Standing Committee
for Economic and Commercial Cooperation
of the Organization of Islamic Cooperation (COMCEC)

DRAFT

IMPROVING THE SMEs ACCESS TOTRADE FINANCE IN THE OIC MEMBER STATES

COMCEC COORDINATION OFFICE
October 2013

Standing Committee
for Economic and Commercial Cooperation
of the Organization of Islamic Cooperation (COMCEC)

DRAFT

IMPROVING THE SMEs ACCESS TOTRADE FINANCE IN THE OIC MEMBER STATES

COMCEC COORDINATION OFFICE
October 2013

This report has been commissioned by the COMCEC Coordination Office to OPUS Advisory Services International Inc. Views and opinions expressed in the report are solely those of the author(s) and do not represent the official views of the COMCEC Coordination Office or the Member States of the Organization of Islamic Cooperation. Excerpts from the report can be made as long as references are provided. All intellectual and industrial property rights for the report belong to the COMCEC Coordination Office. This report is for individual use and it shall not be used for commercial purposes. Except for purposes of individual use, this report shall not be reproduced in any form or by any means, electronic or mechanical, including printing, photocopying, CD recording, or by any physical or electronic reproduction system, or translated and provided to the access of any subscriber through electronic means for commercial purposes without the permission of the COMCEC Coordination Office.

For further information please contact:
COMCEC Coordination Office
Necatibey Caddesi No:110/A
06100 Yücetepe
Ankara/TURKEY
Phone : 90 312 294 57 10
Fax : 90 312 294 57 77
Web : www.comcec.org

CONTENT

INTRODUCTION 2
I. CONCEPTUAL FRAMEWORK: TRADE FINANCING POLICIES 4
1.1. An Overview of Trade Finance 4
1.2. A Framework for Understanding Trade Finance 5
1.3. Islamic Finance and Trade Finance 20
1.4. Transactional View of Trade Finance 22
1.5. The Importance of Financing to Global Trade 24
1.6. Key Providers of Trade Finance: Private, Public and International Sectors 27
1.7. Importance and Common Challenges for SMEs in Accessing Financing and Trade Finance 38
1.8. Policy Considerations and Framework 44
II. GLOBAL TRENDS AND PATTERNS IN FINANCING SME EXPORTS 46
2.1. The State of Global Trade 46
2.2. Selected Global Trends in Trade & Trade Financing 46
2.3. Global Supply Chains and the Rise of Supply Chain Finance 46
2.4. Technology in Trade and Payments 48
2.5. The Bank Payment Obligation 49
2.6. SMEs and International Commerce 51
2.7. IFI's and Export Credit Agencies in Support of SMEs 52
2.8. Risk Mitigation as a Core Element of Trade Finance 53
2.9. Capacity: A Common Challenge in Trade Finance 54
2.10. Islamic Trade Finance 55
2.11. Political and Policy Context around Trade Finance 55
III. MAIN COMMON CHALLENGES FOR THE SMEs OF THE OIC MEMBER STATES IN TRADE FINANCING 57
3.1. SME Access to Trade Finance: A Near-Global Challenge 57
3.2. Current State Highlights 58
3.3. Trade Finance Today in OIC Member States 70
3.4. Implications for OIC Objectives and Member States 78
IV. CONCLUSIONS AND RECOMMENDATIONS 83
4.1. Conclusions 83
4.2. Recommendations 84
V. APPENDIX A: BAFT-IFSA PRODUCT DEFINITIONS 91
VI. APPENDIX B: SELECTED SOURCES AND REFERENCES 101

INTRODUCTION

The business of trade finance is well-established, using processes and instruments that have evolved over a period of hundreds of years, perhaps longer. Paradoxically, despite the long history and the globally accepted practices, trade finance is very poorly understood, and has, until the eruption of the global crisis, generally been in the background of international commerce.

The crisis did however, place a great deal of focus on trade as an engine of recovery and economic growth, with business and political leaders seeing robust trade as one of the only viable mechanisms to support and enable a reversal of the crisis.

The post-crisis environment is characterized by a substantial reshaping of international sourcing patterns and trade flows, including greater focus on regional trade, with the United States and Europe both continuing to battle the effects of the crisis, and exporters throughout the world forced to seek alternate markets as a result of ongoing issues in the world's two largest consumer economies.

Trade finance, particularly in its traditional form aligns very well with certain key principles of Islamic finance, including Sharia compliant trade financing structures, and the moment is particularly well selected the COMCEC to undertake focused analysis on trade finance in OIC Member States, with particular focus on enabling SME access to such financing.

Trade finance is a low-risk and low loss business, linked directly and demonstrably to "real economy" activity involving the flow of goods and services, creating substantive value, and devoid of speculative mechanisms. In traditional structures such as documentary letter of credit transactions, the parties involved are easily identifiable, and the financial structure, no matter how complex or comprehensive, involves sufficient visibility and transparency to be easily understandable.

Given that the vast majority of global trade flows are supported by some form of trade finance (including the relatively newer form of supply chain finance), it becomes increasingly appropriate to bring financing sharply into focus, in the context of broader initiatives related to trade, trade promotion and international development. In most economies, Small and Medium-sized Enterprises (SMEs) and even Micro-enterprises (together, referred to as MSMEs), play a critical role in the creation of economic value, while facing the greatest challenges in accessing liquidity and financing.

These factors, together with prevailing macro-conditions in the global economy, underpin the need to focus on access to trade finance as a core element of a broader strategy aimed at encouraging greater collaboration among OIC Member States in numerous areas, including trade and development. It is worth noting explicitly that OIC Member States collectively, represent the full range of experiences currently observable across the globe:

- Jurisdictions still wrestling with the consequences of the global crisis
- Countries in recovery and rebound mode, exhibiting growth and some level of return to normalcy

- Jurisdictions mired in serious conflict, seeking to manage long-term implications of transformational events such as the Arab Spring
- Economies in Asia exhibiting potential and identified as part of the next wave of growth-driving economies, including those referred to as the “Next 11” which are identified as the post-BRIC emerging economies
- Jurisdictions in Africa and Europe poised for growth, some of which, nonetheless face significant systemic challenges in the medium term
- Extremes of experience, ranging from the most basic development focus, to positions among the most advanced economies on the globe

Irrespective of the position of a particular country or jurisdiction, there can be no disagreement that OIC Member States can only benefit from enhanced trade flows, including enabling factors such as trade and supply chain finance. Likewise, while trade and supply chain finance may not necessarily be well understood overall, there is a body of knowledge and best practice around trade promotion and development, and there is increasing dialogue around the evolution of Islamic finance, including Islamic trade finance.

The timing for consideration of the challenges and opportunities around trade and supply chain finance is particularly opportune in terms of the growth and development of Islamic finance, as well as the significantly accelerated evolution of international trade finance. Trade and supply chain finance currently enjoy an unprecedented level of profile and visibility, which some have succeeded in translating into a basis for acquiring additional (human and financial) resources, and for developing various propositions related to trade finance. Evolutions in technology and in innovative propositions have excellent potential to help make trade finance more easily accessible in developing and emerging markets, and even in markets that are perhaps perceived to be higher-risk.

Overall, numerous factors, globally and across the Islamic world, are aligning to make this a topic of fundamental importance, and an area where enhanced understanding and improvement of processes and practices will prove to be very valuable to OIC Member States.

I. CONCEPTUAL FRAMEWORK: TRADE FINANCING POLICIES

1.1. An Overview of Trade Finance

1.1.1. Definition of Trade Finance

Trade finance is a specialized branch of finance focused on providing payment, financing and risk mitigation solutions in support of transactions between importers and exporters, or those involving international supply chains. Trade finance, at its core, is nothing more that financing provided in support of the conduct of international trade.

Generally, the term "trade finance" refers to transactions considered to be short-term in nature, up to 18 to 24 months in duration, but most commonly up to 90 or 180 days in duration.

> *"Trade finance differs from other forms of credit (for example, investment finance and working capital) in ways that have important economic consequences during periods of financial crisis. Perhaps its most distinguishing characteristic is that it is offered and obtained not only through third-party financial institutions, but also through interfirm transactions. The vast majority of trade finance involves credit extended bilaterally between firms in a supply chain or between different units of individual firms. According to messaging data from the Society for Worldwide Interbank Financial Telecommunication (SWIFT), a large share of trade finance occurs through interfirm, open-account exchange. Banks also play a central role in facilitating trade, both through the provision of finance and bonding facilities and through the establishment and management of payment mechanisms…"*
>
> Source: Trade Finance During the Great Trade Collapse, IBRD/World Bank, 2011

Transactions that extend beyond 24 months in duration, up to 7 years or so, are referred to as "Medium-Term Trade Finance", while those with even longer timeframes, up to 15 or 20 years or more, fall into the category of Project Finance; the focus of this paper will be on the short term variety of trade finance, where the majority of SME trade activity takes place.

The financing of international trade can be viewed and understood from several perspectives, and the definitions typically utilized are not always consistently applied even among specialists and practitioners. That said trade finance exhibits several important and consistent characteristics that are critically relevant in terms of the nature of the financing involved, the nature of the related risk, and the types of policy measures that can and should be taken to ensure the availability of adequate levels of trade finance.

Trade finance is:

- Linked directly to an underlying flow of goods
- Connected directly to "real economy" activity

- Short-term in nature
- Self-liquidating as a liability or financial obligation
- Exhibits very low loan loss experience globally

Trade finance is critical to the conduct of international commerce, supporting some 80-90% of global trade flows according to IMF, WTO and other estimates, linking directly to the creation of economic value and to international development initiatives linked to trade activity.

The financing of trade activity can be achieved in a variety of ways, and can involve a variety of service providers, from banks to government and international agencies, hedge funds and other capital pools to specialist boutique firms focused on selected industry sectors or international markets. Small businesses might even finance their initial international activity through credit cards or by using existing commercial credit or operating lines; however, these latter options are not captured in the pure definition of trade finance.

While trade finance in some form or other has been in existence for hundreds or years at least, there have been recent developments and innovations aimed at responding to changing needs and expectations of importers and exporters, notably in seeking to better leverage technology and data (as opposed to paper documents), and in seeking to extend financing options within international supply chains. These developments have caused some difficulty with definitions and consistent use of language. For purposes of this paper, we will refer to trade finance as the overall realm of activity related to the financing of international commerce, and within this broad term, will refer to "traditional trade finance" and "supply chain finance" as two complementary (sometimes overlapping) aspects of trade finance.

Traditional trade finance will encompass a series of long-established, well understood and widely adopted instruments such as Documentary Collections and Documentary Letters of Credit, together with a range of specialist products like factoring, invoice financing, warehouse and trust receipt financing and numerous others.

Supply chain finance will refer to trade-related financing solutions, including individual products or comprehensive programs, aimed at supporting trade in the context of international and global supply chains. This form of trade finance also utilizes some of the same mechanisms or individual products linked to traditional trade finance, such as factoring and invoice discounting, but does so in the context of supply chains, and does so as a means of providing financing solutions to companies trading on what is referred to as "open account" terms, where an importer sends payment to an exporter after shipment of the goods.

1.2. A Framework for Understanding Trade Finance

Irrespective of its source, or of the complexity of a particular transaction, trade finance in its many forms is fundamentally about four things:

- The facilitation of secure and timely payment across borders
- The effective mitigation of risk
- The provision of financing and liquidity and
- The enablement of information flow about both the physical transaction and the movement of monies across borders.

These elements are provided in varying degrees by banks, boutique trade finance firms, export credit agencies and international financial institutions.

Table 1: Four Elements of Trade Finance

Payment	Financing	Risk Mitigation	Information
▪ Secure ▪ Timely & Prompt ▪ Global ▪ Low-cost ▪ All leading currencies	▪ Available to importer or exporter ▪ Several stages in the transaction ▪ No impact in Operating Line for exporters	▪ Risk Transfer ▪ Country, Bank and Commercial Risk ▪ Transport Insurance ▪ Export Credit Insurance	▪ Financial flows ▪ Shipment Status ▪ Quality of Shipment ▪ L/C systems include web & desktop solutions

Source: OPUS Advisory Services International Inc.

It should be noted for the sake of clarity that these four elements are not necessarily separate and distinct. That is to say, certain payment mechanisms also allow for the option to provide financing as well as risk mitigation. Techniques or products that are perhaps aimed primarily at the provision of financing will naturally in the end also enable settlement or payment to the exporter, and finally, solutions aimed at risk mitigation may be associated in some way with a payment mechanism or a financing structure.

