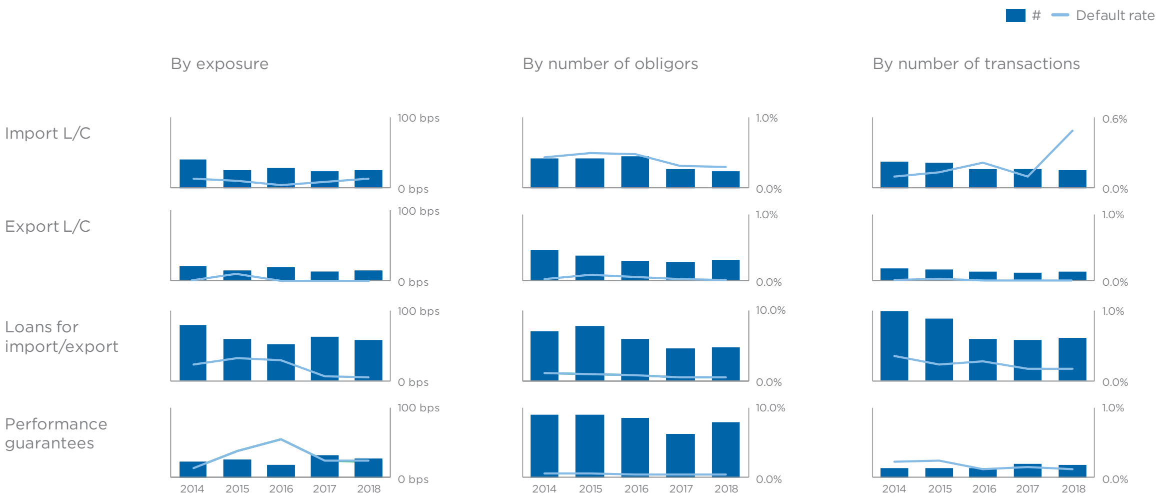
Import L/Cs

Default rates for import L/Cs largely mirrored the 2017 rates when weighted by obligors but have risen considerably when weighted by exposure and transactions (Figure 22) – suggesting that the increase was driven by a small number of large obligor defaults, rather than necessarily a systemic issue.

When weighted by obligors, the default rate decreased from 0.31% in 2017 to 0.29% in 2018. When weighted by exposure, the default rate increased from 0.08% to 0.14%, driven by a significant increase in defaults in APAC (and in Europe to a lesser extent). When weighted by transactions, the default rate for import L/Cs increased from 0.10% to 0.49%, driven almost exclusively by APAC. In 2018, 3,790 transactions defaulted, up from

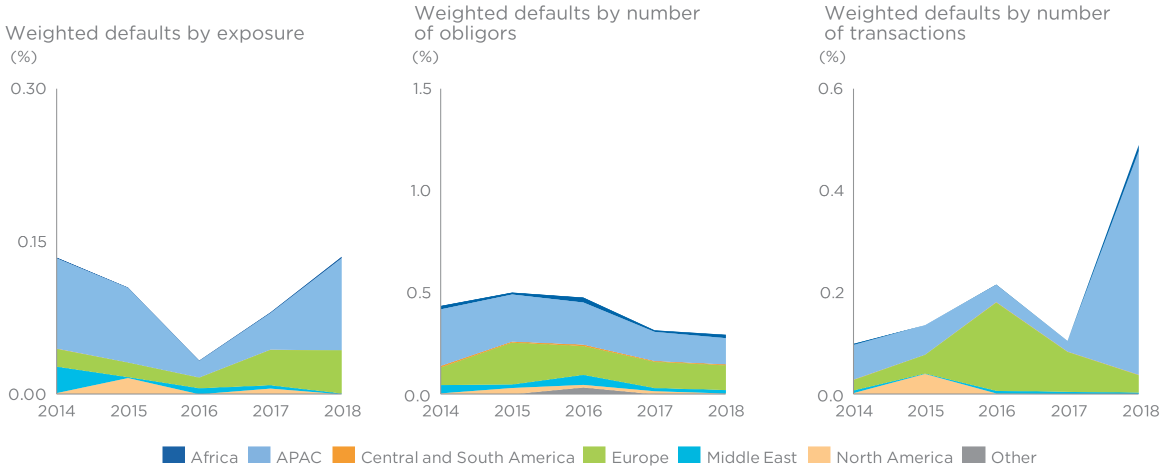
851 the previous year – this is despite overall transactions being lower. Approximately 90% of transaction defaults originated in APAC, with 95% of the regional defaults in Hong Kong, again highlighting that the increase in defaults this year was likely relatively concentrated.

Figure 21:
Summary of default rate trends for trade finance, 2014–2018



Source: ICC Trade Register 2019

Figure 22:
Import L/C default rates by region (weighted), 2014–2018



Note: Regions and countries reflect those of risk holder
Source: ICC Trade Register 2019

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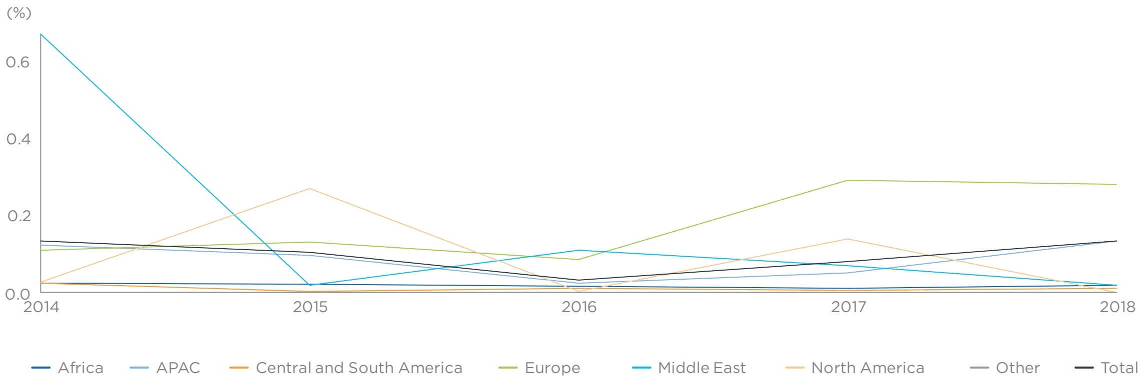
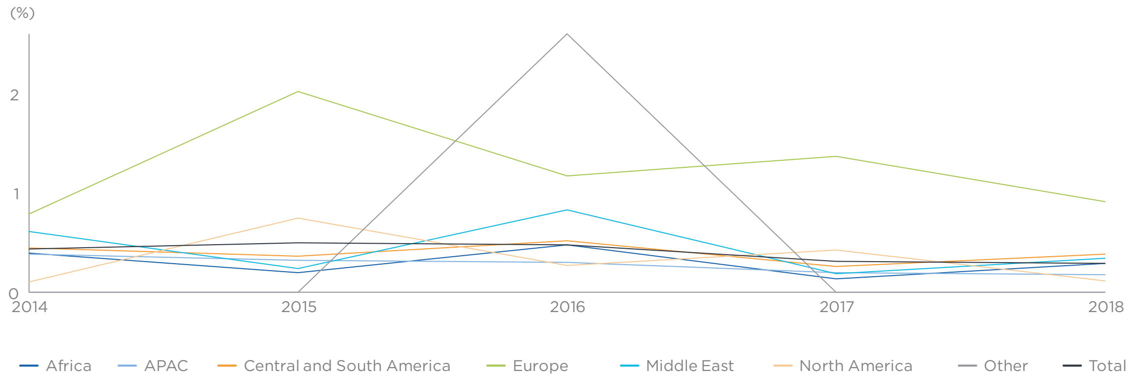
Figure 23:
Import L/C default rates by region (absolute), 2014–2018

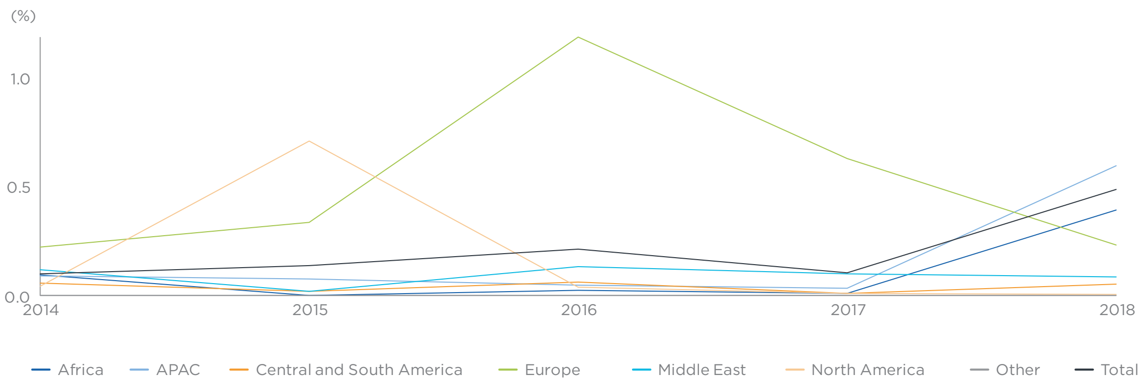
Defaults by exposure



Defaults by number of obligors



Defaults by number of transactions



Note: Regions and countries reflect those of risk holder
Source: ICC Trade Register 2019

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Figure 24:
Import L/C total and defaulted volumes by region, 2014–2018

Note: Regions and countries reflect those of risk holder
Source: ICC Trade Register 2019

In APAC, 2018 saw a continuing downward trend in obligor-weighted defaults, with a further decrease in the default rate from 0.20% in 2017 to 0.18% (Figure 25).

In contrast, the transaction-weighted default rate reversed its decreases of recent years to record a significant increase from 0.03% in 2017 to 0.60% in 2018. Meanwhile, exposure-weighted defaults also increased from 0.05% in 2017 to 0.13% in 2018. Driven primarily by Hong Kong and China, the total value of exposures in default tripled in 2018 compared to the previous year, despite overall lower exposures.

Analysis suggests that the sharp rise in the transaction and exposure-weighted default rates was caused by the default of a Europe-based furniture retailer in 2018, with impacts on a host of products in several geographies and APAC most affected by the default. The company was heavily burdened with debt which could no longer be sustained after an accounting scandal – which erased 95% of its market value – was revealed. Given that the default was driven by a single, large, global organisation, there was a material impact on the exposure- and transaction-weighted default rate but minimal impact at the obligor-level.

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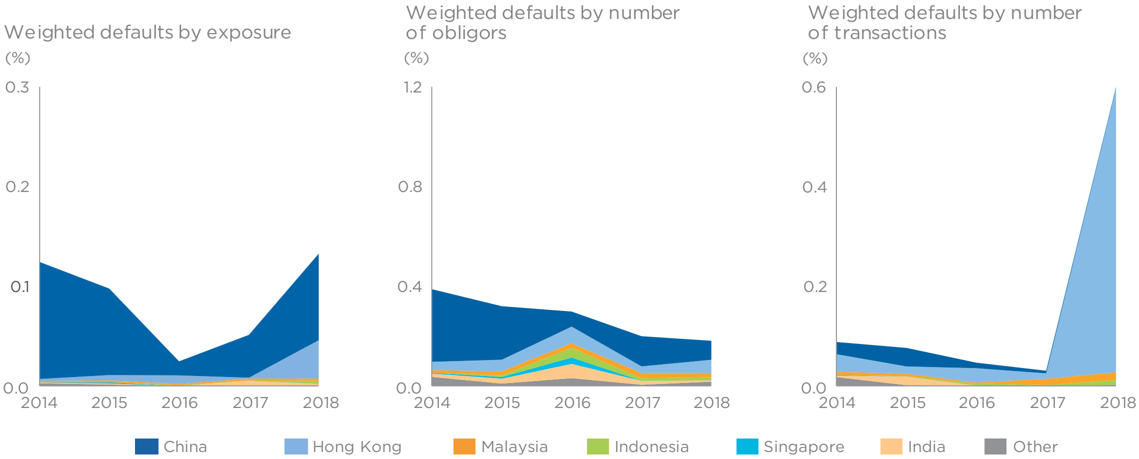
Figure 25:

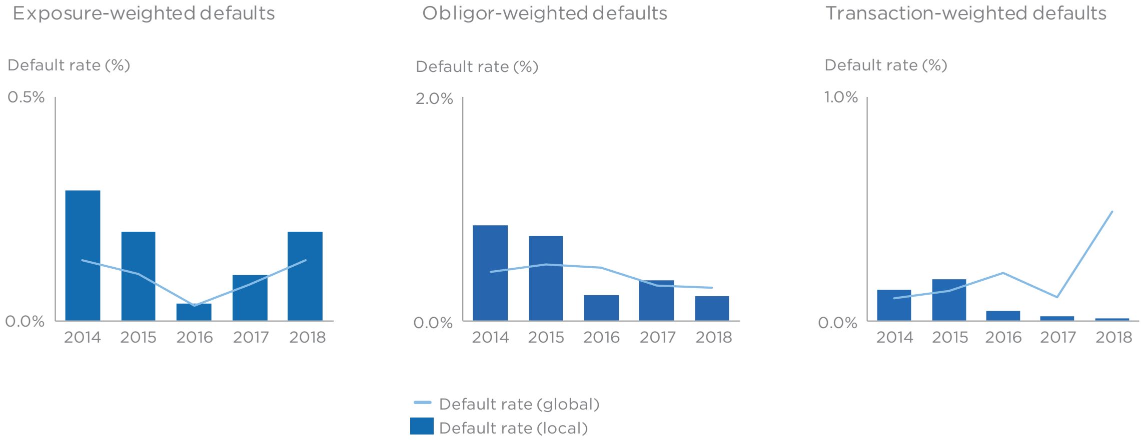
Import L/C default rates in APAC (weighted), 2014–2018



Note: Regions and countries reflect those of risk holder
Source: ICC Trade Register 2019

Looking at APAC by country, China saw its exposure-weighted default rate double from 0.10% in 2017 to 0.20% in 2018 (Figure 26), a clear driver of the increase in the global default rate given China's significant contribution to global exposures. It should be noted that, while this default rate increased from 2017, in absolute terms it remains quite low. While the underlying drivers could not be determined with the data available, one possibility is a rise in defaults due to manufacturing and supply chain pressures caused by escalating trade tensions between the United States and China. Meanwhile, the obligor-weighted default rate in China decreased from 0.36% to 0.22%. Similarly, transaction-weighted defaults decreased from 0.02% to 0.01%, significantly below the global average.

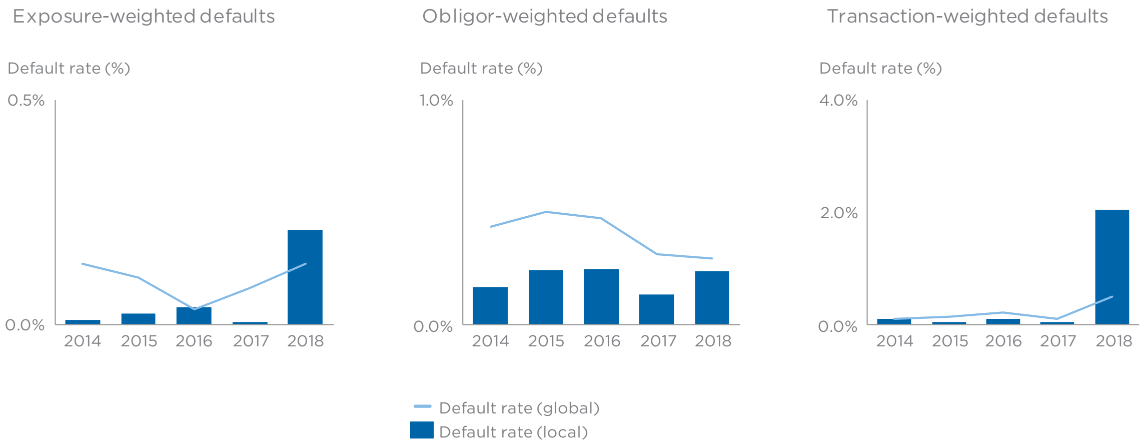
Figure 26:
Import L/C default rates in China (absolute), 2014–2018



Note: Regions and countries reflect those of risk holder
Source: ICC Trade Register 2019

Hong Kong saw its exposure-weighted default rate increase from a very low 0.01% in 2017 to 0.21% in 2018 (Figure 27), primarily due to the default of CorpX. The transaction-weighted default rate also showed a material increase to 2.0%, suggesting that CorpX had many medium-value transactions. Hong Kong's obligor-weighted default rate only showed a modest increase to 0.24%, supporting the case that this trend was not systemic and primarily driven by one large defaulting obligor.

