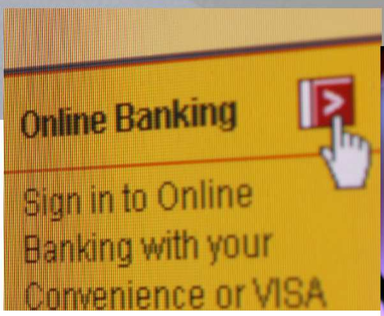
An ICC Banking Commission Market Intelligence Report


# Global Survey




# Rethinking Trade Finance 2010

International Chamber of Commerce
*The world business organization*

# Key Messages

- **The ICC Global Survey is the first survey to ensure full representation and comprehensive coverage for the industry**

  This 2010 ICC Global Survey has received responses by representatives of 161 banks located in 75 countries. This represents a 32% increase over the 2009 Survey in the number of banks that have given their opinions and statistics concerning the current trade finance landscape for their respective countries. Since the Survey attracted comments from an additional 16 countries, when compared with the 2009 Survey, the results are displayed on a global basis rather than having comparisons drawn between responses from banks located in Europe, Asia and North America, which were the major contributors to the 2009 Survey. This Survey has taken the lead in providing key data on trade finance markets worldwide

- **The global economy contracted sharply in 2009 and signs of recovery are still uncertain**

  Global GDP declined by 2.2% in 2009, while the rate of growth in developing countries decelerated to 1.2% in 2009 from 5.6% in 2008. World trade has been a casualty of the financial crisis, contracting in volume terms by around 12% in 2009 according to the World Trade Organization. Compounding the fall in demand from developed countries, developing countries became more vulnerable in 2009 because of a decline in foreign direct investment and remittance inflows. In aggregate, the crisis has prompted a narrowing of global imbalances due to an overall decline in the volume of trade, falling oil prices and a narrowing of China's and the United States' trade imbalances.

- **The supply of trade finance remains constrained both in value and volume**

  The economic crisis has significantly reduced the supply of trade finance, both in volume and value terms, raising fears that the lack of such finance may prolong the recession. The SWIFT trade messaging figures show that the downward trend in volumes experienced in 2008 continued in 2009, with a total of about 46 million messages in 2008 falling to 42 million in 2009. This Survey confirms this trend:

  - In terms of value, some 60% of respondents indicated that the value of trade finance activity had decreased between 2008 and 2009, mainly due to lower commodity prices, the weak USD and debt restructuring processes in 2009; and

  - In terms of volume, 43% of the financial institutions responding continued to report a decrease in export Letters of Credit (L/C) volume, although this is down from 47% in last year's Survey. On the import side, 26% continued to report a decrease in import L/C volume (with 51% seeing no change from 2008).

- **Some regions and sectors show resilience**

  ICC notes that the trade slump was less marked in some regions, in particular in Asian countries. SWIFT data show that the Asia/Pacific region continues to register far greater volumes for both sent (Import) and received (export) messages. Most Chinese trade partners benefited from a fiscal stimulus and the rebound in Chinese imports. The effect of the "great trade collapse" has been more pronounced in certain sectors and products than in others. Exports of durable goods have been the most affected, while trade in non-durable consumer goods such as clothing and food have declined least, as basic demand for these products cannot be put off as long. In general, services trade has been more resilient than merchandise trade.

- **Despite evidence of a lower level of losses, financial institutions are continuing to cut trade credit lines**

  Although the great majority of respondents (96%) indicated that the level of losses incurred in traditional trade products were the same or lower than losses for general banking facilities, banks are still continuing to cut trade credit lines for corporate and financial Institutions. Some 42% of respondents indicated that financial institution credit lines had decreased in 2009, this in addition to the significant decreases that had been the case in 2008.The tightening of trade finance in 2009 is said to be due to the higher lending costs and risk premiums resulting from rising liquidity pressures, scarcity of capital, increased capital requirements and heightened risk aversion to trade finance providers and banks for counterparty and country risks.

- **Demand is still high, but access to affordable trade finance is still constrained**

  Demand for bank undertakings is still strong, with 50% of respondents indicating that demand was increasing for traditional trade finance instruments offering solutions to substantially reduce risks for both exporters and importers. But the pricing of trade finance remains high. The costs remain substantially higher than they were pre-crisis, raising the problem of affordability for exporters. Around 30% of respondents indicated that there had been an increase in fees for commercial letters of credit, standbys and guarantees in 2009. This widespread increase in pricing is said to reflect higher funding costs, increased capital constraints and greater counterparty risk. However, the banking industry appears to believe that the prevailing high fees are an affordable cost, given the additional security that L/Cs and other undertakings offer the parties. SMEs and exporters in emerging markets appear to be facing the greatest difficulties in accessing affordable credit.

- **There is still intense scrutiny of documents, leading to high number of refusals and court injunctions**

  Discrepancies in documents are still on the increase. The Survey results show that 34% of respondents had seen an increase in the number of refusals, up from 30% in 2009. The number of respondents that had seen an increase in spurious or doubtful discrepancies remained high at 44% (48% last year). This trend toward claiming discrepancies that effectively have little or no foundation is worrisome and may prove damaging to the integrity of the documentary credit as a viable means for settlement in international trade. Claims made under standby L/Cs and guarantees surged in 2009. Some 44% of respondents indicated that they had seen an increase in the number of claims received, up from 30% in the 2009 Survey.

- **Level of risk keeps distorting the supply of trade finance**

  Banks continued to report that customers are asking for confirmed letters of credit where they previously dealt with unconfirmed L/Cs, under documentary collections or open account. However, bank perception of risk is leading to a tightening of liquidity in some instances and therefore greater difficulty in obtaining bank undertakings. In 2010, this situation still prevails.

- **Banks are still facing tougher capital requirements for their trade assets**

  Promoting the availability of trade finance was a key theme of the G20 London Summit agenda to support a global recovery. However, evidence is continuing to accumulate that the implementation of the existing capital adequacy regime, at a time when the world is experiencing a global recession, is contributing to the drought of available finance. ICC members also noted that in late 2009 the Basel Committee on Banking Supervision approved for consultation a package of proposals to strengthen global capital and liquidity regulations with the goal of promoting a "more resilient" banking sector. Concerns were noted that the proposal to increase the risk weighting of trade finance under a new framework to limit bank leverage would adversely impact the supply of cost-effective trade credit to businesses. It appears that low-risk trade finance instruments are being lumped together with higher risk off balance sheet items, without an appreciation of the unintended consequences.

- **Trade facilitation programs prove to be a valuable trade support**

  Respondents, including many ICC Banking Commission members, underscore the importance of targeted temporary financing and, in some cases, agreements with international banks, to address liquidity shortages and problems of risk perception. Many respondents reported that the G20 decision to support USD 250 billion worth of trade over a two-year period was a major step towards alleviating the shocks to trade resulting from the financial crisis. Indeed, business has appreciated the measures taken in recent months by export credit agencies, regional development banks and international banks, particularly in the following areas: 1°) trade facilitation programs; 2°) trade guarantees facilities; 3°) increase of financial liquidity pools; and 4°) improvement of export insurance processes.

## Murky trade protectionism is still a persistent problem

The G20 countries' communiques at the Washington, London and Pittsburgh Summits in 2009 provided assurances that governments would refrain from employing discriminatory trade measures. Protectionist responses included tariff increases, non-tariff barriers, trade remedies such as anti-dumping and countervailing measures, domestic subsidies and restrictions on international capital flows and migration. Yet since the onset of the crisis, many countries have veered towards policies that favour domestic products over foreign imports. Many of these are policies aimed at stimulating domestic demand and economic activity, and may have also benefited trading partners when applied on a non-discriminatory basis. Protectionist measures should be resisted, as they curtail trade flows and add to the adverse effects of the global recession on individual country exports, economic activity and unemployment.

## Outlook for 2010 and beyond

Prospects for a strong, lasting, trade recovery were reported to be mixed. The global economy is showing a few signs of recovery, but some major risks remain and we must caution against being overly optimistic. Advanced indicators of trade developments underscore the fragility of the current recovery. For instance, the Baltic Dry Index (BDI) and air freight traffic point to a fragile rebound. Respondents to the Survey asserted that the demand for traditional trade finance products (commercial L/Cs, standby letters of credit, guarantees and collections) would be sustained in 2010. Indeed, 84% of respondents indicated that they anticipated an increase in demand for traditional trade products in 2010, 93% of the respondents were confident that they could meet any increased demand for these products from their client base in 2010.

## Recommendations

The 2010 ICC Survey has confirmed that the current global financial crisis continues to affect financial institutions and markets worldwide. Looking ahead, problems are still expected to hamper the availability of trade finance. For that reason, it is essential that sustained attention be given to the implementation of the G20 trade finance agenda with a view to fostering further improvements in bank finance capacity. Specific recommendations include:

- Filling the information gap in trade finance, in particular in terms of business performance data evidencing the loss history of different trade finance risk categories;

- Improving the resilience of the supply of trade finance in periods of financial instability:

    - To do so, it is important to further enlarge multilateral trade finance programs in order to expand both capacity and coverage, especially for low-income and export-dependent countries;
    - At the same time, national programs should be reinforced to guarantee the flow of trade in times of economic stress and to provide refinancing options, in particular through Export Credit Agencies (ECAs). The latter could also develop more direct lending schemes to emerging markets and could engage in sub-participation in bank lending; and

- Applying appropriate changes to the Basel II framework to allow more proportionate capital weightings for traditional trade finance transactions. In addition, the private sector should be fully represented in the drafting of the new capital adequacy regime through a trade finance working group which could present its research and findings to Basel decision makers for their consideration.

The International Chamber of Commerce (ICC) thanks
its partners and sponsors
for their support in the preparation of this Survey

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# List of Acronyms

| | |
|---|---|
| **ADB** | Asian Development Bank |
| **BAFT** | Bankers Association for Finance and Trade |
| **BCBS** | Basel Committee on Banking Supervision |
| **BIS** | Bank of International Settlement |
| **Bp** | Basis Point |
| **BRIC** | Fast-growing developing economies of Brazil, Russia, India, and China |
| **CCF** | Credit Conversion Factor |
| **DCI** | ICC's quarterly newsletter, *DCInsight* (ICC Publication) |
| **EBRD** | European Bank for Reconstruction and Development |
| **ECA** | Export Credit Agency |
| **GDP** | Gross Domestic Product |
| **ICC** | International Chamber of Commerce |
| **IDB** | Inter-American Development Bank |
| **IFC** | International Finance Corporation |
| **IFSA** | International Financial Services Association |
| **ILO** | International Labor Organization |
| **IMF** | International Monetary Fund |
| **L/C** | Letter of credit |
| **LGD** | Loss given default |
| **MDB** | Multilateral Development Bank |
| **MDGs** | Millennium Development Goals |
| **MIC** | Middle-Income Countries |
| **PRC** | People’s Republic of China |
| **SME** | Small and Medium-sized Enterprise |
| **SWIFT** | Society for Worldwide Interbank Financial Telecommunication |
| **UCP** | Uniform Customs and Practices for Documentary Credits (ICC Rules) |
| **UK** | United Kingdom |
| **USD** | United States Dollar |
| **WTO** | World Trade Organization |

# Foreword

## by Victor K. Fung

ICC is delighted to present the findings of the 2010 Global Survey on Trade Finance conducted by the Banking Commission of the International Chamber of Commerce (ICC). The Survey is the third in a series of these ICC Surveys: the first was conducted in March 2009 and the second in September 2009. Taken in sum, the three offer a wide-ranging overview of global trade finance markets.

The idea for the Survey was conceived in 2008 when ICC was asked by the World Trade Organization to provide data that could feed into the G20 meeting of world leaders at their first economic Summit. It was recognized that world trade was essential to the economic recovery and that the availability of trade finance was key to the smooth functioning of trade flows, as at least 90% of world trade is supported by some form of trade finance. As a result of information compiled from the Survey and other sources, world leaders, meeting in London, pledged USD 250 billion in support of trade finance.

The Survey is a continuation of ICC's long series of actions in support of international trade. Since its inception more than 90 years ago, ICC has affirmed its founders' vision to promote trade as a path to world peace and prosperity. In pursuing that objective, ICC has consistently advocated a fair and rules-based multilateral trading system that would work to the benefit of nations at all levels of development. In recent years, ICC has emphasized the imperative of concluding the Doha Round of trade talks and on continuing the fight against protectionism.

The 2010 Survey contains evidence that international trade finance is beginning to stabilize but that significant challenges remain. The recovery is taking place, but at variable speeds depending on the continent and region. While China and some other Asian nations are experiencing a strong economic upturn, Europe still lags behind and the United States is experiencing a more modest return to growth.

More than ever, the level of activity in trade finance markets is crucial to global economic recovery. Limited access to trade finance significantly curbs import/export activity, one of the principal drivers of economic growth.

With regard to trade finance, the ICC Banking Commission, consisting of more than 500 members from 85 countries, has been an active forum, debating and voicing concern about the ramifications of Basel II international capital adequacy regime, which would impose unrealistic capital requirements on trade finance transactions. In partnership with leading international organizations, including the World Trade Organization and the Asian Development Bank, the Banking Commission has been developing the tools to bridge the information gap and collect the performance data and information necessary to support a new generation of regulations that will strengthen the banking sector and international trade.

The information in the 2010 Survey, the result of fruitful cooperation between ICC and a range of international organizations, should be useful both to business and policymakers as they consider ways to enhance support for international trade and to restore vigorous economic growth.

I am confident that if business and government address our challenges in a forthright manner we will emerge even stronger in the years to come.

Victor K. Fung
Chairman, ICC

# Foreword

by Pascal Lamy

2009 has not been a good year for international trade. As a result of the dramatic drop in consumption, global trade flows contracted by 12% in volume. At the peak of the crisis, we recorded a fall in world trade volume superior to 20% year-on-year. The situation could have been worse if various partners, including G20 governments, multilateral financial institutions, regional developments banks and export credit agencies had not designed a package of measures aimed at injecting additional liquidity and bringing public guarantees in support of USD250 billion of trade transactions in 2009 and 2010.

Given that an overwhelming share of trade transactions involve some kind of credit, insurance or guarantee, it is fair to say that supply side shortages of trade finance would have inflicted even further damage to international trade.

At the outset of the crisis, the WTO became concerned with occurrences of market tightening. This is why, since the fall of 2008, we stepped in to mobilize public institutions to increase resources for trade finance, in partnership with commercial institutions.

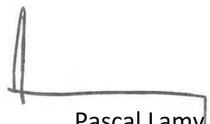
The WTO Expert Group on Trade Finance regularly convened various partners such as the Berne Union, regional development banks, sister multilateral agencies, and last but certainly not least, the International Chamber of Commerce (ICC) to analyze market trends, understand the causes of the shortage of trade finance, and devise cooperative solutions in which public institutions would help private sector financial institutions shoulder the risk of operating in a more unstable financial environment.

ICC provided key contributions to this process. In the absence of a comprehensive set of international statistics for trade finance, the ICC Banking Commission undertook major market intelligence Surveys on trade finance, taking advantage of its large membership across the world. The results of the first Survey relied on a robust participation of 122 banks in 59 countries. Its presentation ahead of the G20 Summit in London contributed to help leaders take informed decisions on a support package for trade finance.

ICC also pleaded for the application of fair prudential rules for trade finance, in recognition of its safe, mainly short-term, and self-liquidating character. It undertook to work with other members of the WTO Expert Group, namely the Asian Development Bank, to develop an International Trade Credit (Loss) Register. This initiative was useful in providing evidence that trade finance is safe and worth promoting, and it will hopefully help regulators as they review the Basle II rules.

I therefore welcome the publication of the ICC Banking Commission's new market intelligence Survey on trade finance focusing on developments in 2009, as well as the upcoming presentation of progress on the Trade Register, as useful inputs in our efforts to improve the conditions for a good functioning of the trade finance market.

I take this occasion to thank ICC for their contribution to the work of the WTO Expert Group on Trade Finance and count on their continued involvement in the course of 2010.



Pascal Lamy,
Director-General, World Trade Organization

# Summary Assessment

by Gary Collyer

This second ICC Global Survey has received responses from representatives of 161 banks in 75 countries. This represents a 32% increase in the number of banks that have given their thoughts, opinions and statistics concerning the current trade finance landscape in their respective countries.

Because the Survey attracted comments from an additional 16 countries, when compared with the 2009 Survey, the results are displayed on a global basis rather than drawing comparisons between responses from banks in Europe, Asia and North America, which were the major contributors to the 2009 Survey.

The comments compare results from the 2009 and 2010 Surveys. They also highlight some evolving trends in the trade finance market place.

Some 44% of the replies were received from banks having global representation, 42% from a bank located in one country and 14% from those having operations in a number of countries, but within the same geographic region. Of the respondents, 86% indicated that their bank processed all transactions in-house, with only 1% reporting that all of their trade processing had been outsourced.

Of the 13% responding that they had outsourced some processing, 21% said they are considering outsourcing the remainder within the next two years. Of the 86% that had not outsourced any processing, 9% are considering some form of outsourcing in the next two years. The decisions to outsource are clearly driven by a desire to bring down costs and manage what can be highly unpredictable trends in trade volumes.

The bottom line is that the trade finance market is shrinking with a small number of banks managing the vast majority of transactions.

Whilst this Survey specifically focuses on traditional trade finance products that involve a bank undertaking, such as commercial letters of credit, guarantees and standby letters of credit, figures submitted by the respondents show an increase to 15% (from 13%) of the overall number of export transactions that are classified as open account. The figure for open account import transactions remained at 12%. As reported in the last Survey, these figures are very low considering the whole scheme of trade finance and reflect that open account transactions are processed apart from the traditional trade products.

The results for documentary collections show a reduction to 20% of export transactions and 16% of import transactions handled using this instrument. These reductions are supported by SWIFT data that evidence documentary collection messages (cat 4), as a total of all trade message traffic, being reduced by almost two million messages between 2008 and 2009. Similarly, documentary credit messages (cat 7) also declined by almost two million messages during the same period.

Demand for bank undertakings is still strong, with 50% of respondents indicating that demand was increasing. Unfortunately, 27% of these respondents reported they were unable to meet the demand of their clients due to reductions in financial Institution and corporate credit lines.

The views expressed on the risk rating of traditional trade products show that 59% of the respondents considered their trade finance losses to be significantly less than those experienced under general banking facilities, with the overwhelming figure of 96% reporting that the level was the same, slightly less, moderately less or significantly less.