Despite the imperfect boundaries between these four elements, the construct remains helpful and serves as a useful framework in understanding trade and supply chain finance, since both traditional mechanisms and emerging solutions incorporate the four core elements.

1.2.1 Payment Facilitation

Trade finance mechanisms and techniques include a component related to the settlement of a transaction – payment to the exporter, or to a supplier for goods provided and shipped according to the commercial terms agreed between buyer and seller.

While payment can take place in numerous ways, from check to credit card to escrow account or through the use of certain payment mechanisms, there are several characteristics to payment solutions in trade finance that exporters will look for:

- Secure payment from a trusted source
- Timely payment in line with the terms agreed with the buyer
- Affordable payment solutions on a global basis
- Available in multiple currencies

Importers and exporters can agree to be paid in several ways, including the following:

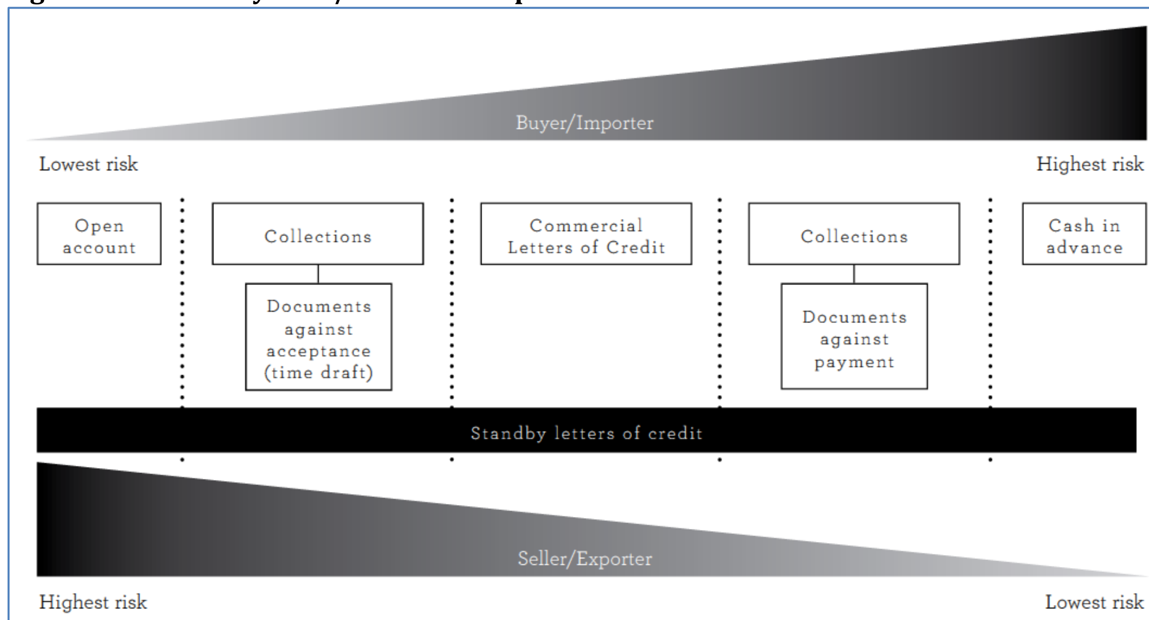
Table 2: Payment/Settlement Options in Trade Finance

Open account	Remittance of funds to exporter on delivery or at a future date	High risk to exporter	Features still evolving
Documentary collection	Documents exchanged against payment or acceptance (D/P or D/A). Sight or term transaction	Cursory examination of documents only, no verification	Limited protection, reserved for trusted relationships
Documentary credit	Most secure and balanced option, expensive and time-consuming Sight or term transaction	Detailed verification, requires full compliance with L/C terms	Balanced protection
Confirmed documentary credit	Documentary credit, with added security for the exporter Additional fees	Separate and distinct payment undertaking by a confirming bank, usually located in the exporter's country	Allows exporter to eliminate the import country risk and the risk of the issuing bank
Payment in advance	Importer remits to exporter prior to shipment of goods	No verification by banks	Trusted relationship, or leverage by exporter

Source: Forum for International Trade Training (FITT), International Trade Finance Textbook, 2005.

The choice of settlement or payment mechanism is a function of the degree of trust established between buyer and seller, the degree of perceived or actual risk of non-payment or non-performance of contract obligations and the impact of any macro-factors such as foreign exchange controls or limitations in the importing country. Additionally, the degree of leverage or influence of one trading partner over the other may also influence such a choice. Exporters that provide a unique product that is not easily sourced elsewhere, for example, might insist on payment in advance. Each settlement option implies a particular sharing of risk between buyer and seller.

Figure 1: Risk in Payment/Settlement Options



Source: International Trade Procedures, Wells Fargo Bank

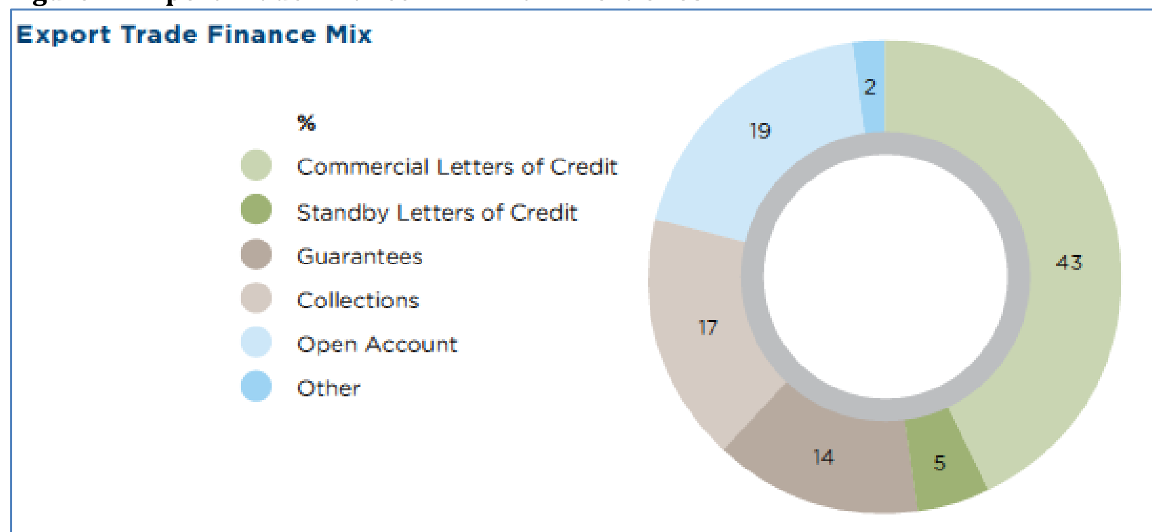
Commercial or documentary letters of credit provide the most balanced protection covering the interests of importers and exporters. Confirmed documentary letters of credit provide equally strong protection to the buyer, while enhancing the protection provided to the exporter.

Standby letters of credit are sometimes used to facilitate trade between buyer and seller, but are more commonly intended to serve as a protective instrument, to ensure that the beneficiary of that credit is protected in the event of non-payment or non-performance of agreed obligations by the party providing the standby credit.

Collections or Documentary Collections involve an exchange of shipping documents (including documents of title to the goods shipped) for payment or for an undertaking to pay at an agreed future date. Such instruments involve banks acting to facilitate an exchange, with no responsibility to engage in any meaningful verification of documents submitted by the exporter.

Documentary letters of credit provide an excellent illustration of the flexibility and efficacy of established trade finance mechanisms, in facilitating and enabling global trade, in that they can show all four elements and a variety of features and mechanisms available for importers, exporters and their financiers.

Figure 2: Export Trade Finance Mix in Bank Portfolios



Source: ICC Rethinking Trade & Trade Finance 2013

Although estimates from banks and IFI sources suggest that about 80% of trade is now conducted on open account terms (ICC Banking Commission, 2013), only about 19% of export trade finance activity in bank trade finance departments relates to this type of transaction – partly because open account transactions typically will involve banks only in the payment step, which can be handled in other areas of a financial institution and may not be tracked as trade finance-related.

Nonetheless, there is an implication that trade finance could be more active in this area, and this is one of the factors that has led banks to devise solutions for open account business under the umbrella of supply chain finance.

1.2.2. Financing

Financing is another core component of trade finance. In effect, this refers to some form of lending to the importer, the exporter or to both, and in the context of supply chain finance, to additional members of the supply chain ecosystem, such as distributors and other service providers.

Financing can involve numerous approaches, from traditional lending to allowing exporters to collect money faster than it would otherwise be due through the financing provided by a bank, or allowing an importer to pay later than would be expected, again through financing from a bank.

Financing can be provided on the basis of lending against an asset, like the shipment that is being sent from exporter to importer, or an invoice approved for payment, or a financial instrument such as a bank draft, evidencing the legal existence of a financial debt, against which lending can be effected.

Financing can be categorized in several ways, including in terms of pre-shipment or post-shipment financing. Pre-shipment financing might be offered to the exporter to help them

source inputs to production, produce the relative goods and arrange for the sale and export of those same goods. In the case of pre-shipment financing, it is notable that the goods may not yet exist to serve as security for the lender, that no invoice or other similar legal obligation or instrument of title (ownership) to the goods yet exists, however, there would typically be a purchase order issued from the importer to the exporter, and some financiers are prepared to provide financing and liquidity on the basis of the existence of the purchase order.

While the area of pre-shipment finance is gaining greater focus and attention, there is significant activity in post-shipment finance, as the transaction is then already well underway, and a lender has several options in terms of financing mechanisms and options, as well as transaction events against which financing can be arrange. Such events (Aberdeen Group, 2005) can include a variety of occurrences, such as the acceptance of an invoice for payment by the importer – referred to as an "approved payable". Likewise, in post-shipment stage, instruments such as drafts have been issued, and the existence of this type of bank instrument also allows for financing to take place.

As noted earlier, financing can amount to simply allowing an exporter to be paid earlier, or an importer to complete their payment obligation later than was intended, by having the bank/lender meet the financial obligation at the originally agreed time. As an example, importer and exporter might agree to payment 90 days after the goods have been loaded onto the vessel for shipment to the importer. If the exporter has sufficient cash flow, they may choose to wait those 90 days, however, there is also the option to ask a trade bank involved in the transaction to pay the exporter immediately (discounting the 90-day receivable), and to then collect funds from the importer or the importer's bank 90 days hence. The financing bank will of course charge fees and interest for doing this.

Similarly on the import side, buyer and seller might agree to payment "At Sight" meaning, at the moment that compliant documents are presented by the exporter for payment and have been "seen" by the verifying bank and deemed compliant. Normally, a payment would involve sending monies to the exporter and immediately debiting the importer's account to cover the payment. In some cases, an importer may not have funds to cover such a transaction, and may ask a bank to pay the exporter, but wait 60 days (until the goods have been received and sold, and thereby, revenues generated) until debiting the importer's account. In this scenario, the exporter is paid in the agreed timeframe, but the importer does not cover the payment until 60 days later – in effect, having been financed for that period, again in exchange for applicable fees and interest.

The critical importance of financing to the conduct of international trade was brought sharply into focus by the global crisis of 2007/2008 and beyond, and the fundamentally important contribution of trade finance to economic value creation was demonstrated beyond debate, with the highest levels of political leadership, international institutions and other entities explicitly focusing on trade finance as a critical enabler of international commerce.

The importance and benefits of trade finance are identified (ITC/UNESCAP, 2005) as:

- Reduced capital outlay, improving the financial and liquidity situation of importing and exporting firms
- Reduced risk, covering risks of non-payment or non-performance of contract obligations, reduced foreign currency risk and related

- Enhanced competitiveness, with attractive financing terms being central to the competitive strategies of exporters seeking to close export deals

In the end, liquidity and financing can be critical to firms of all sizes, be they small and medium-sized suppliers in developing economies, or large multinational buyers located in an OECD economy, and trade finance provides liquidity solutions linked directly to an identifiable flow of goods, eliminating the need for companies to use existing general credit facilities and operating lines of credit in support of their international activities.