Figure 27:
Import L/C default rates in Hong Kong (absolute), 2014–2018

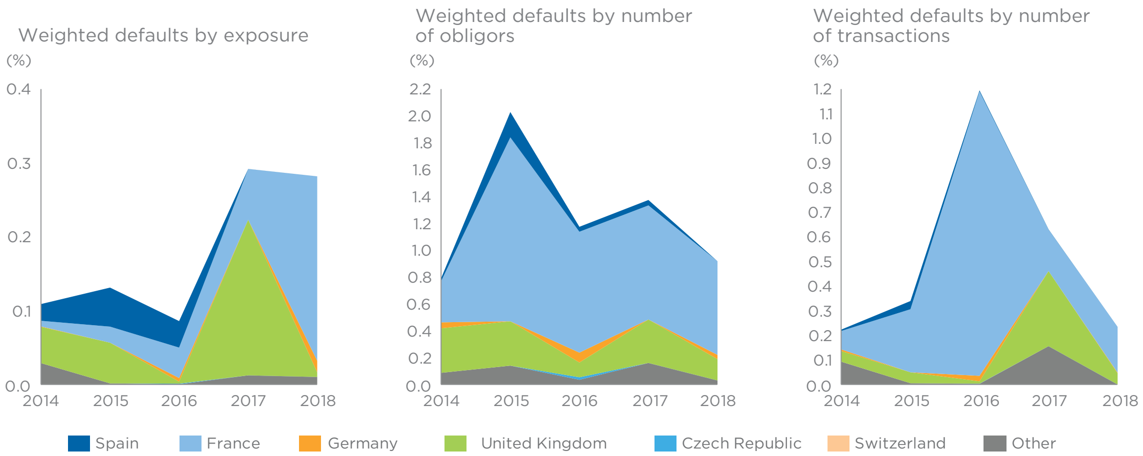


Note: Regions and countries reflect those of risk holder
Source: ICC Trade Register 2019

In Europe, import L/C default rates decreased across all three default measures (Figure 28). The exposure-weighted default rate decreased from 0.29% in 2017 to 0.28% in 2018. Although the United Kingdom saw an encouraging decrease in exposure-weighted defaults, this was outweighed by a sharp increase in France. The obligor-weighted default rate in Europe decreased from 1.38% to 0.92%, and the transaction-weighted default rate decreased to 0.23% from 0.63% – the lowest levels since 2014.

Figure 28:

Import L/C default rates in Europe (weighted), 2014–2018



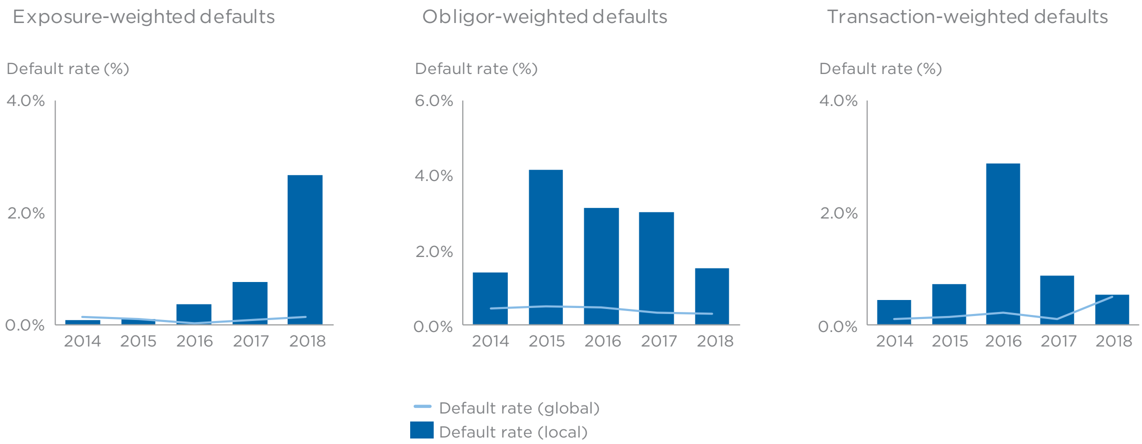
Note: Regions and countries reflect those of risk holder
Source: ICC Trade Register 2019

France saw significant variation across measures between 2017 and 2018 (Figure 29). Exposure-weighted defaults rose from 0.77% in 2017 to 2.67% in 2018. The default of the Europe-based furniture retailed mentioned earlier, which reverberated across products and geographies, particularly APAC, was the most significant driver of the increased default rate in France when weighted by exposure.

In contrast, obligor-weighted defaults halved in 2018 from 3.00% to 1.50%. France also saw a drop in its transaction-weighted defaults to 0.54% – the lowest level since 2014. It is not possible to directly link causality, but this could suggest that the defaulting retailer had high exposures in France with relatively few transactions.

Figure 29:

Import L/C default rates in France (absolute), 2014–2018

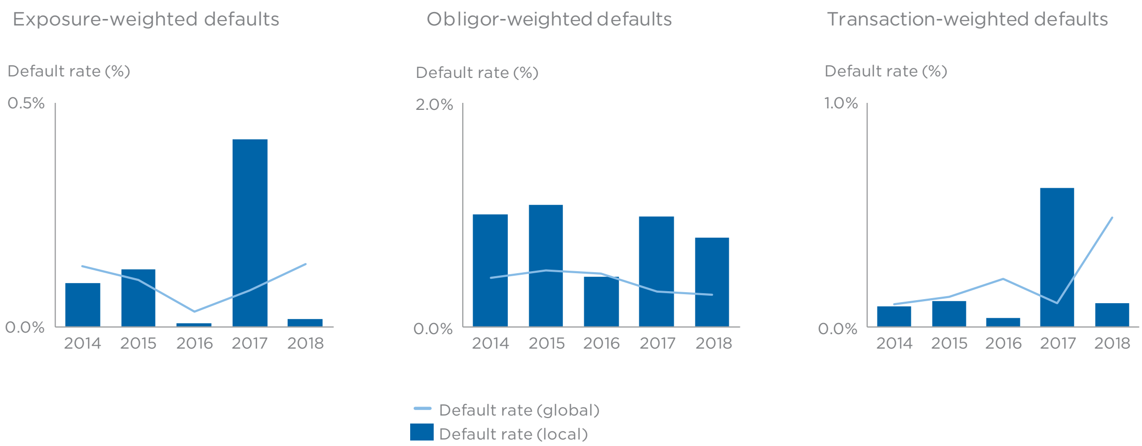


Note: Regions and countries reflect those of risk holder
Source: ICC Trade Register 2019

In the United Kingdom, 2018 saw all three default measures fall, a reversal of 2017 when they all increased significantly (Figure 30). Exposure-weighted defaults returned in 2018 to a level more in line with the years preceding 2017, decreasing from 0.42% to 0.02%. Similarly, transaction-weighted defaults decreased from 0.62% to 0.11%. Obligor-weighted defaults in the UK decreased as well from 0.98% to 0.79%. While 2017 raised the possibility that the 2016 depreciation in the value of sterling might present long-term challenges to UK trade conditions, 2018 offered an encouraging sign that the sharp increases seen in the prior year may have been a single-year event.

Figure 30:

Import L/C default rates in UK (absolute), 2014–2018



Note: Regions and countries reflect those of risk holder
Source: ICC Trade Register 2019

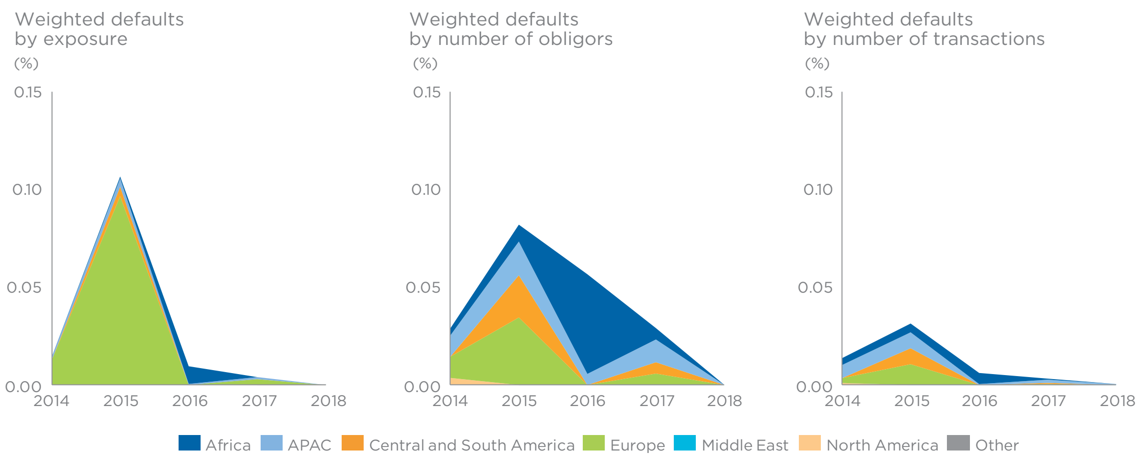
Export L/Cs

Export L/C default rates remained largely in line with 2017 and continue to be very low relative to other products. The Trade Register received no export L/C defaults for 2018, giving the year a default rate of 0.00% across all three weighting methodologies (Figure 31). These default rates, both in 2018 and in the preceding years, are the lowest of the trade finance products in the Trade Register.

The low relative risk results from the fact that the exposure of the bank confirming an export L/C is on the issuing bank (i.e. the bank of the importer in the importing country) and not on the importer itself. As such, defaults are rare and will only occur when either (a) the issuing bank defaults, or (b) a technical default occurs.

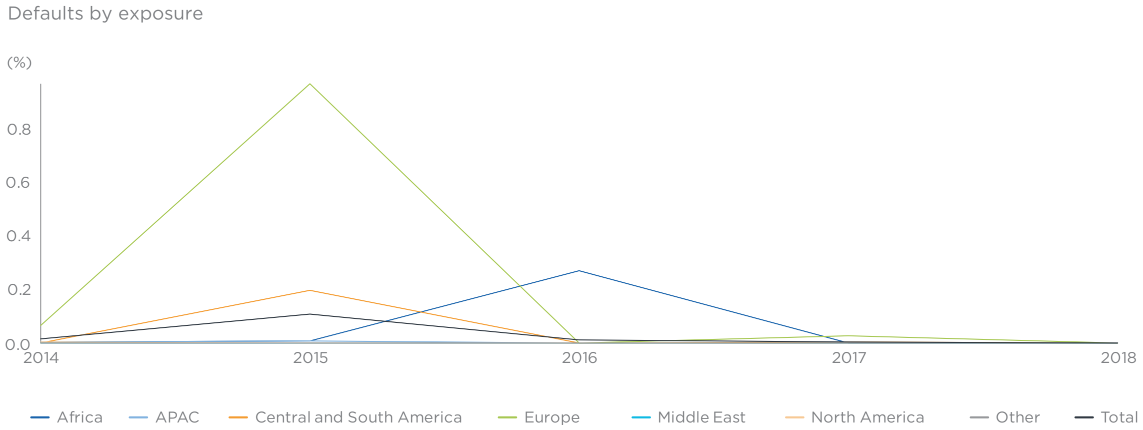
Some caution is needed when interpreting country or regional data. For the Trade Register the country or region reflects the location of risk. For import L/Cs, this is the same as the importer's country – the country in which the organisation taking out the facility is based. However, for an export L/C, the risk arises on the other side of the transaction – the importer's country. This means defaults on export L/Cs are driven by banks in the importing country, rather than the importing business itself.

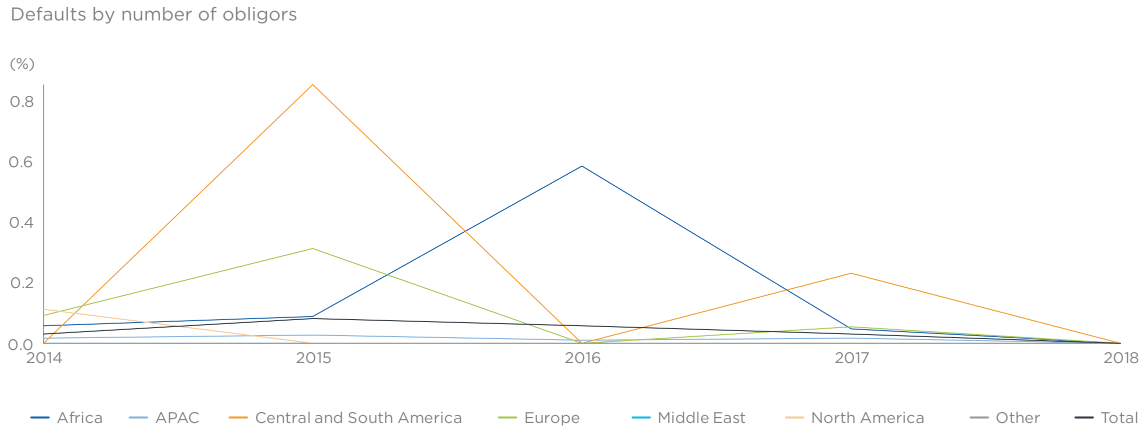
Figure 31:
Export L/C default rates by region (weighted), 2014–2018

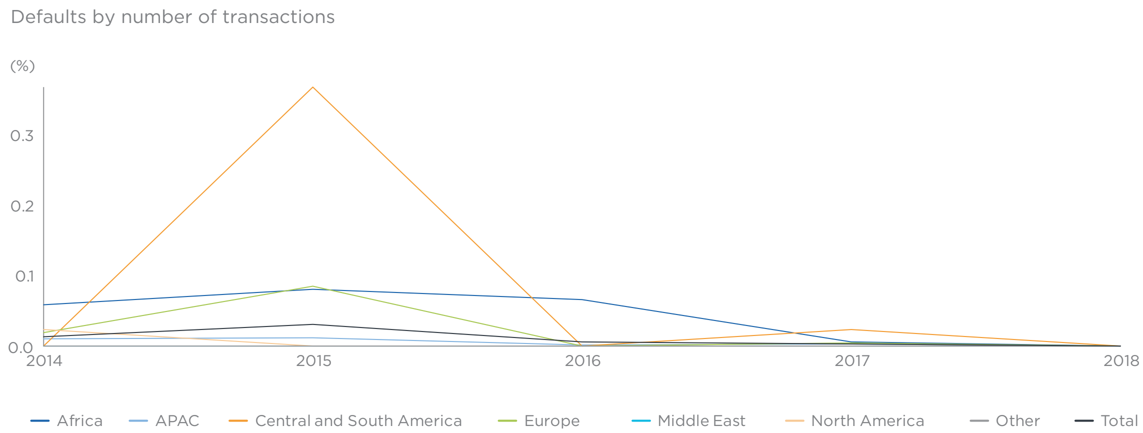


Note: Regions and countries reflect those of risk holder
Source: ICC Trade Register 2019

Figure 32:
Export L/C default rates by region (absolute), 2014–2018







Note: Regions and countries reflect those of risk holder
Source: ICC Trade Register 2019

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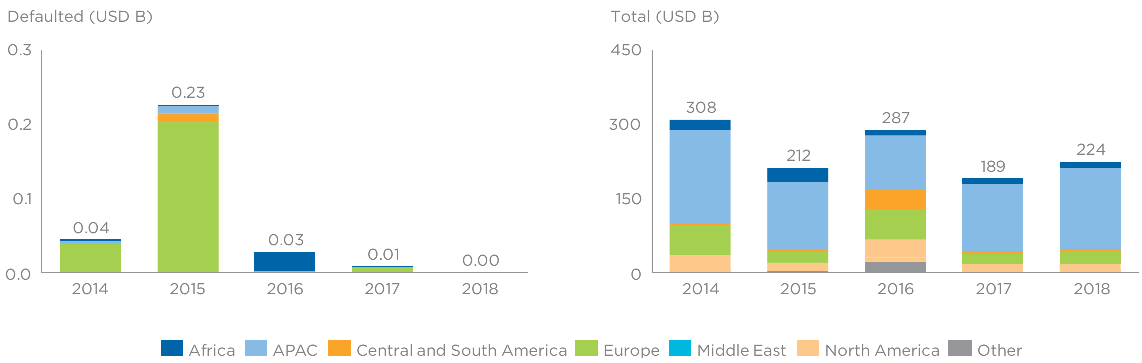
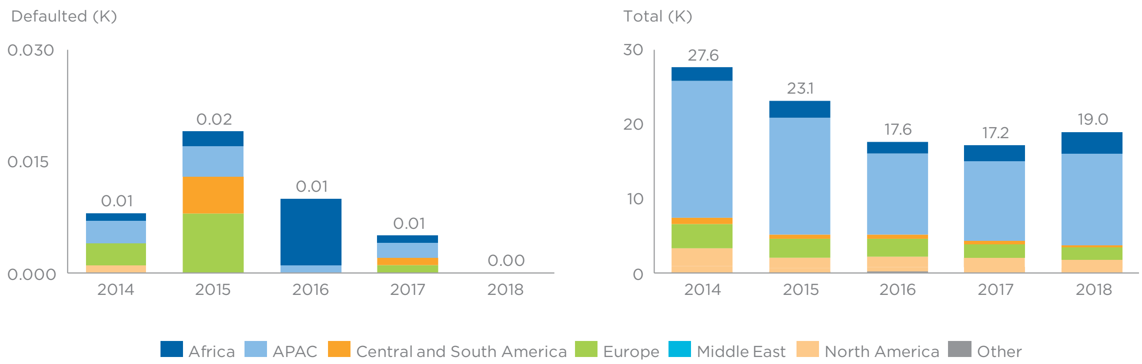
Figure 33:

Export L/C total and defaulted volumes by region, 2014–2018

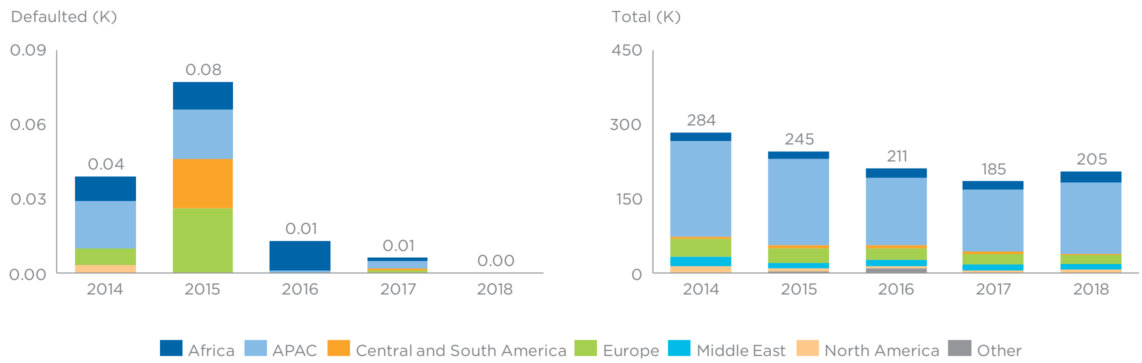
Exposure



Obligors



Transactions



Note: Regions and countries reflect those of risk holder
Source: ICC Trade Register 2019

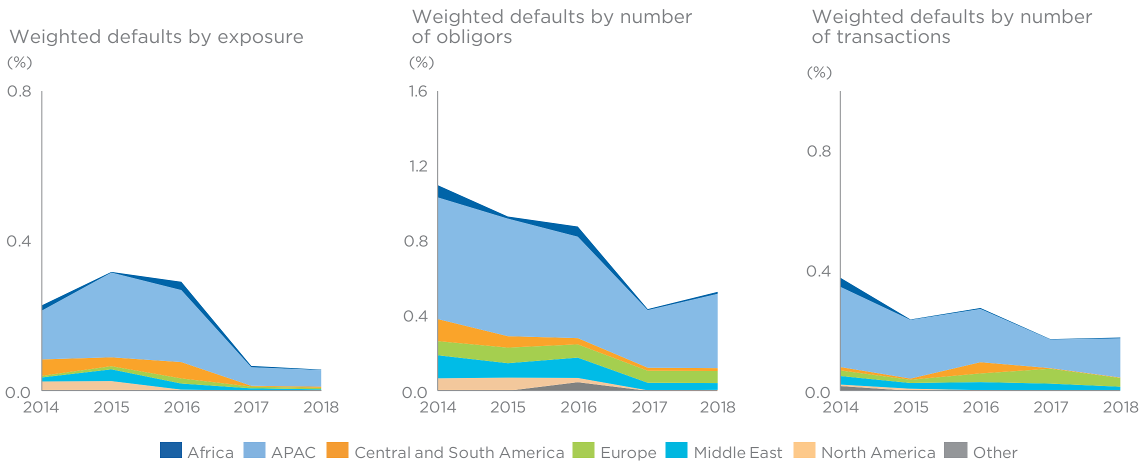
Loans for import/export

In 2018, default rates for loans for import/export were largely similar to the previous year. Exposure-weighted defaults decreased slightly from 0.07% in 2017 to 0.06% in 2018. Meanwhile, both obligor and transaction-weighted defaults saw slight increases versus 2017, at 0.53% and 0.18% respectively (Figure 34).

All regions saw decreases in the exposure-weighted default rates, except for Central and South America, which saw a rise from 0.04% in 2017 to 0.24% in 2018. This was driven primarily by a series of defaults in Argentina, reflecting the macroeconomic difficulties that necessitated intervention from the International Monetary Fund in 2018. Meanwhile, Africa continued to see an encouraging drop in exposure-weighted defaults from 0.13% in 2017 to 0.04% in 2018.

For obligor and transaction-weighted defaults, APAC was the biggest driver of the increases compared to 2017; this was unsurprising given that APAC represents 75% of total obligors and transactions. Compared to 2017, APAC's absolute default rate when weighted by obligors rose to 0.56%, and to 0.21% when weighted by transactions. CorpX, which drove default rates higher for import L/Cs, also had an impact on loans for import/export defaults in APAC.

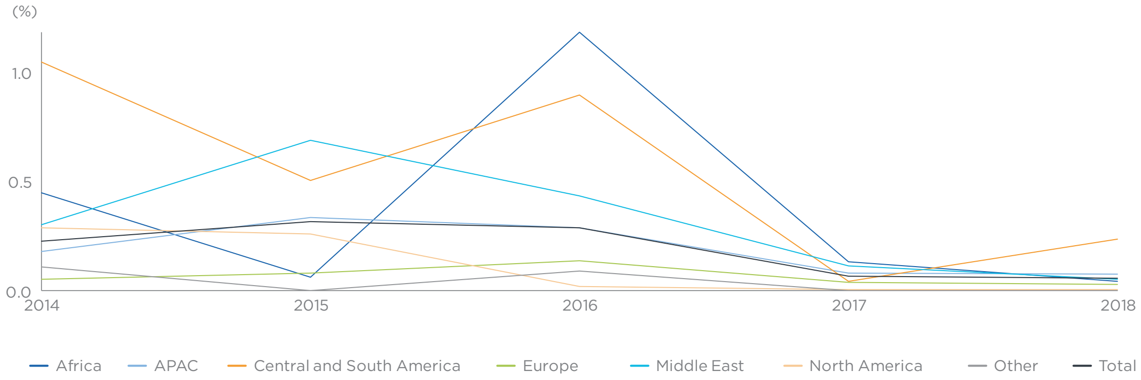
Figure 34:
Loans for import/export default rates by region (weighted), 2014–2018



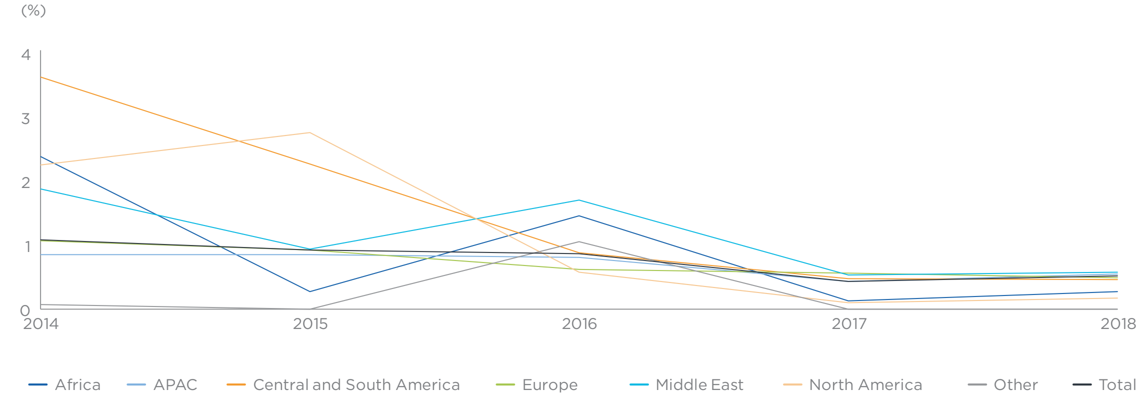
Note: Regions and countries reflect those of risk holder
Source: ICC Trade Register 2019

Figure 35:
Loans for import/export default rates by region (absolute), 2014–2018

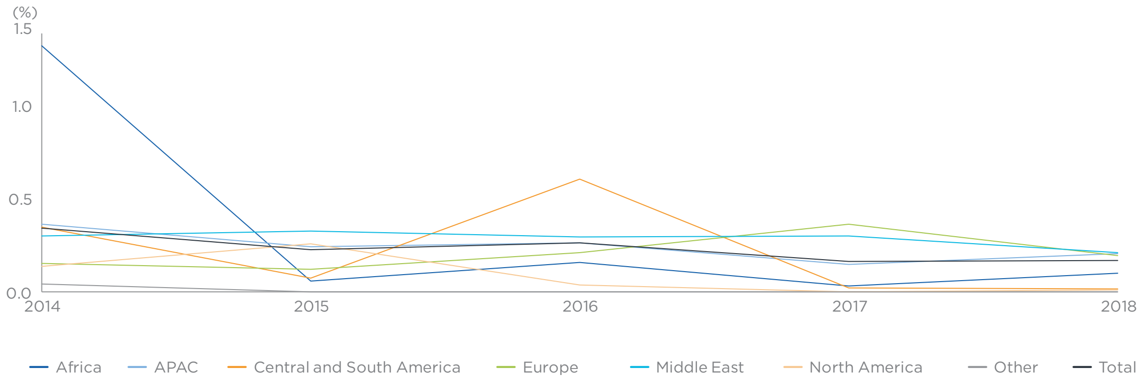
Defaults by exposure



Defaults by number of obligors



Defaults by number of transactions



Note: Regions and countries reflect those of risk holder
Source: ICC Trade Register 2019

Figure 36:
Loans for import/export total and defaulted volumes by region, 2014–2018

Note: Regions and countries reflect those of risk holder
Source: ICC Trade Register 2019

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Performance guarantees

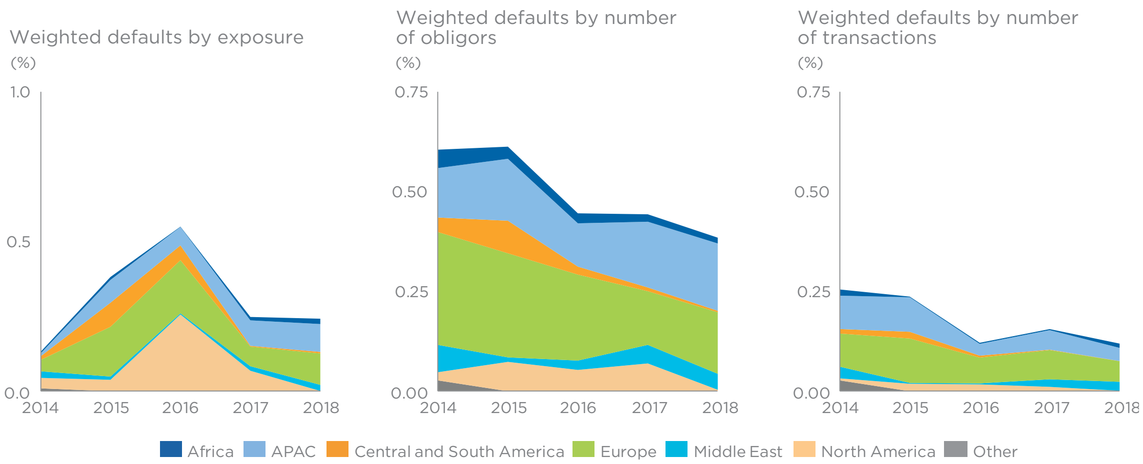
While performance guarantees (including standby L/Cs) tend to have the highest default rates of trade finance products, in 2018 this was only the case for exposure-weighted defaults. This change was driven in part by an across-the-board decrease in default rates for performance guarantees.

The exposure-weighted default rate decreased in 2018 to 0.24% from a peak of 0.55% in 2016 (Figure 37). The obligor-weighted default rate also decreased from 0.44% in 2017 to 0.38% in 2018. Likewise, transaction-weighted defaults decreased to 0.12% in 2018 from 0.16% in 2017.

APAC and Europe, the two regions with the highest contribution to performance guarantees in 2018, saw a divergence in their default rates. In APAC, default rates decreased across all three measures compared to 2017: 0.26% for exposure; 0.36% for obligors; and 0.08% for transactions. In contrast, Europe saw default rates either similar to or above the previous year, with the exposure-weighted default rate rising to 0.25% in 2018 from 0.18% in 2017. This was driven by several banks in Spain, Malta, Germany, and France, due to isolated local events but also the default of CorpX.

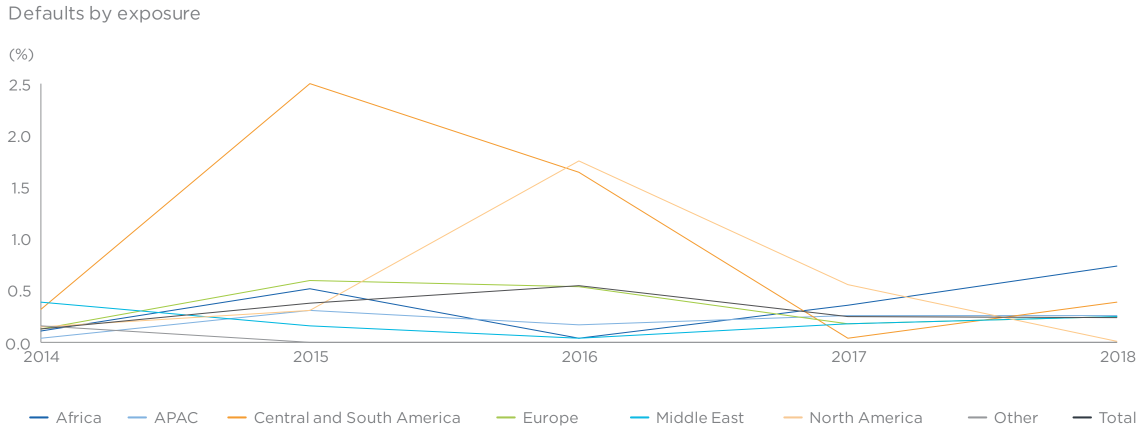
Performance guarantee default rates in North America reached their lowest levels in several years across all three measures, with all North American banks that contributed to this year's report revealing similar declines. Meanwhile, Africa's exposure-weighted default rate doubled to 0.74% in the year from 2017 to 2018, reaching its highest level in years and the highest default rate among all regions. This increase was primarily driven by the default of a single obligor with a large exposure in South Africa (also likely to be connected to the default of CorpX).

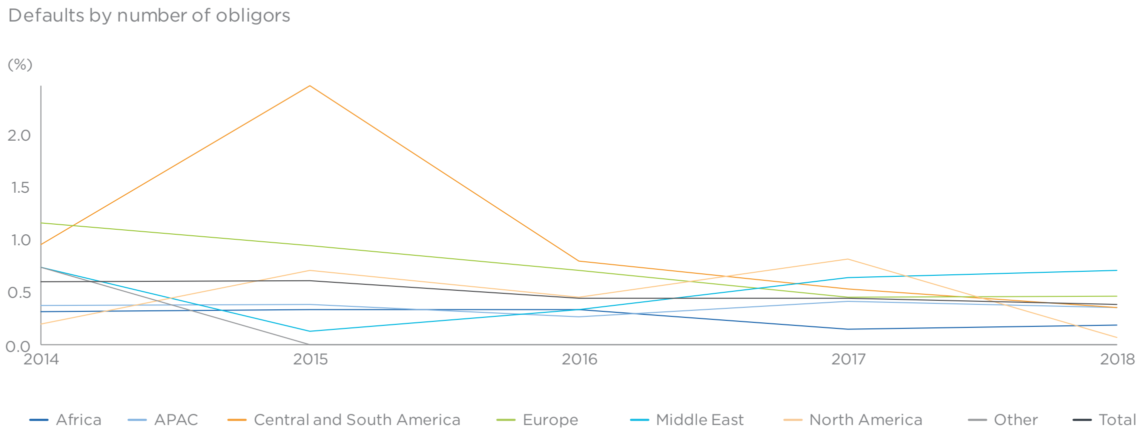
Figure 37:
Performance guarantee default rates by region (weighted), 2014–2018

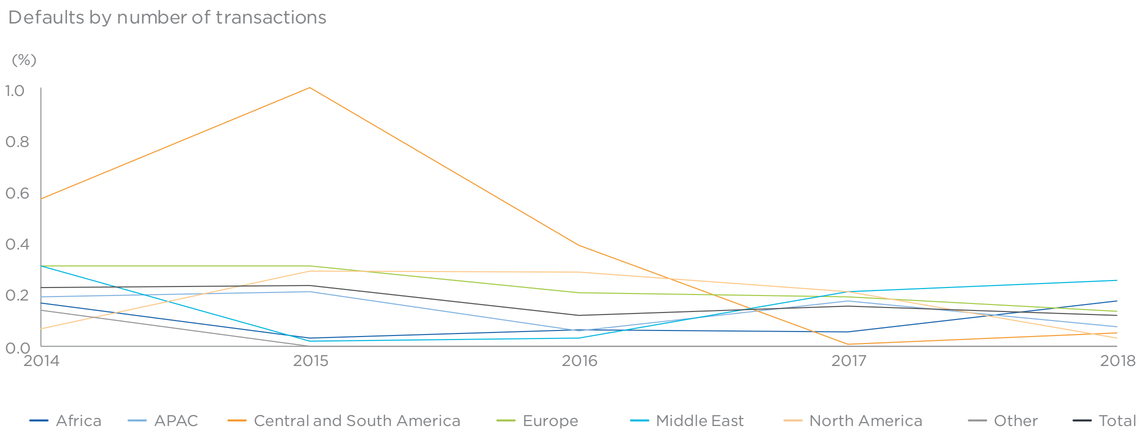


Note: Regions and countries reflect those of risk holder
Source: ICC Trade Register 2019