This message reinforces the one made to regulators in the last Survey concerning the need to reform the current guidelines in order to stimulate the marketplace and encourage banks to actively participate in the level of traditional trade products volume that pre-dates that of Q4 2007.

Despite continuing evidence of the very low level of losses for traditional trade products, when compared to general banking products, it would appear that banks are continuing to cut trade credit lines for corporate and financial Institutions. The results show that 42% of respondents reported that financial institution credit lines had declined in 2009, this in addition to the significant decline that was reported in 2008.

This reduction in trade credit lines has been in the face of an increased demand for the issuance of bank undertakings, such as letters of credit, guarantees and standby letters of credit, including confirmation requests as mentioned below.

More stringent credit criteria, selective exiting of customer relationships due to credit deterioration, exiting of markets and credit allocation restrictions were the main reasons cited for the declines. As a result, 59% of respondents indicated that they had seen a decline in the value of trade finance activity during the course of 2009.

Demand for commercial L/C confirmation requests continues to increase substantially, with 73% of respondents reporting that they had experienced demand from exporters for this form of payment security. This figure is up from 52% of respondents in the 2009 Survey. Over 30% of the banks reported that their fees for confirmation had increased in 2009; this was in addition to significant increases that were reported between Q4 2007 and Q4 2008. Taking account of the further increases in confirmation fees in 2009, 75% of the respondents said they did not foresee any further increases in 2010.

Discrepancies in documents are still on the rise. The Survey results show that 34% of respondents had seen an increase in the number of refusals, up from 30% in 2009. The number of respondents seeing spurious or doubtful discrepancies declined from 48% to 44%, although this still represents a very high percentage of discrepancies that have little or no foundation and which are seriously damaging the integrity of the documentary credit as a viable means of settlement in international trade. When banks were acting in the role of issuing bank, applicant pressure to refuse documents due to falling commodity prices was still a major factor.

Whilst notices of refusal can be sent in a variety of ways, SWIFT has provided the following data with respect to the use of the MT734 messages (Notice of Refusal) when compared with the number of MT700 messages (Issuance of a Documentary Credit) sent in the years 2007, 2008 and 2009:

- The MT734 use represented 25% of the number of MT700s sent;
- The MT734 use represented 30% of the number of MT700s sent; and
- The MT734 use represented 26.5% of the number of MT700s sent

These figures highlight the refusal messages sent bank to bank and do not take account of the often-quoted 70-75% of refusals that are sent between the nominated bank and the beneficiary on first presentation of documents. They also do not account for refusals sent using SWIFT message type 799 or other forms of messaging.

Of the respondents, 11% reported that in 2009 they had taken the initiative to return discrepant documents without first seeking a waiver from the applicant. This is counter to the usual trend of returning the documents only when all else fails, i.e. when the applicant is requested, and then refuses, to grant a waiver of the discrepancies. Returning the documents without first seeking a waiver indicates that in a number of cases the issuing bank was unwilling to extend further credit to the applicant and used supposedly discrepant documents as a means of justifying this refusal.

Claims made under standby L/C and guarantees surged in 2009. Of the respondents, 44% reported they had seen an increase in the number of claims received, up from 30% in the 2009 Survey. Another area of concern is the rise in the number of court injunctions that stop payment for bank undertakings. This figure, reported by 23% of respondents, is almost double that indicated in the 2009 Survey (12%).

On a positive note, 84% of respondents (an increase of 13% on 2009) reported that in 2010 they expected an increase in demand for traditional trade products. This may be optimistic, but it demonstrates a willingness of banks to listen to the needs of their customers and hopefully to meet those needs. However, this information needs to be balanced against reductions in credit lines and in the declining availability of credit.

The results of last year's Survey were delivered ahead of the G20 Summit in London in 2009 and helped world leaders create a substantial package of measures to support trade flows – including additional funding of at least USD250 billion over the following two years. This Survey will also be delivered to the Heads of State and Ministers at the next G20 meeting scheduled for Toronto on 26-27 June 2010.

The results and feedback in this Survey demonstrate that there is a long way to go before trade finance attains the level and scope of pre-Q4 2008 days.

Gary Collyer
ICC Banking Commission Technical Adviser

# Acknowledgements

The ICC Survey would not have been possible without the pathfinding work done during 2007-2010 by the ICC Banking Commission. We would like to thank Gary Collyer, Technical Adviser of the Banking Commission; Vincent O'Brien, Banking Commission Representative to the WTO Group of Experts; and Leo Cullen of Coastline Solutions for their timely inputs to this report. Ron Katz, the Editor of ICC's quarterly newletter, *DCINSIGHT*, has reviewed the document with great care and made numerous valuable suggestions.

We would like to express our gratitude to ICC's network of 92 national committees for providing information and advice to lead us through the often-complex process of conducting such a global survey. In particular, we would like to thank ICC UK and Andrew Wilson for their support.

The present report would not have been possible without the support of various experts from different organizations outside ICC. Marc Auboin of the World Trade Organization was instrumental in requesting that this work be conducted. We would like to extend our special thanks to our partners to this survey: Jean-Pierre Chauffour and Mariem Malouche of The World Bank Group; Steven Beck of the Asian Development Bank; Rudolf Putz of the European Bank for Reconstruction and Development; Bonnie Galat and Rogers LeBaron of the International Finance Corporation; Daniela Carrera Marquis of the Inter-American Development Bank; and Dan Taylor of BAFT-IFSA.

SWIFT once again graciously provided background information and contemporaneous data on trade finance messaging volumes worldwide. Fabrice Morel from the Berne Union provided the much-needed analysis on credit insurance.

More than ever, we renew our thanks to ICC's technology partner, Coastline Solutions, for compiling the online Survey.

# SECTION 1.
# Background

## ICC Banking Commission

1.1 The ICC Banking Commission is the leading global rule-making body for the trade finance industry, as well as a worldwide forum for trade finance experts whose common aim is to facilitate international trade finance. The commission has more than 500 members in 85 countries, many of them from developing countries.

1.2 The Banking Commission is known for producing universally accepted rules and guidelines for documentary credits, documentary collections, bank-to-bank reimbursements and bank guarantees. ICC's voluntary market-based approaches have often been praised for levelling the playing field in trade finance practices.

## The ICC Survey: Purpose and Scope

1.3 At the request of the WTO, the ICC Banking Commission has undertaken another global trade finance Survey to gather reliable quantitative and qualitative data for the trade finance market and to gauge the outlook for trade in 2010.

1.4 The purpose of the Survey is to obtain information from the marketplace that reflects current commercial and operational practice in the international trade finance banking community that can facilitate the formulation of a coherent response to the problems being faced in trade finance.

1.5 In addition to the participation of members of the ICC Banking Commission, the cooperation and partnership of the following trade organizations was key to the production of this Survey Report:

- The World Bank
- Society for Worldwide Interbank Financial Telecommunications (SWIFT)
- The Berne Union
- BAFT-IFSA
- The European Bank for Reconstruction and Development (EBRD);
- The International Finance Corporation (IFC);
- The Asian Development Bank (ADB);
- The Inter-American Development Bank (IDB); and
- ICC national committees network

1.6 The contributions of these organizations have helped us to build on the success of last year's Survey – both in terms of content examined and participation. The World Bank and the Society for Worldwide Interbank Financial Telecommunications (SWIFT) have again provided recent and historical trade flow data (volume and value) for contextual and comparative purposes. This year the Berne Union has also provided an analysis showing that the credit insurance industry maintained stability against a backdrop of reduced world trade.

1.7 The members of the ICC Banking Commission once again responded to the call to provide information on trade products to the marketplace. Responses to the Survey were up significantly on last year, both in terms of the number of participating banks and countries. The Development Banks (EBRD, IFC, IDB and ADB) once again mobilized the member banks of their respective trade facilitation programs to participate in the online Survey and provided a section to the Report on their responses to the crisis over the past year.

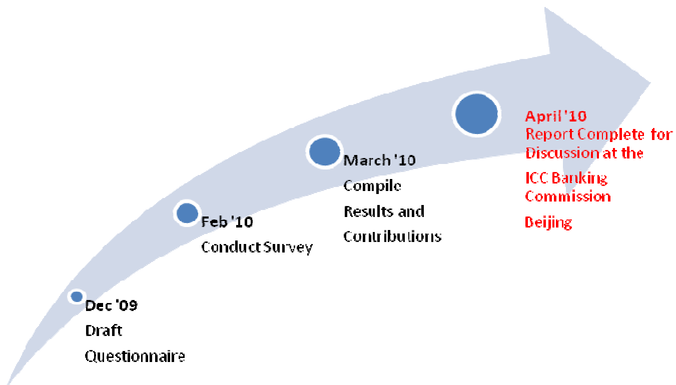
1.8 The methodology for this Report was, again, primarily based on a 25-item questionnaire developed to collect information from the trade finance banking members of the participating organizations.

## Methodology Outline and Timetable

1.9 The Survey questions targeted trends occurring in trade finance operations of banks in 2009 and specifically addressed the following topics:

- Breakdown of traditional trade finance products handled within banks
- Trends in volumes of traditional trade products
- Trends in demand and pricing for bank undertakings and L/C confirmations
- Operational impact of the credit crisis
- Trade credit line availability
- Loss experience for rating traditional trade products versus general banking facilities

Figure 1: ICC 2010 Survey timetable

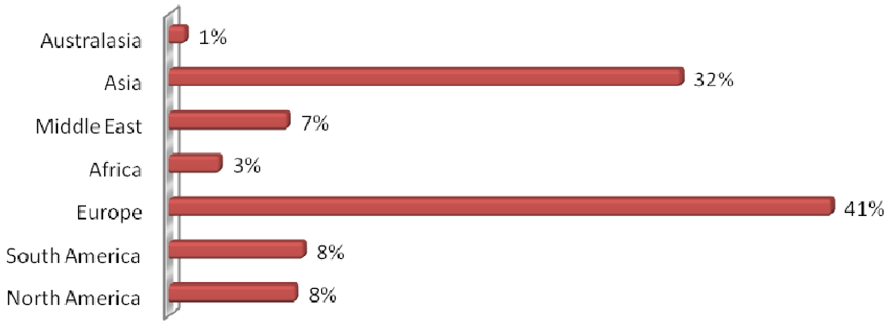



## Participants in the ICC Global Survey

1.10 The present report has been prepared by the ICC Secretariat based on a Survey conducted in early 2010. Coastline Solutions, ICC's information technology partner, has been responsible for the collection of the data. The Survey received responses from 161 banks in 75 countries. This is a sharp increase from last year's Survey, which received responses from 122 banks in 59 countries, already a very satisfactory response level. We are therefore pleased to note that ICC Surveys have been gaining recognition in the industry, and are now perceived as the much-needed tool to bridge the information gap in trade and finance.

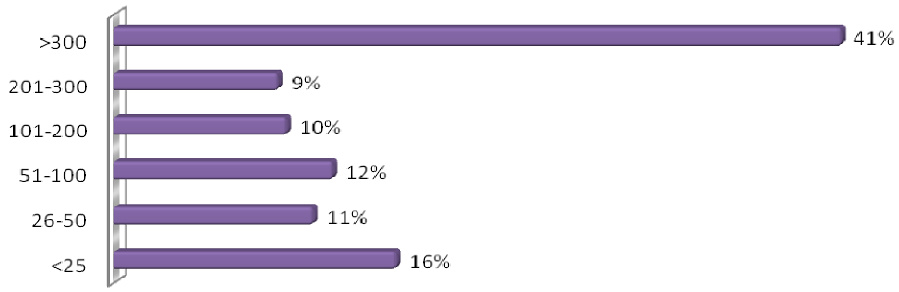
1.11 The breakdown of respondents to the ICC Survey by geographic region was as follows:

Figure 2: Location of respondents




1.12 The above graph shows that we had a satisfactory geographical distribution across the world. The profile of respondents (by size of employer) varied significantly, but most of the ICC respondents were from large financial institutions (41% of respondents were from banks with more than 300 trade finance employees).

Figure 3: Employee level involved in processing of trade finance within the bank

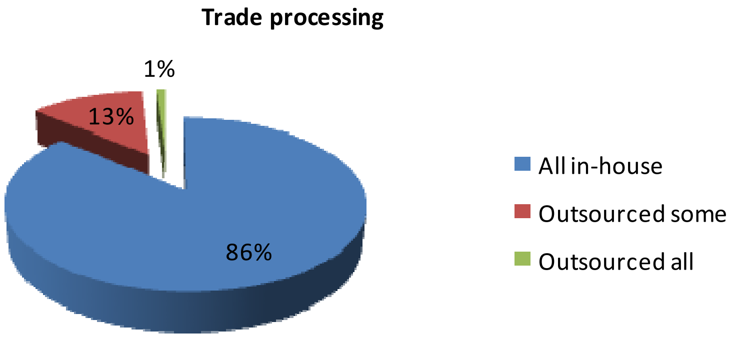



1.13 The structure of respondent banks' international trade operations was as follows:

- 44% of banks' trade finance operations are distributed globally;
- 42% of banks' trade finance operations are based in one country; and
- 14% of banks' trade finance operations are based within a number of countries in one geographic region

1.14 It should be noted that 86% of respondents indicated that all of their trade processing was carried out in-house, 13% reported that some of their trade processing had been outsourced (Figure 4). Of the banks that have outsourced some of their trade processing, 21% responded that they are considering outsourcing the remainder within the next two years. Of the banks that have not outsourced any of their trade processing, 9% indicate that they are considering some form of outsourcing within the next two years.

Figure 4: Trade processing profile of ICC respondents




1.15 When respondents were asked to indicate the percentage breakdown, by volume, of the type of trade finance products handled by their trade finance departments for 2009 (Figures 5 and 6), they responded that the majority of transactions, for both export and import transactions, by volume, were commercial letters of credit.

1.16 However, it is necessary to point out that about 80%-85% of trade transactions are estimated to be settled on an open account basis, the rest being "traditional" trade products such as documentary and standby L/Cs, documentary collections and guarantees. The graphs below did not contradict this, but they revealed that ICC respondents were responding mainly from the trade finance departments of financial institutions, with open account trading being handled in separate areas of the bank.

Figure 5: Export transaction volumes

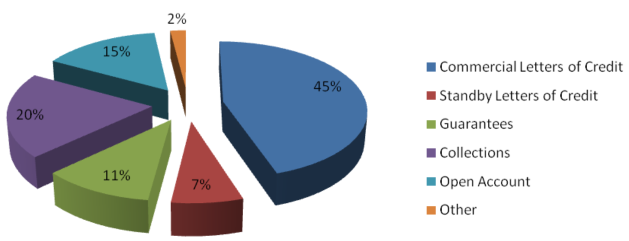
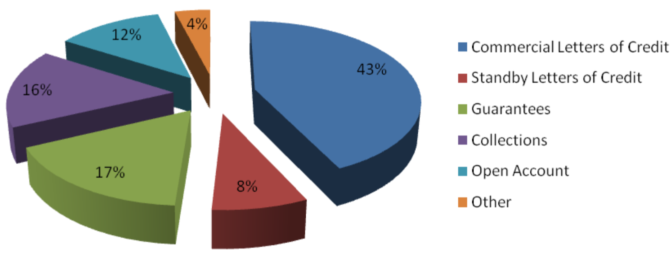



Figure 6: Import transaction volumes




1.17 This report is an amalgamation of the feedback and opinions of this geographically and organizationally diverse cross-section of the trade finance banking community.

# SECTION 2.

# Trade Developments and Prospects

## Overview

2.1 World trade has been a casualty of the economic crisis, contracting in volume terms by around 12% in 2009, according to the World Trade Organization (WTO). The spillover effects of the current global economic crisis on trade, trade finance and trade policies have presented unprecedented challenges to low-income countries that are likely to outlast the current economic recovery and adversely affect progress toward the Millennium Development Goals (MDGs).

2.2 Opening trade and strengthening the multilateral trading system, ensuring affordable trade finance and delivering effective aid-for-trade programs are key to overcoming the collateral damage of the crisis on low-income countries.

## Trade as a Casualty of the Global Economic Crisis

### Impacts of the crisis are still strong in some regions and markets

2.3 According to the World Bank Global Economic Prospects 2010, the dollar value of world trade plummeted 31% between August 2008 and its low point in March 2009.[1] The decline in volume terms was somewhat less pronounced when falling commodity prices and exchange rate fluctuations are taken into account. As it is now well documented,[2] the collapse of global trade starting in late 2008 was mainly attributable to a sudden decline in global demand resulting from firms reducing inventories in anticipation of a global slowdown.

2.4 With the global integration of supply chains, trade had become proportionally more responsive to output changes. Historical data shows that the elasticity of global trade volumes to real world GDP has increased gradually from around 2 in the 1960s to above 3 in recent years, driven by production-sharing networks and the proliferation of global supply chains.[3] The higher elasticity means that trade declines faster than in the past as output drops, but it also suggests that a more rapid recovery will take place as the recession ends. Recent trade data show signs of recovery along a "U-shaped" trajectory (Figure 6). Trade data for June 2009 exhibited the first signs of improvement since the onset of the crisis.

2.5 The decline in international trade has broadly followed a uniform pattern, with some variation by countries, sectors and products (Figure 7). While all regions have been severely affected, the initial fall-off in import volumes was relatively stronger in high-income countries, partly reflecting the growth slowdown that had already begun before the failure of Lehman Brothers.

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[1] Global Economic Prospects 2010, World Bank, Washington D.C.