1.2.2.1. Illustrative Financing Options

There are numerous financing options under the umbrella of trade and supply chain finance, including:

a. Documentary letter of credit

A long-established, traditional mechanism of trade finance, where the buyer asks a credible bank to issue a letter of credit – in effect, a promise to pay (with legal force) provided the exporter demonstrates having fully met the terms and conditions of the credit, which once issued, his a separate undertaking and payment promise of the Issuing Bank, A documentary letter of credit provides (arguably) balanced safety to both the importer and exporter, and involves the banks as active participants at minimum, as they ensure compliance by the exporter by verifying documents related to the shipment.

b. Documentary collection, including documents against payment and documents against acceptance

Also a long-established instrument of traditional trade finance, but one where the banks are far less engaged in the transaction, and have no responsibility to verify documents as they do under documentary letters of credit.

c. Export credit

Financing and/or risk mitigation provided through organizations that were historically public sector entities with a trade and export development remit.

d. Various forms of guarantees, including standby letters of credit

Various instruments and mechanisms which can be used to enable trade or the fulfillment of commercial activity and obligations, or that can be used directly to enable trade flows. Guarantees (and related mechanisms such as bid bonds, performance bonds and standby credit) are legally binding instruments that protect commercial partners by assuring the beneficiary of the instrument that they can obtain redress – in the form of a payment under such an instrument – if the entity that requested the instrument to be issued somehow fails to meet their commercial or financial commitment.

e. Warehouse and Trust Receipt Financing

A form of financing that requires the goods being financed be in a secure warehouse for some agreed period of time, allowing a bank or financier to provide financing on the basis that such

goods are in the control of a trusted third-party, and that this party has issued a “Trust Receipt”, on the basis of which financing may be provided.

There are additional instruments or variations of mechanisms related to the financing of international trade that are used to address a wide range of requirements and to provide viable financing and risk mitigation options across a wide variety of political, economic and commercial contexts.

f. Importer credit

An importer credit is used to finance an export over a medium or long term. Funds are lent directly to the foreign importer as a means of encouraging the purchase of the goods from a particular exporter. These credits are usually suited to large transactions involving capital goods or to turnkey projects.

g. Supplier credit

A financial institution purchases a foreign importer’s debt from their exporter client. Arranging this type of financing may be easier and more economical than arranging an importer credit, because the bank or lender does not have to negotiate directly with the foreign importer. Supplier credits are generally suited to transactions with a value between $100,000 and $5,000,000, with terms of payment ranging from six months to five years.

h. Forfaiting

Forfaiting, or forfait financing, is usually a medium-term form of exporter credit provided by trade banks. A bank purchases promissory notes due to the exporter from a foreign importer. The value of the promissory notes is discounted at a fixed rate so that the exporter receives cash, after deduction of the interest charge or discount.

i. Countertrade

Countertrade is an arrangement in which a sale to an importer is conditional on a reciprocal purchase by the exporter. It therefore includes any international trade contract in which the reciprocal obligations of the parties are substituted for payment in kind. Instead of being paid in cash for a shipment, the exporter receives products—or even certain kinds of services—from the target market. Several types of countertrade common in international trade include barter, counter purchase, advance purchase, buybacks, bilateral, and offset arrangements.

j. Export leasing

Exporters can use leasing arrangements when dealing with countries where import restrictions prevent the importer from purchasing foreign equipment. Export leasing can also be used when a country’s tax regime favours leasing over purchase, so that the importer can acquire capital goods cost-effectively.

k. Supply chain finance

Supply chain finance is the term used to refer to a set of “new” solutions, which can involve for some banks, one or two very specific products, and for others, comprehensive programs covering, say one large buyer and dozens of suppliers.

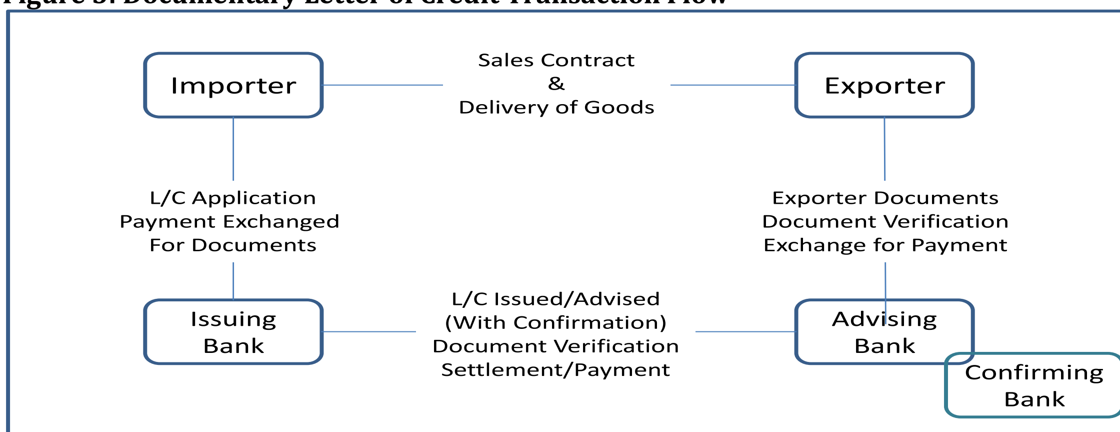
The development of supply chain finance as a proposition evolved from the near-global shift away from traditional mechanisms to trade on open account terms. This trend which began prior to the global financial crisis was seen as a serious threat by banks in particular, as their role in open account transactions was typically limited only to the transmission of payment, without any need for risk mitigation or financing. Supply chain finance was seen as one way for banks to “re-intermediate” themselves back into a more significant (and profitable) role in supporting international trade activity.

Supply chain finance is particularly promising in terms of assuring adequate levels of trade finance to SMEs, including those located in developing and emerging markets, thus potentially well suited to providing financing solutions in support of international development. It should be noted that supply chain finance can involve the use of certain financing mechanisms long-established in trade finance, such as factoring or invoice-based finance. It is the way in which such mechanisms are applied to the financing of supply chains that makes the framework around supply chain finance innovative and evolutionary.

1.2.2.2. The Documentary Letter of Credit: Illustrating the Flexibility of Trade Finance

Documentary letters of credit are among the most established instruments of trade finance, favoured by markets across the MENA Region and parts of Asia in particular, as proven mechanisms of trade payment and financing and as effective means for mitigating a wide range of risks. Letters of credit are also appreciated for their linkage to international commercial practice and to long-established guiding rules like the Uniform Customs and Practice for Documentary Credits. The transaction flow and structure around a documentary letter of credit can be used to illustrate the flexibility and features available through trade financing practices and mechanisms.

Figure 3: Documentary Letter of Credit Transaction Flow



Source: OPUS Advisory Services International Inc.

The transaction flow in a documentary credit, as in other such instruments, begins with the importer and exporter agreeing terms of delivery and payment (as well as financing where needed), and agreeing to settle on the basis of a letter of credit. The importer requests their bank to issue a letter of credit based on the agreed terms; once issued, the L/C represents a payment undertaking of the issuing bank, as a separate and distinct legal obligation to the exporter, provided the exporter can demonstrate full compliance with the terms and conditions of the credit. This is meant to give comfort to the exporter, that they are relying on the payment promise (and the stability and financial health) of a reputable bank as opposed to that of a commercial counterparty in a foreign country.

The issuing bank will transmit the letter of credit, usually in the form of a structured electronic message called a SWIFT message, to a bank based in the country of the exporter, most commonly the exporter's bank. That bank will receive the transmission through the SWIFT network, thereby able to authenticate the message as being legitimately from the issuing bank.

The exporter's bank, referred to in this case as the advising bank, is meant to review the terms and conditions of the credit, assisting the exporter in ensuring that the exporter will be able to meet all the terms and conditions of that credit, and that the credit is workable as issued. L/Cs will have expiry dates beyond which they are no longer valid; if an advising bank notices an expiry date that is too close to the date of receipt of the credit, practically guaranteeing that the exporter will fail to be compliant to the terms of the credit, and may therefore not be paid, the advising bank will suggest that the exporter request an amendment to the expiry date of the credit, for example.

The exporter then prepares and submits the required documentation to the advising bank or to another institution expected to facilitate payment to the exporter. These documents are intended to demonstrate that the exporter has fulfilled the obligations under the credit.
Such documentation might include:

- Commercial invoice
- Packing list
- Certificate of origin
- Transport document, such as marine bill of lading or air waybill
- Certificate of inspection
- Certificate of insurance

The banks involved then in turn, verify the documents against the terms specified in the letter of credit. Terms will include the type and number of documents required, and may indicate that specific terms be reflected in the documentation, such as a "latest shipment date" or a particular routing for the cargo, among others.

A common challenge arises when the banks disagree (as happens with some regularity) as to whether the documents are really compliant or not. The practical reality is that historically, levels of non-compliance on first presentation of documents by exporters range as high as 65-80% (International Chamber of Commerce and OPUS Advisory interviews). In the case of non-compliance, the exporter effectively loses all protection otherwise available under letters of credit, and relies on the importer to accept documents as presented, unless there is both the opportunity and the possibility to correct elements of non-compliance.

In the event that the exporter is not sufficiently confident of the ability of the issuing bank to make payment against compliant documents, either due to doubt about the bank's standing, or perhaps concern about the stability of the importing country, the exporter can request that the L/C be confirmed. This is a process whereby another bank (usually the exporter's bank, or at minimum, a well-known international bank) is asked, for a fee, to add its own independent payment promise to the L/C, effectively allowing the exporter to claim monies from the confirming bank, and thus eliminating any risk of non-payment by the importer or the importer's bank, or any risk related to the stability of the importing country which could prevent the exporter from collecting any monies due.

Confirmed documentary credits offer the greatest level of protection for the exporter provided again that the exporter is fully compliant with the terms and conditions of the letter of credit. In that instance, the exporter can effectively bypass any risk associated with doing business with the importer, the importer's bank and the importer's country, arranging to receive payment from a trusted international bank, usually the exporter's own bank, and usually in the home country of the exporter, or at least, in a stable financial centre where there is no risk of non-payment against fully compliant documents.

Confirmation of a letter of credit can be expensive, particularly when the risk is high, but it is often the only way certain types of trade transactions can take place, and as such, various international institutions including those linked to OIC Member States, will provide guarantees to enable trusted international banks to confirm the letters of credit issued by banks that are located in high-risk or high-volatility markets, or indeed, that are themselves not completely solid.

The use of letters of credit, including confirmed credits, enables two situations: credit enhancement and risk transfer. Credit enhancement refers to the improvement in credit quality (and the attendant lowering of risk) resulting from a shift of payment obligation from the importer to the issuing bank: most commonly a situation where the bank is more established and probably has a higher credit rating than the importer client. Risk transfer, similarly, refers to the outcome under an L/C (and other trade finance mechanisms) where the risk is shifted from one party to another. A confirmed letter of credit allows the exporter to benefit from a shift in risk, away from the issuing bank and the importing country, to the confirming bank, usually located in the exporter's home country.

Confirmed credits also provide protection for the importer or buyer, in that no payment is effected unless the exporter demonstrates, by submitting the proper documentation, that all required terms and conditions have been met.

Letters of credit, as other traditional mechanisms such as documentary collections, are governed, or at minimum, their use is guided by, a long-established set of rules called the UCP, or the Uniform Customs and Practice for Documentary Credits, first published in 1933 by the International Chamber of Commerce in Paris. The rules are complemented by various guiding publications and opinions on interpretation, published by the ICC Banking Commission and others.

The existence of these rules, that have been revised and updated roughly once every ten years, is fundamental to the wide acceptance and success of letters of credit across the globe and

across a wide variety of commercial and legal contexts, and it can be important for businesses of all sizes engaged in international trade to be conversant in the fundamentals of the various ICC rules.

Documentary letters of credit provide the most balanced protection for buyer and seller, compared to other available settlement options. Unless one of the trading partners possesses more leverage than another, and can demand or impose advantageous payment terms, the popularity of the L/C is also based on this potential for balanced protection of commercial interests between buyer and seller. Despite the issues related to discrepancy and non-compliance it remains true that letters of credit can be very effective in enabling quick payment, various forms of financing and numerous options linked to risk mitigation.

A letter of credit can provide a combination of solutions for importers and exporters, including payment, financing, risk mitigation and the facilitation of information flow about the trade transaction.

1.2.3. Risk Mitigation

Traditional trade finance in particular has evolved numerous mechanisms aimed at effective mitigation of a wide variety of risks, allowing trade to take place in the most complex and challenging environments on the globe.