Figure 38:
Performance guarantee default rates by region (absolute), 2014–2018







Note: Regions and countries reflect those of risk holder
Source: ICC Trade Register 2019

Figure 39:

Performance guarantee total and defaulted volumes by region, 2014–2018

Note: Regions and countries reflect those of risk holder

Source: ICC Trade Register 2019

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Trends in Loss Given Default and Expected Loss Analysis

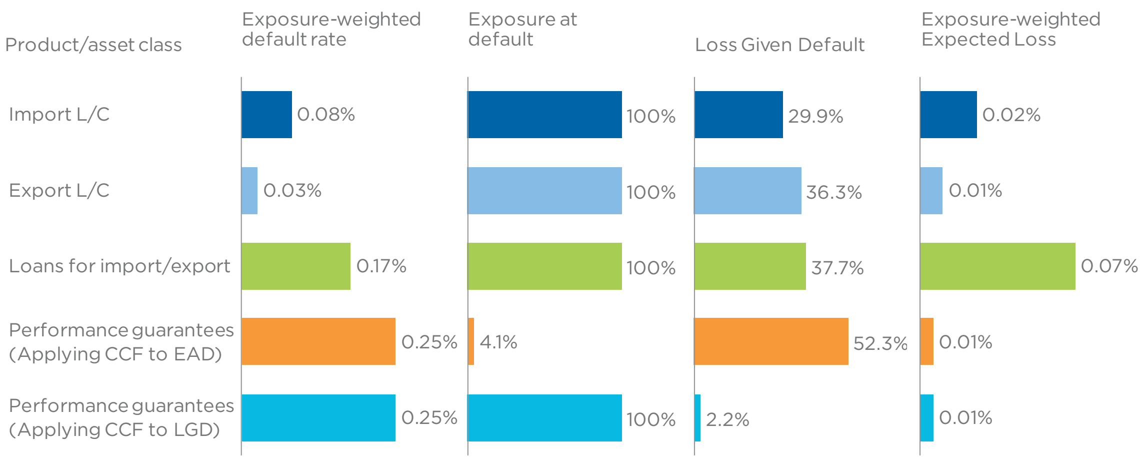
Trade finance products continue to have low Expected Losses. Between 2008 and 2018, exposure-weighted ELs were 0.02% for import L/Cs, 0.01% for export L/Cs, 0.07% for loans for import/export, and 0.01% for performance guarantees (Figure 40). These results are similar to those in previous years.

Loans for import/export continue to have a higher Expected Loss than other trade finance products driven by both default rate and moderate LGDs. The relative contribution of each of these factors to the ELs can be seen in Figure 40.

As in previous versions of the Trade Register, EL for performance guarantees is calculated using two alternative methods. In the first methodology, the call rate – the number of successful claims that are made on performance guarantee transactions – is applied to the exposure at default, which results in a higher LGD. In the second method, the call rate is applied to the LGD, resulting in a higher EAD and a lower LGD.

The call rate for the 2019 Trade Register was 4.1%, based on all data from 2008–2018. This is a reduction from 7.6% in the 2017 report (2008–2016), although this decrease may be the result of the smaller data pool used for the 2017 report, rather than any meaningful change in the call rate (see Appendix A for more detail on the call rate calculation and the differences between these methodologies).

Figure 40:
Expected Loss breakdown for trade finance products, 2008–2018



Source: ICC Trade Register 2019

LGD rates for 2008–2018 remain relatively low across all product types, with some differences between products driven by differences in recovery rate and, to a lesser extent, differences in average time to recovery (Figure 41). This year's report does not contain any new data submissions on the recovery rates for import and export L/Cs, and caution is needed when interpreting any year-on-year changes. This is not altogether surprising as it frequently takes multiple years to complete the recovery process. 2018 data is expected to be updated in next year's report.

As such, LGD for import L/Cs and export L/Cs are unchanged from last year's numbers because there are no new data submissions for 2018. Compared to last year's data set (2008–2017), loans for import/export saw a modest rise in their LGD from 36.2% to 37.7%. This increase was driven by a slight reduction in the recovery rate from 67.7% to 66.2%. The LGD for performance guarantees also increased from 41.3% to 52.3%.

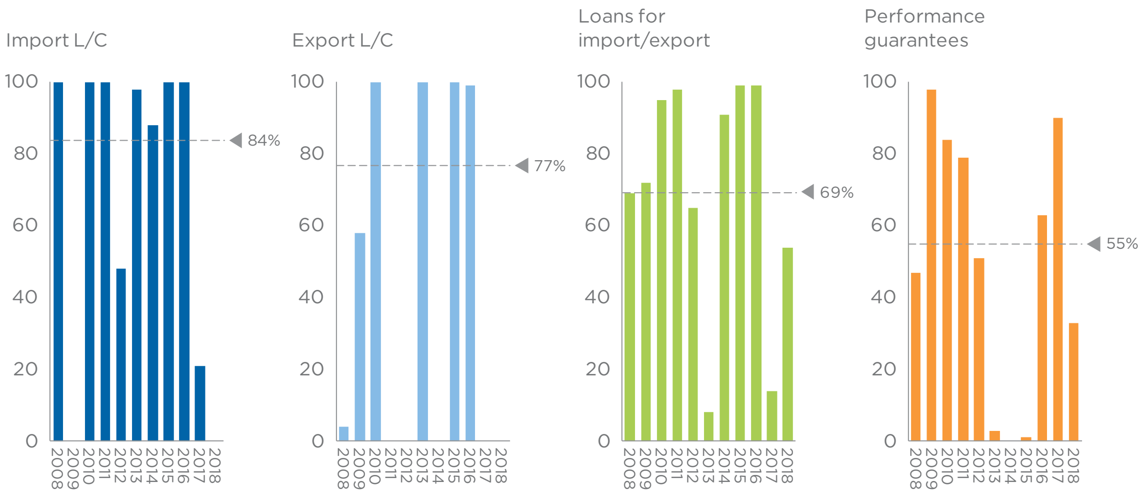
Figure 41:

LGD calculation for trade finance products, 2008–2018

Product/asset class	Exposure-weighted recovery rate	Cost of recovery	Average time to recovery	Discount rate	Loss Given Default
Import L/C	75.3%	200 bps	0.50 years	9%	29.9%
Export L/C	67.4%	200 bps	0.30 years	9%	36.3%
Loans for import/export	66.2%	200 bps	0.34 years	9%	37.7%
Performance guarantees (Applying CCF to EAD)	50.5%	200 bps	0.18 years	9%	52.3%
Performance guarantees (Applying CCF to LGD)	50.5%	200 bps	0.18 years	9%	2.2%

Source: ICC Trade Register 2019

Figure 42:
Average exposure-weighted recovery rates for trade finance products, 2008–2018



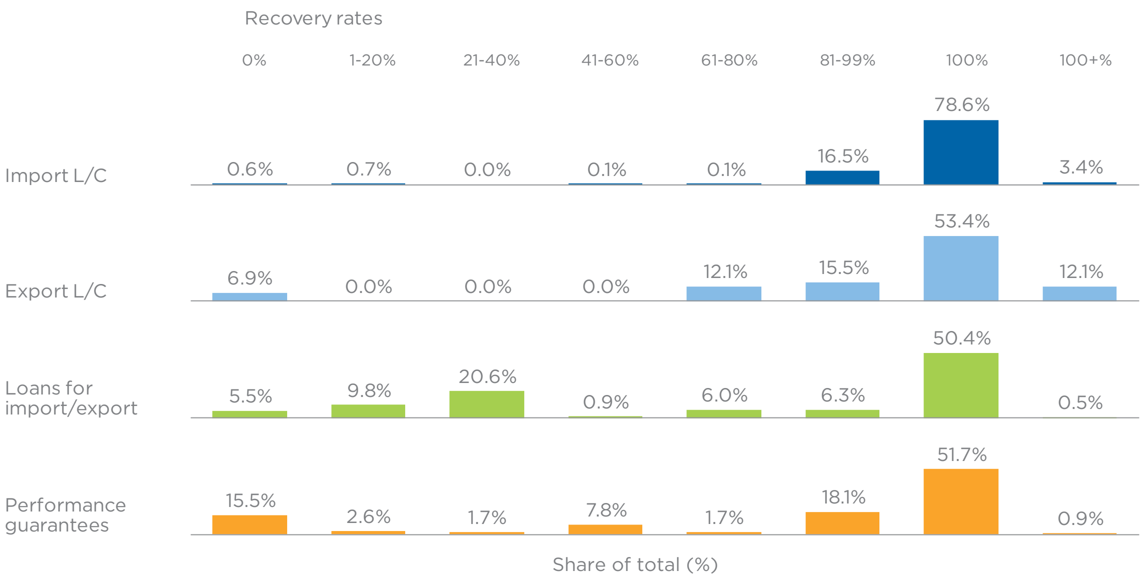
Source: ICC Trade Register 2019

The distribution of recovery rates (Figure 43) shows how a significant majority of transactions have greater than 80% recovery rates, particularly for L/Cs. For import L/Cs, 98.5% of transactions have recovery rates above 80%, while for export L/Cs it is 81.0%.

Loans for import/export have more variation in recovery rates; around 50% of transactions have 100% recovery rates, but just over one-third of transactions have recovery rates below 40% (a reduction from 2017).

For performance guarantees, the percentage of transactions with a recovery rate of 0% increased from 5.9% in 2017 to 15.5% in 2018. This is likely driven by the small sample size (13 cases in 2018), rather than a systemic trend driving down recovery rates.

Figure 43:
Distribution of recovery rates across trade finance products, 2008–2018



Source: ICC Trade Register 2019

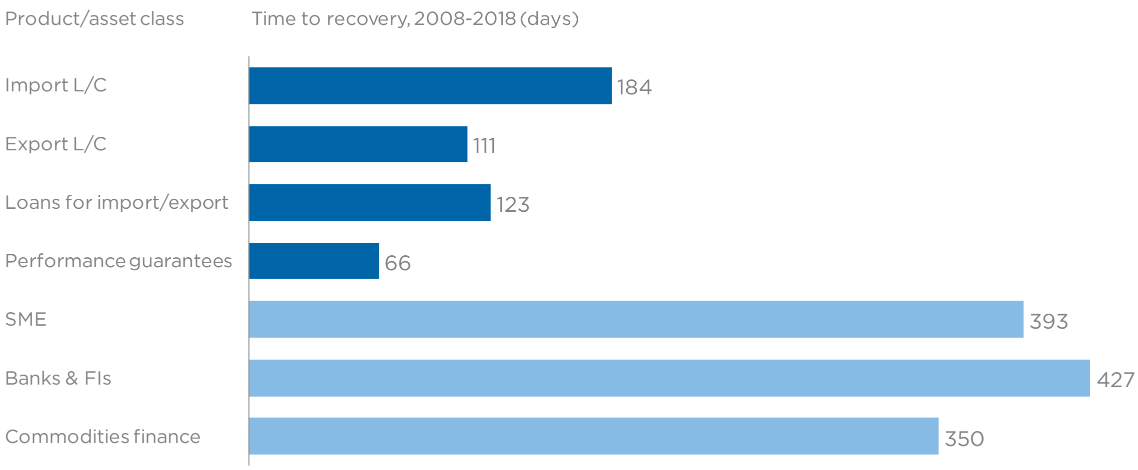
Time to recovery is the second major driver of the LGD calculation; the longer it takes to recover the defaulted value of a transaction, the higher the LGD. Trade finance products have significantly lower time to recovery than other comparable asset classes (Figure 44) – ranging from 66 days for performance guarantees to 184 days for import L/Cs. Potential explanations vary by product. When it comes to import L/Cs, depending on the commodity, banks can take ownership of underlying goods and sell them quickly. This results in the exposure being held on the balance sheet for a short time, reducing the discount factor on the potential loss.

For performance guarantees, in the event of a default, the obligor will often indemnify swiftly as the guarantee was called for technical reasons.

Note that some caution is needed when comparing data between the Trade Register and other asset class benchmarks. The underlying data sets for trade finance products and other asset classes are quite different; the former being business data (e.g. transaction-level data), and the latter being risk data (which requires far stricter data submission requirements given its use in risk modelling).

Figure 44:

Average time to recovery between trade finance and other asset classes, 2008–2018



Source: ICC Trade Register 2019

ANALYSIS OF SUPPLY CHAIN FINANCE

Last year's edition of the Trade Register marked an important step in its history by including supply chain finance for the first time. The 2019 report builds on that foundation to once again analyse SCF data, although it continues to only focus on payables finance (out of the various other SCF products in the market). The data collection for SCF is in its early stages, which makes it challenging to draw any widespread conclusions from the limited data points. Nevertheless, it is important to share preliminary observations (though the data is not ready to be used for financial modelling purposes).

SCF and other open account trade products are becoming increasingly important in trade finance. As discussed earlier in the report, trade finance revenue growth is projected to be largely driven from the growth in open account trade, which has already overtaken documentary trade in terms of exposures.

In addition, the regulatory treatment of SCF, along with the accounting and reporting treatment, is still evolving with ongoing dialogue, advocacy, and engagement between regulatory authorities and industry leaders. Ideally, this will lead to the design and delivery of regulatory regimes that align with the risk characteristics of SCF, achieve regulatory objectives, and do not result in adverse or unintended consequences for the associated products. These factors highlight the need for data-driven insights into the risk associated with SCF.

Over the past two years, the Trade Register has gathered data on USD 133 billion in exposures and 2.4 million individual facilities. While this data set is small relative to that of trade finance products, it is an important step in the expansion of the scope of the report.

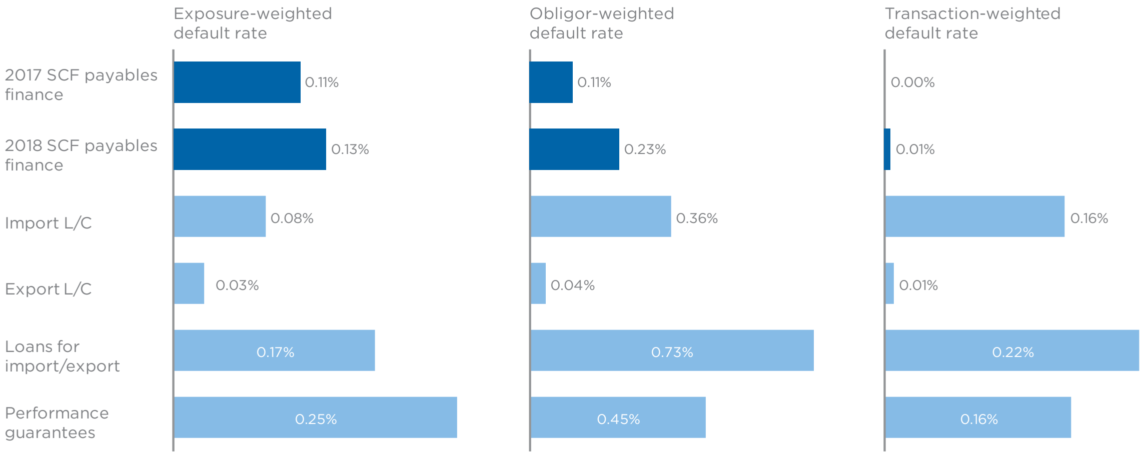
Exposure-weighted default rates for SCF in 2018 were 0.13%, a slight increase from 0.11% in the previous year, and comparable to other trade finance products (Figure 45). Meanwhile, the obligor-weighted default rate increased from 0.11% to 0.23% – below all documentary trade finance products in this year's report (except for export L/Cs).

Given the relatively small size of the data pool, it may be challenging to reach meaningful conclusions about the riskiness of SCF; for example, the number of obligor defaults in 2017 was just three, while in 2018 it increased to 10. This year's report also includes transaction-weighted default data for SCF, but again for a relatively small sample size. Defaults weighted by transactions rose to 0.01% in 2018 from <0.01% in the previous year. Looking forward, the report is likely to need three to five years of data to draw meaningful, industry-wide conclusions.

In addition, many clients (particularly large corporates today, but this may trickle down) choose to distribute their SCF programmes across multiple providers, which drives a risk of double-counting. This is because the default of one obligor may appear as a default with multiple banks, and without legal entity identifiers (LEIs), it is not possible to determine whether they are indeed the same. However, if anything this would overestimate the default rates of SCF, ensuring that the Trade Register provides a conservative view.

While these results are based on a small data set of two years and submissions from only a few banks, they indicate that the probability of default for SCF is comparable to that of trade finance products. The Trade Register will continue to collect data to substantiate and de-average this result across regions and years in subsequent editions.