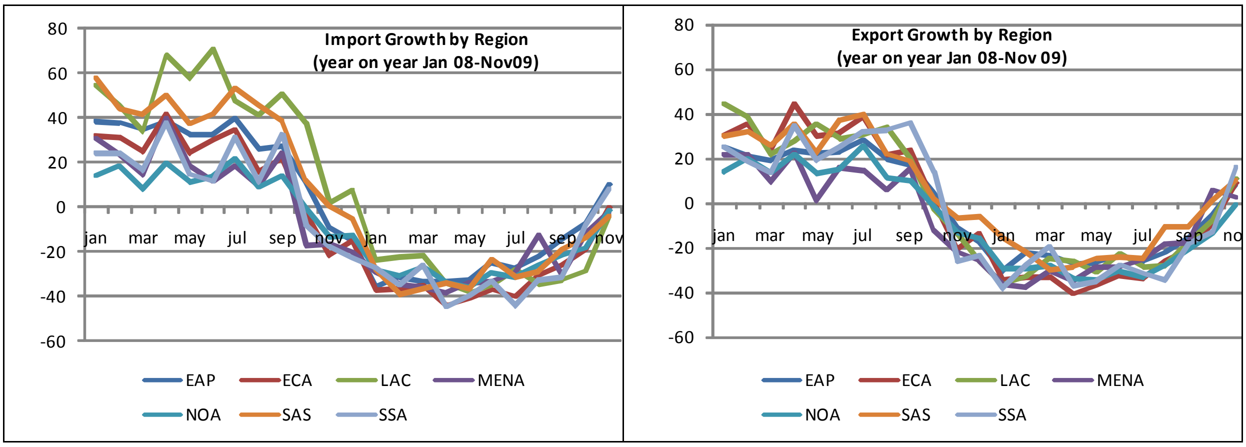
[2] See for instance Baldwin, R. (2009). "The Great Trade Collapse: What Caused It and What Does It Mean?" VoxEU.org Ebook, http://www.voxeu.org/index.php?q=node/4297

[3] Freund Caroline, 2009, "The trade response to global downturns: historical evidence", Policy Research Working Paper 5015, World Bank.

The impact of the decline has been more severe in countries that are integrated and dependent on trade with developed countries where demand sharply contracted. With the crisis, the decline accentuated and broadened, with global import volumes falling at a 40% annualized pace in the first quarter of 2009. At the trough, imports in high-income countries were 24% off their August 2008 levels; in developing countries they were also down by 25%.

2.6 The trade slump was less marked in Asian countries, in part because of fiscal stimulus in China. Most Chinese trade partners benefited from the rebound in Chinese imports. By the third quarter, import demand had strengthened in most countries. After a period of some weakness, reflecting faltering domestic demand, the United States' import volume growth jumped to 29% in October, in Germany to 27%, and in Japan to 31% as of November 2009.

Figure 7: Trade decline has bottomed-out and started to recover (2009)




Source: World Bank calculations and data from Datastream

Note: EAP: East Asia and the Pacific; ECA: Europe and central Asia; LAC: Latin America and the Caribbean; MENA: Middle East and North Africa; NOA: North America; SAS: South Asia; SSA: Sub-Saharan Africa

2.7 The effect of the "great trade collapse" has been more pronounced in certain sectors and products than others. Exports of durable goods have been most affected, while trade of non-durable consumer goods, such as clothing and food have declined least, as basic demand for these products cannot be put off as long. In general, services trade has been more resilient than merchandise trade.

2.8 Monthly trade data show that trade in services has declined at a slower pace across developed and developing countries. For instance, between July 2008 and February 2009, US trade in goods declined by 33% in value whereas trade in services declined by only 10%. This is mainly due to the fact that the demand for services is less cyclical than demand for goods and not subjected to the decline in inventory supplies. Services trade has also been less dependent on trade finance than trade in goods.[4] Tourism represents something of an exception — such expenditures tend to be luxury goods and therefore more volatile. The World Tourism Organization reports that, compared with 2008, tourism arrivals were off 7% in the first six months of 2009.

[4] Ingo Borchert and Aaditya Mattoo, "The Crisis Resilience of Services Trade," in Evenett, Hoekman and Cattaneo, The Fateful Allure of Protectionism: Taking Stock for the G8, (World Bank and CEPR).

## The global economy contracted sharply in 2009

2.9 As indicated by the World Bank, the global economy contracted sharply in 2009, but the acute phase of the credit crisis has abated. According to the Global Economic Prospects 2010,[5] global GDP declined by 2.2% in 2009, with the rate of growth in developing countries decelerating to 1.2% in 2009 from 5.6% in 2008. Unemployment rates worldwide continue to rise. The International Labour Organization (ILO) estimated that world unemployment figures increased by more than 30 million in 2009, raising the estimated number of jobless worldwide at over 200 million and posing further challenges to a swift recovery.[6]

2.10 Compounding the fall in demand from developed countries, developing countries have become more vulnerable due to a decline in foreign direct investment and remittance inflows, although the latter has shown some resilience.[7] In aggregate, the crisis has prompted a narrowing of global imbalances due to an overall decline in the volume of trade, falling oil prices and a narrowing of China's and the United States' trade imbalances. Overall, the absolute value of global current account balances (the sum of all surpluses plus the absolute value of all deficits) is estimated to have declined from a peak of 5.9% of world GDP in 2008 to around 3.9% in 2009.

2.11 Net private capital flows to developing countries in 2009 are estimated to have fallen by $795 billion (relative to their high in 2007), or by almost 70%. Even with recovery on the horizon, projected flows in 2010 are only $517 billion, or 3.2% of GDP. Lower-income countries will likely suffer the most from this shrinkage as the capital inflows to these countries represent a significant share of national income and investment, and their loss will certainly have a severe impact on the ability of these countries to meet their financing needs in the short to medium term. Remittances, another growing source of external financing for developing countries, representing as much as 20% of GDP in some countries, have been more stable than capital flows and merchandise trade, but have nevertheless declined by an estimated 6.1% in 2009.

## Trade finance developments

2.12 With the global credit crunch, trade credit – the financial backbone for international trade transactions – contracted sharply in late 2008. As the financial crisis deepened, the availability of trade finance tightened due to the higher lending costs and risk premiums as a result of rising liquidity pressures, scarcity of capital, increased capital requirements and heightened risk aversion of trade finance providers and banks for counterparty and country risks. The drying up of the secondary market for short-term exposure as banks and other financial institutions deleveraged, and key players such as Lehman Brothers exited the market, further exacerbated the problem. The implementation of the Basel II Accord on banking laws and regulations, with its increased risk sensitivity of capital requirements, in an environment of global recession may have also put additional pressure on banks to hold back on trade finance.

[5] Global Economic Prospects 2010: Crisis, Finance, and Growth, World bank, January 2010.
[6] Global Employment Trends, International Labour Organization, January 2010.
[7] Ratha, D. (2009). "Dollars Without Borders: Can the Global Flow of Remittances Survive the Crisis?" October 2009. Foreign Affairs.

2.13 With statistics on trade finance notoriously scarce, surveys conducted by the World Bank and the IMF indicate that the contraction of trade finance in late 2008/early 2009 was mostly influenced by the fall in demand. Different surveys, including the ones prepared by ICC and IMF/Bankers Association for Finance and Trade (BAFT) in 2008 and 2009, supported the view that the cost of trade finance has increased and that the supply of trade financing instruments has dried up in late 2008-early 2009.[8] Although the surveys found that the demand for trade activities has been the major driving factor behind these developments, a large number of respondents acknowledged that the lower availability of trade finance instruments in their institution had played a notable role in the fall of trade finance volumes. In the most recent surveys, respondents suggest that recovery is underway in some regions, but that trade finance markets have not fully bounced back.

2.14 In early 2009, a World Bank survey of 425 firms and 78 banks and other financial institutions in 14 developing countries confirmed that trade finance became more expensive and less available, with the banks becoming more risk averse and selective in the supply of credit.[9] Moreover, the ICC 2009 Survey corroborated earlier results that trade decreased both as a result of the recession and tighter credit conditions, although the peak of the impact of the financial crisis on trade finance appeared to have been reached in the first half of 2009. The surveys also detected an increased need for more guarantees and insurance to facilitate the release of trade finance funds.

2.15 In an effort to mitigate the effects of trade finance constraints, governments and multilateral development institutions have responded with a range of trade finance programmes, including a pledge by the G20 leaders at their April 2009 London Summit to ensure UDS250 billion of support for trade. The World Bank Group has responded by providing additional guarantees as well as liquidity for trade finance through the IFC's Global Trade Finance Program and Global Trade Liquidity Program.

2.16 Indeed, recent data on export insurance and guarantees suggest that export credit agencies (ECAs) have played an important role in preventing a complete drying up of trade finance markets during the global economic crisis.[10] These efforts have complemented the support provided by international financial institutions and regional development banks and indicate that the call by the G20 leaders and the international community to ensure the availability of trade finance during the crisis has been largely followed through.[11]At their September 2009 Summit in Pittsburgh (USA), leaders of the G20 welcomed the swift implementation of the USD250 billion trade finance initiative that was agreed in London, including through their ECAs.[12]

[8] IMF-BAFT (2009),"IMF-BAFT Trade Finance Survey: A Survey Among Banks Assessing the Current Trade Finance Environment," http://baft.org/content_folders/Issues/IMFBAFTSurveyResults20090331.ppt.

[9] Malouche, M. (2009), "Trade and trade finance developments in 14 developing countries post September 2008 - a World Bank survey", World Bank Policy Research Working Paper 5138.

[10] Chauffour, J.-P., C. Saborowski and A. Soylemezoglu (2010), "Trade Finance in Crisis: Should Developing Countries Establish Export Credit Agencies", World Bank Policy Research Working Paper 5166.

[11] Auboin, M. (2009), "Restoring Trade Finance During a Period of Financial Crisis: Stock-Taking of Recent Initiatives", Staff Working paper ERSD-2009-16, WTO.

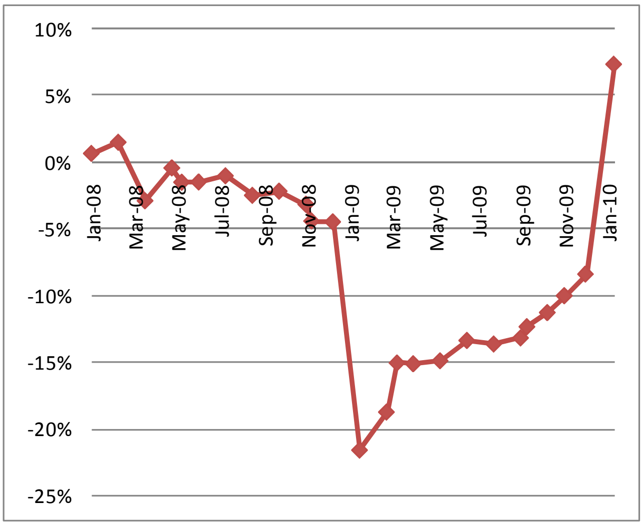
[12] http://www.g20.org/Documents/pittsburgh_summit_leaders_statement_250909.pdf and http://www.g20.org/Documents/final-communique.pdf .

2.17 Yet, drawing on the lessons from past crises, effective public actions in support for trade finance should remain guided by a number of key principles, including avoiding moral hazard and crowding out of commercial banks by setting clear time limits and exit strategies for intervention programmes and sharing rather than fully underwriting risk.[13] Given the substantial resources committed by G20 leaders and multilateral institutions to supporting trade finance during this crisis, it is critically important to put in place a systematic and reliable mechanism to collect data on trade finance. Such a system would enable monitoring of the market, not only to assess the degree to which current interventions are influencing credit supply, but to provide, on an ongoing basis, a useful early warning of stress in trade credit provision.

## Recent trends in trade finance

2.18 Recent trade finance data indicated slight signs of improvement. According to the September 2009 ICC Survey, the ability of banks to provide trade credit had improved, reflecting enhanced capacity and liquidity in the banking sector, as well as efforts by the international community to support trade finance instruments.[14] Data from the Society for Worldwide Interbank Financial Telecommunication (SWIFT) show that messages sent between banks for letters of credit, guarantees and documentary collections have been steadily increasing since January 2009 (Figure 8), but have still a long way to go to recover their pre-crisis level.

Figure 8: SWIFT year-on-year growth in trade finance messages




Source: www.swift.com

## Murky trade protectionism: still a dominant trend

2.19 World leaders recognized early on the systemic risks that arise from protectionist policy responses such as those used during the Great Depression. Historical evidence of rampant protectionism, such as that during the 1930s, illustrates that if some countries put in place measures that discriminate against other countries, this risks retaliatory policies that would

[13] Chauffour, J.-P. and Farole, T. (2009). "Trade Finance in Crisis: Market Adjustment or Market Failure?" Policy Research Working Paper 5003, World Bank.
[14] Trade Finance Survey: An Interim Report - Summer 2009. International Chamber of Commerce. Document No. 470-1124 TS/WJ, September 2009.

further deepen an existing crisis. The G20 countries' communiqués at the Washington, London, and Pittsburgh Summits in 2009 provided assurances that governments would refrain from using discriminatory trade measures.

2.20 Yet, since the onset of the crisis, many countries have veered towards policies that favour domestic products over foreign imports.[15] The World Bank monitoring of trade protectionist measures, through the Global Anti-Dumping/Safeguard Database and the Global Trade Alert website, indicates that all G20 countries have imposed measures restricting trade since the November 2008 G20 summit.[16] Numerous policy measures have been implemented that affect trade. Many of these comprise policies aimed at stimulating domestic demand and economic activity may have also benefited trading partners when applied on a non-discriminatory basis. Many others have explicitly been trade-restrictive. According to the WTO quarterly monitoring report, about 350 of such trade restrictive measures had been put in place as of December 2009, including some 86 temporary measures that had been removed in the meantime. Many countries, however, have also reacted to the crisis by reducing trade barriers (with about 77 trade-liberalizing measures taken since the onset of the crisis) in an effort to reduce costs for industries and households.[17]

2.21 Looking in greater detail at the type of trade policy measures introduced since the onset of the crisis, one finds a wide range of policy actions.[18] Protectionist responses including tariff increases, non-tariff barriers, trade remedies such as antidumping and countervailing measures, domestic subsidies and restrictions on international capital flows and migration. The use of tariffs has not been uniform, with tariff increases co-existing with tariff reductions. In contrast, the use of trade remedies – antidumping, countervailing duties and safeguard actions – has increased significantly. In addition, more "murky" protectionist measures have emerged that are more difficult to identify and quantify but that nonetheless have potential discriminatory effects, such as "buy national" and other local procurement provisions attached to stimulus packages. Murky protectionism was said to be particularly insidious as it is generally difficult to detect and monitor. It may, however, trigger retaliatory responses with long-term effects on the international market that are much more difficult to reverse than the more transparent trade remedy type actions.

2.22 A feature of the overall policy response has been a shift from explicit discriminatory policies, such as tariff hikes on foreign imports, to instruments such as subsidies and other policies that provide preferential treatment to domestic firms. This shift could reflect the increasing dominance of intra-industry trade, which implies that domestic firms that are part of a global supply chain will be just as negatively affected by tariff increases as foreign exporters. The reliance on domestic support measures such as subsidies rather than border barriers is most noticeable for high-income countries. Developing countries have relied to a greater extent on traditional trade policy instruments, reflecting more limited capacity to engage in fiscal expansion.

2.23 Developing countries have emerged as the most active users of trade remedies during the crisis, initiating three-quarters of all investigations since 2008, with India and Argentina as the most active users, followed by Turkey, Brazil and China. Developed economy use has been

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[15] Gamberoni Elisa and Richard Newfarmer (2009). "Trade protection: Incipient but worrisome trends", Trade Note 37, World Bank.

[16] See http://www.globaltradealert.org/

[17] G20 Trade and Investment Measures, WTO, OECD and UNCTAD Joint Report - September 14, 2009.

[18] Hoekman, Bernard, Simon Evenett and Olivier Cattaneo (2009). "Trade-Related Policy Responses to the Crisis: A Stock Taking", PREM Note No. 139, World Bank.

driven by cases initiated by the United States and the European Union. In the fourth quarter of 2009, developing countries imposed 62% of new measures compared to 38% by developed economies. This trend can have serious implications for “South-South” trade, as initiated and imposed trade measures by all countries are mainly targeting developing country exporters, with China being targeted most intensively. It has led to retaliatory actions by China and other developing countries that may be a drag on the trade rebound. For instance, the US government’s decision to impose safeguard tariffs on imported Chinese passenger and light truck tyres has been immediately followed by the Chinese government’s announcement to investigate potential dumping of US chicken and auto products.

## The effects of protectionism remained muted

2.24 Notwithstanding the number of individual measures, protectionism has remained circumscribed in aggregate. The trade-restricting or distorting measures introduced since October 2008 have amounted to a maximum of 1% of world merchandise trade – a large sum in absolute terms but a relatively small one as a share of global trade. They were mainly applied to specific sectors, such as agriculture and iron and steel products, followed at some distance by consumer electronics and textiles, clothing and footwear.

2.25 Although these measures have undoubtedly curtailed trade flows, their effect on international trade has been secondary to factors such as lack of aggregate demand and the global credit crunch. Nonetheless, in some cases they have taken their toll on bilateral trade flows, adding significantly to the adverse effects of the global recession on individual country's exports, economic activity and unemployment.[19]

2.26 A key factor behind this “great moderation” is probably the fact that pressures for protectionism are weaker today than in the past because of the extensive globalization of production that has made countries around the world interdependent through supply and production chains. Domestic producers have become reliant on imported parts, and exporters are reliant on foreign end-user markets, and vice versa. The average trade-to-GDP ratio today is 96% as compared to 55% in 1970, and trade in parts and components, an indicator of the internationalization of supply chains, has more than doubled as a proportion of total trade in manufactures. While this development has greatly increased the incentives of a broad range of industries to support an open trade regime, it has not completely prevented domestic political pressures to protect employment against import competition.

2.27 Comparing this crisis to the Great Depression and late 1970s/early 1980s – the last time the world economy experienced a serious downturn – there has not been an outbreak of serious protectionism and pernicious “beggar-thy-neighbour” policies. The primary reason for this is probably the changed incentives for industry arising from global integration and the existence of the multilateral trading system. WTO rules and disciplines have had a positive effect, as has the pro-active monitoring and surveillance and information exchange under its auspices. The fourth report of the Global Trade Alert published in February 2010 indicates that “low fever” protectionism continues apace with a number of the largest economies taking discriminatory measures. Keeping trade open remains, therefore, as important as ever to counterbalance the exit from expansionary fiscal and monetary policies and overcome the global economic crisis.

[19] WTO Trade Policy Review Body (2009), Overview of Developments in the International Trading Environment, WT/TPR/OV/12.