Most commonly, importers and exporters require the mitigation of several fundamental risks:

- Country and sovereign risk
- Bank risk
- Commercial risk
- Foreign exchange or currency risk

While there are complexities and nuances in the definition, for purposes of this analysis, it is sufficient to note that country risk covers a range of risks associated with doing business in or with a particular country or jurisdiction, including risk of civil unrest or war, risk of default of the country, risks related to economic conditions that might impede a country's ability to meet its trade obligations, and risks related to possible expropriation or nationalization of foreign assets.

a. Country Risk

Country risk is a very real consideration in international business and trade; there are countless examples where such considerations have impeded the flow of trade, or caused financial challenges to companies attempting to do business under difficult conditions only to find that they sustain significant financial loss due to inadequate mitigation. Country, sovereign and political risk is a very real consideration in numerous OIC Member States, in some cases due to systemic economic issues, in other cases due to serious instability and risk arising from civil war, military action and unrest and relatedly difficult conditions.

These difficulties directly impact risk analysis and risk ratings related to these jurisdictions, either making it impossible to obtain risk mitigation and financing assistance, or making the cost of such measures prohibitively expensive and commercially impractical. It is under such

conditions that private sector financiers often retreat from markets, and any measures to respond to the resulting gaps in support generally must come from public sector sources or from multilateral institutions.

Country and political risk assessments are available from a variety of sources including multilateral institutions, banks, risk insurers, export credit agencies and others.

b. Bank Risk

Bank risk relates to the risk of default or non-payment by a bank involved in a trade transaction. An exporter and the exporter's own bank may face bank risk if a transaction involves a financial institution in the importing country (for example, the bank issuing a letter of credit in favour of the exporter) with questionable standing or financial health.

The realities and potential scope of bank risk were brought sharply into focus by the global crisis, when top-name UK, EU and American financial institutions teetered on the brink of bankruptcy as a result of exposure to toxic mortgage assets. Several of these institutions were effectively nationalized and rescued by government bailout, and others were merged with or taken over by competitor institutions. Several highly regarded banks were deemed unviable and the payment and trade finance undertakings they made were accorded very little confidence, with the effect that these banks needed to seek risk mitigation against their own undertakings to assure importers and exporters of the viability of transactions in which they were involved.

Letters of credit issued by formerly top-name financial institutions had to be confirmed, for example, by banks that were known to be solid and to have negligible exposure to the high-risk mortgaged assets that generated huge losses. American and European institutions sought help from Canadian banks, for example, in backstopping trade finance commitments by providing confirmations of letters of credit issued by these US and European institutions.

To be clear, when an importer seeks support, they do so from a bank with which a credit relationship already exists, or can be quickly established: on the import side, risk relates to the risk of non-payment by an importer and as such, a bank will want to ensure that the importer is a well-known existing customer prior to providing the support of a letter of credit, for example.

On the export side, the exporter's bank may provide financing or some form of risk mitigation to an exporter, but does so on the basis that the importer's bank will meet its obligations under the relative letter of credit. The importer's actions are irrelevant to the exporter's bank, as it relies strictly on the payment undertaking of the issuing bank of the L/C. This is one example of the way in which export transactions typically involve a focus on foreign bank risk, rather than risk related to the financial health and capacity to pay of the importer.

c. Commercial Risk

Commercial risk involves various risks related directly to the actions (or inactions) of the importer and exporter relative to their respective obligations under the trade transaction. Will the exporter perform as agreed, producing goods of agreed quality and shipping them in the timeframe agreed? Will the importer act in good faith and approve payment against compliant

documents, or will the importer seek to manipulate the process through frivolous issues of non-compliance (such as a typographical error in a key shipping document) as a means of obtaining commercial advantage? Will either party commit outright fraud? Is there a possibility that either party may face bankruptcy or insolvency, and thus cause commercial loss or hardship to their trading partner?

Commercial risk is a reality of business, but one that is magnified significantly in the context of international commerce, given the distances involved, the lack of transparency about the health of a business, and challenges related to the conduct of appropriate due diligence. It is a recognition of this reality that motivates importers and exporters developing new trading relationships to include appropriate risk mitigation in their trade financing structures, until such time as the relationship has been tested and proven over time, and focus can shift (somewhat) away from risk considerations and allow emphasis on efficient payment and appropriate financing solutions.

Importers and exporters also frequently contend with various types of transactional risk, such as risk related to volatility in foreign currency markets. The majority of global trade is still conducted in US Dollars, with the Euro generally in second position, and the Renminbi gaining traction quickly as China's influence grows on both the import and the export side of the commercial equation.

d. Foreign Exchange Risk

Importers or exporters doing business in foreign currency face the risk of unfavourable movements in exchange rates, possibly raising the cost of purchasing for the importer, or reducing the profitability of a transaction for the exporter, when assessed in terms of their respective domestic currencies. There are also possibilities of exchange rate shifts that are favourable to one or the other, reducing the cost of the imported goods, or making the export sale more profitable, however, the key is to manage for the risk of adverse impact, and trade financiers can assist in this regard by combining trade financing solutions with appropriate currency hedging solutions.

Figure 4: Risks in International Trade

Risk Category	Economic (commercial) risks related to the trading partner	Exchange rate risk	Transportation risk	Political risks		
				Foreign policy	Domestic policy	Economic policy
Examples	Importer is not willing or unable to pay Importer does not accept merchandise Exporter does not deliver on time or products agreed	Floating exchange rates: variations in exchange rates Fixed exchange rates: risk of devaluation	Damaged or loss of goods	War Embargo Restrictions	Revolt Civil War	Prohibition to transfer foreign exchange Currency declared non-convertible
Methods to mitigate risks	Private insurance or public export credit agencies Letter of Credit Bank guarantees	Bank provide hedging facilities; public exchange risk insurance	Private insurance	Export credit agencies or private insurance		

Source: WTO

It is possible, in combination with various trade financing mechanisms, to obtain a variety of types of insurance to cover a range of risks. Such insurance solutions can be secured from private sector sources, or from export credit agencies; certain guarantee schemes and solutions can also prove invaluable in securing the interests of buyers and sellers against a variety of risks related to international commerce. The Islamic Corporation for the Insurance of Investments and Export Credit is one such entity.

e. Additional Considerations in Risk

The conduct of business across borders involves significantly more risk in general, than the pursuit of commercial activity within familiar national borders.

One of the realities of risk analysis and assessment is that perception plays a significant role in shaping expectations and conclusions about the degree of risk involved in a given transaction, relationship or market. This is a critical element particularly for markets that are perhaps not well known or particularly well understood beyond their immediate regional context, and more so where such markets seek greater engagement in international commerce.

Risk perception can be shaped by numerous factors, and in trade finance, these include:

- Limited technical expertise of the risk analyst
- Limited first-hand knowledge of the market being assessed
- Lack of transparency or visibility of key indicators or data elements

At times, the opportunity to correct optics and perceptions presents itself in simple and obvious ways that are well worth pursuing, and in other circumstances, the process can be more complex and time-consuming, and may require a variety of complementary initiatives, from public sector engagement and political discourse, to commercial initiatives, including efforts to create transparency and favourable conditions for international engagement.

Risks that are clearly and objectively communicated and understood can be equitably mitigated and managed. Absence of information and visibility tends to result in overestimation of risk, particularly when risk assessors have limited international experience, and thus, the pricing of risk mitigation options can be inflated unnecessarily.

Risk mitigation solutions in support of trade can be provided by banks and trade financiers, but they are also very frequently provided by private insurers, export credit agencies (that can be public, private or hybrid institutions) and international agencies such as the various multilateral development banks.

1.2.3. Information Provision

Trade finance is increasingly facilitated and enabled through sophisticated technology, whether through bank systems or other platforms.

Importers and exporters have sought increasingly high levels of visibility – on a near real-time basis – about the financial flows related to their trade transactions, as well as the physical movement of the goods involved. Treasury and finance professionals within importing and

exporting companies of all sizes need to understand, increasingly quickly, the details about payment due dates, expected maturity dates of future payments, impact of transaction processing delays on their respective financial situations and the impact of foreign currency fluctuations on financial positions. Both buyers and sellers are concerned about cash positions and the effect of trade transactions (and their typically longer timeframes) on liquidity and working capital.

These needs and expectations linked to liquidity and financial management are especially critical in the context of ongoing global liquidity constraints and in times where borrowing remains relatively difficult and expensive.

Relatedly, banks and financiers also seek greater visibility on the state of the financial aspect of a trade transaction, while concurrently looking to better track the status of the movement of the physical goods, which may at times serve as collateral against loans or facilities extended to the buyer or seller by the banks.

Bank systems that provide increasingly rich and granular reporting and tracking functionality related to trade finance transactions are complemented by evolutions in logistics and shipping technology, including the increasingly common use of Radio Frequency Identification (RFID) Technology to track the movement of ships and specific containers of goods aboard ships.

The level of detail and the speed with which information – financial and physical – is provided has been improving dramatically over the last decade, and the information provision element of trade finance has direct implications on the ability of financiers to provide additional financing or to gain additional comfort from a risk management perspective, through enhanced and accelerated visibility.

1.3. Islamic Finance and Trade Finance

Islamic Finance, including Islamic Trade Finance, has been an area of growth, not only within Shari'ah compliant and focused institutions in the Islamic world, but more broadly, attracting the interest of European, American and Canadian banks and institutions over the last several years in particular. At the highest level, the requirements around direct linkage between financing and identifiable, real economy flows, together with the conservative and non-speculative character of the sector has been very attractive under global crisis and post-crisis conditions.

There are certainly distinctions and differences in approach and principle between conventional and Islamic Finance and trade finance, however, there are also sufficient parallel elements to allow for the (duly adjusted) transfer of experiences from one discipline to the other, and thus far, no fundamental obstacles or differences of a nature to prevent the application of insights, recommendations and practices between Shari'ah-compliant and conventional trade finance.

It has been suggested that Islamic Trade Finance has an opportunity to become the preferred financing option in so-called "Rapid Growth Markets" (RGMs) such as Turkey, Indonesia, Malaysia, Qatar, Saudi Arabia and the UAE among others, as a result of the growing influence

and impact of these markets, and as a direct result of the evolution of trade flows across the MENA Region and Asia (Trade & Forfaiting Review, 2013). The related suggestion is that corporate and banking executives globally will need to become more familiar with and more comfortable in the use of Islamic Trade Finance structures.
At the most basic level, companies engaged in trade require financing and other forms of support, whether they are based in or trade with Islamic jurisdictions or not.

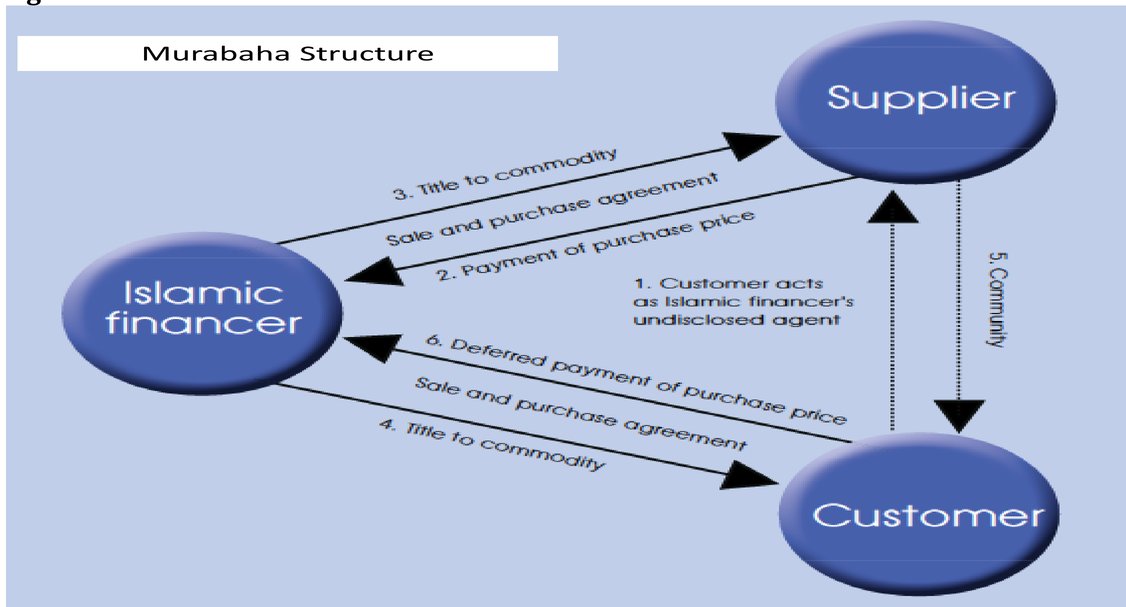
> *"Islamic trade finance refers to financing import and export through Islamic financing modes and instruments. Trade finance has become one of the major challenges facing SMEs today. The situation of trade finance even becomes more complicated due to shortage of liquidity and scarce financial resources due to the recent global financial crisis. Unlike the larger competitive corporate firms which have strong economic and political bargaining power, SMEs have lower capital, high risk and less competitiveness. For these reasons and in addition to the recent difficulties facing the conventional finance, Islamic trade finance becomes the legitimate alternative to provide SMEs with the required working capital, shrink the liquidity gap, reduce the risks of insolvency and may help in improving their competitiveness. Good facilitating Islamic trade finance might play vital role to the growth of SMEs in the IDB member countries."*
>
> Source: The Challenges of Islamic Trade Finance in Promoting SMEs in IDB Member Countries, Abdelrahman Elzahi Saaid Ali, Islamic Research & Training Institute, 2013.