Figure 45:
Summary of default rates for SCF (2017 and 2018) vs. trade finance products (2008–2018)



Source: ICC Trade Register 2019

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ANALYSIS OF EXPORT FINANCE

Overview of Findings

The ICC Trade Register draws from a data set comprising nearly 46,000 data points (this is higher than the number of transactions given that a single long-term export finance transaction is likely to appear multiple times across different years in the sample) spanning from 2007–2018.

This large data set allows us to conduct meaningful analysis on the Probability of Default, Loss Given Default, and thereby Expected Loss in export finance.

The findings in this year's report support the long-running conclusion that export finance presents a low risk for banks. This finding is due to its low EL, which derives from low LGD combined with a PD comparable to below-investment grade project finance and corporate finance assets. Export finance has a particularly low LGD as most transactions are covered by Export Credit Agencies at up to 100% of their value (and an average of 94% in the Trade Register sample), which grants the banks the capacity to be indemnified by an ECA for up to the level of cover provided by the ECA.

Looking at completed/accelerated cases only from 2007–2018, the exposure-weighted default rate is 0.62% with an LGD of 2.9%, resulting in an EL of 0.018%. This is marginally lower than the EL of 0.021% reported in 2007–2017, driven by a slight decrease in exposure-weighted LGD. When partially completed cases are also included, LGD is 4.4%, resulting in EL of 0.027%. These higher values are driven by incomplete recoveries in partially completed cases, which lower the recovery rate and in turn increase LGD and EL.

Risk Characteristics of Export Finance Products

As in previous editions of the report, the export finance products included within the Trade Register are export credits with the backing of high-income, OECD member-based ECAs, representing the full faith and credit of their respective governments. Building on last year's report, the scope of products considered in this report also includes non-OECD ECAs to reflect their growing importance in export finance. The number of data points collected on non-OECD ECAs is relatively low at this point, but their inclusion is important for the ongoing relevance of the Trade Register.

While these in-scope export finance transactions have different product characteristics from the transactions included in the trade finance component of this report, their risk profile is similarly low. This low risk to banks is largely a function of the ECA coverage. Losses are limited unless the ECA itself defaults, which is unlikely because in-scope ECAs are sponsored by governments (largely high-income, OECD members). If an obligor defaults on a loan with 95% coverage from an ECA, the bank can expect recoveries of 95% from the ECA for:

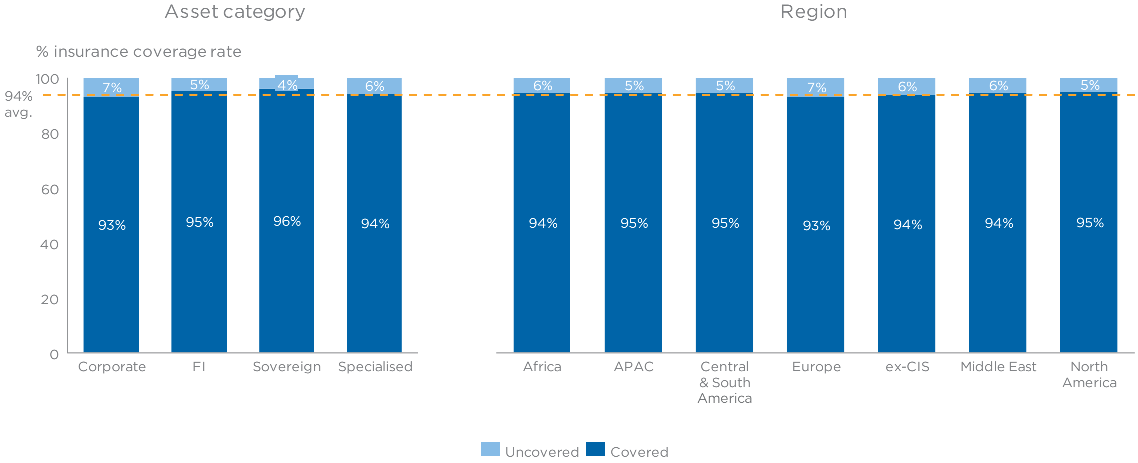
- Outstanding principal at the point of default;
- Interest contractually due but unpaid; and
- Direct costs associated with recovery from the customer (e.g. legal fees).

While the average level of cover in the 2007–2018 data is 94%, it varies slightly across products and regions (Figure 46). For sovereign obligors, the rate of cover is for political risk because they do not present a commercial risk. For other obligors, comprehensive cover is considered to reflect the portion of the transaction covered for both political and commercial risks. Observing the regional differences, Europe sits slightly below the average at 93%, while all other regions are at or above the average.

If an obligor ultimately makes good on its obligations, the recoveries are shared between the bank and the ECAs in proportion to their uncovered and covered portions, as the ECA is subrogated in the rights of the bank after indemnification.

Figure 46:

Average ECA insurance coverage rate by asset category and region, 2007–2018



Source: ICC Trade Register 2019

Observed Average Maturity

Export finance products (sometimes referred to as medium-to-long-term products) have significantly longer maturity than trade finance products (often referred to as short-term products). Over half (56%) of transactions across all asset categories have an original maturity of greater than 10 years, while just 11% have maturities of five years or less (Figure 47). The Trade Register defines four broad asset classes of export finance: corporate, financial institution, sovereign borrowers, and "specialised" borrowers (comprising project and asset-based finance).

Financial institution borrowers continue to have the widest spread of maturities (per the original tenor when the facilities were signed); 22% of transactions have maturities of five years or less, and 18% have maturities of 15 years or more – the highest of any asset class in both time brackets. Sovereign and specialised assets have the longest maturities with unweighted average tenors of 12.4 years and 11.8 years respectively. These are, on average, around two years longer than the average tenors for corporate and financial institution assets, and often relate to long-term programmes or projects.

As seen in previous years, the exposure-weighted average tenor is longer than the unweighted tenor, indicating that larger transactions have longer maturities than smaller transactions.

Figure 47:

Average maturity by asset class, 2007–2018

Asset class	5 years or less	5–10 years	10–15 years	15 years or more	Unweighted average tenor	Exposure-weighted average tenor
Corporate	13%	38%	43%	5%	10.0	11.7
Financial institutions	22%	37%	23%	18%	10.2	11.5
Sovereign	3%	26%	55%	16%	12.4	12.8
Specialised	2%	21%	71%	6%	11.8	12.1
Total	11%	33%	46%	10%	11.1	12.1

Trends in Default Rates

Default rates from 2007–2018 have risen slightly across all weighting methodologies when compared to average rates from 2007–2017. Obligor-weighted default rates have risen to 1.00% from 0.99%; similarly, exposure-weighted default rates have risen to 0.62% and transaction-weighted default rates have increased to 0.93% (Figure 48).

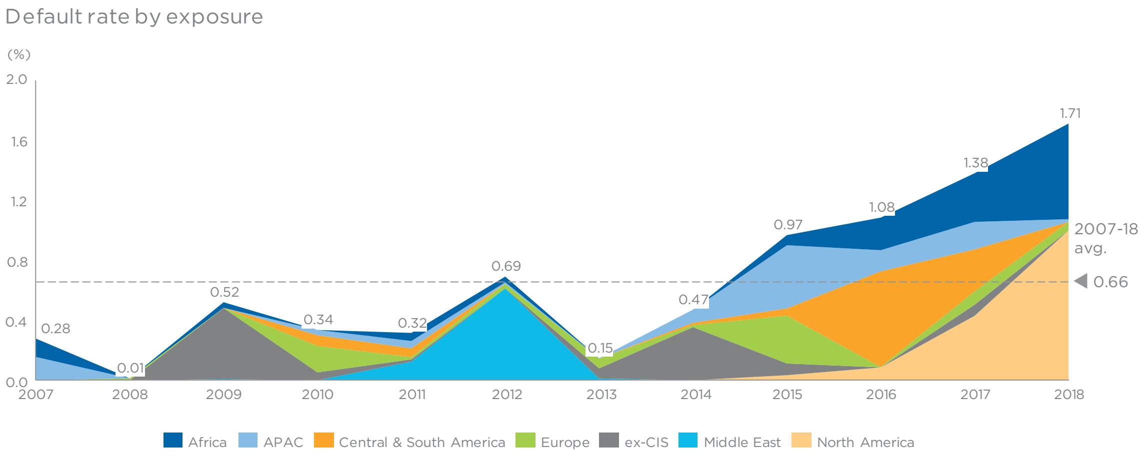
Figure 48:

Asset class export finance defaults by obligor, transaction and exposure, 2007–2018 (vs. 2007-2017)

	Defaults by obligor		Defaults by exposure		Defaults by transaction	
Asset class	**2007–2017**	**2007–2018**	**2007–2017**	**2007–2018**	**2007–2017**	**2007–2018**
Corporate	1.13%	1.18%	0.68%	0.77%	0.97%	1.07%
Financial institutions	1.37%	1.38%	1.21%	1.20%	1.41%	1.46%
Sovereign	0.44%	0.46%	0.28%	0.27%	0.34%	0.38%
Specialised	0.53%	0.49%	0.39%	0.38%	0.62%	0.58%
Total	0.99%	1.00%	0.58%	0.62%	0.88%	0.93%

Figure 49:

Export finance exposure-weighted default rates by region, 2007–2018



Note: Regions and countries reflect those of risk holder
Source: ICC Trade Register 2019

Figure 50:

Regional export finance defaults by obligor, transaction and exposure, 2007–2018 (vs. 2007-2017)

	Defaults by obligor		Defaults by exposure		Defaults by transaction	
Region	**2007–2017**	**2007–2018**	**2007–2017**	**2007–2018**	**2007–2017**	**2007–2018**
Africa	0.93%	0.92%	0.64%	0.83%	0.80%	0.83%
APAC	0.57%	0.55%	0.41%	0.39%	0.56%	0.71%
Central and South America	1.16%	1.14%	0.68%	0.66%	0.74%	0.78%
Europe	0.66%	0.74%	0.35%	0.35%	0.58%	0.60%
ex-CIS	1.23%	1.23%	1.01%	1.00%	1.28%	1.34%
Middle East	2.32%	2.23%	0.91%	0.84%	2.07%	1.99%
North America	0.66%	0.83%	0.49%	0.82%	0.63%	0.70%
Total	**0.99%**	**1.00%**	**0.58%**	**0.62%**	**0.88%**	**0.93%**

Trends in Loss Given Default and Expected Loss Analysis

Observed Recovery Rate

The 2019 Trade Register shows an observed recovery rate of 97.3% for completed / accelerated and partial completed cases from 2007–2018 (Figure 51), up slightly from 96.1% in 2007–2017. As in prior years, this recovery rate remains well above the 94% average coverage rate as ECA recovery amounts include coverage for principal, interest, and costs, and recoveries often also occur – at least in part – for the uncovered portion of the exposure.

The overall level of recoveries before and after customer recoveries is attributed to the ECA (Figure 51), while subsequent figures (Figures 52-54) show recoveries only post-attribution.

Figure 51:

Export finance observed recovery, 2007–2018, pre- and post-attribution of customer recoveries for ECA completed/accelerated and partial completed cases

	Exposure (USD M)	ECA recoveries (USD M)	Customer recoveries (USD M)	Total recoveries %
Pre-attribution of customer recoveries	1,735	1,402	286	97.3%
Post-attribution of customer recoveries (observed recovery rate)	1,735	1,672	16	97.3%

Loss Given Default

LGD was calculated using the same approach as in previous years – a discounting and recovery cost approach. This requires a transaction level discounting calculation, and a standard addition of 1.0% to account for the exposure recovery cost.

This year, the LGD was 5.2% for ECA completed/accelerated and partially completed cases (Figure 52). This was lower than the 6.2% reported last year, driven by an increase in the recovery rate from 95.3% to 96.4%, and a decrease in the loss rate from 3.9% to 2.7%.

For completed cases from 2007–2018, the LGD of 3.6% is slightly above last year's LGD of 3.5%. This is expected to be lower than the 5.2% cited above, as looking at completed cases strips out recent defaults for which recovery activities have not been completed.

Figure 52:

Recoveries and estimated LGD for partially completed and fully completed cases, 2007–2018

	ECA recoveries	Customer recoveries	Total recoveries	Loss rate	Dis-counting	Costs	LGD
ECA completed/accelerated and partial completed cases	96.4%	0.9%	97.3%	2.7%	1.4%	1.0%	5.2%
ECA completed and customer completed cases	96.1%	2.7%	98.8%	1.2%	1.5%	1.0%	3.63%

Expected Loss

The Expected Loss for ECA completed/accelerated and partially completed ECA cases in 2007–2018 is 0.032% (Figure 53), down from 0.036% in 2007–2017. This is driven mostly by the exposure-weighted LGD decreasing from 6.2% in 2007–2017 to 5.2% in 2007–2018. The EL for fully completed cases is 0.025%, slightly higher than the 0.021% reported last year.

Figure 53:

Estimated Expected Loss for export finance products using exposure-weighted default rate, 2007–2018

	Exposure-weighted default rate	Exposure at default	LGD	Expected Loss
ECA completed/accelerated and partial completed cases	0.62%	100.0%	5.2%	0.032%
ECA completed and customer completed cases	0.62%	100.0%	3.9%	0.025%

As with trade finance products, obligor-weighted ELs are higher than exposure-weighted ELs (Figure 54), as a result of the higher obligor-weighted default rate. Exposure-weighted data also gives more weight to larger (and therefore typically better-rated) obligors, resulting in lower default rates on average. For both ECA completed/accelerated and partial completed cases and ECA completed and customer completed cases, obligor-weighted ELs compare favourably to the other asset classes – SMEs at 0.44%, banks and financial institutions at 0.07%, and commodities finance at 0.16%. These results support the low-risk nature of export finance.

Figure 54:

Estimated Expected Loss for export finance products using obligor-weighted default rate, 2007–2018

	Obligor-weighted default rate	Exposure at default	LGD[1]	Expected Loss
ECA completed/accelerated and partial completed cases	1.00%	100.0%	5.2%	0.052%
ECA completed and customer completed cases	1.00%	100.0%	3.9%	0.039%

1. These LGD numbers are exposure-weighted. See Appendix A for further details.

FUTURE OF THE TRADE REGISTER: LISTENING TO OUR MEMBERS

As part of our continued review of the value the Trade Register brings to our Member Banks, the Banking Commission conducted a brief survey with 16 contributors to capture and reflect upon their feedback and steer the development of the Trade Register accordingly. In the survey, we considered several key aspects of the project.

Value from the Trade Register for our Member Banks

- Overall, almost all banks were in full support that the Trade Register is a valuable exercise and should be continued. Indeed, the single bank that felt differently cited concerns around lack of efficiency and the time involved in data collection as the reason for this.
- Further, the majority of the banks surveyed were satisfied with the current member benefits that they receive from the project. Some felt, however, that these benefits could be of further value if they were extended to include raw data for model building and a bank vs. industry analysis.
- Most respondents found the Trade Register to be beneficial for their specific business line and half also felt that it has value for their risk department, which is positive to see. However, the majority felt that the benefits were more limited for potential investors in trade assets, and therefore ways in which the report can benefit this group further in the future should be considered.
- On the whole, members did not feel that their operational and credit controls were directly benefiting from their participation in the Trade Register. However, it was positive to receive the feedback that some members have indeed benefitted in these areas, citing having a framework with which they can evaluate credit risk and having an improved awareness of default rates as benefits.

Expanding the Scope of the Trade Register

- There appears to be only limited appetite to extend the scope of the report to other areas at this point in time, for example to cover operational risk or fraud risk. Members were largely concerned about confidentiality breaches and their ability to provide the relevant data, as opposed to having a lack of interest in these areas. Therefore, these practical obstacles will need to be considered and addressed before any scope changes can be introduced.

Subscription Model

- While two-thirds of respondents did not find the membership fees prohibitive, one-third showed concern in this area and therefore some changes may be needed in future years.
- In particular, among those who raised concerns, many cited the discrepancy in fees for participants and non-participants as the reason for this. Further supporting this sentiment, most respondents felt that there should be a differential in the content available to non-fee paying and fee-paying recipients. This is something that the Banking Commission is actively considering, and more information will be shared at a later date.

Data Collection

- A key obstacle faced by the participants is the data gathering exercise itself, primarily due to the manual and time-consuming nature of this exercise. There is opportunity to reduce this obstacle as currently only one-third of participants have a partly or fully automated data collection process. To address this challenge, the majority of respondents would like to receive assistance with data collection from ICC/GCD, provided data confidentiality issues could be mitigated.
- Despite the above concerns regarding the time-consuming nature of data collection, most respondents found that they had sufficient time to gather the data. Additionally, most respondents are satisfied with the timing of completion and release of the annual report, and state Q3 of the following year as the preferred timing and therefore no changes are needed to these timings.

As conversations on the evolution of the Trade Register continue, the Banking Commission looks forward to further engaging with its Member Banks and broader affiliates to ensure that the project maximises value for those involved and continues to provide a worthwhile return on investment for the trade finance community. Looking ahead, the Banking Commission is exploring ways to incorporate sustainability data into the report, such as by measuring the portion of transactions deemed sustainable by the contributing banks. In addition, we anticipate demand for 2020 data to materialise as swiftly as possible – to understand how trade finance risk fared amid the COVID-19 crisis – and as such the Banking Commission will work with Member Banks to learn how data collection could be accelerated for this purpose.