# SECTION 3.

## Trade Finance Statistics and Trends

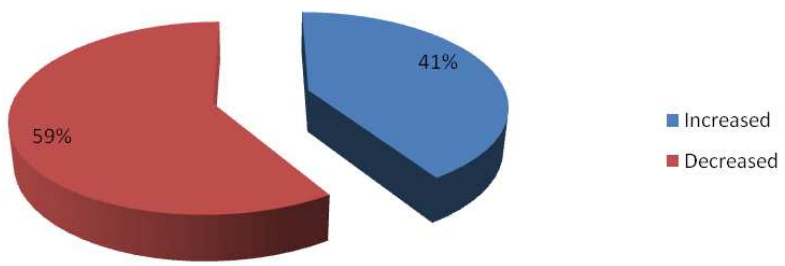
### Evidence of Trade Contraction Persisting in 2009

3.1 As noted in Section 2 of this report, today there is still evidence of major challenges, spreading across the global economy when some 90% of the USD14 trillion of world merchandise trade is supported by trade finance. The ICC Survey confirms the anecdotal evidence gathered over the past few months that the financial problems were still impacting trade as a whole in 2009.

3.2 In 2009, we had been reporting that the world was facing the most severe recession since the Great Depression, which originated in developed countries but had been spreading to developing countries at an ever-increasing speed. Emerging markets were more directly affected in 2008 because they were more financially integrated. Low-income countries were also harmed because of lower commodity prices and less remittances. GDP growth for developing countries had been severely impacted, with negative growth in the 3-6% range for some regions.

3.3 The deterioration of trade has been felt worldwide in 2009. According to respondents, markets kept being constrained by credit availability, a decrease in import and export volumes and lower confidence among financial institutions. Indeed, 59% of respondents to the ICC 2010 Survey indicated that the value of trade finance activity had decreased between 2008 and 2009, mainly due to lower commodity prices, the weak USD and debt restructuring processes in 2009.

Figure 9: Value of trade finance activity between 2008 and 2009




3.4 In terms of volume, the situation was still showing a decrease of volume in 2009. From the financial institutions responding, 43% continued to report a decrease in export L/C volume, although this was down from 47% indicated in the 2009 Survey (Figure 10). For guarantees, 38% of respondents indicated no change between 2008 and 2009, with 31% indicating a decrease over the same period. For import collections, we note that 40% of respondents reported a decrease and 31% reported no change.

3.5 On the import side (Figure 11), 26% report a decrease in standby L/C volume (with 51% seeing no change from 2008). For guarantees, 39% of respondents indicated no change between 2008 and 2009, with 33% of respondents reporting a decrease over the same period. For commercial L/Cs, 53% indicated a decrease and 17% indicated no change.

Figure 10: Export processing volume trends – 2009

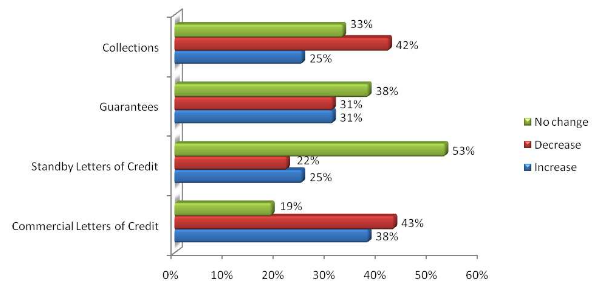
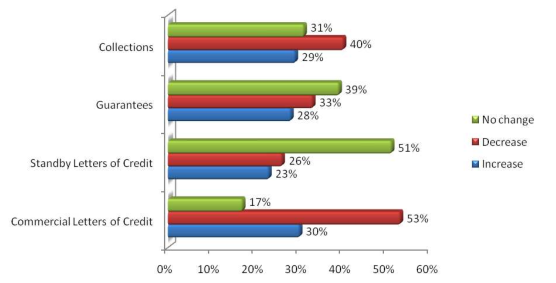



Figure 11: Import processing volume trends – 2009




# SWIFT Trade Traffic Analysis

## Background information

3.6 Before considering the SWIFT trade volume statistics and related comments, we should consider their context. It is generally accepted that 80-85% of trade transactions are settled on an open account basis, the rest using "traditional trade" products such as commercial letters of credit, standby letters of credit, guarantees and documentary collections.

3.7 Open account settlement is achieved by making a payment which may or may not be over the SWIFT network. In any case, SWIFT "payment messages" are not useful as a source of statistical data for open account trading, since a payment may be used for an FX deal, or a trade in securities, as well as a trade-related transaction.

3.8 SWIFT "trade" statistics, therefore, deal with the remaining percentage, the 15-20% portion of trade not settled on an open account basis. All the comments below must be taken in this context. At the end of 2007, in a SWIFT trade survey, 20 of the top trade banks worldwide reported on their usage of SWIFT for trade. Around 80% of the banks surveyed indicated that 90% of their letter of credit (L/C) transactions went via SWIFT, the remaining 20% of the banks said that 50% of their L/C transactions used SWIFT. SWIFT statistics can therefore be considered a good indication of the overall usage trends for the L/C product.

3.9 SWIFT trade statistics concern trade volumes. Traditionally, SWIFT cannot look at the content of the messages, and therefore cannot comment on the value of the trade. However, early in 2009 the SWIFT Board agreed for a "trade snapshot" to be carried out. This exercise looked into specifically defined trade data, extracting information on value, maturity and currency. Some of this information is reproduced here; the complete report is available on www.swift.com. In addition, values and currencies of some of the trade messages will be available as part of the SWIFT Value Analyser from end 2010. SWIFT hopes that both of these initiatives will add to the understanding of the dynamics of the industry as a whole.

3.10 "Traffic" refers to messages sent over the SWIFT network. Where global figures are recorded, messages sent equal messages received.

3.11 The charts/graphs refer to "category 4" and "category 7". SWIFT category 4 messages are flows for Documentary Collections – with the exception of three little-used "cash letter" messages. SWIFT category 7 messages are flows for commercial and standby letters of credit, and guarantees. Regarding the most used messages in each category (Figure 14), in category 4 they are Message Type (MT) 400 (Advice of Payment), MT 410 (Acknowledgement), and MT499 (Free Format). In category 7 the most used messages are the MT 799 (Free Format), MT 700 (Issue of a Documentary Credit) and the MT 707 (Amendment to a Documentary Credit) (Figure 15).

## SWIFT traffic figures on a downward trend in volumes over the last years

3.12 The 2004–2009 SWIFT Trade Traffic figures (Figure 12) show that the downward trend in volumes experienced in 2008 continued in 2009, with the 2008 total of 46m (rounded) falling to 42m. Documentary collections represented 31% of total trade traffic in 2004, falling to 27% in 2009.

Figure 12: SWIFT trade traffic worldwide in number of messages, 2004-2009

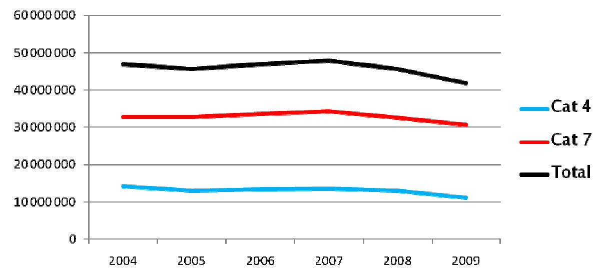



Figure 13: Comparing MT 700 with MT 734, 2007-2009 (percentages of MTs compared with total cat 7)

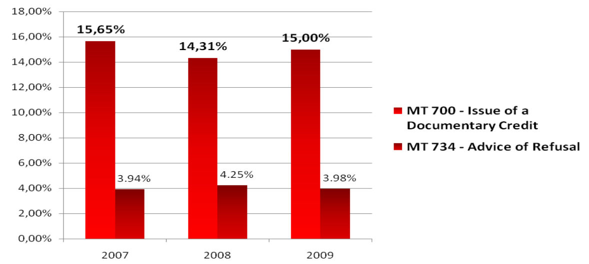
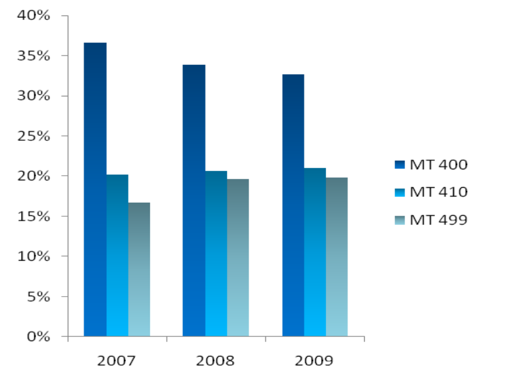
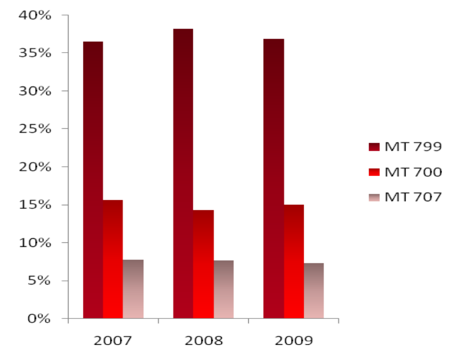



Figure 14: SWIFT top 3 messages, cat 4, 2007-2009




MT 400 – Advice of Payment
MT 410 – Acknowledgement
MT 499 – Free Format

Figure 15: SWIFT top 3 messages, cat 7, 2007-2009




MT 799 – Free Format
MT 700 – Issue of a Documentary Credit
MT 707 – Amendment of a Documentary Credit

3.13 Although the margins are small, it is interesting to note that use of the MT 734 rose in 2008, but in 2009 was back to 2007 levels. Figure 13 shows the number of MT734 messages sent bank to bank, as a percentage of the overall cat 7 message traffic. As stated in the SWIFT User Handbook, "the MT 734 is sent by the issuing bank to the bank from which it has received documents related to a documentary credit. It may also be sent by the bank nominated to pay/accept/negotiate/incur a deferred payment undertaking to the bank from which it has received documents. It is used to advise the Receiver that the Sender considers the documents, as they appear on their face, not to be in accordance with the terms and conditions of the credit and that, consequently, it refuses them for the discrepancies stated.

The Sender also provides the Receiver with details regarding the disposal of the documents. This message type may also be used for claiming a refund." As noted by ICC, it is generally accepted that refusal rates on first presentation are in the region of 70-75%, so these figures would therefore seem to be very much at the lower end of most people's expectations. This may be due to the fact that not all banks utilize the structured MT734 and choose to use the free format MT799. However, the percentage of MT734 refusal messages indicated is still significant. It should also be noted that the 70-75% figure includes refusals made bank to beneficiary/presenter, which would fall outside the SWIFT messaging system for advising.

## Signs of recovery were evident in 2009 for some regions

3.14 2009 shows an overall total climb in trade traffic transactions from the low in February. It is also clear that worldwide use of category 4 messaging over SWIFT is flat – it is thus category 7 that is leading the recovery.

Figure 16: SWIFT Trade Traffic worldwide 2008

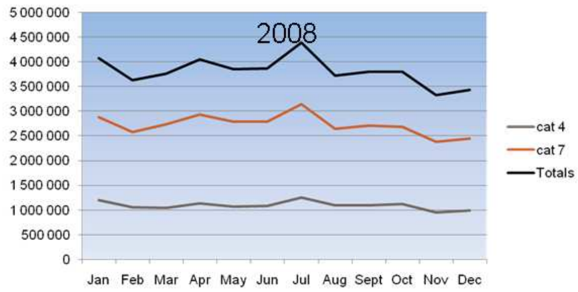
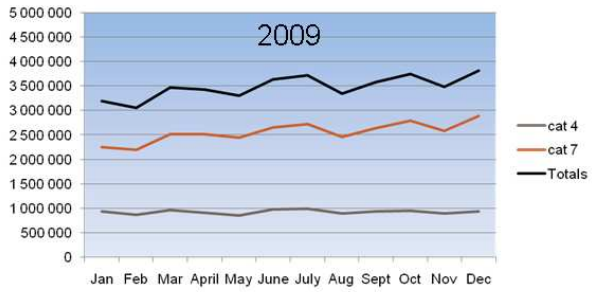



Figure 17: SWIFT Trade Traffic worldwide 2009




3.15 Asia Pacific continues to register far greater volumes for both sent (Import) and received (export) messages. As one might expect, the regions with the largest volumes – Asia-Pacific, Europe Euro zone and North America – show larger fluctuations than those with smaller volumes. All regions showed an improvement in December 2009 on November 2009, sent and received. Figures 18 and 19 demonstrate that the vast majority of Asia Pacific 'sent' messages remained within the region. Asia Pacific also features prominently in the destination for messages sent from all other regions.

Figure 18: SWIFT Trade Traffic: By Region (Sent), 2008 & 2009, category 4 and 7

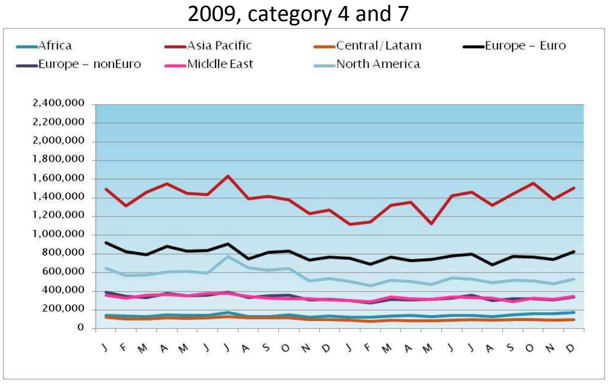
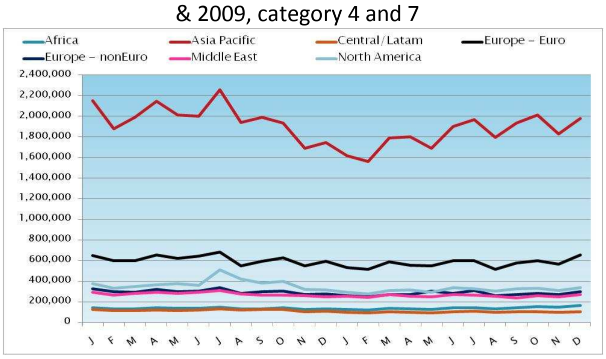
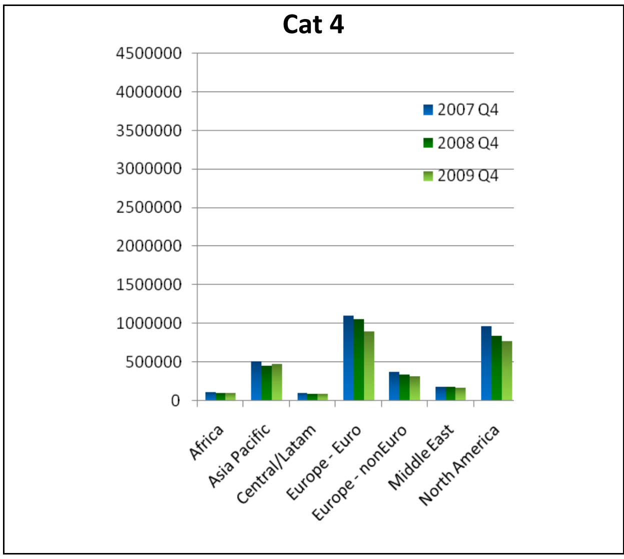


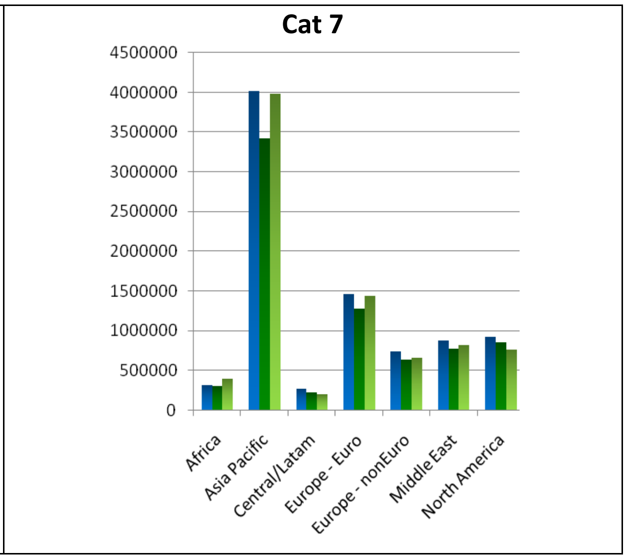

Figure 19: SWIFT Trade Traffic: By Region (Received), 2008 & 2009, category 4 and 7




3.16 It is striking, although not surprising, to see the difference in usage between category 4 and category 7 on a regional basis (Figure 20). Use of category 4 is low in Asia-Pacific, compared to the use of L/Cs, whereas in the Europe Euro zone, use of category 4 is much higher as a percentage of the whole. This is also true of North America. Over the period of the charts, we see that usage of the category 4 messages is declining, while that of category 7 is continues to grow.

Figure 20: Trade Traffic: category 4 & 7 by Region Sent, 2007, 2008 & 2009




3.17 Looking at major recipient regions (See Figure 21), we see that the two regions which import more (sent messages) from their own regions than others (using SWIFT messages) are Asia-Pacific and the Middle East, both in 2008 and 2009. This is also true for exporting (received messages). However, on the export side, Europe Euro-zone's principal export market is also its own region. All of this intra-regional trade was stronger in 2009 than in 2008.