Starting from this premise, and considering the unique characteristics of Islamic Trade Finance in the context of a framework discussion, the reality is that Shari'ah compliance requirements will be increasingly important in regional trade flows, certainly among OIC Member States, and increasingly with importers and exporters based in non-Islamic markets but seeking to engage in trade with counterparties wishing to conduct business in Shari'ah-compliant manner.

It is worth illustrating the parallels between conventional and Islamic Finance through a straightforward example. It is well-known that Islamic Law forbids the charging of interest, and perhaps less well-known to non-specialists that the transfer or sale of a debt is also deemed non-compliant. This might seem problematic at first, considering the core role of debt transfer (sale of a receivable, for example) in conventional finance, however, the desired outcome can be achieved in full compliance with Shari'ah Law, if a bank takes ownership of the goods and facilitates the transfer of ownership from seller to buyer. Linking this process to a Shari'ah-compliant "Murabaha" contract allows a trade finance solution to be provided, while fully respecting the requirements of Islamic Finance.

From a framework perspective, the conclusion must be that there are sufficient similarities at the core of conventional and Islamic Trade Finance that enable consideration of both varieties in the context of broader trade development and collaboration initiatives to be conceived and developed for OIC Member States. The direct linkage between financing and an identifiable flow of goods, the non-speculative, "back-to-basics" focus of trade practitioners, and the merchant banking parallel where a financier takes ownership of the goods financed, all combine to provide a strong sense of compatibility between conventional and Islamic Trade Finance.

Figure 5: Islamic Trade Finance Murabaha Structure



Source: Trade & Forfaiting Review, 2013

The opportunities for mutual learning are brought sharply into focus when consideration is given to certain fundamental tenets of Islamic Finance, contrasting those with the underlying causes of the recent global financial crisis:

> *"Speculative transactions are deemed to involve a type of unjust increase prohibited by the Quran. The underlying motivation is to ensure a fair correspondence between the expected benefits and obtained benefits of both parties to a contract. All activities that contain elements of uncertainty, such as commercial transactions in which there is uncertainty about an asset or its price, are covered by the prohibition of gharar (uncertainty) and maysir (gambling) stipulated in the Quran. Because an element of uncertainty can be found in almost all commercial transactions, it is excessive gharar that is prohibited. For example, excessive gharar can be identified in the case of insurance contracts. Futures, forwards and other derivatives also fall under gharar, as there is no certainty that the object of the sale will exist at the time the trade has to be executed. These instruments are also subject to the prohibition on maysir, which condemns the speculative exploitation of legal uncertainty in order to draw an unjustified (because it is unfair) advantage. In addition, speculation (maysir) is seen as diverting resources from productive activities."*
>
> Source: Islamic Finance in Europe, ECB, 2013

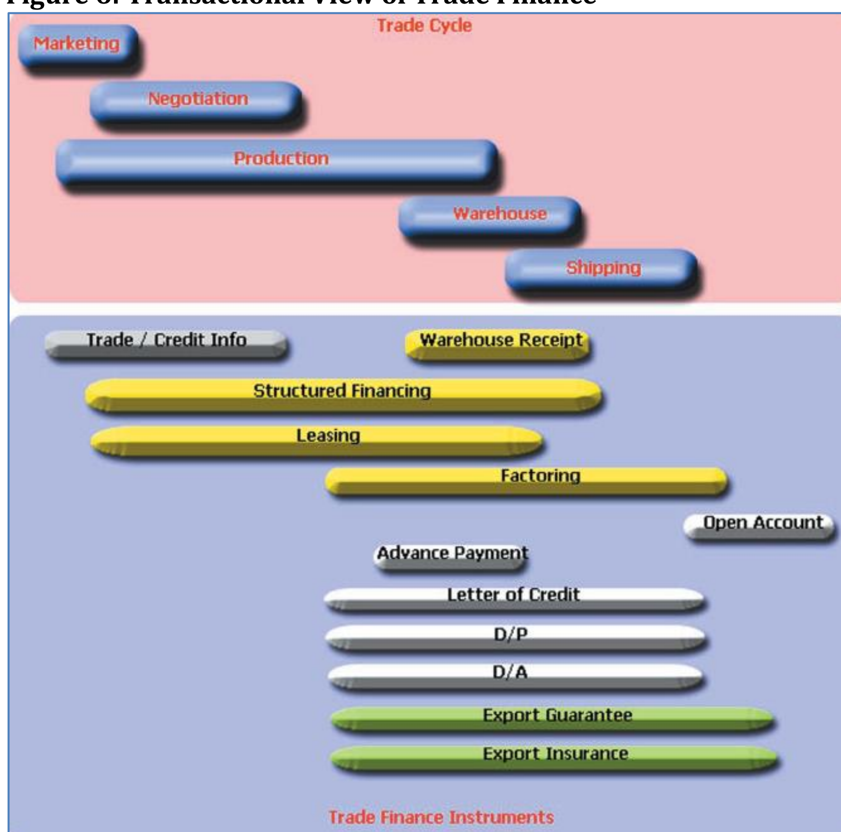
1.4. Transactional View of Trade Finance

As illustrated, trade finance involves several core elements to its value proposition, and the numerous instruments of trade finance can combine features and solutions across one or more

of the four core elements (payment, financing, and risk mitigation and information flow). In addition to this proposed framework for understanding trade finance (including emerging solutions in supply chain finance), it is instructive to consider trade finance in terms of the transaction flow related to trade activity, as well as in terms of the various providers of trade finance that combine to make up the global trade financing landscape.

The requirements and options related to financing across the lifecycle of a trade transaction are illustrated by the following graphic from UNESCAP/ITC. The illustration provided by the UN Economic and Social Commission for Asia Pacific (UNESCAP) together with the International Trade Centre (ITC) in Geneva (Trade Finance Infrastructure Development Handbook, 2005). The UNESCAP/ITC approach, devised before significant focus was put onto supply chain finance, is instructive in its attempt to map financing options and solutions against an illustrative trade transaction, or what is referred to as the trade cycle.

Figure 6: Transactional View of Trade Finance



Source: Trade Finance Infrastructure Development Handbook, UNESCAP/ITC, 2005

Irrespective of the specific instrument or financing structure under consideration, a view can be taken based on one or more of the categories above, to determine the nature and suitability of a particular trade finance mechanism to meet the needs of one or more parties to the underlying trade transaction.

Similarly, policy measures and overall market context assessments can be undertaken in terms of analyzing the adequacy and availability to trade finance for SMEs and other parties, based on the four "views" above.
Certain OIC Member States, for example, will be more concerned about the risk mitigation dimension than others, where perhaps accelerated payment, or the provision of adequate – and affordably priced – financing might be more important in meeting the needs of local companies seeking to engage in international markets.

The sources and providers of trade finance can also serve as a basis for understanding the nature, scope and options around trade financing. Banks currently provide the majority of trade finance capacity globally, and within the banking sector, it is estimated anecdotally by practitioners that the top ten financial institutions control a majority of global market share in traditional trade finance today. Open account transactions, and financing related to supply chains, is still very much in development and evolution, with non-banks, including factoring houses, playing a significant role.

Export credit agencies (ECAs), entities that can be public sector, private sector or hybrid organizations but are particularly important in supporting trade involving higher-risk emerging and developing markets, support approximately 10% of global trade flows, providing over $1.5 trillion in short-term insurance cover alone in 2012 according to the industry association called the Berne Union (Berne Union Yearbook, 2013). ECAs support trade through credit and financing as well as through the provision of various forms of insurance, guarantee and bonding products.

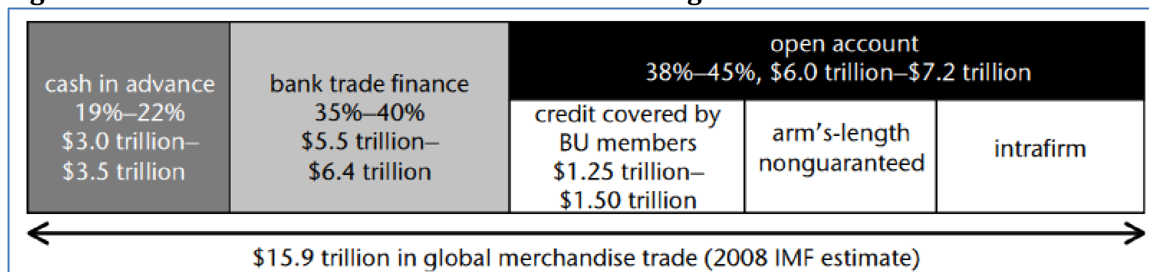
Additionally, various international institutions like the World Bank/International Finance Corporation, the Asian Development Bank and the International Islamic Trade Finance Corporation (ITFC) are very active in supporting trade through various forms of financing and risk mitigation solutions, in both the traditional trade space and in emerging solutions such as supply chain finance.

1.5. The Importance of Financing to Global Trade

Trade financing is simply essential to the conduct of international trade. As noted earlier, it is estimated (IMF, WTO and others) that 80-90% of trade flows globally are enabled by some form of trade finance.

This can be bank-sourced, traditional trade finance such as letters of credit, or it can be trade finance provided by export credit agencies or international institutions, or it can be other forms of lending and financing that support trade, without necessarily being easily identified as trade finance. Even for the types of financing that can be identified as trade finance, the link is direct and substantial, between trade finance solutions and the ability of companies to engage in international commerce.

Figure 7: Trade Settlement and Finance: Market Sizing



Source: Trade Finance During the Great Trade Collapse, World Bank, 2012

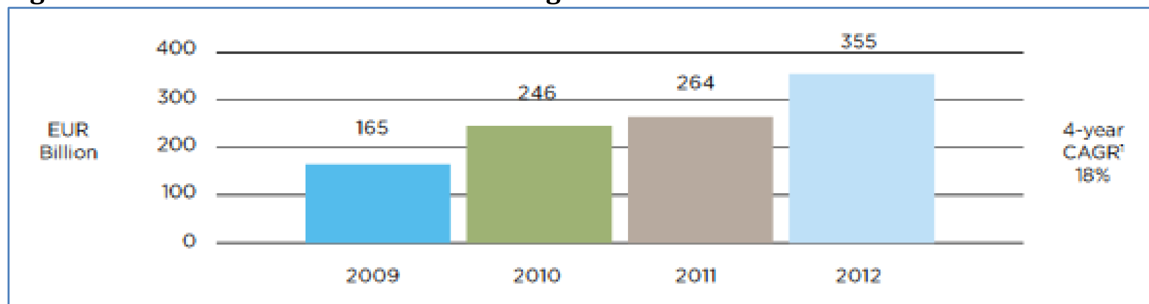
Finance and risk mitigation solutions provided by export credit agencies supported approximately 10% of global trade flows in 2012 according to industry estimates (Berne Union, 2013).

The importance of financing to the conduct of international trade was compellingly demonstrated over the course of the global crisis of 2007/2008 and beyond.