CONCLUSIONS

Trade finance, including supply chain finance and export finance, act as essential facilitators of global trade by providing low-risk financing methods across a range of maturities for importers and exporters who are often transacting with unknown and distant counterparties. These products are also important transaction banking products, providing considerable revenue pools for global and regional banks.

Given the significance of trade finance, regulators and banks rely on up-to-date, accurate information on the risk profile of trade finance and export finance products. The ICC Trade Register plays an important role in this process. Its data-driven approach provides an objective and transparent view of the credit-related risk profile and characteristics of trade finance and export finance. These findings are essential for informing policy and regulatory decisions and broadening the awareness and understanding of the risk and regulation associated with trade finance and export finance.

At the same time, the underlying data set of the Trade Register is not real-time. In the fast-moving crisis created by the COVID-19 virus, industry and regulators need not only past risk data but also a timely and nimble understanding of the here-and-now. The utility of the Trade Register is not only in its analysis of risk data, but also in its inclusion and promulgation of industry experts. The report's analyses on risks in supply chain finance and the expected impact of COVID-19 on trade finance are highly topical and provide key data-driven and qualitative insights to the industry. It is precisely analyses like these that elevate the Trade Register from a risk assessment report to a flagship publication for the global trade finance community.

The findings of this year's report show that trade finance and export finance both remain low-risk products for banks. Trade finance default rates were broadly consistent with previous years and maturities remain short. Expected Loss percentages remain below many comparable asset classes. While export finance default rates increased slightly in 2018, export finance continues to be very low risk, particularly when considering fully completed recovery cases. And early indications are that supply chain finance – specifically payables finance – default rates are comparable with those of traditional trade finance products.

The Trade Register is constantly evolving to improve the value it delivers to industry participants by enhancing data quality and methodology to make the data more useful for internal risk modelling and keeping aligned with regulatory practice. To date, the ICC Trade Register, with 22 Member Banks, is the only authoritative source of credit risk and default data in trade finance and export finance. We will continue to explore ways to enhance the scope, improve the data quality, and refine our methodology to ensure that trade receives consistent risk-aligned capital treatment across all jurisdictions.

APPENDICES

APPENDICES

APPENDIX A: APPROACH TO ANALYSIS AND DEFINITIONS

Report Limitations

Data quality and completeness: The ICC collects data from Member Banks at the most granular level of detail, resulting in large numbers of fields for each transaction and many thousands or hundreds of thousands of transactions per bank. This volume of data is therefore large and complex. To reduce input errors, we take great care to validate and review the data, and to apply consistent definitions across banks. In particular, since the 2018 report we have implemented a new digital submission process which performs a number of these validation checks at source, in an automated fashion.

In addition, we perform a number of manual checks to ensure accuracy. For example: the number and percentage of defaulted obligors per facility type per year is compared between each bank to look for outliers. If a bank's initial input data suggests a default rate outside of a normal range or inconsistent with its prior year's input, then we discuss this with the bank involved to ensure that the data input is both complete and accurate.

The size of the data helps to reduce the effect of any small errors, while the complexity allows us to cross-validate the numerous averages to check consistency. No database of this size will be error-free, so the aggregates and averages per year and per product provide a good approximation.

Comparability of results: The ability to compare results between years is affected by improvements to the methodology and new participants to the Trade Register. In some cases, the underlying data sample may differ between analyses as some banks have not contributed to all years.

Consistency of definition of default: The bank-declared defaults contributed to this database are in line with Basel methodology, in which defaults are counted whenever an obligor is declared as "in default" by the reporting bank. The definitions prescribed require the bank to identify not only borrowers with overdue payments of 90 days or more but also other borrowers judged by the bank as "unlikely to pay". This element of judgement will always result in a difference between banks; for example, one contributing bank may regard a certain importer bank as "unlikely to pay" and default it due to political unrest in the importer bank's home country, while another bank may have a different political or economic interpretation of the events and not default it.

Furthermore, differences in default recognition can arise from setting divergent materiality levels for overdue payments (e.g. very small amounts are not regarded as causing a default). Bank regulators have set very different minimum thresholds, which can affect the recognition of defaulted counterparties substantially.

Finally, the definition of a "technical default" varies widely between regulators. For example, one bank may be required to briefly declare that an otherwise sound borrower is in default due to a mistaken mis-booking of a payment, overlooked for 90 days, while another regulator may allow a similar event to be ignored for default counting purposes.

As a result, the Trade Register reports of defaults include many cases where the borrower restored the position quickly and no loss was incurred by the bank. For this reason, care should be taken not to interpret a certain default rate as a loss rate.

Potential double-counting of obligor defaults: In the current methodology, if an obligor defaults across one country, product or transaction, it is assumed that they default across all countries (where they have business), products and transactions. This conservative approach is also driven by confidentiality, which prevents banks from disclosing names (or LEIs) of obligors in default. This means that: (i) summing the defaults in each country will slightly overstate the true global total number of defaults; but that (ii) obligor and transaction default rates will be correct as both the numerator of defaults and denominator of all transactions and obligors are proportionally increased.

Obligor-weighted Expected Loss: Due to limitations of obligor-level recovery data provided by some banks, obligor-weighted EL is calculated using exposure-weighted LGD.

The data template for the trade finance element of the Trade Register comprises sections covering non-defaulted transactions and borrowers in aggregate (used for default rates), and sections covering detailed reporting of defaulted cases which are used for recovery rate analysis and CCF analysis. For the detailed recovery rate data, each bank has a different ability to provide the granular data requested (e.g. a higher level of detail for workouts of these defaults), while for the aggregated statistics used in the default analysis, banks were able to provide most of the aggregated data for non-defaulted obligors.

Transaction count data has been included to increase the trade finance data available across regions and products for obligors and exposures. Given the changes in sample size, improvements in data collection processes made by individual banks and their differing ability to provide granular level data, some degree of caution must be exercised when comparing default and recovery rates. These risk metrics as reported in this report are historically observed averages. Further adjustments would be necessary to convert historical averages into forward looking calibrated projections.

For the limitations above, it is important for readers of the ICC Trade Register Report to apply caution in how data is used. The ICC strongly encourages the usage of the report's data and information for research purposes, but strongly advises against its usage to inform investment decisions. Please reach out to the Banking Commission if you would like to understand whether your usage of the Trade Register data is recommended and / or appropriate.

Trade Finance

Scope of Trade Finance Products

For the purpose of the ICC Trade Register participating banks are requested to submit data for five trade finance product categories. The definitions of these product categories are included in Figure 55.

Figure 55:
Definitions of trade finance products

Trade finance products	Definition
Issued import L/Cs (Referred to as import L/Cs)	Documentary letter of credit issued by the participating bank, covering the movement of goods or services.
Confirmed export L/Cs (Referred to as export L/Cs)	Documentary letter of credit confirmed by the participating bank but issued by another bank also including "silent confirmations". Consequently, it should be noted that the vast majority of exposures in this product category constitute bank risk.
Loans for import/export	All loans classified as "trade" including but not limited to clean import loans, pre-export finance and post-import finance. Participating banks are asked to report loans for import and loans for export separately; additionally, a breakdown of loans where the counterparty is a bank and loans where the counterparty is a corporate is also requested.
Performance guarantees and performance standby L/Cs (referred to as performance guarantees)	Guarantee instruments issued by the participating banks, representing an irrevocable undertaking to make payment in the event the customer fails to perform a non-financial contractual obligation. Note – only includes performance instruments as distinguished from financial guarantee instruments (as determined by the nature of the contractual obligation that would trigger a payment under the guarantee).
Supply chain finance - payables finance	Buyer-led program within which sellers in the buyer's supply chain are able to access finance by means of receivables purchase.

Default Rate

Banks may treat default as a product-specific phenomenon, meaning that a customer can be in default on one product but not another. Under Basel II, however, banks are supposed to take an "obligor default perspective", meaning that if a customer defaults on any product, then all the customer's products held with the bank should be deemed in default. For example, if an import L/C customer defaults on a loan, then its L/C is also deemed to be in default even if the customer has met all its obligations under the L/C. The ICC Trade Register uses the Basel II definition of default.

Banks were asked for information on how many customers had a trade finance product when they entered Basel default. Using this obligor default perspective gives a higher default rate, but a lower LGD, than a transaction-specific perspective.

Exposure at Default

Exposure at Default measures a bank's exposure to a counterparty at the time of default. It is defined as the gross exposure, including an estimate of undrawn or unutilised facilities. L/C and performance guarantee exposures are contingent on an act that must be performed before the exposure is created. For example, trade documentation must be presented and accepted to trigger a valid claim under an L/C.

Once the contingent event has occurred, the bank will attempt to pay the required balance from their customer's account. If the customer's account has insufficient funds to cover the balance, the bank will pay the remaining balance from its own funds. The contingent liability has then been converted into an (on-balance sheet) exposure for the bank.

In many cases, the amount requested for payment of the default is lower than the limit on a facility over the course of a transaction's lifecycle. This occurs where a reduction in volumes reduces the total exposure level, as in the case of a partial shipment under an L/C. A total exposure often comes by way of multiple transactions. For example, a customer may have a limit and contingent exposure of USD 900,000, but typically purchases goods of up to USD 300,000 each, meaning that the EAD might be considerably less than the whole USD 900,000.

EAD plays a major role in Expected Loss calculations. However, there is an ongoing industry debate about whether the potential events described above should be taken into account in the EAD or LGD component of the calculation by means of Credit Conversion Factors.

It is difficult to determine accurate EAD figures across banks. Efforts to gather this information on a consistent basis across the sample are at an early stage. One obstacle is that many jurisdictions require exposures for defaulted obligors to be consolidated under one account, which eliminates the granular information required for the calculations. To deliver this data, banks would need to track transactions through their lifecycles, which some banks could do only manually and others not at all. Many banks collect data on performing and non-performing credits in separate systems of books, which creates another obstacle for analysing pre- and post-default exposures.

Given these data limitations, a CCF of 100% has been used in this report to estimate an EAD figure for import L/Cs, export L/Cs and loans for import/export. As discussed in previous reports, the report intends to continue building the database over the coming years to calculate a robust CCF for these products.

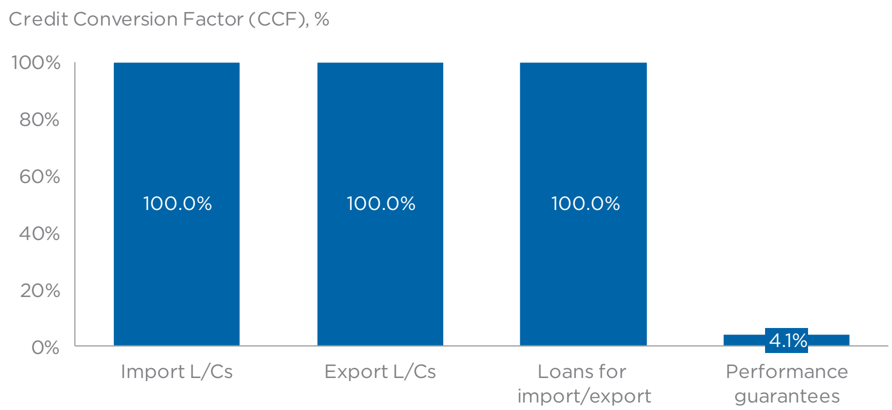
The CCF is particularly important for performance guarantees. These instruments exist primarily to protect against unforeseen outcomes, such as non-performance or performance below the standards agreed, and only a small call rate is expected. As with L/Cs, the Trade Register has been collecting data since 2013 to better determine CCFs for performance guarantees. The data points collected remain few, and limited additional data points were submitted by banks for 2017. Using the data collected, the call rate has been calculated (and therefore assumed CCF) as 4.1% (Figure 56). This value is below the 7.6% calculated in last year's report. It is important to note that the 4.1% figure does not mean that in all cases the customer defaulted on its obligations to the bank. In many cases, the transaction is settled from the customer's account, but current data does not allow us to estimate how much is paid from the client's versus the bank's account.

As per the ongoing debate, this 4.1% call rate can be applied to either EAD or LGD calculations. Technically speaking, in the case of a claim, the true EAD is likely to be the outstanding exposure value of the performance guarantee (presumably higher than 4.1% of the limit), and therefore the Trade Register's historical methodology of applying the call rate to EAD is incorrect. The more correct alternative would be to apply this 4.1% to LGD and assume EAD to be 100% as done for L/Cs and loans for import/export.

Both methodologies derive the same EL result, which means there is limited impact from changing approach. For consistency both methodologies are used in this report.

As discussed in the 2019 paper "Performance Guarantees and Claims", jointly authored by the ICC and GCD, the underlying data to calculate CCF is difficult to come by. Using similar methodologies on different data pools can yield CCFs of anywhere from less than 1% to 8%. However, whichever data set is used to calculate CCF, any and all support the case that a CCF of 20% is acceptably conservative.

Figure 56:
Assumed CCFs by trade finance product



Source: ICC Trade Register 2019

APPENDICES

Loss Given Default and Expected Loss

Loss Given Default measures the loss incurred by a bank in relation to the overall exposure of the bank at the time that an obligor defaults. Under Basel rules, this should be the net present value of recoveries discounted at an appropriate discount rate and should include direct and indirect costs associated with recovering the bank's money.

Basel requires that "the definition of loss used in estimating LGD is economic loss. When measuring economic loss, all relevant factors should be taken into account. This must include material discount effects and material direct and indirect costs associated with collecting on the exposure". As a result, LGD is made up of three key components:

- Observed recovery rates, as a percentage of the Exposure at Default
- Direct and indirect costs incurred in the recovery process, which are deducted from the recoveries
- Discounting of any post-default cash flows using an appropriate discount rate.

Calculating Expected Losses requires transaction-level data from banks, which limits the data points available for analysis. As a result, EL cannot be broken down by region and country, as was done for default rates. For recovery rates in particular, acquiring sufficient data points to estimate recovery rates accurately continues to be a challenge for the Trade Register, and large one-off events can skew overall patterns.

Benchmarking: Comparison of Trade Finance to other Asset Classes

The benchmarks/comparisons between trade finance and other asset classes used in this report bring together data from different databases to make a very high-level comparison of observed loss statistics by product and borrower types.

When using this data, please apply the following caveats:

1. The ICC Trade Register data for trade finance and the GCD data for other asset classes are based on separate data pools for default rate and Loss Given Default, meaning that the underlying data effectively comes from four different data pools. Each pool is supplied by an overlapping but not perfectly consistent set of lenders.
2. For each of the trade finance and other asset class pools, the defaulted borrowers in the default rate calculation are not completely consistent with the defaulted borrowers used in the LGD calculation.
3. The trade finance default rate data is obligor weighted, while the LGD data is exposure weighted. The GCD other asset class data is obligor weighted for both default rate and LGD data.
4. The discount rate for LGD has been applied at a consistent 9%.
5. Borrower size, borrower industry and country profile differ between the trade finance and other asset class data pools.
6. The data templates differ between the ICC Trade Register and GCD. The ICC Trade Register LGD collection of short-term data receives exposure amounts at the time of default and the final loss or recovery, meaning that the recoveries are delivered net and aggregated before discounting. GCD collects detailed cash flows tagged by date and source and uses this to compute a discounted recovery rate and LGD.

Numerous choices of data selection and methodology have been added made in the calculation of default rates and LGDs, and the choices are not necessarily consistent between each of the data pools. For example, post default advances in LGD from the GCD data pool have been added back to the exposure at default, which has not been done within the trade finance data pool. Both methods are valid and many other possibilities exist.

Credit Conversion Factors (CCFs)

The Credit Conversion Factor estimates the likelihood of an undrawn trade facility being drawn down, and is a key input in the calculation of Exposure at Default. CCFs are also applicable to both funded and unfunded trade products. Additionally, CCFs are used as a proxy to estimate the on-balance sheet exposure of contingent liabilities (e.g. L/Cs and performance guarantees). In practical terms:

- For an import L/C, the CCF is an estimate of the likelihood of an L/C becoming an on-balance sheet liability; when the import L/C does become an on-balance sheet liability it becomes a bill receivable for a sight L/C and a deferred payment bill for a usance L/C.
- For a performance guarantee, the CCF could be used to reflect the likelihood of a claim being made and being paid out against the performance guarantee.

As noted in previous ICC Trade Register Reports, the definition of CCF in the Basel framework is open to interpretation and has led to different interpretations by regulators and institutions. This presents a key challenge as: a) the CCF is a critical factor in calculating risk capital and leverage exposure for a bank; and b) in the case of default, the CCF is a key driver in the loss calculation through EAD.