Figure 21 : SWIFT trade traffic: major recipient regions 2008 & 2009

**Sent - 2008**

| Total SWIFT Messages Sent (% of each row total) | Africa | Asia-Pacific | Central & Latin America | Europe - Euro Zone | Europe - Non Euro Zone | Middle East | North America | All C'party Countries |
|---|---|---|---|---|---|---|---|---|
| Africa | 16% | 23% | 1% | 34% | 14% | 5% | 7% | 100% |
| Asia-Pacific | 1% | 70% | 2% | 9% | 4% | 4% | 11% | 100% |
| Central & Latin America | 0% | 31% | 27% | 13% | 3% | 1% | 24% | 100% |
| Europe - Euro Zone | 7% | 40% | 3% | 31% | 10% | 6% | 3% | 100% |
| Europe - Non Euro Zone | 6% | 40% | 2% | 20% | 19% | 7% | 6% | 100% |
| Middle East | 2% | 30% | 1% | 18% | 9% | 31% | 10% | 100% |
| North America | 2% | 57% | 6% | 7% | 6% | 6% | 16% | 100% |
| All Countries | 4% | 52% | 3% | 16% | 8% | 7% | 10% | 100% |

**Received – 2008**

| Total SWIFT Messages Rec'd (% of each row total) | Africa | Asia-Pacific | Central & Latin America | Europe - Euro Zone | Europe - Non Euro Zone | Middle East | North America | All C'party Countries |
|---|---|---|---|---|---|---|---|---|
| Africa | 16% | 11% | 0% | 40% | 16% | 5% | 11% | 100% |
| Asia-Pacific | 2% | 50% | 2% | 17% | 7% | 5% | 18% | 100% |
| Central & Latin America | 1% | 18% | 25% | 19% | 5% | 2% | 30% | 100% |
| Europe - Euro Zone | 8% | 20% | 2% | 41% | 11% | 10% | 7% | 100% |
| Europe - Non Euro Zone | 6% | 20% | 1% | 29% | 23% | 10% | 12% | 100% |
| Middle East | 2% | 18% | 0% | 19% | 9% | 39% | 13% | 100% |
| North America | 3% | 41% | 7% | 8% | 5% | 9% | 27% | 100% |
| All Countries | 4% | 37% | 3% | 22% | 9% | 9% | 16% | 100% |

**Sent – 2009**

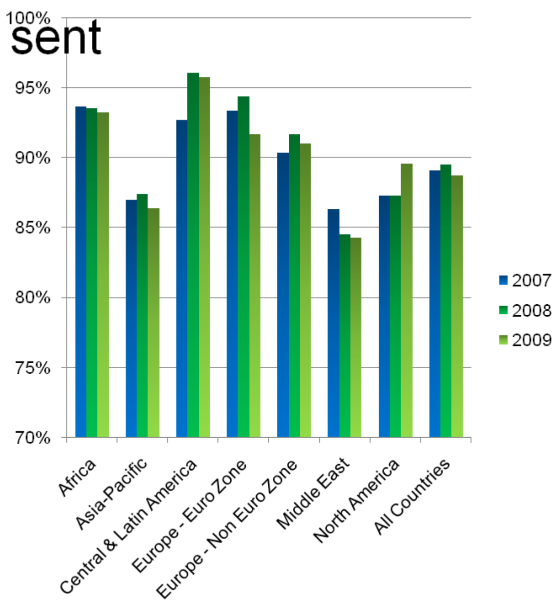
| Total SWIFT Messages Sent (% of each row total) | Africa | Asia-Pacific | Central & Latin America | Europe - Euro Zone | Europe - Non Euro Zone | Middle East | North America | All C'party Countries |
|---|---|---|---|---|---|---|---|---|
| Africa | 16% | 22% | 1% | 36% | 13% | 5% | 7% | 100% |
| Asia-Pacific | 1% | 71% | 1% | 9% | 4% | 3% | 10% | 100% |
| Central & Latin America | 0% | 33% | 26% | 15% | 3% | 1% | 23% | 100% |
| Europe - Euro Zone | 8% | 38% | 3% | 32% | 11% | 6% | 3% | 100% |
| Europe - Non Euro Zone | 7% | 40% | 2% | 20% | 20% | 7% | 5% | 100% |
| Middle East | 3% | 29% | 1% | 18% | 8% | 33% | 9% | 100% |
| North America | 3% | 59% | 6% | 7% | 6% | 6% | 15% | 100% |
| All Countries | 4% | 52% | 3% | 16% | 8% | 7% | 9% | 100% |

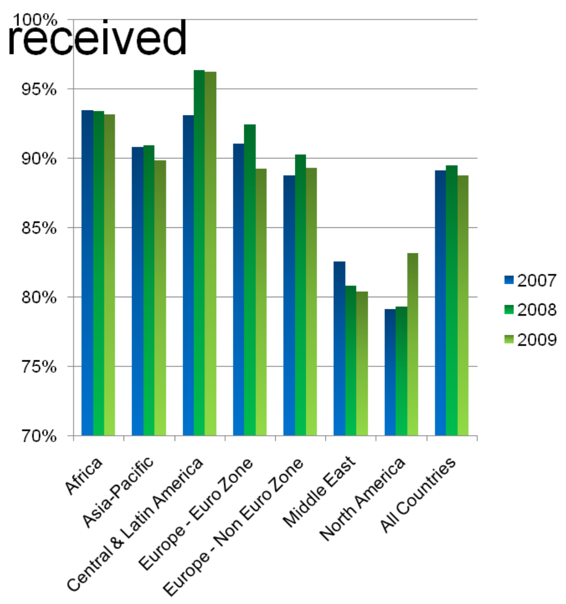
**Received – 2009**

| Total SWIFT Messages Rec'd (% of each row total) | Africa | Asia-Pacific | Central & Latin America | Europe - Euro Zone | Europe - Non Euro Zone | Middle East | North America | All C'party Countries |
|---|---|---|---|---|---|---|---|---|
| Africa | 16% | 11% | 0% | 42% | 15% | 6% | 10% | 100% |
| Asia-Pacific | 2% | 53% | 2% | 16% | 7% | 5% | 16% | 100% |
| Central & Latin America | 1% | 19% | 23% | 21% | 5% | 2% | 29% | 100% |
| Europe - Euro Zone | 9% | 20% | 2% | 42% | 11% | 10% | 6% | 100% |
| Europe - Non Euro Zone | 6% | 21% | 1% | 29% | 22% | 10% | 11% | 100% |
| Middle East | 3% | 18% | 0% | 18% | 8% | 41% | 11% | 100% |
| North America | 3% | 44% | 6% | 8% | 5% | 9% | 24% | 100% |
| All Countries | 4% | 39% | 3% | 22% | 9% | 9% | 15% | 100% |

3.18 Nearly 90% of import (sent messages) and export (received messages) – messages sent over SWIFT – are cross-border (Figure 22). North America (Canada the US, and Mexico) and the Middle East show the lowest exports cross-border (received messages), with the Middle East declining over the period 2007-2009 while North America increased in 2009. Central and Latin America countries figure highest on both import and export.

Figure 22: Trade traffic: categories 4 & 7 cross-border messaging 2007, 2008 and 2009



# Availability of Trade Finance Remains Limited

3.19 Major problems still persist, as tight credit conditions have continued to reduce access to trade finance. Thus, the subject of trade credit line availability remains critically important at the present time.

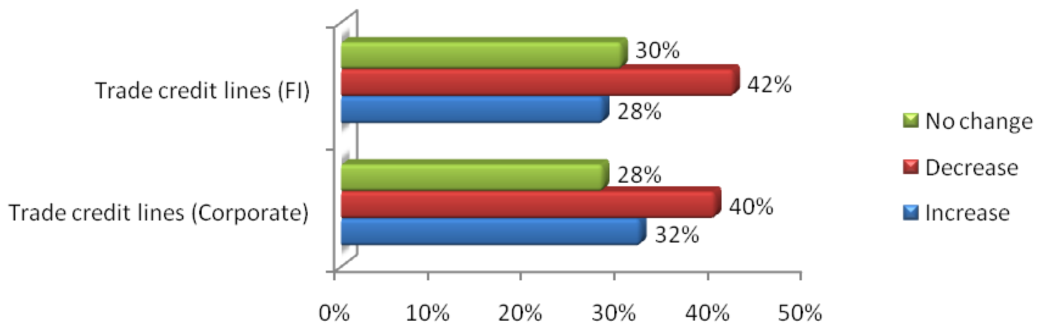
3.20 It should be noted that 40% of respondents indicated that their trade credit lines for corporates decreased 40% in 2009, which it must be remembered is on top of a similar sized decrease indicated in last year's Survey. Some 28% of respondents noted no change between 2008 and 2009. At the same time, 42% of respondents indicated that the trade credit lines for financial institutions declined in 2009, with 30% of respondents mentioning no change between 2008 and 2009.

3.21 The main reasons given by banks for difficulties in securing credit lines were the following:

- 76% – more stringent credit criteria being applied;
- 41% – selective exiting of customer relationships due to credit deterioration;
- 26% – exiting markets;
- 25% – capital allocation restrictions; and
- 21% – reduced inter-bank lending.

3.22 In a capital constrained environment such as the one prevailing in 2008 and 2009 (See also Section 5), lending departments of banks have been reporting that they are still competing internally for each unit of the bank's scarce capital.

Figure 23 : Availability of trade finance




# Trade Finance Demand

## Trade finance demand was sustained in 2009

3.23 The 2010 Survey continued to address issues related to demand. According to the respondents, trade finance is still in demand for trade products. However, shortage of liquidity and disproportionate aversion to risk have driven up interest rates on loans and advances in many countries, especially in emerging markets. The following was noted in the ICC Survey:

- 50% of respondents indicated they had experienced an increase in demand for the issuance of bank undertakings during 2009, a slight increase on the 2009 figure of 48% but a sign of the continued increased security sought by exporters for their shipments;

- 27% of respondents who had experienced an increase in demand reported they had been unable to satisfy all of their customers' needs; and

- 73% of respondents reported they had experienced an increase in confirmation requests in 2009. This is a 21% increase on the figure reported in the 2009 Survey and, again, this is a strong indication of the increased security sought by exporters and the perceived payment risk of the country of the issuing bank.

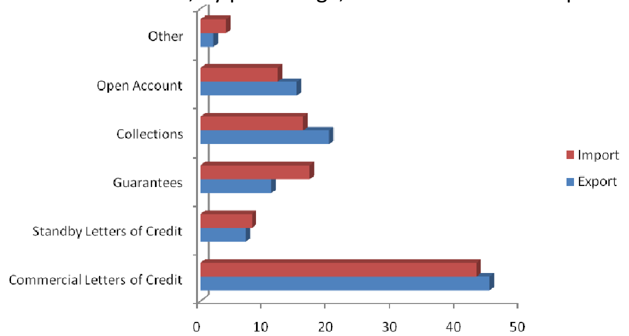
## Trade finance instruments gained prominence

3.24 Many respondent banks to the ICC Survey continued to comment on an increase in demand for documentary credits (or "L/Cs"). These instruments are considered to substantially reduce risks for both the exporter and the importer. Not surprisingly, therefore, the documentary credit is today seen as the classic form of international export payment, especially in trade between distant partners. Other trade finance instruments were mentioned by respondents, including bank guarantees. With the greatest economic crisis since the Great Depression still a fresh memory, bank guarantees were said to provide greater security in trade, as they are designed to restore confidence by protecting the parties against performance breaches without the need for businesses to post onerous cash deposits to secure their performance duties.

3.25 ICC noted that there was an increased demand for implementation of ICC rules governing trade finance. For instance, we witnessed higher demands for training on the use of the URDG rules, which specifically apply to billions of US dollars of guarantees securing monetary and performance obligations in a wide array of international and domestic contracts. The same trend existed for UCP rules applying to documentary credits.

3.26 This trend is confirmed from data collected in the ICC Survey. Figure 24 shows that L/Cs remain the predominant settlement product. However, the data for open account trade should be understood in the context that the Survey was directed at individuals located within the offices of banks which typically deal with the traditional trade finance instruments. Historically, open account trade has been understood to be in the region of 80-85% of world trade. It is widely expected that this figure fell between 2007 and 2009 as exporters sought a more secure method of settlement.

Figure 24 : Breakdown, by percentage, of international trade products



# Affordability of Trade Finance

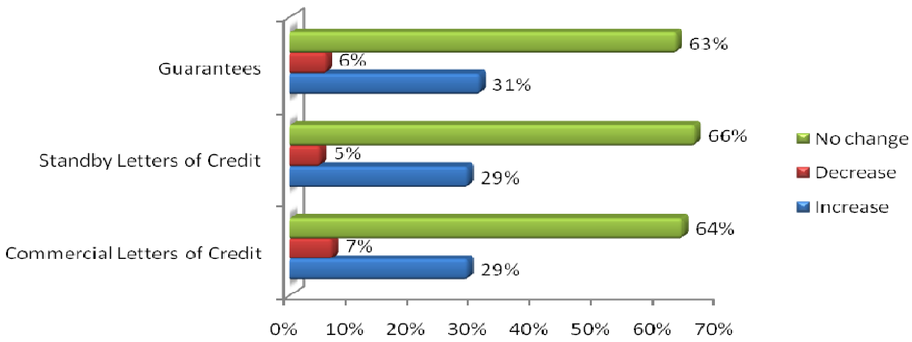
3.27 The 2010 Survey continued to address issues related to pricing. The following is noted in the ICC Survey:

- Around 30% of respondents indicated that their fees for issuance of bank undertakings had increased in 2009, although the overall message is that pricing seems to have leveled off, even if it is at a higher level than at the end of 2007; and

- 25% of respondents anticipate that their fees for the issuance of bank undertakings will continue to rise in 2010.

3.28 It is important to note that about 30% of respondents reported an increase in fees for commercial letters of credit, standbys and guarantees in 2009. These increases were in addition to what was reported in the 2009 Survey which reported significant increases between Q4 2007 and Q4 2008 (Figure 25).

Figure 25 : Change in fees for issuance of bank undertakings




3.29 The 2010 Survey has also revealed that requests for confirmation significantly increased between 2008 and 2009 (Figure 26), with fees also being much higher in many circumstances. 73% of respondents reported that requests for confirmation had increased in 2009 (conversely, 27% of respondents reported that the requests for confirmation had decreased in 2009).

Figure 26 : Requests for confirmations

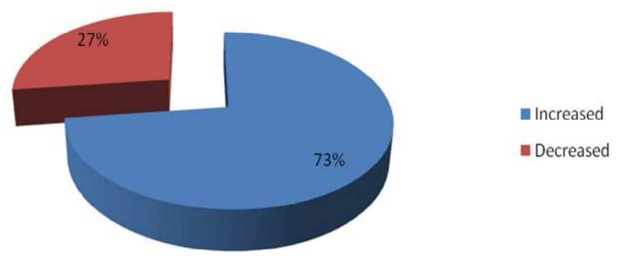
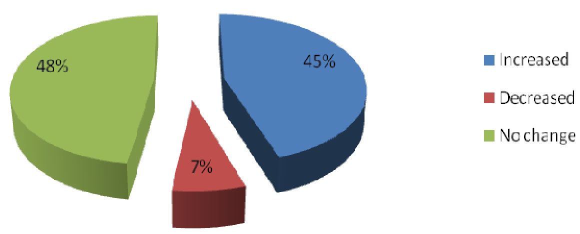



Figure 27 : Change in confirmation fees




3.30 At the same time, 45% of respondents reported further increases in fees for confirming commercial L/Cs in 2009 (Figure 27):

- 45% indicated an increase in fees for confirming commercial letters of credit in 2009;

- 7% reported a decrease in fees for confirming commercial L/Cs in 2009, which may reflect a re-positioning of fees that were increased in the previous year; and
- 86% said they do not expect any change in fees for confirming commercial letters of credit in 2010. Again, this may reflect that the pricing in 2009 was increased to a level that did not require further increases in 2010.

## Operational Impacts

### The number of court injunctions and refusals is still high

3.31 Last year's Survey reported that 12% of respondents had seen an increase in the number of court injunctions barring payment under letters of credit on grounds other than fraud. Some respondents also reported intense scrutiny of documents by some banks, eventually leading to higher rates of rejection of trade documents under L/Cs for minor or non-existent discrepancies.

3.32 From the 2010 Survey, we conclude that these problems persist. The following should be noted:

- 34% of respondents (up from 30%) have experienced an increase in the number of refusals by issuing banks in 2009;
- 17% of respondents (down from 20%), when acting in the capacity of an issuing bank, indicated that there has continued to be increased pressure from applicants to refuse documents. The main reasons cited were "falling commodity prices" and "financial downturn in local market;"
- 71% of respondents, when acting in the capacity of a nominated bank, reported they had experienced an increase or no change in the number of spurious/questionable refusals; and
- 44% of respondents (up from 30%) indicated an increase in the number of claims received under standby letters of credit and guarantees. This reflects the value of the additional security and the previously reported demand for this type of undertaking.

3.33 11% of respondents had taken their own decision to refuse and return documents without seeking a waiver from their client. The same respondents indicated that on average they had only taken this course of action less than five times in the previous three years. Such actions by banks clearly demonstrate their unwillingness to extend further credit to a client by allowing the client to waive discrepancies.

3.34 The 2010 Survey also showed that 23% of respondents (up from 12%) had experienced an increase in the number of court injunctions stopping payment under bank undertakings. This shows that parties are seeking legal remedies to opt out of their obligations under the sale or performance contract.

## Levels of claims and discrepancies remained high

3.35 Although the pressure to refuse documents was said to be low, the level of discrepancies and claims remained quite high.

3.36 Some 83% of respondents indicated that there was no increased pressure from applicants to refuse documents in 2009, only 17% of respondents said there was increased pressure from applicants to do so in 2009. Of those who indicated increased pressure, the main reasons provided were falling commodity prices and a financial downturn in local market.

3.37 The 2010 Survey also noted that 11% of respondents said that in 2009 they had taken their own decision to refuse and return documents without seeking/accepting a waiver from the applicant. Of the respondents who reported that they had rejected and returned documents without seeking/accepting a waiver, on average they had taken this course of action less than five times in the previous three years.

3.38 At the same time, we noted that the number of discrepancies and claims were still quite high. 44% indicated that there was an increase in the number of spurious discrepancies in 2009 (while 29% said there had been a decrease in the number of spurious discrepancies in 2009 and 27% saying there was no change). Similarly, 44% of respondents indicated that there was an increase in the number of claims under guarantees and standbys in 2009 (with 25% reporting there was a decrease and 31% indicating there was no change).