> *"While most firms have reported a tightening in trade financing since September 2008, SMEs were the most affected. The most often cited constraints relate to the increase in cost of trade financing instruments, banks' more stringent selectivity and guarantee requirements, and delays in payments from buyers. [...] Even firms that have not been relying extensively on the banking system for trade finance have also been affected. These firms usually use open account with self-financing, cash in advance and accounts payable. The scarcity of trade finance originated from the slower demand from their export markets and the consequent drop in revenues, delays in payment terms by buyers, and shortening payment terms by suppliers. This has in turn squeezed the capital base of exporters and importers, their working capital and capacity to self-finance their transactions."*
>
> Source: Trade and Trade Finance Developments in 14 Developing Countries Post September 2008, World Bank, 2009

In addition to illustrations of the importance of traditional trade finance and export credit support, it is instructive to look at growth rates in cross-border factoring volumes, which by definition involve foreign receivables and therefore relate to trade flows.

Figure 8: Growth of International Factoring Volumes



Source: Factors' Chain International/ICC, 2013

With global factoring volumes approaching €1 trillion, about a third of this activity relates to cross-border factoring, as shown below in an illustration of total international cross-border factoring volumes from 2009 to 2012.

The Export Credit Guarantee Company of Egypt (ECGE) includes both international and domestic factoring among its service offerings. On the international front, ECGE leverages its membership in Factors Chain International to provide both import and export factoring services:

> *1 - Export Factoring:*
>
> *ECGE provides export factoring service which is a package of financial services including finance, protection and collection through the purchase of export sales invoices without recourse.*
>
> *2- Import Factoring:*
>
> *ECGE offers "Import Factoring" service including issuing guarantees on Egyptian importers to the export factor, in order to facilitate importation from foreign suppliers through open account transactions without cash collateral or bank guarantees.*
>
> Source: Export Credit Guarantee Company of Egypt, 2013

Even emerging solutions in the trade finance space are being acknowledged as important to the conduct of global trade. Supply chain finance, through programs aimed at granting access to finance for SME suppliers on the back of the borrowing capacity of large buyers, is enhancing the overall health and viability of key international supply chains, arguably reducing the overall cost of financing and enhancing the ability of buyers to manage strategic suppliers.

> *"…the credit differential among investment grade buyers and their SME suppliers is wide enough in the current funding market to make the credit arbitrage of reverse factoring an attractive way to improve liquidity for both buyers and suppliers. For example, SCF programs allow buyers to extend payment terms from 60 to 120 days while providing suppliers access to better financing rates (e.g., 120 days at 100 bps instead of 60 days at 500 bps). According to industry sources, SCF could unlock $100*

billion to $500 billion of liquidity by accelerating the cash conversion cycle for suppliers and extending days payables outstanding for buyers."

Source: Supply Chain Finance: From Myth to Reality, McKinsey, 2010

Just as trade has long been identified as an important enabler of international development and poverty reduction, trade finance is now understood to play an important role in supporting the trade flows required to succeed in international development activity, and during the course of the global crisis, the importance of accessibility to timely and equitably priced trade finance for SMEs in developing economies, was the subject of significant focus and comment from numerous stakeholders (World Bank, IMF, WTO and others).

"The [Asian Development Bank Trade Finance] program delivers tangible and measurable development impact. For example, in 2009 and 2010, TFP provided trade support for more than 540 SMEs. Supporting SME growth is a priority for ADB because smaller firms employ the largest number of people in most Asian countries. Increased trading activities and cross-border relationships enabled by TFP are helping to boost economic integration and cooperation in challenging Asian markets, which should, in turn, spur faster economic growth and help reduce poverty. In 2009 and 2010, nearly half of the TFP portfolio supported trade between ADB's developing-member countries (south-south trade)."

Source: Trade Finance During the Great Trade Collapse, World Bank, 2012

1.6. Key Providers of Trade Finance: Private, Public and International Sectors

1.6.1. Banks

Banks currently provide the majority of traditional trade finance across the globe, and their activities in supply chain finance are growing rapidly, suggesting that the role of these financial institutions will grow also in trade flows involving open account transactions.

The global financial and economic crisis of 2007 and beyond has resulted in pronounced reaction in leading financial centres – the imperative for banks to "get back to basics" in their return) investment banking activity, to the more conventional, core activities around deposit-taking and lending, and related areas now often grouped under lines of business called Transaction Banking.

Banks active in trade finance typically maintain dedicated trade finance departments, with transactional/operational units specialized in the issuing and processing of traditional instruments like documentary collections or documentary credits, together with "front office" client relationship and sales functions. Additionally, the more advanced institutions will maintain product development and product management functions, commonly referred to as "middle office" activities.

The most effective trade banks actively work in partnership with public or private sector export credit agencies, international institutions and private insurers to complement their own capabilities and to engage in risk mitigation or risk-sharing where necessary. Additionally, it is common for banks to share risk among themselves, through risk participation and syndication arrangements – transactions where a lead bank might decide to invite selected financial institutions to share in the risk (and revenue) associated with a particular deal, perhaps because the lead bank does not have the necessary risk or credit capacity to hold the transaction on its own books, or perhaps simply as a means of diversifying its own risk portfolio.

Bankers increasingly appreciate the importance of trade finance within the broader scope of transaction banking activity, and have been working for some years now, on better integrating their capabilities and solutions around trade finance, and related areas such as cash management and foreign exchange. At the same time, several top banks, (including major European and American institutions) saved from bankruptcy by government support, are now being mandated to provide greater support to SME clients, as political leaders recognize the critical role of small business in sustaining national economies.

This relatively recent demand on bankers, particularly in the US and Europe, conflicts to some extent with the pressure on those same banks to minimize undue risk exposure and financial loss: one of the reasons that banks claimed it was prudent not to engage in excessive SME-focused financing.

OIC Member States face a somewhat different reality, with the majority of businesses likely to fall in the SME segment, and a differing level of focus among banks and political authorities relative to the support and servicing of SME businesses, however, some of the same challenges apply, and the concern of SMEs around access to finance – and access to affordable finance – is a common thread on a global basis.

As the trade practices and requirements of importers and exporters have evolved to shift away from traditional mechanisms, to emphasize trade on open account terms, the banks have responded by developing value propositions aimed at meeting the needs of global supply chains. This approach is still very much in development however, bank involvement in supply chain finance allows these institutions to fulfill several objectives at once:

- Demonstrate engagement in and support of real economy activities linked to the flow of goods across borders
- Demonstrate a desire to service the SME sector, through programs that facilitate access to financing and liquidity for small business
- Show commitment to the back-to-basics mantra of the post-crisis financial environment
- Maintain activities in a business with an attractive risk profile and very low loan-loss experience, balancing low risk with steady, conservative returns

While trade (and more recently, trade finance) enjoys significant profile in business and political circles, as a driver for global recovery and growth, it is worth noting that trade finance is poorly understood within financial institutions. Until recently, the business of trade finance was poorly championed within banks, and very few outside the international divisions of banks had more than a cursory understanding of the financing of international commerce.

This challenge is nearly universal, and is problematic in that non-trade bankers often exercise decisive influence on the decisions that enable a bank to support customers – including SME's – in the pursuit of international trade opportunities. Specifically, credit and risk decisions which impact a bank's ability to pursue trade finance business are often the purview of domestic bankers with limited international experience, and often, little or no direct knowledge of the markets on which their decisions have so much impact.

1.6.2. Non-Bank Providers: Boutique Firms

Importers and exporters can avail themselves of the services of non-banks in seeking to obtain support in trade and supply chain finance.

Several boutique or specialist finance firms focus on providing solutions to companies engaged in international commerce, some particularly focusing on supporting the aspirations of small and medium-sized enterprises.

The SME focus of certain boutique firms may make them particularly attractive as alternative providers of trade and supply chain finance, as much due to their domain focus, as to their willingness to support small businesses with transactional advice, and their preparedness to assess risk and viability on a bespoke basis, as opposed to on the basis of rigid credit models that do not typically allow for the unique positive factors shaping the opportunity pursued by an SME.

Such specialist entities may vary significantly in size, and may face a significantly different compliance and regulatory regime than banks; such a difference in certain markets might allow boutique firms to provide financing and liquidity solutions to SMEs on a more cost-effective basis. Falcon Trade Finance, based in Dubai and with offices across the Middle East and in Europe, is one such specialist firm with close connections to markets of interest to the COMCEC, and Kuwait Finance House, likewise, exhibits focus and domain expertise in the business of trade finance, including Islamic trade finance.

1.6.3. Non-Bank Providers: IFIs and ECAs

a. IFIs

International financial institutions (IFIs) and various multilateral development banks (MDBs) are donor-supported institutions with mandates focused primarily on international development. Given the well-established linkages between international development and trade, and the more recent realization of the importance of trade finance to the pursuit of trade opportunities, every major IFI now has some form of trade finance program within their portfolio of activities, lined directly to broader efforts to support development.

IFI trade finance programs include several dimensions:

- Lending and financing products and solutions
- Risk mitigation, guarantee and insurance solutions
- Local bank engagement programs
- Training, technical assistance and competency enhancement programs

- Advisory support

While the specific characteristics of various programs may differ, the overarching objectives of these programs is to assist beneficiary economies in engaging more effectively in international trade, by ensuring adequate supply of trade finance support for the importers and exporters seeking to pursue international commerce. Additionally, the banks and financial institutions of beneficiary economies may not be very experienced in trade financing; in order to assure adequate and sustainable levels of local support, IFI programs will include elements aimed at developing the technical competence of local trade bankers.

Perhaps equally importantly, the reputations of local financial institutions may not be particularly well established in international markets, and as such, international trade banks may not be sufficiently comfortable with these local institutions, to trust the trade finance instruments issued by local banks in developing markets. In such cases, IFI specialists will conduct appropriate due diligence on local financial institutions, and will offer to guarantee the obligations and undertakings of these banks, as one way of mitigating the concerns of international institutions in dealing with the local banks.

The World Bank/IFC's Global Trade Finance Program has been in operation for nearly a decade, and was established with a fairly broad mandate and potential scope of operations:

> *The GTFP aims to help increase the availability of trade finance in underserved markets. In November 2004, the Board of Directors approved IFC's proposed $500 million GTFP. The goal of the program was to "support the extension of trade finance to underserved clients globally." The new model sought to address a range of weaknesses in IFC's past trade finance efforts. To encourage the flow of trade finance, IFC would guarantee the payment obligation of a local bank in a developing country to an international confirming bank. The program was intended to allow IFC to respond quickly to support liquidity when and where it was needed, assist local banks develop relationships with international counterparts, and enhance trade finance capabilities among local banks.*

Source: World Bank Independent Evaluation Group: IFC GTFP Evaluation, 2013

Every major IFI has developed and deployed some form of trade finance program, and several provide metrics related to their financing activities and default/loss experience which, as shown below, amounts to zero losses over a period of nearly fifteen years, despite the fact that these programs deliberately target the highest risk markets in the world.

Figure 9: IFI Trade Finance Programs

	EBRD	IFC	IDB	ADB
Program title	Trade Facilitation Program (TFP)	Global Trade Finance Program (GTFP)	Trade Finance Facilitation Program(TFFP)	Trade Finance Program (TFP)
Number of countries of operation	20	91	20	16
Program commencement	1999	2005	2005	2004
Number of transactions since commencement (year end 31 December 2011)	11,600	11,255	1,966	4,236
Value of transactions since commencement	EUR 7.2 billion equivalent to USD 9.5 billion	USD 15.8 billion	USD 1.96 billion	USD 8.8 billion (USD 3.5 billion of which in 2011)
Number of confirming banks	800	800	264	112
Claims to date	2 claims, zero losses	zero	zero	zero
Website	www.ebrd.com/tfp	www.ifc.org/gtfp	www.iadb.org/tradefinance	www.adb.org/tfp

Source: ICC Rethinking Trade and Finance

The role of such programs and organizations and the fundamental importance of their contributions to the facilitation of trade, and the support of developing economies was brought sharply and clearly into focus at the peak of the global crisis. The lack of liquidity in global markets directly impacted availability of trade finance, and resulted in a precipitous drop in trade flows from Asia to Europe and the Americas, and the lack of trade-focused liquidity was deemed sufficiently serious for the World Bank's International Finance Corporation to be mandated by the G20 and the WTO to manage the injection of $250 billion in new capital into global trade finance markets.

The IFC Global Trade Finance Program is comprehensive in nature, including both traditional and emerging supply chain finance solutions, as well as solutions targeted to meet the needs of specific types of trade flow, deemed strategic from a development perspective. The scope of the program, from a solutions perspective, and from the perspective of supporting technical assistance and advisory capabilities, is notable.