The following areas of ambiguity make a statistically sound analysis of the CCF, which is one of the aims of the Trade Register, challenging for now:

- As EAD is recorded on facility level, aggregating across undrawn proportions of, for example, overdraft lines, guarantees, documentary credit, isolating the EAD data of a specific trade finance product is difficult for most banks.
- The lifecycle of a documentary trade transaction, and the document processing and checking steps and their results, has a significant impact on whether a claim does or doesn't exist on the level of the trade finance product when the obligor defaults. For example, if documents were rejected as not compliant, a claim on the trade finance product could not be constituted.
- Estimates of EAD in trade finance are interpreted in two ways:
  - If a successful claim is never made against a product, and no money is ever paid by the bank, it should be reflected in a lower EAD throughout the transaction life cycle.
  - If a customer defaults, there is outstanding exposure for the bank and EAD should equal 100%. Other factors should be reflected in the LGD itself.
  - Both of these approaches result in the same Expected Loss.

For a precise CCF calculation, transaction/product level data is critical to reconcile the transaction lifecycle of a trade finance product. The ICC Trade Register is looking at collecting this data in the future. Given the practical challenges in reporting data consistently on product level and across the full lifecycle (including the pre-default and post-default periods), only very few banks have been able to provide data in the required format. As a result, the Trade Register uses assumed CCFs across products.

Export Finance

Definitions of Export Finance Asset Categories

For the purpose of this report, export finance transactions are split into four specific asset categories to allow for analyses of the exposures to each of these categories. These are outlined in Figure 57.

Figure 57:
Definitions of export finance asset categories

Export finance asset categories	Definition
Sovereign	This category covers all exposure to counterparties treated as sovereigns under the standardised Basel approach. This predominantly includes sovereigns and their central banks. However, certain Public Sector Entities (PSEs), e.g. regional governments and local authorities identified as sovereigns in the standardised Basel approach, are also included in this category.
Financial Institutions	Banks and non-bank financial institutions including leasing companies.
Corporate	In general, a corporate exposure is defined as a debt obligation of a corporation, partnership or proprietorship. This excludes “sovereigns”, “financial institutions” and “specialised” as separately defined. Contrary to “specialised”, the source of repayment of the loan is based primarily on the ongoing operations of the borrower, rather than the cash flow from a project or property.
Specialised	• The economic purpose of the loan is to acquire or finance an asset • The cash flow generated by the collateral is the loan’s sole or almost exclusive source of repayment • The subject loan represents a significant liability in the borrower’s capital structure • The primary determinant of credit risk is the variability of the cash flow generated by the collateral rather than the independent capacity of a broader commercial enterprise Examples include: project finance, income producing real estate, object finance (e.g. ships, aircraft, and satellites), commodities finance.

Observed average maturity

The maturity describes the total maturity of the contract upon its initial issuance. The Trade Register Report shows the distribution of maturities across the entire sample, and a comparison of the transaction average and the exposure weighted average. These calculations are made over the entire sample of transactions for which maturity values were submitted.

Default rate

The data underlying the analysis of the export finance element of the Trade Register is collected at the transaction level, and banks are asked to provide both unique customer and transaction IDs. As a result, consistent transaction-level and customer-level default rates can be calculated for closer alignment to the Basel methodology. All transactions are reported by four major asset categories – corporate, FI, sovereign and specialised – to highlight the differences in risk profile.

Given that export finance transactions typically span 10–15 years, and banks report data to the export finance Trade Register on an annual basis, any individual transaction is likely to appear in multiple years. However, as Basel default rate measures are based on a 12-month outcome window (as opposed to a transaction or customer lifetime perspective), different methodologies can be applied to arrive at these metrics. In short, the default rates presented in this report are annual averages over 2008–2018; the sum of the number of defaults across all years is divided by the sum of total transactions in each year. Defaults are only counted in the year that they occur and are excluded from the total transaction count in subsequent years.

Three different default rates (by exposures, number of obligors, and number of transactions) are calculated based on the same set of underlying transactions and the methodological approach outlined above. For each of these metrics, the sums are calculated across the entire sample for 2008–2018.

Loss Given Default

Overview

As detailed in the trade finance analysis, Loss Given Default is a measure of the loss incurred by a bank in relation to the overall exposure of the bank at the time that a counterparty defaults. This is calculated as:

LGD = (1 - recovery rate) + discount on recoveries (%) + costs (%)

Completed and observed recovery rates

By definition, a large proportion of the recovery of export finance products is insured by an ECA. For example, if a customer defaults on a loan that has a 95% comprehensive coverage from an ECA, then the bank can expect recoveries from the ECA covering 95% of:

- The outstanding principal at the point of default
- Interest contractually due but unpaid
- Direct costs associated with recovering from the customer (including for example legal fees)

Typically, when a customer defaults the ECA will assume responsibility for the payments due under the terms of the contract and make payments in line with the original contract. This does cause potential challenges when analysing observed recoveries for which the full recovery period is not available. For example, if 3.5 years remain contractually at the point of default, on average 25–30% of the total recoveries would be expected to come from the ECA each year.

In this report, we analyse two different views of recovery rates:

- Completed and customer completed cases
- Completed/accelerated and partial completed cases (or observed recoveries)

Completed and customer completed cases consider data from those cases where the recovery has been completed. Because recovery efforts can take several years, this method may not capture significant data points from recent years of defaults.

Completed/accelerated and partial completed cases, or observed recoveries, provide a view on more recent defaults, even if recovery is not complete.

As a result, observed recoveries for the most recent defaults may amount to the instalments due as agreed originally (i.e. not to the full contractual loan lifecycle expected recovery rate, based on the level of cover). While the defaulted amount recognised will be the full outstanding amount, the observed recovery will be a portion of the defaulted amount as the ECA will pay out based on the agreed payment schedule instead of the full outstanding amount. In other situations, the ECA will make an upfront lump-sum payment. Where the ECA recovery is not complete, the amount due is determined by comparing the original payment profile with the observed recoveries.

Even in situations where the ECA has accelerated the workout or the workout is complete, additional recoveries from borrowers may occur and eventual recoveries may be higher than those indicated in this report.

Additionally, where recoveries are made from the customer, they are shared between the bank and the ECAs based on the uncovered and covered portions, as the ECA is subrogated in the rights of the bank after indemnification.

For example, if a customer defaults owing the bank USD 1 million, with ECA cover of 95%, the ECA will pay the bank USD 950,000. If the customer makes a payment of USD 100,000, USD 95,000 (95%) would be given to the ECA and USD 5,000 (5%) would be retained by the bank. The bank's overall recovery is USD 955,000.

Discounting

For Basel Loss Given Default purposes, the following factors need to be accounted for:

- Discount rate on recoveries, with recoveries discounted from the point of default to the point of recovery
- Direct external recovery costs, typically shared with an ECA
- Downturn effects (i.e. the potential impact of an economic downturn on recovery cash flows and cure rates) in addition to export finance transactions

The discount rate applied to these products differs significantly across banks and is an area of ongoing debate. Applying a discount rate to the export finance Trade Register data is further complicated as many of the products in the data set have state backing from OECD sovereigns – with 2017 being the first year for which data was collected also on non-OECD ECAs. This state backing means the stream of payments from these products can be assumed to be similar to those of a government bond. Therefore, a discount rate is applied to a bond from the government of the ECA with a similar maturity. For example, if the recovery from the ECA occurs two years after default, we use a discount rate based on the two-year sovereign bond rate.

Given that highly-rated ECAs have never defaulted on a valid claim, some practitioners believe the discount rate should be based on the three-month sovereign bond rate as the ECA is committed to indemnify within a few months, instalment-by-instalment (and not at the date of the default), and to cover interest.

However, this rate needs two adjustments:

- A liquidity premium to reflect the fact that ECA claims are a relatively small and illiquid market (a liquidity premium of 1% has been used as in previous years)
- An adjustment for the risk of disagreement on the validity of the claim (as this is increasingly rare, no adjustment has been made at this stage. Most practitioners argue that the risk of disagreement on the claim validity is an operational risk and more appropriately reflected in operational risk capital)

The discount rate for the covered portion of the repayments is based on a point on the government yield curve (based on the maturity of the underlying transaction) with an additional 1% liquidity premium. The last 12 months of data and the average time to recovery suggest an average discount rate of approximately 1.5%. However, where the export finance element of the Trade Register only reflects principal repayments, no discounting effect has been applied as the interest due would offset any discounting effect.

For the uncovered portion of the portfolio (i.e. those recoveries from the customer rather than the ECA post-attribution), a discount rate of 9% is applied, similar to the one used for trade finance products and a typical unsecured recovery.

Costs of recovery

The ECA will typically cover a substantial share of the collection/workout costs for the defaulted exposure in line with the level of cover provided.

For this year's calculations, workout costs are assumed to be 1% of export finance exposures (including banks' internal indirect costs in line with Basel requirements).

Expected Loss

Using the results generated in default and LGD calculations, overall EL is estimated based on the formula:

EL = Default Rate x EAD x LGD

Sufficient information to appropriately calculate the EAD based on empirical data is not available, and for the purposes of this calculation EAD is assumed to be equal to the current balance.

Results are based on the average coverage ratios from the export finance element of the Trade Register. In some instances this coverage is higher, up to 100%, and the EL will vary by case.

APPENDIX B: DATA COLLECTION & FILTERING

Data Availability

Data collection under the revised methodology is now in its sixth year (covering six years of data from 2012–2018) and significant improvements have been made:

- Significantly larger data set from more banks with more data points across years
- More complete data set across the granular data categories in particular, such as geographical breakdowns
- More consistent data items across submitted data sets and between contributing member banks
- Improved data gathering and data processing across participating banks, including the introduction of a digital portal for collection of data for the 2019 report

Despite recent improvements, several difficulties in the data gathering process need to be considered when reviewing the results:

- Data definitions and terminology may vary between member banks, requiring significant verification and validation to make sure the data is as accurate and consistent as possible. These variations include the definition of default, which requires expert judgment by the Member Bank to determine the crucial element of "unlikeliness to pay". This is particularly significant for larger borrowers, banks and sovereigns
- Data sourcing, collection and submission may involve multiple systems within a single financial institution, and may require manual intervention. This can introduce errors or cause the dataset to be incomplete
- Data is not always accessible or available at the desired level of detail, and some observations can only be presented in aggregated form which can make comparisons difficult

One specific area where the number of observations continues to be considerably smaller than for other analyses is the recovery rate and LGD analysis. This is the result of the low number of defaults and the fact that, after the date of default of an obligor, many banks aggregate exposures and recovery data at either a customer or facility level and cannot break them down into the transaction- or product-level information required to estimate recoveries and losses. This issue is not specific to trade finance data and is not a weakness of data collection or processing. It reflects the complex legal and operational environment faced by banks when collecting defaulted loans and transactions when every case is unique.

To account for these challenges and maintain data quality, consistency and comparability, the final dataset is compiled using an iterative four-step data cleansing process:

1. New data submitted by Member Banks is evaluated critically to identify outliers, data errors, omissions and any other issues in each submission
2. A detailed audit report is provided to each member bank, followed by audit and questioning as data is replaced or clarified
3. New and updated data is aggregated with prior data from each Member Bank, followed by a further round of audit and questioning
4. Unresolved issues or erroneous data points are filtered, resulting in the omission of certain years, products and banks where necessary (in collaboration with the submitting banks)

This four-step process delivers a qualified, quality-controlled data set that maximises the acceptance of available data.

APPENDICES

Quality and Quantity of Submitted Data

As the Trade Register evolves, so do the abilities of Member Banks to submit accurate, granular data. The dataset in the 2019 report shows continued improvement in quality and quantity over the datasets used in earlier editions of this report.

For trade finance, 92% of the transactions now included in the Trade Register have successfully passed the data-filtering process. This compares to 91% in last years' analyses and demonstrates an improvement in the quality of data received for the Trade Register – in part driven by the new methodology.

For export finance, the filtering process includes approximately 83% of available transactions. This results in 45,821 transactions available for analysis, which is a 6% increase on the data set used in last year's report.

As noted, the complexity of data access in complex global financial services firms and limitations to data availability means not all Member Banks can complete the data collection templates in full. In some cases different subsets of the data are used for different analyses to include as many observations as possible and represent the fullest scope of trade finance.

Figures 58-59 show the unfiltered data set that comprises the Trade Register. It should be noted that the following sections are to be treated as additional detail and are not a comprehensive overview of all aspects of the analysis contained in this report.

Figure 58:
Unfiltered data sample for trade finance, 2008–2018

	Banks in sample	# Transactions	# Customers	Exposure (USD B)
Submitted data	25	32,155,108	1,311,758	16,345
Default rate analysis	23	29,534,596	1,162,185	14,411
Recovery rate analysis	12	7,899	516	2

Figure 59:
Unfiltered data sample for export finance, 2007–2018

	Banks in sample	# Transactions	# Customers	Exposure (USD B)
Submitted data	18	54,928	6,454	835
Default rate analysis	17	45,821	5,306	775
Recovery rate analysis	13	234	145	2

Data required to accurately calculate observed LGD rates must come from cases where the recovery has been completed. Incomplete cases can give some information as to the future likely outcome, but only fully complete cases can tell us how much a bank has lost, if anything. Due to the long recovery process for export finance cases, it takes many years after the date of default to complete the set of all defaulted cases with their final outcomes, leading to the relative scarcity of completed data for LGD in the export finance data set.

Data Quality Checks and Filtering Process

In the trade finance element of the Trade Register, the filtering criteria that lead to most exclusions are linked to the requirement for each bank to be able to submit obligor, transaction and exposure level information on a consistent basis. This is reflected in the "customer" and "transaction" filters (e.g. if a bank cannot provide customer information it would be reflected in the customer filter). The transaction filter also includes transactions excluded due to other data quality issues that could not be resolved over the course of the data collection process.

The customer filter and transactional filter can be applied independently to derive the customer level default rate and the transaction level default rate. On the one hand this would create a larger sample set, but on the other hand this approach would lead to two different subsamples to analyse. When compared, these subsamples would always have inherent differences and could lead to incorrect conclusions. As a result, a smaller, more comparable dataset has been produced for the purposes of the overall default rate analysis, using only data where both customer and transaction information were available. However, this filter has been relaxed where possible for other analyses such as maturity and LGD. The unavoidable result of this difference in filtering is that the Expected Loss calculation is a mixture of different borrowers for each of the default rate and LGD elements.

Almost 90% of the excluded transactions are for 2007–2012. This reflects recent improvements in data quality and completeness of the Trade Register, and the challenges associated with the introduction of new data collection templates in 2012.

In the export finance element of the Trade Register, the following filters are applied for the purpose of the default rate analysis:

- ECA filter: as transactions in which an OECD ECA has provided a guarantee or insurance are in scope of the export finance element of the Trade Register, the ECA filter excludes transactions without information about the ECA or the level of political or commercial coverage
- Year and default filter: to establish analytical integrity, each default is considered once in the database (in the year that default occurs); this filter excludes defaulted transactions reported in multiple years and any transactions with misaligned dates (e.g. a default date prior to the trade date)
- Customer and transaction data quality filter: to measure customer and transaction default rates accurately, any transactions without unique customer or transaction IDs are excluded. This filter also excludes transactions with other data quality reasons such as zero exposure values or missing country or asset category information

Given the long-term character of export finance transactions, data submissions always cover multiple years on a transaction-by-transaction basis. This was the fifth year in which Member Banks submitted data to the export finance element of the Trade Register, after initial submissions in 2012 asked participants to submit data back to 2007. Significant effort has been put into comparing submissions from different years and appropriate cleansing to arrive at a consistent year-after-year data set for individual transactions. Ultimately a coherent data set covering export finance data from 2007–2018 has been derived. In the last five years, the Trade Register has experienced a healthy increase in the number of transactions and the number of banks participating and this trend is expected to continue.