Figure 28 : Increased applicant pressure to refuse documents

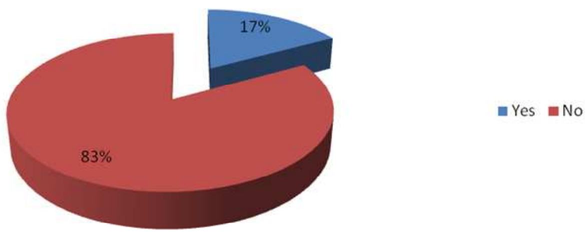



Figure 29 : Refused documents without seeking/accepting waiver

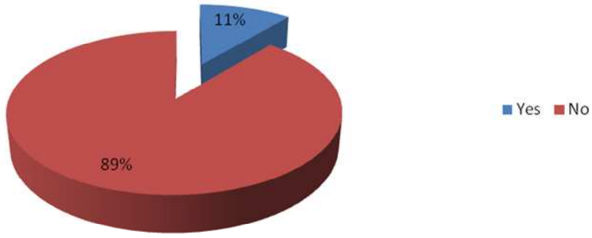



Figure 30 : Increased number of spurious discrepancies

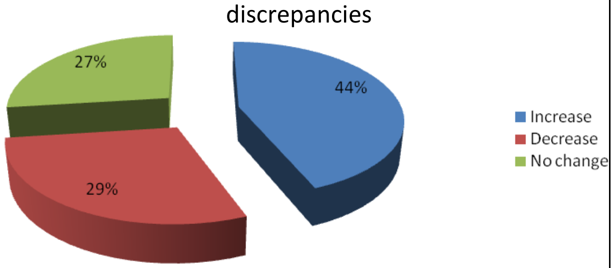
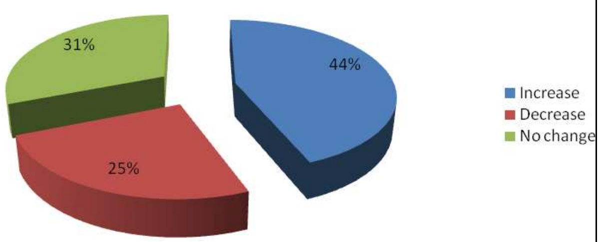


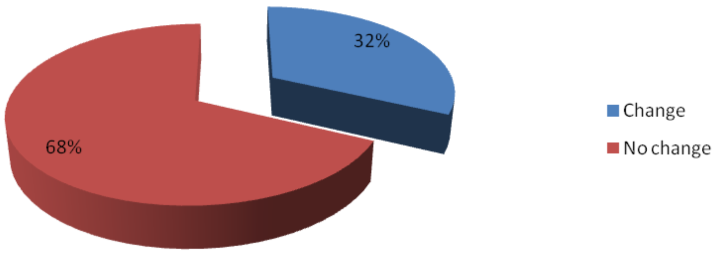

Figure 31 : Claims under guarantees and standbys




## No major change in risk ratings

3.39 68% of respondents indicated that the criteria for rating the risk of traditional trade products did not change in 2009 with some 32% reporting that the criteria had changed.

Figure 32 : Risk rating



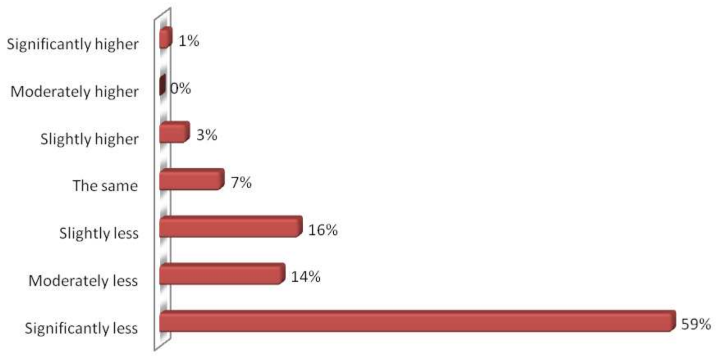

## Loss experience of traditional trade products versus general banking facilities

3.40 Banks continued to report that customers are asking for confirmed letters of credit though they previously had dealt under unconfirmed L/Cs, documentary collections or open account. However, bank perception of risk is leading to a tightening of liquidity in some instances, therefore causing greater difficulty in obtaining bank confirmations. In April 2010, this situation still prevailed.

3.41 Other key points noted in the ICC Survey are as follows:

- 59% of respondents indicated that the level of their actual losses when using traditional trade products was significantly lower (i.e. > 50% less) than losses incurred under general banking facilities. It is important to note that 96% reported that the level of losses incurred in traditional trade products were the same or lower than losses for general banking facilities;
- Only 4% of respondents said that their losses under general banking facilities were less than when using traditional trade products; and
- 84% of respondents expect an increase in demand for traditional trade products in 2010.

Figure 33 : Losses in traditional trade finance products versus general banking facilities



# SECTION 4.

# Facilitating Trade in Times of Turbulence

## The Response of the Multilateral Development Banks

4.1 It has been clearly demonstrated that international trade has been a serious victim of the financial crisis with the disruptions evident in trade flows in all corners of the world. It is argued that trade is part of the solution to this crisis rather than one of its causes. Trade is typically a very important element in maintaining and regaining financial stability, and trade facilitation measures provide critical support in advancing trade routes to recovery.

4.2 Trade facilitation measures of the multilateral development banks were originally to facilitate the development of trade from emerging and developing countries, but in the context of the economic crisis these already important objectives have taken on much more focused and targeted responses to maintain trade lines and supply routes open for business to and from developing emerging markets,.

4.3 This section of the report details the measures and economic crisis responses initiated by the key development banks:

- European Bank for Reconstruction and Development (EBRD);
- International Finance Corporation (IFC);
- Asian Development Bank (ADB); and
- Inter American Development Bank (IDB)

4.4 Historically, the EBRD was the first trade facilitation programme to commence activity in what are considered to be high-risk emerging markets. The EBRD programme started operations in 1999. The programme achieved such clearly demonstrated success in stimulating trade finance that the methodology has been substantially replicated by the IFC, the ADB and the IDB. The preferred creditor status of the development banks has also been seen as a key factor in developing risk-sharing agreements with commercial banks around the world.

4.5 These trade facilitation programmes focus predominently on the support of "short-term trade" trade finance transactions through the issuance of standby letters of credit subject to the UCP rules. However, as outlined in the remainder of this section, the development banks also implemented effective initiatives to bridge the liquidity gap in the respective markets where they operate.

4.6 It must be acknolwedged that the high level of due diligence, and institutional relationships inherent in the development banks' trade facilitation programmes, together with quality technical assistance and training in trade finance operations provided to their issuing banks, greatly reduces the operational risks involved in the delivery of trade finance.

# European Bank for Reconstruction and Development (EBRD)

## General overview

4.7 Compared to many Western European countries which felt the effects of the current financial crisis as early as in late 2007, most countries in Eastern Europe and the CIS region initially remained largely unaffected. High commodity prices in resource-rich countries and generally buoyant domestic demand have led to a “decoupling”-effect between Eastern Europe, the CIS region and Western Europe, where countries were experiencing the first signs of a cooling economy much earlier.

4.8 Following the accelerated decline in Western Europe, with commodity prices starting to fall in July 2008 and foreign capital flows into the Eastern Europe and CIS region diminishing on an exponential basis, the economic crisis hit the countries in the East with full impact in September 2008. In 2008/2009, Eastern Europe and the CIS region witnessed the worst crisis since the collapse of the centrally planned economies in the early 1990s.

4.9 As a direct consequence, economic activity contracted rapidly, and by November 2008 many countries in Eastern Europe and the CIS were experiencing a substantial decline in industrial production. February 2009 was particularly significant, as the crisis was spilling back from the real economy to the financial sector. Fears of bank credit losses triggered a new wave of currency pressures, coupled with an already ongoing depreciation of local currencies. The first quarter of 2009 saw sharply negative output, even in countries that had remained more resilient in the fourth quarter of 2008, such as Bulgaria, Moldova, Mongolia, Romania, Russia and the Slovak Republic.

4.10 Though industrial output declines started to slow in many countries from March 2009 onwards, the crisis of 2008/2009 had already left its mark in the trade finance business of Eastern Europe and the CIS. After the financial shock of September 2008, world trade was severely hit in the fourth quarter of 2008. After years of developing trade integration in Eastern Europe and the CIS within the region and the outside world (and partially double digit growth in export and import volumes) countries experienced a sharp fall in volumes. In the first quarter of 2009, even previously insulated countries in the Balkans or the Caucasus regions were eventually hit by the collapse in global trade.

4.11 Though dependent on the specifics of the economy of each country the general reasons for such a sharp decline in global trade can be summarized as follows:

- the fall in demand is more widespread than in the past, as the economy is slowing concurrently across the globe due to the first decline in world output since the 1930s;
- there is less risk-taking capacity and liquidity available for trade finance through banks, export credit agencies, private insurance underwriters and investment funds; and
- lower commodity prices, lower export revenues, devaluation of local currencies and the slowdown of domestic economic growth have resulted in lower demand for imported goods.

4.12 For 2009 the IMF predicted in its World Economic Outlook that world trade would decline by 12%, a figure which included many countries in Eastern Europe and the CIS region. To give a brief overview of the region, it has to be noted that with lesser trade credit available in global markets, the most export-dependent countries in the region, such as the Czech Republic, Hungary and Slovak Republic, have witnessed a significant reduction of their respective GDP.

4.13 The extraordinary decline in trade volumes seems to have bottomed out, and that there are tentative signs of a slight and gradual recovery in trade finance. The key for sustained recovery will be a turnaround of exactly those factors which caused the decline in the first place. Recent GDP data point to an end of the recession in some countries, and commodity prices have gained ground again. Nevertheless, trade finance for trade with countries in Eastern Europe and the CIS region remains scarce in commercial markets. Until such flows are fully restored there is no full potential to grow to levels reached before the crisis. This is the key factor in the recovery process.

## Crisis response under the EBRD's Trade Facilitation Programme (TFP)

4.14 The EBRD's Trade Facilitation Programme (TFP) aims to promote foreign trade to, from and within South-Eastern Europe and the CIS (the EBRD countries of operations). Through the programme, EBRD provides guarantees to international confirming banks, taking the political and commercial payment risk of international trade transactions undertaken by banks in the countries of operations (the issuing banks).

4.15 The programme can guarantee any genuine trade transaction to, from and within the countries of operation. Some 114 issuing banks in 21 countries where EBRD operates currently participate in the programme, which has limits exceeding Euro2 billion. In addition, more than 700 confirming banks throughout the world have joined the TFP, including 128 banks in 23 EBRD countries of operations. The programme strengthens the ability of local banks to provide trade finance and gives entrepreneurs in Eastern Europe and the Commonwealth of Independent States the support they need to expand their import and export trade.

4.16 The programme started in July 1999 and has been successful ever since. It provides a viable and much-needed service and has a fast approval process. There is no minimum or maximum amount for transactions (as long as transactions fit within available limits for approved issuing banks), and transactions as small as Euro1,000 and up to Euro48 million have been guaranteed.

4.17 Originally, the programme aimed at servicing primarily short-term transactions of up to 180 days tenor to facilitate basic trade. However, the facility was later extended to accommodate longer tenor transactions in order to accommodate purchase of equipment, construction and other term payment guarantees for up to three years for selected banks and countries. Deals are discussed and approved on a case-by-case basis.

## Co-financing involving development agencies and the private sector

4.18 Since the start of the programme in 1999, the EBRD has facilitated more than 8,600 foreign trade transactions for the total amount of Euro5.3bn, and has successfully invited other development agencies, export credit agencies, foreign commercial banks, private insurance underwriters and investments funds to co-finance with the EBRD.

4.19 On average, confirming banks shared 23% of the risk covered under the program. FMO Netherlands, OFID and private insurance underwriters share EBRD´s risk in TFP facilities for selected banks in Azerbaijan, Belarus, Georgia, Kazakhstan, Moldova, Russia, Tajikistan and Ukraine.

### Crisis response

4.20 An increase in the TFP program limit from Euro800 million to Euro1.5bn in 2009 enhanced EBRD's ability to respond to the current lack of liquidity and risk-taking capacity in the private trade finance market. In 2009, many foreign commercial banks and private insurance underwriters suspended their trade finance facilities for banks and importers in the CIS and South-East Europe and were ready to consider new business only with risk cover by export credit agencies or under the EBRD's TFP.

4.21 However, many foreign exporters and foreign commercial banks are now declining new business, even with 100% EBRD risk cover under TFP guarantee facilities, because they do not have sufficient liquidity to finance these transactions, particularly in cases of larger amounts and longer tenors. If at all, foreign exporters are ready to accept payment by L/Cs until delivery of the goods, but they are no longer able to grant longer payment terms for financing sales of machinery and equipment, storage and distribution of the imported goods in EBRD countries of operation. Importers and exporters in these countries are therefore finding it more and more difficult to finance foreign trade transactions, particularly imports of machinery and equipment, exports from EBRD countries of operation and intra-regional trade transactions.

4.22 As a result, the EBRD offers, not only up to 100% risk cover for letters of credit issued by TFP client banks in Eastern Europe and the CIS, but also provides issuing banks with the necessary liquidity for pre-export finance, post-import finance and financing for the local distribution of imported goods. Therefore, in many cases the EBRD is the only institution which can still provide risk cover and liquidity for financing foreign trade with importers and exporters in this area.

4.23 A good example of EBRD's on-going support to the region was an EBRD TFP guarantee which covered the import and distribution of agricultural machinery to Ukraine. This guarantee covered a L/C issued by a bank in Ukraine and confirmed by a bank in Germany. The framework for the transaction was pre-2009, and it was originally concluded without EBRD support, but new shipments of machinery and equipment continued throughout 2009, and in the light of the recent financial crisis, EBRD was asked to support the deal by guaranteeing payments under this contract up to an aggregate value of at least Euro50 million.

4.24 In 2009, in order to compensate for the lack of available trade limits from the commercial market, more than 850 foreign trade transactions for the total amount of Euro550 million were supported by the EBRD's TFP programme, providing additional benefits to the trade finance market.

## The International Finance Corporation (IFC)

### General overview

4.25 In the autumn of 2008, IFC's Global Trade Finance Programme (GTFP), entering its fourth year of operation, was playing an important role as an international trade facilitator, complementing and extending the capacity of banks to deliver trade finance in emerging markets. GTFP offers confirming banks partial or full guarantees covering payment risk on banks in the emerging markets. Guarantee volume was steadily growing as a result of an ever-expanding list of banks included for coverage (143 banks located across 68 emerging market countries at the time) and because the GTFP ceiling was increased to $1.5 billion in September 2008. The feeling was that IFC was well positioned to continue supporting trade in an effective, responsive manner via its GTFP, that is, until the full implications of the deteriorating economic/banking environment became painfully obvious a month later.

4.26 By October 2008, the word “crisis” was front page, and its viral, global nature was being charted. Centuries-old financial names were caving or collapsing; the banking market was paralyzed and high level summits convened to address the biggest meltdown since the Great Depression. It was no surprise that the contraction of trade finance was among the first victims of the crisis. Its costs skyrocketed because of growing liquidity pressure in the money centre banks, the general scarcity of capital and a perception of heightened country and counterparty risks.

4.27 The contraction in trade finance was also fueled by the loss of critical market participants, such as Lehman, a drying up of the secondary market for short-term exposure (as banks and other financial institutions deleveraged) and the volatility of commodity prices. The implementation of the Basel II Accord on banking laws and regulations, with its increased capital requirements, put additional pressure on the accessibility to trade finance, which was increasingly limited for small- and medium-sized enterprises (SMEs) and banks in emerging markets.

4.28 The dysfunction within the bank market, which was clearly evident in late 2008, led to delays in international trade, and goods being docked for weeks before shipment, as terms of financing were finalized. IFC was witness to the negative effects of the liquidity pressure on trade finance through its extensive network of banks participating in the Global Trade Finance Program. A steep decline in guarantee volumes in October 2008 was irrefutable evidence that even with 100% guarantees from a multilateral, many of the major international banks were not in a position to transact with counterparty banks.

4.29 By the end of 2008, trade finance deals were reportedly offered at 300–400 basis points over interbank refinance rates – two to three times more than the rate a year earlier. The initial impact was felt by the banks actively engaged in pre-export finance in Latin America and then in Asia and Africa. The cost of L/Cs was reported to have doubled or tripled for buyers in emerging countries, including China, Turkey, Pakistan, Argentina and Bangladesh. This assessment was confirmed in the IMF/BAFT survey, which found widespread increases in pricing of all trade finance instruments relative to banks’ costs of funds.

4.30 As part of the global response to the crisis, the World Bank Group (WBG) was asked to play a stabilizing and catalytic role for trade finance. IFC, in collaboration with the International Bank for Reconstruction and Development (IBRD), assumed a leadership role in developing strategies and delivering a coordinated series of initiatives to lend support to trade and respond to the call for early action. Leveraging the experience and expertise IFC had built up in trade through its unfunded GTFP, the World Bank Group proposed a complementary programme to deliver a funded trade product: the Global Trade Liquidity Programme (GTLP).

4.31 The GTLP is a unique, collaborative crisis response initiative among development finance institutions, bilateral and multilateral organizations and governments to mobilize funding on a temporary basis targeted to support trade finance in the developing world. GTLP is designed as a vehicle whereby aggregated funding from IFC, DFIs, bilateral and multilateral organizations, and governments of up to USD5 billion (including IFC up to USD1 billion), will be mobilized and disbursed to individual banks in phases over the next three to nine months. Funding will go to selected global or regional banks with an extensive trade finance presence in the developing world through a number of investment structures to extend liquidity for trade finance to reach underserved clients globally.

### Results to date

4.32 GTLP has made important strides since it was launched in mid-2009. USD 4 billion in funds have been successfully mobilized from IFC and governments of Canada, Japan, UK, Netherlands, Saudi Arabia and Austria. There are seven facilities established totaling USD6.6 billion: Standard Bank South Africa, Standard Chartered Bank, Citibank, Rabobank, Commerzbank, JP Morgan Chase, and Afreximbank. As of 31 January 2010, GTLP had disbursed USD1 billion supporting total trade of close to USD 3 billion. IFC expects to disburse USD2.5 billion in committed funding over the coming months, supporting trade of USD4 billion or USD 8billion p.a., considering a 180 day cycle.

4.33 Of the total programme utilization to date, 35% is in sub-Saharan Africa, 40% is in IDA countries, and 80% is benefiting SMEs. As the economic recovery continues, market needs reflect priority shifting gradually from liquidity to guarantees over the next 12-24 months. Thus, a GTLP Phase 2 will include the GTLP Guarantee (same GTLP platform, but unfunded) and GTLP Agri (to support food and agriculture sector) where demand is still high and we have a strong case for a role and additionality. To that end, IFC has recently signed with SIDA of Sweden, which committed to provide USD 125 billion for GTLP guarantees.

## The Asian Development Bank (ADB)

### General overview

4.34 The much-anticipated recovery in the global economy is driving a sharp rise in trade, particularly in Asia. World trade volumes for goods rose 4.8% in December 2009, its fourth straight month of gains. This is driving a rising demand among exporters, importers and their banks for the finance to support their trading activities. As such trade and trade finance markets are likely to end 2010 in a much healthier state than when they started in 2009.

4.35 However, there will be challenges ahead and the recovery will be uneven. Developed nations are likely to recover from the crippling effects of the downturn much more slowly than emerging Asia. The Asian Development Bank (ADB) expects developing Asia to expand by 6.6% this year against a 1.6% expansion in the US and further stagnation in the Eurozone.