Table 3: IFC Trade Finance Program Elements

Global Trade Finance Program

- Established in FY06, the GTFP is IFC's flagship trade finance program that developed a new, more flexible, quicker-response means to support trade finance.
- GTFP aims to support access to trade finance in underserved markets worldwide. Its authorized ceiling has grown from $500 million in FY06 to $5 billion in FY13.

Global Trade Liquidity Program

- Established in FY09, the GTLP is a multipartner initiative of governments, development finance institutions, and private sector banks that aims to help address the shortage in trade finance resulting from the global financial crisis.
- Using both funded and unfunded instruments, the program has sought to increase access to trade finance in emerging markets by providing liquidity and risk mitigation to some international banks with large trade networks.

Global Trade Supplier Finance

- Established in FY11, this program is a combined investment and advisory program that provides short-term financing to exporters in emerging markets that sell to large international companies on open account terms.
- The program seeks to increase direct access to short-term finance for exporters in developing countries, reduce the costs of finance for exporters, and increase local supplier sales to large international firms in the program.

Global Warehouse Finance Program

- Established in FY11, the program aims to increase working capital financing to farmers and agriculture producers by leveraging their production stocks.
- The program provides banks with liquidity or risk coverage backed by warehouse receipts, which can be used to provide short-term loans or guarantees to agricultural producers and traders ahead of export.

Critical Commodities Finance Program

- Established in FY12, the Critical Commodities Finance Program supports the movement of agricultural and energy products to and from developing countries by promoting commodity-backed finance.

Source: IFC GTFP Evaluation, World Bank Independent Evaluation Group, 2013

Regional IFIs or IFIs with more focused/selective mandates include the Asian Development Bank headquartered in Manila that has specifically decided to target its support at Asian economies in greatest need. The ADB has also systematically and consistently sought to improve knowledge about trade finance on a global basis, contributing high-value initiatives, analyses and studies to advance the dialogue and understanding about trade finance beyond a core group of specialist practitioners. It was the ADB for example, the conceived and funded the development of the Trade Finance Default Register – an annual survey of trade banks' default and loss experience in trade finance that proved critical to discussions with international and national regulatory bodies over the course of the global crisis and beyond, demonstrating objectively, the negligible loss history of trade finance and thus advocating successfully for more equitable and appropriate regulatory treatment of trade finance transactions.

More recently, ADB has also initiated analysis aimed at linking the availability of trade finance to the creation of economic value and to the demand for human resources (ADB Survey, 2013).

In addition to fulfilling individual mandates, several IFIs have opted to work toward alignment of their respective trade finance programs, with a view to enhancing efficiency and consistency for various stakeholders seeking to deal with international financial institutions.

> *"IFC has helped make good progress toward establishing a single standard for MDB support for trade finance. One of the original objectives of the program was to help standardize the approach to trade finance among MDBs. A more uniform approach to trade finance would provide advantages to commercial banks in terms of time and cost savings, easier communication, and multiple solutions to getting more difficult transactions done. Substantial progress toward this objective has been made. The GTFP itself was based on EBRD's model. IFC subsequently helped other MDBs, including the Asian Development Bank and the African Development Bank, establish their trade finance programs. Each MDB trade finance program is based on"*

Source: World Bank Independent Evaluation Group: IFC GTFP Evaluation, 2013

The International Islamic Trade Finance Corporation (ITFC), likewise, mirrors other IFIs in its mandate and scope of operations, with several distinctive characteristics. ITFC naturally focuses on the provision of Shari'ah-compliant trade finance and structured trade finance solutions, and does so explicitly with a view to supporting trade involving OIC Member States, as well as specifically, trade flows between OIC Member States.

> ITFC aims to "…serve as a catalyst for economic solidarity by establishing new trade links with member countries, creating an environment that is conducive to on-going, direct trade relationships, and strengthens corresponding banking networks among member countries."

Source: ITFC Website

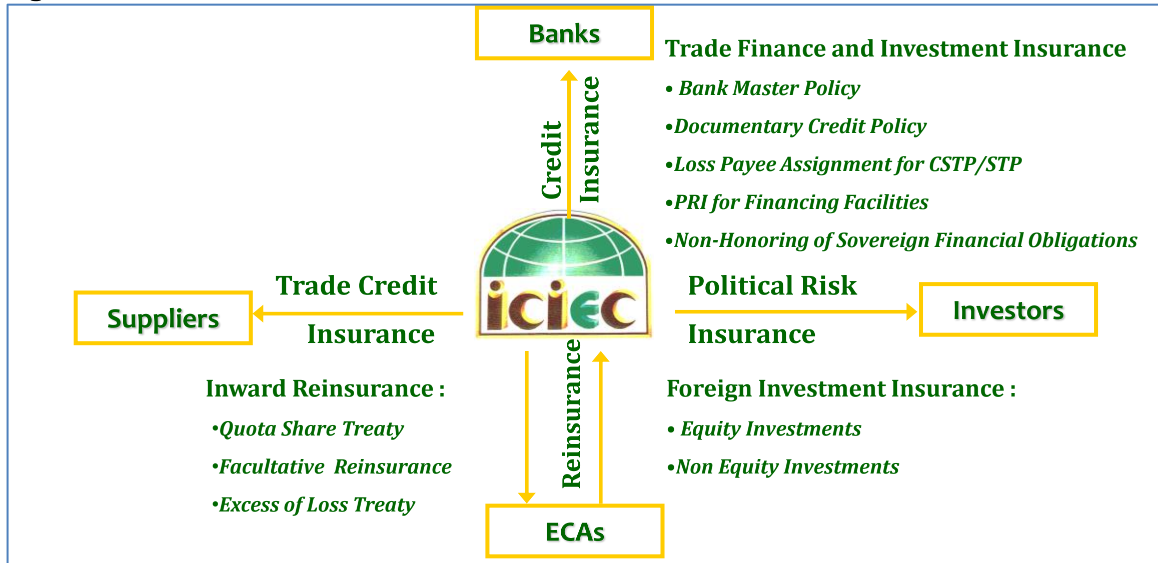
The ITFC notably also aims to reduce the cost of trade financing for companies operating in OIC Member States – an objective that addresses both the commercial realities of high-cost financing, and the objectives of IFIs in supporting international development among their member nations.
The Islamic Corporation for the Insurance of Investment and Export Credits (ICIEC) is the Islamic Development Bank-owned credit and insurance agency based in the Kingdom of Saudi Arabia, established in 1994, currently the only ECA that provides export and investment insurance solutions that are fully Shari'ah compliant. The ICIEC is a member of various industry associations, including the Berne Union.

The ICIEC combines a risk mitigation proposition related to both trade and investment activity, supporting intra-OIC trade flows and also seeking to enable and encourage inward investment into OIC Member States, on the basis of Shari'ah compliant structures and practices.

The scope and mandate of the ICIEC is consistent with recent developments in international activity, where traditional distinctions between trade and investment have given way to a

more closely linked dynamic between these two dimensions of international engagement (Integrative Trade, EDC and Conference Board of Canada). The notion is that companies engaged in export trade are now often also importers due to the need to sources inputs to production, and that companies engaging in trade activity are increasingly likely to become investors in the markets in which they trade. This view, referred to as "Integrative Trade" has seen some exposure in academic circles as well as among practitioners.

Figure 11: Trade Finance and Investment Insurance



Source: ICIEC 2013

The offerings of ICIEC are both comprehensive and strategically defined, and provide a clear complement to the value proposition of the ITFC, while encompassing international activities (trade and investment) that are both complementary and directly linked to the broader objectives of OIC Member States.

The differentiated focus of ICIEC on Shari'ah compliant products and solutions is notable however, it is also clear that the ICIEC is actively working to develop partnerships, alliances and collaborations with selected partners, including Canada's EDC.

b. Export Credit Agencies (ECAs)

In addition to the critical contributions of international financial institutions, particularly in the context of ongoing crisis and economic challenge, the role of export credit and insurance agencies has also been shown to be of critical importance in responding to the trade financing needs of companies of all sizes.

Export credit agencies (ECA) were originally public sector entities mandated to enable economic recovery through support for export trade. ECAs provided financing and various forms of guarantees, insurance and other forms of risk mitigation, linked directly to the export aspirations of their sponsoring national governments.

While ECAs were originally created as institutions of post-war reconstruction in Europe, mandated to support economic recovery through export, the scope of activities of export credit entities has expanded significantly since then.

There is no single or definitive model related to the mandate, structure or focus of an export credit agency. A spectrum of institution types, ranging from public sector to hybrid to fully privatized, is wide, and the exact nature of mandates and areas of focus varies significantly.

While many ECAs are guided by the OECD Consensus (www.oecd.org) in terms of their approach to the market the interpretations of ECAs and of their governments about scope and nature of operations varies significantly.

The Export-Import Bank of the United States, for example, is directed by Congress to actively avoid competing with private sector providers of finance or risk mitigation solutions. Not only is US Exim expected to avoid such a competitive posture, but they are meant to exit a particular realm of activity if it appears that there is interest from a private sector provider in becoming active in a particular area.

Canada's national ECA, Export Development Canada (EDC), by contrast, takes a very wide view of its mandate, particularly since the last Parliamentary review of its mandate. EDC provides a comprehensive set of financing and risk mitigation solutions, and is empowered to take equity stakes in foreign companies if it can be shown that there is the potential for some level of benefit to flow to Canada. The dynamic between EDC and the Canadian banks includes a significant collaborative dimension, as well as a degree of competitiveness that some of the banks have found historically objectionable, given the inherent advantage that a government entity will have, over a financial institution.

In addition to the broad range of mandates for various ECAs, it is notable that the product and solution set available through these various agencies is also at significant variance.

Some ECAs, including US Exim and UK Export Finance will periodically undertake competitive analyses of the operating models and product offerings of agencies in other markets, as a means of influencing national policy and potentially also impacting international practice in the realm of export credits, which can sometimes generate significant dispute, if such credits are seen to be unfair subsidies in support of export activity.

Figure 12: ECA Product and Services Comparison

Countries	ECAs/Other government agencies	OECD member	Short-term insurance	Medium/ Long-term export credit schemes	Fixed rate financing (CIRR)	Foreign exchange risk cover	Direct lending	Investment insurance	Bond support scheme/ issuance	Unfair calling insurance	Letter of credit guarantee scheme	Working capital facility	Score
United Kingdom	ECGD	Yes	✗	✓	✓	✗	✗	✓	✗	✓	✓	✗	5
Australia	EFIC	Yes	✗	✓	✓	✗	✓	✓	✓	✓	✓	✓	8
Austria	OeKB	Yes	✓	✓	✓	✗	✗	✓	✓	✓	✓	✗	7
Belgium	ONDD	Yes	✓	✓	✓	✗	✗	✓	✓	✓	✗	✓	7
Brazil	SBCE	No	✓	✓	?	?	✓	?	✗	?	?	?	3
Bulgaria	BAEZ	No	✓	✓	?	?	✗	✓	?	✓	✓	✓	6
Canada	EDC	Yes	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	10
China	Sinosure	No	✓	✓	✗	✗	✗	✓	✓	?	✓	✓	6
Croatia	HBOR	No	✓	✓	✓	✗	✓	✓	✓	?	✓	✓	8
Czech Republic	EGAP/CEB	Yes	✓	✓	✓	✗	✓	✓	✓	✓	✓	✓	9
Denmark	EKF	Yes	✓	✓	✗	✗	✓	✓	✗	✓	✗	✓	6
Finland	Finnvera/FEC	Yes	✓	✓	✓	✗	✓	✓	✓	✓	✓	✓	9
France	Coface	Yes	✓	✓	✓	✓	✗	✓	✓	✓	✓	✓	9
Germany	Euler Hermes/KfW	Yes	✓	✓	✓	✗	✓	✓	✓	✓	✓	✗	8
Greece	ECIO	Yes	✓	✓	?	✓	✗	✓	✓	?	?	?	5
Hungary	MEHIB/Eximbank	Yes	✓	✓	✓	✗	✓	✓	✓	✓	✓	✓	9
India	ECGC/Exim Bank	No	✓	✓	✗	✓	✓	✓	✓	?	✓	✓	8
Italy	SACE/SIMEST	Yes	✓	✓	✓	✗	✗	✓	✓	✓	✓	✓	8
Japan	NEXI/JBIC	Yes	✓	✓	✓	✗	✓	✓	✗	✓	✗	✓	7
Luxembourg	ODD	Yes	✓	✓	✓	✗	✗	✓	✗	✓	✗	✗	5
Malaysia	Exim Bank	No	✓	✓	✗	✗	✗	✓	✓	✓	✓	✓	7

Source: ECGD (UK Export Finance), 2010

Even an extract of a competitive landscape analysis, as above, illustrates the sometimes significant differences in the product and solution offerings provided by various export credit and export insurance agencies.