APPENDIX C: DETAILED ANALYSIS TABLES

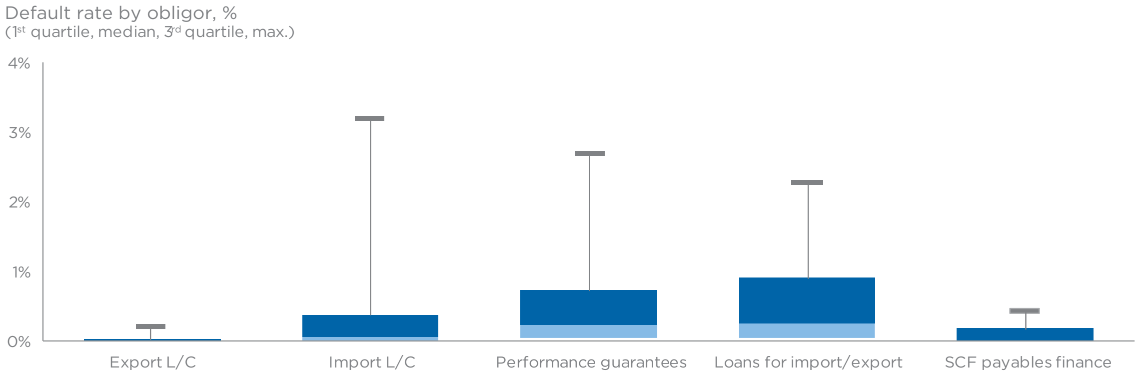
Trade Finance

Default Rate Analysis

Figure 60:
Total customers and default rate by loan sub-product, 2008–2018

Loan sub-product	Obligors	Defaulting obligors	Default rate
Loans for import/export (Bank & Corp.)	331,683	2,419	0.729%
Loans for import (Bank & Corp.)	131,407	1,175	0.894%
Loans for export (Bank & Corp.)	119,892	859	0.716%
Loans for import/export (Bank)	69,270	108	0.156%
Loans for import/export (Corp.)	262,413	2,311	0.881%

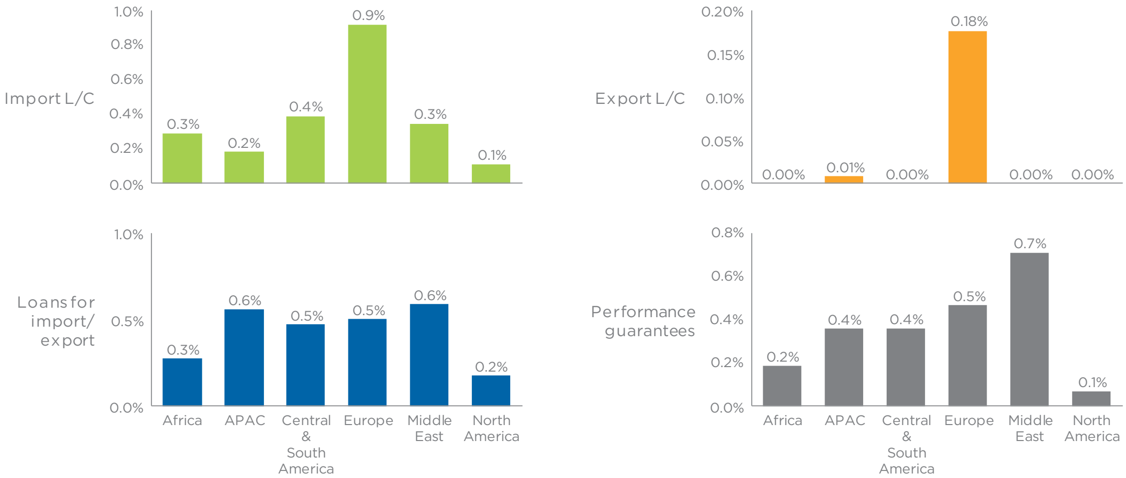
Figure 61:
Variance of obligor default rates across banks by product, 2008–2018



Source: ICC Trade Register 2019

Figure 62:

Obligor-weighted default rates by product and region, 2008–2018



Source: ICC Trade Register 2019

Figure 63:

Import L/Cs obligor-weighted default rates by region, 2014–2018

	2014	2015	2016	2017	2018
Africa	0.39%	0.20%	0.48%	0.14%	0.29%
APAC	0.39%	0.32%	0.30%	0.20%	0.18%
Central & South America	0.45%	0.37%	0.52%	0.26%	0.39%
Europe	0.80%	2.03%	1.18%	1.38%	0.92%
Middle East	0.61%	0.23%	0.83%	0.19%	0.35%
North America	0.10%	0.75%	0.27%	0.43%	0.11%
Other	0.00%	0.00%	2.62%	0.00%	0.00%
Total	0.43%	0.50%	0.48%	0.31%	0.29%

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Figure 64:
Import L/Cs exposure-weighted default rates by region, 2014–2018

	2014	2015	2016	2017	2018
Africa	0.02%	0.02%	0.02%	0.01%	0.02%
APAC	0.12%	0.10%	0.02%	0.05%	0.13%
Central & South America	0.02%	0.00%	0.01%	0.01%	0.01%
Europe	0.11%	0.13%	0.09%	0.29%	0.28%
Middle East	0.67%	0.02%	0.11%	0.07%	0.02%
North America	0.03%	0.27%	0.00%	0.14%	0.00%
Other	0.00%	0.00%	0.00%	0.00%	0.00%
Total	0.13%	0.11%	0.03%	0.08%	0.14%

Figure 65:
Export L/Cs obligor-weighted default rates by region, 2014–2018

	2014	2015	2016	2017	2018
Africa	0.057%	0.088%	0.586%	0.049%	0.000%
APAC	0.016%	0.025%	0.009%	0.018%	0.000%
Central & South America	0.000%	0.858%	0.000%	0.232%	0.000%
Europe	0.093%	0.314%	0.000%	0.054%	0.000%
Middle East	0.000%	0.000%	0.000%	0.000%	0.000%
North America	0.113%	0.000%	0.000%	0.000%	0.000%
Other	0.000%	0.000%	0.000%	0.000%	0.000%
Total	0.029%	0.082%	0.057%	0.029%	0.000%

APPENDICES

Figure 66:
Export L/Cs exposure-weighted default rates by region, 2014–2018

	2014	2015	2016	2017	2018
Africa	0.002%	0.007%	0.270%	0.000%	0.000%
APAC	0.002%	0.007%	0.001%	0.001%	0.000%
Central & South America	0.000%	0.197%	0.000%	0.002%	0.000%
Europe	0.064%	0.971%	0.000%	0.027%	0.000%
Middle East	0.000%	0.000%	0.000%	0.000%	0.000%
North America	0.003%	0.000%	0.000%	0.000%	0.000%
Other	0.000%	0.000%	0.000%	0.000%	0.000%
Total	0.014%	0.107%	0.010%	0.004%	0.000%

Figure 67:
Loans for import/export obligor-weighted default rates by region, 2014–2018

	2014	2015	2016	2017	2018
Africa	2.403%	0.276%	1.471%	0.131%	0.274%
APAC	0.866%	0.855%	0.812%	0.433%	0.559%
Central & South America	3.665%	2.285%	0.887%	0.474%	0.470%
Europe	1.084%	0.929%	0.630%	0.564%	0.502%
Middle East	1.894%	0.942%	1.722%	0.544%	0.589%
North America	2.269%	2.787%	0.584%	0.104%	0.176%
Other	0.066%	0.000%	1.068%	0.000%	0.000%
Total	1.098%	0.931%	0.878%	0.437%	0.529%

Figure 68:
Loans for import/export exposure-weighted default rates by region, 2014–2018

	2014	2015	2016	2017	2018
Africa	0.448%	0.061%	1.192%	0.132%	0.044%
APAC	0.180%	0.334%	0.289%	0.080%	0.074%
Central & South America	1.053%	0.510%	0.899%	0.042%	0.236%
Europe	0.054%	0.082%	0.137%	0.038%	0.028%
Middle East	0.305%	0.691%	0.436%	0.116%	0.053%
North America	0.290%	0.259%	0.018%	0.003%	0.006%
Other	0.107%	0.000%	0.092%	0.000%	0.000%
Total	0.228%	0.318%	0.291%	0.067%	0.057%

Figure 69:
Performance guarantee obligor-weighted default rates by region, 2014–2018

	2014	2015	2016	2017	2018
Africa	0.316%	0.330%	0.333%	0.147%	0.187%
APAC	0.369%	0.386%	0.267%	0.414%	0.358%
Central & South America	0.958%	2.477%	0.797%	0.527%	0.359%
Europe	1.159%	0.941%	0.714%	0.450%	0.467%
Middle East	0.735%	0.126%	0.336%	0.636%	0.709%
North America	0.194%	0.711%	0.451%	0.817%	0.068%
Other	0.736%	0.000%	0.000%	0.000%	0.000%
Total	0.606%	0.613%	0.446%	0.444%	0.385%

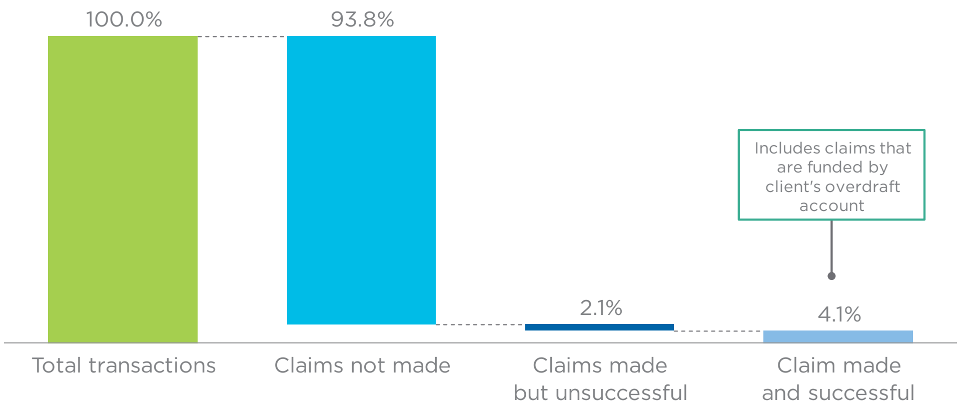
Figure 70:

Performance guarantee exposure-weighted default rates by region, 2014–2018

	2014	2015	2016	2017	2018
Africa	0.110%	0.524%	0.044%	0.363%	0.743%
APAC	0.038%	0.307%	0.168%	0.264%	0.263%
Central & South America	0.324%	2.518%	1.654%	0.037%	0.393%
Europe	0.127%	0.602%	0.537%	0.178%	0.246%
Middle East	0.386%	0.159%	0.036%	0.181%	0.250%
North America	0.146%	0.308%	1.762%	0.563%	0.009%
Other	0.156%	0.000%	0.000%	0.000%	0.000%
Total	0.131%	0.382%	0.550%	0.248%	0.242%

Loss Given Default and Expected Loss Analysis

Figure 71:
Average "event likelihood" in the life of a performance guarantee, 2008-2018



Source: ICC Trade Register 2019

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Figure 72:
Average time to recovery in days and years, 2008-2018

Product	TTR - days	TTR - years
Import L/C	184	0.50
Export L/C	111	0.30
Loans for import/export	123	0.34
Performance guarantees	66	0.18

Figure 73:
Cumulative recoveries and exposure weighted recovery rates, 2008-2018

Product	Cumulative recoveries (USD K)	Balance at default (USD K)	Recovery rate
Import L/C	225,346	299,363	75%
Export L/C	125,504	186,087	67%
Loans for import/export	888,550	1,342,690	66%
Performance guarantees	196,102	388,505	50%

Figure 74:
Exposure-weighted recovery rate range across banks, 2008-2018

Product	Minimum	Maximum
Export L/C	0.5%	100.0%
Import L/C	51.3%	100.0%
Loans for import/export	7.5%	91.7%
Performance guarantees	0.0%	101.7%

Figure 75:
Transaction-weighted recovery rate, 2008-2018

Product	Recovery rate
Export L/C	81.7%
Import L/C	92.7%
Loans for import/export	60.5%
Performance guarantees	75.7%

Figure 76:
Exposure-weighted LGD by product (discount rate sensitivity adjusted), 2008-2018

			Discounted recoveries & costs (at 2%)			LGD		
Product	**Recovery rate**	**TTR - years**	**5%**	**9%**	**13%**	**5%**	**9%**	**13%**
Import L/C	75%	0.50	1.8%	3.2%	4.5%	28.6%	29.9%	31.2%
Export L/C	67%	0.30	1.0%	1.7%	2.5%	35.5%	36.3%	37.0%
Loans for import/export	66%	0.34	1.1%	1.9%	2.7%	36.9%	37.7%	38.5%
Performance guarantees	50%	0.18	0.4%	0.8%	1.1%	52.0%	52.3%	52.6%

Figure 77:
Expected Loss calculation by product, 2008-2018

		Default rate		EAD	LGD (9% discount rate)	Expected Loss		
Product	Exposure-weighted	Obligor-weighted	Transaction-weighted			Exposure	Obligor	Transaction
Import L/C	0.08%	0.36%	0.16%	100.0%	29.9%	0.02%	0.11%	0.05%
Export L/C	0.03%	0.04%	0.01%	100.0%	36.3%	0.01%	0.01%	0.00%
Loans for import/export	0.17%	0.73%	0.22%	100.0%	37.7%	0.07%	0.28%	0.08%
Performance guarantees	0.25%	0.45%	0.16%	4.1%	52.3%	0.01%	0.01%	0.00%

Export Finance

Default Rate Analysis: By Asset Category

Figure 78:
Obligor-weighted default rates by asset category, 2007-2018

Asset	Total obligors	Defaulting obligors	Default rate
Corporate	10,261	121	1.18%
FI	3,758	52	1.38%
Sovereign	2,376	11	0.46%
Specialised	3,876	19	0.49%
Total	20,271	203	1.00%

Figure 79:
Transaction-weighted default rates by asset category, 2007-2018

Asset	Total transactions	Defaulting transactions	Default rate
Corporate	21,300	227	1.07%
FI	7,858	115	1.46%
Sovereign	6,806	26	0.38%
Specialised	9,839	57	0.58%
Total	45,803	425	0.93%

Figure 80:
Exposure-weighted default rates by asset category, 2007-2018

Asset	Total exposures (USD K)	Defaulting exposures (USD K)	Default rate
Corporate	415,138,039	3,179,769	0.77%
FI	52,358,573	630,636	1.20%
Sovereign	135,812,545	366,121	0.27%
Specialised	171,451,133	645,285	0.38%
Total	774,760,291	4,821,812	0.62%

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Default Rate Analysis: By Region

Figure 81:
Obligor-weighted default rates by region of risk, 2007-2018

Region	Total obligors	Defaulting obligors	Default rate
Africa	2,056	19	0.92%
APAC	3,815	21	0.55%
Central & South America	2,451	28	1.14%
Europe	4,078	30	0.74%
ex-CIS	4,461	55	1.23%
Middle East	1,572	35	2.23%
North America	1,807	15	0.83%
Total	20,240	203	1.00%

Figure 82:
Transaction-weighted default rates by region of risk, 2007-2018

Region	Total transactions	Defaulting transactions	Default rate
Africa	5,397	45	0.83%
APAC	10,541	75	0.71%
Central & South America	5,806	45	0.78%
Europe	8,712	52	0.60%
ex-CIS	7,335	98	1.34%
Middle East	4,227	84	1.99%
North America	3,730	26	0.70%
Total	45,748	425	0.93%

Figure 83:
Exposure-weighted default rates by region of risk, 2007-2018

Region	Total exposures (USD K)	Defaulting exposures (USD K)	Default rate
Africa	86,212,775	715,480	0.83%
APAC	180,396,923	707,794	0.39%
Central & South America	111,051,873	732,781	0.66%
Europe	156,768,786	554,367	0.35%
ex-CIS	77,901,941	779,954	1.00%
Middle East	79,491,812	665,997	0.84%
North America	81,405,967	665,439	0.82%
Total	773,230,077	4,821,812	0.62%

APPENDIX D: LIST OF ACRONYMS

ADB	Asian Development Bank
A/F-IRB	Advanced / Foundation-Internal Ratings-Based Approach
AML	Anti-Money Laundering
APAC	Asia-Pacific
ASEAN	Association of Southeast Asian Nations
BCBS	Basel Committee on Banking Supervision
BPS	Basis Point(s)
CAGR	Compound Annual Growth Rate
CCAR	Comprehensive Capital Analysis and Review
CCF	Credit Conversion Factor
CIS	Commonwealth of Independent States
EAD	Exposure At Default
ECA	Export Credit Agency
EL	Expected Loss
EU	European Union
FI	Financial Institution
GDP	Gross Domestic Product
IFRS	International Financial Reporting Standards
ICC	International Chamber of Commerce
IMF	International Monetary Fund
KYC	Know Your Customer
L/C(s)	Letter(s) of credit
LGD	Loss Given Default
MENA	Middle East and North Africa
MFW	Maturity Floor Waiver
NAFTA	North American Free Trade Agreement
NSFR	Net Stable Funding Ratio
OECD	Organisation for Economic Co-operation and Development
PD	Probability of Default
RWA	Risk Weighted Assets
SA	Standard Approach
SME	Small and Medium-Sized Enterprises
UCC	Unconditionally Cancellable Commitment
UNGA	United Nations General Assembly
WTO	World Trade Organization

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The International Chamber of Commerce (ICC) is the world's largest business organization representing more than 45 million companies in over 100 countries. ICC's core mission is to make business work for everyone, every day, everywhere. Through a unique mix of advocacy, solutions and standard setting, we promote international trade, responsible business conduct and a global approach to regulation, in addition to providing market-leading dispute resolution services. Our members include many of the world's leading companies, SMEs, business associations, and local chambers of commerce.

Rules

The ICC Banking Commission produces universally accepted rules and guidelines for international banking practice. ICC rules on documentary credits, UCP 600, are the most successful privately drafted rules for trade ever developed, serving as the basis of USD 2 trillion trade transactions a year.

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The ICC Banking Commission is helping policymakers and standard setters to translate their vision into concrete programs and regulations to enhance business practices throughout the world.

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Used by banking professionals and trade finance experts worldwide, ICC Banking Commission publications and market intelligence are the industry's most reputable and reliable sources of guidance to bankers and practitioners in a broad range of fields.

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The APPG for Trade and Export Promotion is always on the lookout for new partners and supporters. If you would like to get involved with the work of the APPG please email: secretariat@appgtrade.uk

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