4.36 That will be reflected in a sharper rise in trade volumes notably in Asia as the region produces more for local consumers whose incomes are gradually rising, as well as for customers elsewhere who are starting to rebuild the inventories they ran down during the crisis.

4.37 And within Asia itself, some countries will have more trouble than others in getting hold of enough trade finance. Small- and medium-sized enterprises (SMEs) will also continue to find it tough to get pre and post-shipment financing.

## ADB's Trade Finance Facilitation Programme

4.38 ADB's Trade Finance Facilitation Program (TFFP) aims to fill the gaps, not only in times of crisis but also to support recovery and to foster better long-term links between banks and companies internationally. The TFFP provides guarantees to confirming banks as well as trade loans to banks in developing member countries in support of pre-export and post-shipment finance and does so within 24-48 hours from the time it receives guarantee and loan applications from partner banks.

4.39 In response to the economic crisis, the TFFP exposure limit was increased to USD1 billion and more staff were recruited to support the expanding programme, fuelling a sharp rise in the programme's activities. In 2009, the TFFP supported USD2 billion in trade, an increase of over 300% compared with 2008. The TFFP had the bulk of its exposure in as Bangladesh, Pakistan and Vietnam, but was also very active in Indonesia, Sri Lanka and other markets.

4.40 The TFFP currently works with over 90 confirming banks around the world and 87 issuing banks in developing member countries. The number of participating banks is growing and ADB expects approximately 125 issuing banks to be part of the programme by the end of the third quarter 2010.

4.41 Given its tangible and measurable contribution to economic development, ADB is committed to supporting the TFFP. For example, in 2009, the TFFP provided trade support for 263 small- and medium-sized enterprises (SMEs). Supporting growth of SMEs is a priority for ADB since smaller firms employ the largest number of people in most Asian countries. Promoting SMEs also contributes to private sector development in Asia, which is key to diversifying and developing local economies.

4.42 Increased trading activities and cross-border relationships enabled by the TFFP are helping boost economic integration and cooperation in Asia, which should, in turn, spur faster economic growth and help reduce poverty. In 2009, 56% of the TFFP's portfolio supported intra-regional trade. Furthermore, 47% of the TFFP's USD2 billion portfolio supported trade between ADB's developing member countries.

4.43 Given its large development benefits, ADB will continue to expand the TFFP. For 2010, ADB intends to expand the TFFP rapidly throughout Central Asia. The TFFP will in coming months expand in Mongolia, Azerbaijan, Uzbekistan, Tajikistan, Kyrgyzstan, Georgia, Armenia and Afghanistan, to be followed by Turkmenistan later in the year.

## International Chamber of Commerce (ICC)-ADB cooperation

4.44 As well as supporting trade in Asia's more challenging markets, ADB is working closely with ICC to address Basel II capital requirements on trade finance.

4.45 Basel II imposes capital requirements on trade finance that are commensurate with much riskier forms of finance such as overdrafts. Trade finance, however, is much safer since it tends to be short-term in nature and supports self-liquidating transactions.

4.46 Recent research by Global Business Intelligence showed that these very strict capital requirements are damaging trade because banks used the capital they would have otherwise used for trade finance to comply with Basel II's higher capital ratios. Basel II, and any succeeding regulations, need to recognize the relatively low-risk features of trade finance by lowering capital requirements.

4.47 The trade finance community has to work with the regulators to make this happen. One critical step is to collect more empirical data from commercial banks and multilateral organizations to clearly show that trade finance has a lower default, lower loss and lower credit conversion ratio than other forms of finance. ADB has partnered with the ICC to establish the ICC-ADB Trade Finance Default Register. The Register collects and analyzes data that will provide empirical data to demonstrate to regulators that capital requirements for trade finance should be lowered, which would be of significant benefit to international trade.

### Going forward

4.48 ADB looks forward to expanding TFFP partnerships with commercial banks to support more trade in developing Asia, an important source of global economic growth. We anticipate that ADB's TFFP will support more than $3 billion in trade in 2010.

4.49 We also look forward to continuing our work with ICC and commercial banks to develop statistics in trade finance that will benefit the trade finance community's understanding of risk, as well as to develop an appreciation among national and international regulators of the low risk profile of trade finance and the capital requirements that should apply to it.

## The Inter-American Development Bank (IDB)

### General overview

4.50 The Inter-American Development Bank (IDB) was established in 1959 as a multilateral development finance institution whose mission is "to contribute to the acceleration of the process of individual and collective social and economic development of member countries in key areas of development". The IDB is the largest multilateral public lender for Latin America, providing the region's governments and private sector entities with:

- loans, grants and guarantees;
- equity investments (via two affiliated bodies);
- technical cooperation (interest-free loans); and
- technical assistance for planning and implementing development projects and policy and sector reform programmes.

4.51 According to an agreement made by the Governing Assembly as part of the eighth replenishment of the Bank by the US Treasury, the IDB should also "prioritize social equality and the reduction of poverty, the growth of sustainable economy, the modernization of the state and regional integration". Together with other multilateral development banks, the IDB is mandated to be a catalyst for sustainable social and economic development in Latin America.

4.52 The Inter-American Development Bank started its trade facilitation programme in 2005 with a focus on supporting trade finance operations to, from and within the Latin American and Carribean countries.

### The IDB Trade Finance Facilitation Programme (TFFP) crisis response

4.53 The global economic crisis has reduced access to trade finance and increased borrowing costs for countries in the region. The IDB has expanded the scope of its trade finance programme with banks to help companies preserve their export markets and to keep trade routes open:

- Trade Finance Facilitation Program (TFFP) guarantees and loans increased the program size from USD400million to USD1billion and added flexibility to include other hard currencies and global imports to Borrowing Member Countries;
- In response to the liquidity trap, the IDB also provided direct trade finance loans through its network of issuing banks;
- Since the inception of the economic crisis, 14 new issuing banks have been added by the IDB with facilities of approximately USD210 million;
- Trade finance through special vehicles – Trade Funds continued support by means of extension of existing financing, increasing funding available and mobilizing additional financing from institutional investors and banks to enable Trade Funds to expand their coverage of small- and medium-sized companies in the LAC region;
- Capacity building – in its Trade Financing Training Programme from 2008 to 2009, IDB provided training to 19 TFFP Issuing banks and their small trade clients in Argentina, Ecuador, Guatemala, Nicaragua, Panama, Paraguay and Uruguay. This training was attended by 657 employees from the banks and small trade clients; and
- Liquidity for Growth Sustainability (LGS): through this programme IDB made available USD6 billion to the Borrowing Member Countries, enabling them to have access of up to USD500 million to address the need of trade finance in its local financial institutions due to the financial crisis and recovering trade demand.

## The Berne Union and the Role of Credit Insurers

### Credit insurance industry shows stability against at backdrop of reduced world trade

4.54 In 2009, members of the Berne Union globally insured an estimated USD1.3 trillion worth of international trade. While this is a decrease of around 9% compared to 2008, it has to be put in the context of a much stronger reduction of global trade which, according to IMF staff estimates, seems to have contracted by as much as 25% to USD11.9 trillion. As a result, the share of global trade covered by Berne Union members appears to have increased from 9% to 11%.

4.55 The business covered under Short Term Export Credit Insurance (ST) – insurance of trade transactions with a tenor of one year or below – declined by 13% to USD1.1 trillion. On the other hand, the Medium Long Term Export Credit Insurance (MLT) – insurance of trade transactions with a tenor of more than one year (typically 3-5 years up to ten years or even up to 15 years in exceptional cases) – showed an increase by 25% to more than USD190 billion worth of insured trade.

## Short term

4.56 The main drivers for the drop in ST business were: 1) the lower underlying trade volumes due to the reduction in the international economic activity; and 2) a more cautious risk assessment by credit insurers faced with a seriously deteriorated global economic environment. A number of players started to reduce credit limits offered to customers in the second half of 2008. This was the time when the looming crisis had become apparent and buyer defaults started to accumulate. The decline in international trade, coupled with the risk mitigating measures taken by insurers, showed their effect in 2009 and resulted in a reduction in turnover covered.

4.57 Total claims paid to insured customers by all Berne Union members more than doubled from 2008 to 2009 and reached USD2.4 billion. As the total premium stayed roughly the same at an estimated USD2.8 billion, the loss ratio jumped from 40% to 87%.

4.58 The global nature of the crisis was evident in the claims numbers. The US and Western European countries (Italy, the UK, Spain and Germany) were among the top claims countries where buyer defaults occurred for which insurers had to pay claims. Claims paid by Berne Union members due to defaults in these five countries amounted to nearly USD 800 million or 32% of total claims. This is not surprising as these countries are also among the largest exposure countries where Berne Union members have covered transactions, totalling around 31% of Berne Union members' total exposure.

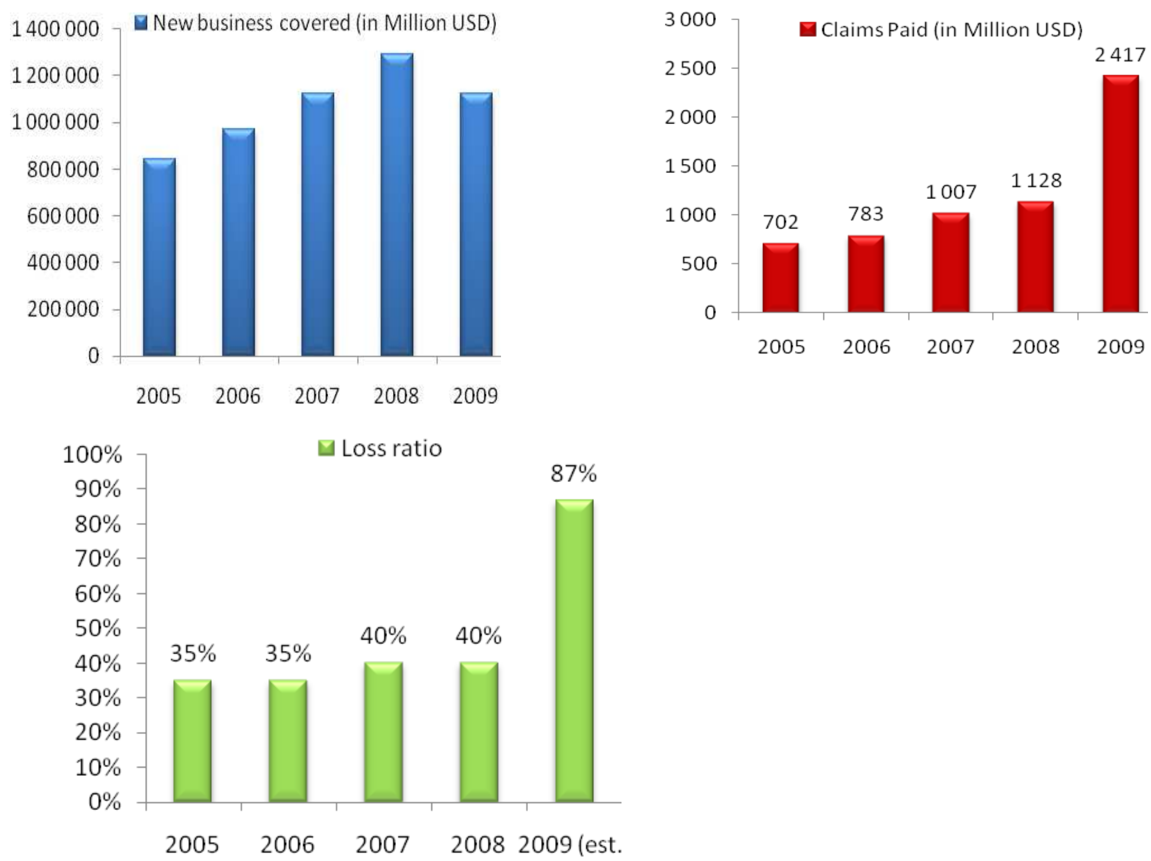
4.59 A group of emerging economies (Russia, Ukraine, Brazil, Turkey and Mexico) showed claims volumes of a similar magnitude – more than USD550 million or 23% of total claims – despite the exposure in these countries being much smaller at around 6% of total Berne Union exposure.

4.60 For a number of exporters, the support from credit insurers proved vital to continue to trade and sell goods internationally. Having secured receivables through credit insurance is often a requirement for banks to provide financing to exporters. This insurance cover has become even more important during the crisis.

4.61 With the support of their governments, many Export Credit Agencies (ECAs) – the government-linked providers of export credit insurance – took initiatives to support ST export credit insurance. In fact, in the ST statistics of the Berne Union, the part of business insured by ECAs increased from around 25% to slightly more than 30%, with the remainder being covered by private market insurers. While the majority of ST insurance coverage is provided by the private market, the intervention of ECAs came at a crucial time, supplementing private market capacity. This helped to smooth the impact on exporters of coverage reduction by private players. ECAs, particularly in Europe, are now starting to gauge the market and assess when it might be the right time to reduce their ST activity.

4.62 At the end of 2009, ST capacity provided by Berne Union members was below the level provided in 2008 and 2007, but still at higher levels than in 2006 and prior years. This shows the resilience of ST credit insurers when faced with the worst crisis in decades.

Figure 34: Short term export credit insurance




## Medium Long Term

4.63 The MLT statistics of the Berne Union capture insurance coverage provided by ECAs only. As the deterioration in the risk environment was coupled with a general lack of liquidity, bank financing dried up at the end of 2008 and at the beginning of 2009. At that time, ECA insurance coverage had become a condition without which banks would not finance MLT transactions.

4.64 ECAs, who traditionally are big providers of MLT cover, faced a substantial increase in demand for their products. After a slow start in the first quarter of 2009 due to the lack of available finance, the volumes of new MLT transactions insured increased steadily with the fourth quarter, showing the highest amount ever insured in one quarter. At the end of the year, the new business covered had reached an all-time high of USD191 billion, up by 25% compared to 2008.

4.65 Claims paid to customers in 2009 for defaults on MLT transactions nearly tripled compared to the previous year and reached USD3.1 billion. The insurance premium income increased by 25% to an estimated total of 4.7billion, and the loss ratio reached 66%. By nature, MLT business is much more subject to volatility in loss development compared to ST business. The reason is that MLT usually covers large transactions with long repayment periods, and this business is by nature more "lumpy" than ST, which typically has a broad spread around thousands of relatively small risks in many countries.

4.66 Again, also in the MLT field, the support of ECAs proved effective in helping banks to extend financing and therefore helping exporters to sustain international trade.

## Outlook

4.67 Economic recovery seems to have started, at least in some regions of the world and at different levels, and the credit insurance industry will continue to support its customers involved in global trade. It appears that obligor defaults and resulting notifications of losses for credit insurers have stopped rising and may be starting to taper off. It remains to be seen whether this possible trend will be confirmed in Berne Union figures over the year 2010.

4.68 The bottom line is the demonstration of the solidity of the credit insurance industry in light of an unprecedented global crisis. Berne Union members, private and public providers of risk mitigation through credit insurance, will play an important role in sustaining trade flows into the recovery.

# SECTION 5.

# The Changing Regulatory Environment: Risks and Opportunities

## The Basel Framework and Trade Finance

5.1 In the context of the economic crisis, ICC respondents and members expressed concerns about the impact of the Basel II capital adequacy charter on the provision of trade finance. These concerns were first raised at the WTO Expert Group meeting on Trade and Finance in November 2008, which was convened to discuss reported shortages of trade credit, particularly in developing and emerging economies.

5.2 Following this meeting, a survey of major international trade finance banks undertaken by ICC's UK chapter found that implementation of the Basel II charter had significantly increased the capital intensity of trade finance lending, hence constraining the ability of banks to lend short-term trade credit. The survey results indicated that these increases in capital requirements had had particularly adverse consequences on trade finance for SMEs and counterparties in developing economies.

5.3 In contrast, the relatively favourable treatment received by trade finance under the previous international capital adequacy framework (Basel I) was reflected in the moderate rate of capitalization for cross-border trade credit during the 1980s and 1990s.

5.4 However, as the banking and regulatory communities moved toward "internal-rating based" and "risk-weighted assets" systems under Basel II, a number of concerns emerged with respect to the treatment of trade credit, particularly in periods of economic crisis. These trends can be ascribed to three primary factors:

- **the focus of Basel II on counterparty risk rather than product or performance risk:** Basel II makes capital requirements an increasing function of banks' estimates of their loans' "probability of default" and "loss given default". However, insufficient mitigating consideration is given to the inherent strengths of trade finance products, e.g. its short-term self-liquidating nature, and the tendency for companies to avoid defaulting on trade finance facilities. As a result, the anomaly is that trade is treated almost as having the same type of risk as other unsecured lending, such as overdrafts.

- **rigidities in the maturity cycle applied to short-term trade financing:** Whilst trade financing is usually short-term in nature, based on between 0 to 180 days maturity, the Basel II framework applies a one-year maturity floor for all lending facilities. Since capital requirements (naturally) increase with maturity length, the capital costs of trade financing are artificially inflated as a result. All regulators have the (national) discretion to waive this floor. Although the UK Financial Services Authority did so at the end of 2008, several regulators have chosen not to take this step.

- **a lack of historical and performance data to assist in validating risk attributes:** Many banks face difficulties identifying and isolating sufficient data to produce estimates of risk attributes for trade financing that can be validated. The factors causing this are wide and varied, but particular problems include: (a) migration of facilities (i.e. when a trade loss results in an exposure on another facility, such as an overdraft); (b) customer-centric data collection practices; and (c) inherent biases in the data collected.

5.5 By increasing the amount of capital banks are required to hold against trade finance lending, each of the above factors significantly restrict the ability of banks to provide essential short-term credit to businesses, particularly in the current, capital-constrained environment. In this context, the ICC Banking Commission issued a recommendations paper in advance of the G20 London Summit in April 2009, calling on the international community to address the impact of Basel II on the provision of trade credit.

## The Evolving Context

5.6 The G20 summit came up with a substantial package of measures to support trade finance – specifically, USD250 billion of funding to be made available through multilateral banks and export credit agencies, as well as a mandate for regulators to "make use of available flexibility in capital requirements for trade finance".

5.7 With regard to the latter, there has been limited push through from regulators in relation to the mandate set out at the London Summit to address the impact of Basel II on trade finance. ICC understands that a small number of national supervisors have exercised limited flexibilities under Basel II for trade products (i.e. by waiving the one-year maturity floor), but ICC continues to press the case for further capital relief for traditional trade transactions. We consider that this agenda is all the more urgent as a result of the findings set out in paragraphs 3.22–3.25, above.

5.8 To further advance this agenda, ICC and ADB have recently established a project known as the "ICC-ADB Trade Finance Credit Register" to collect performance data for trade finance products. This initiative should assist in developing a pool of data to substantiate the argument that trade finance is, relatively speaking, a low-risk form of financing. The initial phase of this project will end in mid-May 2010, with a key findings report issued at this point.

## Basel Committee Proposals on "Strengthening the Resilience of the Banking Sector" and the Implications for Trade Finance Instruments

5.9 At its December 2009 meeting, the Basel Committee on Banking Supervision approved for consultation a package of proposals to strengthen global capital and liquidity regulations with the goal of promoting a "more resilient" banking sector.

5.10 The consultation document includes proposals to introduce a new framework to limit the build-up of excessive leverage in the banking system, referred to as a "leverage ratio constraint". We understand that this concept was broadly endorsed by the G20 at the Pittsburgh Summit in September 2009.

5.11 Without commenting on the appropriateness of a new mechanism to limit bank leverage, we have been concerned to note, however, that the proposals group trade products with a number of other instruments which exhibit significantly different characteristics, effectively categorizing some trade products (such as L/Cs) as "risky" asset classes.

5.12 It is our contention that this approach is unjustified; moreover, it is liable to lead to an overall reduction in the supply of trade finance, contrary to the G20 London Summit agenda to promote international trade as a key vector of economic recovery. A short summary of the proposals/our concerns is set out below. A full technical analysis of the paper is contained in the ICC statement: "ICC response to the Basel Committee consultation on *Strengthening the Resilience of the Banking System*".

## The leverage ratio constraint and "off-balance sheet" items

5.13 Under the current Basel II framework, "Credit Conversion Factors" (CCF) are used to calculate the potential future credit exposure for off-balance sheet (i.e. contingent) items. The most frequently used CCF values for contingent trade products are 20% for L/Cs and 50% for performance guarantees. These values reflect the fact that an off-balance sheet exposure for a contingent trade product will not necessarily crystallise in full into a credit exposure for the bank.

5.14 The Basel Committee proposes, however, to increase the CCF for all off-balance sheet exposures (including trade products) to 100% for the purposes of calculating a leverage ratio constraint. This proposal is based on the view that:

a) all off-balance sheet items are a significant source of leverage within the financial system; and

b) the failure to include off-balance sheet items in the measure of exposure creates an "incentive to shift items off the balance sheet to avoid the leverage ratio constraint".

5.15 We consider that this blanket approach to "off-balance sheet" items under the proposed leverage ratio is based on a fundamental misunderstanding of both the operational context and the mechanics of trade financing. Specifically:

a) it is difficult to maintain that trade-related exposures are a source of significant leverage, as the underlying transactions are driven by genuine economic activity, e.g. the sale of goods or services; and

b) as trade transactions are originated at the request of a client, these types of facilities are unlikely to be written to avoid leverage constraints.

5.16 What is more, the conversion of off-balance sheet trade exposures is not driven by counterparty default, but rather is performance-related (e.g. performance guarantees), or dependent on documentary requirements (e.g. L/Cs). With regard to the latter, for example, a bank has no obligation to make payment to an exporter under an import L/C unless a range of documentation is submitted in compliance with the requirements of the instrument. In this connection, if the bank is not comfortable with the creditworthiness of the transaction, it has no obligation to waive the documentary discrepancies and make payment.

### Potential implications and proposed next steps

5.17 Increasing the CCF to 100% for trade-related contingencies for the purposes of calculating a leverage ratio could significantly disadvantage trade finance-focused banks. When the leverage ratio becomes the “binding constraint” on a bank, it may choose to increase the cost of providing trade products; or only selectively offer these products to customers. It is the fundamental concern of ICC members surveyed that this cycle will adversely impact on the supply of cost-effective trade credit to businesses, thus compounding existing market constraints.

5.18 In this context, we recommend that, if a leverage ratio is to be adopted, a framework be developed to allow trade finance products to retain the CCF values used under the current Basel II framework. It is our view that such an approach would be consistent with the G20 agenda to promote trade finance, without compromising the overall objective of the Basel Committee proposals.

## Towards a Basel II “Working Group” on Trade Finance?

5.19 Given the broader concerns that exist surrounding the (unintentional) impact of Basel II on trade financing, mentioned above, ICC considers that it may be timely for the Basel Committee to establish a specialist trade finance “working group”. Such a group, we believe, would be well placed to examine the specific characteristics of trade finance products, the issues that arise when applying the existing regulatory framework to trade facilities, as well as the trade-related aspects of the Basel Committee’s current proposals. ICC would be delighted to support the work of such a group.

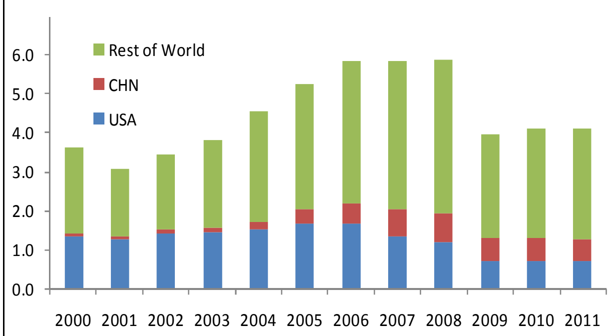
# SECTION 6

## Outlook 2010 and Beyond

### Prospects Are Mixed

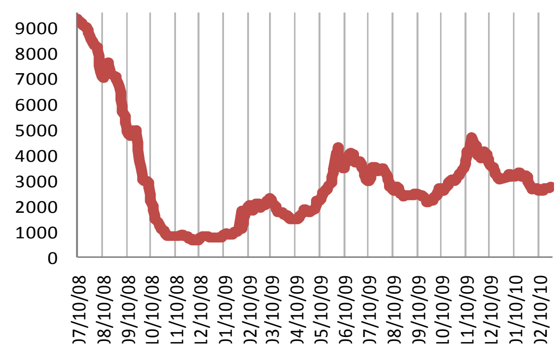
6.1 The Survey reveals that prospects for a lasting strong trade recovery are mixed. As shown for the period 2008-2009, the absolute value of global current account balances (the sum of all surpluses plus the absolute value of all deficits) was estimated to have declined from a peak of 5.9% of world GDP in 2008 to around 3.9% in 2009. It is believed that global imbalances as a percentage of world GDP will remain at the same level for some time (Figure 25).

Figure 35: Global imbalances as a % of world GDP




Source: World Bank Global Economic Prospects 2010

Figure 36: Baltic Dry Index July 2008 to February 2010




Source: Baltic Dry Index website

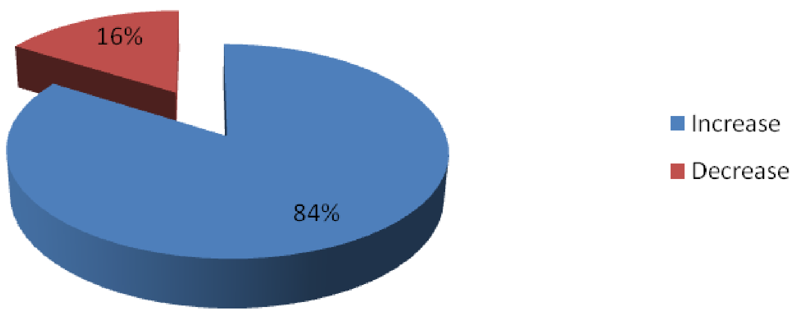
6.2 Advanced indicators of trade developments underscore the fragility of the current recovery. For instance, the Baltic Dry Index (BDI) and air freight traffic point to a fragile rebound. The BDI, a measure of the cost of shipping bulk cargo by sea, picked up in February 2009 after a seven month drop, but has been hovering at the same levels since then (Figure 3).

6.3 Given the expected uncertain recovery and the effects of a weak base, trade is projected to expand by only 4.3% in 2010 and by 6.2% in 2011 (World Bank Global Economic Prospects 2010). This lag in the trade rebound appears to reflect the still depressed level of investment activity; investment goods generally are heavily traded. Global investment fell by an estimated 9.7% in 2009, and in 2010 investment is forecast to grow by only 4.9%. Almost a year into the recovery, trade values remain around 20% lower they were at pre-crisis levels and 40% lower than they would have been if world trade had continued to grow in accordance with its 2002-2008 trend. The lag in the trade rebound could also be a reflection of weak trade finance.

6.4 Respondents to the 2010 Survey asserted that the demand for traditional trade finance products (commercial L/Cs, standby L/Cs, guarantees and collections) would be sustained in 2010. Indeed, 84% of respondents reported that they anticipated an increase in demand for traditional trade products in 2010 (Figure 26). 93% of them were confident that in 2010 they could meet any increased demand for these products from their client base.

6.5 At the same time, bankers have indicated that the forms in which financial intermediaries were providing lending, working capital or liquidity for the purpose of financing trade may have significantly changed, in particular to accommodate the expansion of international supply chains, but also to reflect regulatory changes that may have constrained trade (See Section 5). It is not certain whether new forms of unsecured financing will be strengthened to maximize importers and exporters' cash flow while minimizing the cost of trade finance (open account financing, forfaiting, etc.).

Figure 37 : Demand for traditional trade products in 2010




## The Way Forward: Protectionism and the Doha Round

6.6 The crisis has revealed that trade rules matter and that WTO rules have positive effects in constraining protectionism. However, it is also apparent that for areas not covered by multilateral disciplines, or where there is limited coverage, countries have been less able to resist protectionist pressures. Some examples of this include the reintroduction of export subsidies by the EU and the US, the passing of bail-out packages that call for preferential treatment for domestic firms, more restrictive policies affecting the movement of workers providing cross-border services and discriminatory procurement policies.

6.7 Conclusion of the Doha Round is critical for the future of trade. As the global economy continues its gradual recovery, governments must ensure that the long-run benefits of an open and transparent multilateral trading system are not compromised by short-term pressures to protect domestic markets. Concluding the Doha Round would help, not just to gain more market access, but to strengthen the international trading system, constrain future increases in tariffs and subsidies and help governments resist protectionist pressures as they unwind current expansionary policies and provide a much needed boost to keep markets open.

6.8 Therefore, what's on the table in the negotiations in Geneva is significant. Based on current proposals, the Doha Round would do as much if not more than any previous round to encourage broader trade.[20] The benefits in terms of actual improvements in market access would be significant, even after factoring in exceptions for special and sensitive products. The Round would not just lower tariff bindings, but would also ban agricultural export subsidies and cap agricultural and marine production subsidies. It also offers scope for significantly increasing the security of market access in services. Finally, the Round would help lower trade costs and enhance the competitiveness of developing countries through an agreement on trade facilitation.

[20] Hoekman, Bernard, Will Martin, and Aaditya Mattoo, 2009, "Conclude Doha: It Matters", Policy Research Working Paper, World Bank.

6.9 At the Seventh WTO Ministerial Conference in Geneva in November 2009, ministers reiterated the importance of trade and the Doha Round to economic recovery and alleviating poverty in developing countries. They reaffirmed the need to conclude the Round in 2010 and urged that a stock-taking exercise take place in the first quarter of 2010. Yet, at this stage, only leadership and engagement from world leaders can revive the Round and bring it to closure.

6.10 Beyond Doha, government actions in response to the crisis emphasize the need for the multilateral trading system to broaden its scope for cooperation in order to ensure that cross-border policy matters currently not on the Doha Development Agenda are appropriately addressed. Potential areas for negotiating new rules and discipline(s) include trade-related climate change, food and energy security, as well as other issues left unaddressed or unfinished in the Doha Round. The stalled Round is crowding out these issues that need to be properly addressed through negotiated rules and norms. Limited guidelines and rules in these areas allow discriminatory actions to be imposed with impunity.

6.11 The crisis has also revealed the importance of strengthening the monitoring and public reporting of government measures to ensure that there is transparency in the trading system to distinguish WTO-compatible from discriminatory policies. Transparency plays a critical role in maintaining a predictable and open trading system. Free-flowing information on policies affecting trade is essential for cooperation among countries seeking to manage the crisis. Comprehensive and timely notification of trade contingency measures to the relevant WTO bodies is required to ensure proper monitoring. Currently, the lack of this information on public procurement, subsidies and other non-tariff measures highlights the need to strengthen institutional notification and data collection mechanisms.

# SECTION 7.

## Conclusion and Recommendations

7.1 In this Survey, we have treated a number of issues related to trade credit internationally – a priori (treatment by banking regulators) and a posteriori (treatment by debtors and creditors in the case of default). These issues are of current interest to the trade finance community, in particular the traditional providers of trade credit and guarantees, such as banks, export credit agencies, regional development banks and multilateral agencies.

7.2 The 2010 ICC Survey has confirmed that the current global financial crisis has continued to affect financial institutions and markets worldwide. This is a challenging economic environment, and trade volumes may be further impacted in the coming months. On a global basis, the predictions for 2010-2011 remain cautious; many expect that the economic turmoil will continue to predominate.

7.3 Although in the 2000s the relative market share of traditional forms of trade credit such as letters of credit has declined, ICC Surveys, including the present one, demonstrate that there has been a "re-securitization" of lending, as payment defaults increased. Because liquidity shortages have been detrimental to lending, the relative market shares of open account financing versus letters of credit seem to have been reversed, to the benefit of letters of credit.

7.4 Still, the majority of financial institutions have restricted and limited their lending policies and activities, which has negative implications for liquidity in the financial markets. There is a global concern that if the recession continues, capital costs will further increase, exacerbating current trends. In this environment, banks remain focused on how to best structure and manage their working capital needs. This encompasses providing guidance concerning decisions on new ventures, knowledge of counterparties, better structuring of deals and assessing cross-border liquidity to obtain the best leverage possible.

7.5 In this respect, we propose a few recommendations as follows.

7.6 First, we believe that it remains important to improve the resilience of emerging market economies. Our members indicated that, particularly in times of economic uncertainty, it was necessary to build trust among nations at all levels of development. Structural measures to achieve this could include an expanded use of asset-backed securitization funding structures, risk-sharing and greater risk differentiation by banks and public authorities.

7.7 Second, the industry is well aware that a lack of a comprehensive set of statistics on trade finance limits efforts to confirm the trends revealed by market intelligence surveys. With no precise statistics available, there is nonetheless anecdotal evidence indicating that L/C will continue to account for a significant, if not a growing share of trade finance. One development reinforcing this belief is the dynamic nature of South-South trade, where letters of credit play a prominent role for a variety of reasons – higher levels of security, enforceability and standardization. ICC has recently proposed to fill the information gap in trade finance, in particular by providing business performance data evidencing the loss history of different trade finance risk categories As noted above, ICC is now designing a Register to collect such information, in partnership with the ADB.

7.8 Third, we continue to recommend a further enlargement of multilateral trade finance programs to expand the supply and coverage of trade finance, especially for low-income and export-dependent countries during periods of instability. At the same time, national programs to guarantee trade and to provide refinancing options must be reinforced, in particular through ECAs. The latter could develop more direct lending schemes to emerging markets, including through sub-participation in bank lending.

7.9 Fourth, we believe that ICC past recommendations concerning the existing capital adequacy regime are still valid, especially in times of turbulence. Appropriate supervisory changes to the Basel II framework should be adapted to allow more proportionate capital weightings for traditional trade finance transactions. In particular, we urge national regulators to exempt trade finance products from the one-year maturity floor applied to lending facilities in most countries and to allow key risk attributes to be determined on the basis of industry benchmarks reflecting the low risk nature of trade finance.

7.10 Finally, it is crucial to consider the views of the industry in order that regulators can craft more realistic regulations. International banks are continue to voice concern about the ramifications of proposed rules that would replace the current Basel II international capital adequacy regime and which could further drive up the cost of capital provisioning for traditional forms of short-term trade finance, such as letters of credit. We understand that a full set of “Basel III” standards has been earmarked to be phased-in by the end of 2010, with the aim have to them fully implemented by the end of 2012. With reference to the consultative document prepared by the Basel Committee on Banking Supervision or BCBS (“Strengthening the Resilience of the Banking Sector”), ICC has asserted that the safe, short-term and self-liquidating nature of trade finance should be properly recognized in the new framework. Furthermore, ICC recommended that if a leverage ratio is to be adopted, off-balance sheet trade products should be allowed to retain the CCF values used by banks under the current “risk weighted assets” calculation. This would move in the direction foreseen in the “additional option for impact assessment” contained in the consultative document, which would allow financial institutions to “apply a lower (positive) CCF for unconditionally cancellable commitments or Basel II standardized CCFs”.

7.11 Given the broader concerns that exist about the impact of Basel II and upcoming regulations on trade finance, we suggested that it may be timely for the BCBS to establish a specialist trade finance working group. Such a group, we believe, would be well placed to examine some of the issues that arise when applying the existing regulatory framework to trade finance, as well as the trade-related aspects of the Basel Committee’s proposals. ICC would be pleased to contribute to the work of such a group.

International Chamber of Commerce
*The world business organization*

# The International Chamber of Commerce (ICC)

ICC is the world business organization, a representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world.

The fundamental mission of ICC is to promote trade and investment across frontiers and help business corporations meet the challenges and opportunities of globalization. Its conviction that trade is a powerful force for peace and prosperity dates from the organization's origins early in the last century. The small group of far-sighted business leaders who founded ICC called themselves "the merchants of peace".

ICC has three main activities: rules-setting, dispute resolution and policy. Because its member companies and associations are themselves engaged in international business, ICC has unrivalled authority in making rules that govern the conduct of business across borders. Although these rules are voluntary, they are observed in countless thousands of transactions every day and have become part of the fabric of international trade.

ICC also provides essential services, foremost among them the ICC International Court of Arbitration, the world's leading arbitral institution. Another service is the World Chambers Federation, ICC's worldwide network of chambers of commerce, fostering interaction and exchange of chamber best practice.

Business leaders and experts drawn from the ICC membership establish the business stance on broad issues of trade and investment policy as well as on vital technical and sectoral subjects. These include financial services, information technologies, telecommunications, marketing ethics, the environment, transportation, competition law and intellectual property, among others.

ICC enjoys a close working relationship with the United Nations and other intergovernmental organizations, including the World Trade Organization and the G8.

ICC was founded in 1919. Today it groups hundreds of thousands of member companies and associations from over 120 countries. National committees work with their members to address the concerns of business in their countries and convey to their governments the business views formulated by ICC.