The breadth and variety of strategic priorities, mandates and product offerings among ECAs is such that importers and exporters can benefit from the programs of ECAs that may not be based in their home markets and may not be directly mandated to support those businesses' objectives.

Importers and exporters seeking trade finance, or some form of risk mitigation associated with a financing transaction, can look well beyond the offerings of their home country's ECA and may even find it useful to explore various ECAs, their mandates and their country or industry sector level expertise, to determine which ECA might best be suited to provide solutions in support of a particular transaction or trading relationship.

There is a wide range of product and solution options around export credit and export insurance linked to ECAs, with many such institutions well-disposed to serving SME clients.

> *"Traditionally, the purpose of an ECA has been to directly support the financing of domestic exports. However, for a variety of reasons, an increasing number of ECAs have broadened the scope of their activity to include untied export credit support. In addition, many export credit agencies have ramped up their investment insurance programs. Although untied financing and insurance programs are not required to be*

tied to domestic procurement and exports, Market Window financing (at least from EDC of Canada) is tied to domestic procurement and exports. Moreover, such programs may often be priced on commercial terms even if the parameters of the financing may be more attractive than standard OECD Arrangement terms (e.g., no 15% cash payment requirement or tenor restrictions)."

Source: US Exim Bank ECA Competitiveness Report 2012

1.6.4. Hedge Funds, Platforms and Other Providers and Sources

Numerous other potential sources of trade and supply chain finance can be identified in the global marketplace. Some are technology-based, platform type providers that offer a basis on which trade financing and liquidity can be brought to the market by banks, or platforms where importers and exporters can engage directly in the buying and selling of trade-related receivables, thus accessing financing in non-traditional ways, and perhaps at competitive cost.

Several UK and US-based hedge funds demonstrated interest, particularly pre-crisis, in providing liquidity in support of high-margin trade flows involving Africa, and there are efforts underway to design and deploy various forms of capital pools in support of trade activity, including around commodity trade.

It is worth noting that emerging models of e-commerce and electronic trade are paying more attention to the need for and opportunity in providing financing. While such online marketplaces initially focused on facilitating a transaction and enabling simple payment, advanced approaches now consider various forms of financing, including the use of letters of credit, and support for trade on open account terms, to be core elements of their overall value proposition.

One example of such a model is China-based One Touch (APTFF, Beijing, 2013), which is an affiliate of online marketplace Alibaba.com. This Chinese company has perceived a need to complement its global trading platform with broader capabilities aimed at facilitating more efficient conduct of trade, including the ability to provide trade financing support for customers.

Figure 13: Global Concentration of Finance Activity

Top ten banks' share of all mandated-lead-arranger volume, H1 2009 (2005), %

High concentration (>80%)
Medium concentration (50–80%)
Low concentration (<50%)

	Leveraged buyout (LBO) finance	Acquisition finance	Project finance	Structured trade finance	Asset finance[1]	Total[2]
Europe	97 (61)	50 (63)	51 (52)	66 (60)	87 (89)	45 (55)
North America	100 (79)	94 (73)	44 (77)	100 (100)	100 (90)	83 (71)
Latin America	N/A (100)	100 (93)	87 (74)	100 (77)	100 (97)	78 (68)
Middle East and Africa	100 (100)	57 (92)	51 (47)	99 (84)	100 (97)	48 (49)
Asia-Pacific	89 (88)	76 (75)	93 (54)	100 (85)	88 (74)	78 (54)
Global	62 (62)	56 (60)	54 (34)	66 (58)	73 (82)	47 (54)

Source: Turning the Crisis to Advantage in Structured Finance, McKinsey 2010

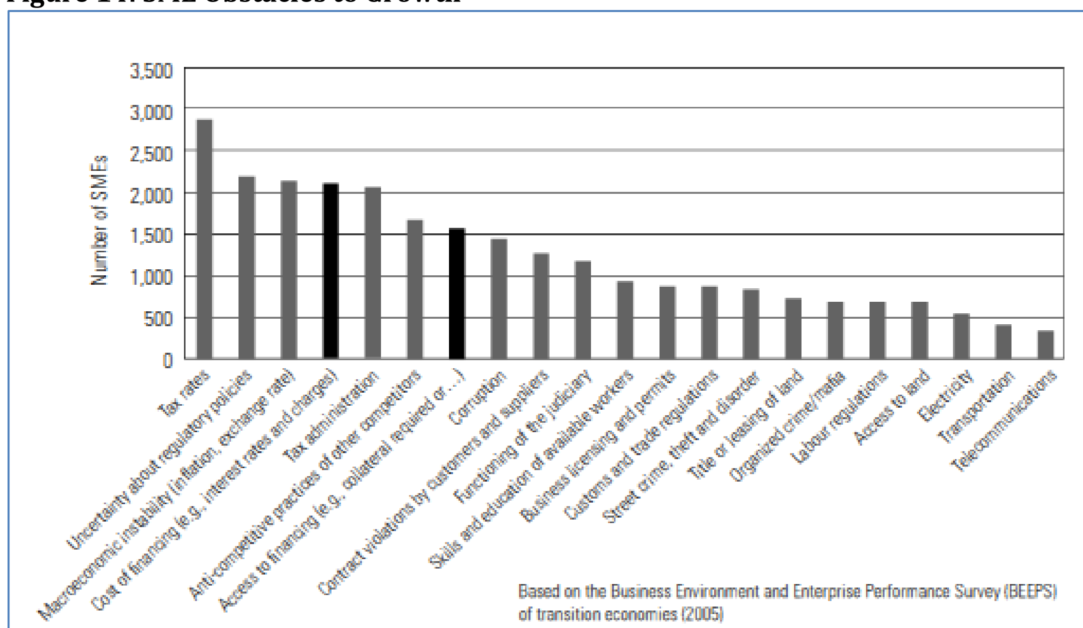
While sources of trade finance remain concentrated on a global basis, it is evident that there is increasing interest in the financing of international commerce, and that the sources of liquidity and financing targeted at trade activity will increase in the medium term.

1.7. Importance and Common Challenges for SMEs in Accessing Financing and Trade Finance

The critical role of small businesses creating economic value and in generating employment is well-known among development practitioners and within international institutions, and has gained increasing profile and priority in the political context, even as small businesses continue to report challenges in accessing affordable and timely financing, including trade finance.

Small and medium-sized enterprises, globally, face challenges in accessing timely and affordable financing: a systemic reality that may be showing signs of favourable shift as a direct result of the global crisis, the redesign of global trade flows and the increasing realization of the importance of SMEs to economic growth and value creation.

Figure 14: SME Obstacles to Growth



Source: How to Access Trade Finance, UN ITC, 2009

At the same time, SMEs, and particularly those in developing and emerging markets, continue to report difficulty in accessing financing and consistently report that financing costs are high relative to other customer segments. The graphic above illustrates that SMEs are concerned about both the high cost of financing (fourth item from left) and inadequate access to financing (sixth item from left). Limitations on access to finance are consistently identified as a significant obstacle to growth and long-term sustainability of small businesses.

Historically, small business had the luxury of taking the time to establish solid domestic operations prior to venturing into higher-risk, costly international markets, and were often advised to ensure legal and operating structures aimed at shielding the domestic business from any adverse impact originating from the international activities of the company.

The commercial reality today is very different, with companies increasingly seeking opportunities in international markets, much earlier in their lifecycle – often almost at start-up – in order to ensure rapid growth, diversification of markets and access to technology or other inputs that may be required by the company in its own production activity. That is, international engagement is likely to happen much earlier for small businesses today, and may very well involve both import and export activity.

While the formal definition of an SME can vary based on number of employees or average annual turnover, and those variances can be significant even within one country (where sub-national jurisdictions define their segments differently), it is likely that the majority of businesses requiring access to trade finance in OIC Member States will fall into the SME segment, with some likely to be considered micro-enterprises. This will be relevant not only in domestic terms, but also in terms of international definitions of the SME segment, particularly in trade and supply chain finance, where the lender may be an international bank or institution with segmentation definitions that vary from those of domestic institutions.

Finance discussions at a high level will suggest that the primary requirement of a small business is to assure access to liquidity, cash flow and working capital, without which most such businesses do not have the wherewithal to survive over the medium term, and indeed may be unable to sustain any significant delay in collecting receivables, or unexpected cost related to accessing international markets, or to the resolution of an expensive commercial dispute, for example. For such businesses, the expression "cash is king" is very much a reality of daily business, and the urgency is compounded when international activities are involved, given the extended timeframes involved in international commercial activity.

This is true for several reasons:

- International market development is a time-consuming, resource-intensive and costly proposition
- Development of local relationships likewise can be a long process requiring multiple trips to the new market
- Due diligence and risk mitigation related to international ventures can be expensive, as can any type of dispute resolution
- Payment and settlement timeframes can be significantly longer due to the extended timeframe in completing a transaction and due to differing practices related to the settlement of foreign payables by a foreign client
- SME exporters may even be expected to provide attractive terms of sale as a competitive reality of international sales, perhaps accepting payment terms extending to 90, 180 or 360 days in order to assure closure of a deal with a new buyer

In addition to the imperatives driving a need for financing among SMEs, there are challenges in providing such financing, that arise at the client side (with the SMEs) as well as with the lender side (banks and other institutions). It should be noted that the Asian Development Bank has estimated a global gap in trade financing (excess of demand over supply) in the range of US

$1.6 trillion per year, about 25% of which is in the Asia Pacific region. It bears repeating here that industry estimates, supported by the WTO and others, suggest that 80-90% of global trade flows are supported by some form of financing. With these numbers in mind, it is not surprising that small businesses, especially those in developing markets, would be adversely impacted in terms of both access to, and cost of, trade finance.

International development specialists focusing on trade, development and trade finance (ITC, ADB and others) have noted that part of the "access to finance" challenge relates to the nature of the SMEs themselves, and the difficulty of conventional financiers in engaging with SMEs due to the SMEs own approach and practices (How to Access Trade Finance, ITC 2009).

Factors noted include:

- An entrepreneurial mind-set and related distrust of banks and large institutions
- Hesitancy in providing visibility around business operations, strategic direction and financial status
- Limited technical competence in finance which prevents small businesses from "speaking the language of the lender" and appreciating the critical importance to timely and adequate disclosure
- Opacity relative to the purposes and planned use of borrowed funds, and a related perception of heightened risk
- Inability to prepare credible loan or financing requests
- Limited collateral or other forms of security
- Perceptions of non-bankability especially in developing markets

Numerous challenges on the SME side appear to be attitudinal in nature, and efforts have been made by bankers and by international financial institutions, to provide various forms of training and other resources, to assist SMEs in engaging effectively with potential financiers, including bankers and others.

Markets in the Middle East and North Africa have shown an enduring affinity for traditional trade finance products and for long-established commercial practice in trade, however, there is a broad issue with transparency related to companies based in the region. International banks have tightened their requirements around the need for basic information such as audited financial statements, visibility relative to income sources and flows at the operating and the holding company level, and a general alignment of practices to international standards, as opposed to the historical relationship and reputation based "name lending' approach.

This is an issue that extends beyond SMEs but one that has gained significant attention post-2008. Recent reports from industry sources suggest that there is momentum among local banks and businesses, to better align with international practices including accounting and reporting standards among others. Banks also, it must be said, face challenges in providing adequate levels of support to SME clients. These include:

- Perceived high risk of SME finance and trade finance
- High level of coaching and resource intensive nature of SME relationships
- Internal competition for limited capital, meant to be deployed in support of secure, profitable business
- Lack of technical competence around trade finance among credit and risk analysts

Non-bank providers face similar issues, in addition to even tighter constraints on the amount of capital and financial resources that can be deployed in support of SMEs.

While the importance of financing and liquidity to SMEs is clearly recognized, particularly in the context of international commercial transactions, the challenges to accessing/providing the necessary capital are not insurmountable, and in numerous cases, appear to be primarily a matter of training, education and adequate information flow.

The experience of Grameen Bank with microfinance (low loan losses even among the highest risk borrowers as described by Muhammad Yunus, SWIFT Conference, Osaka, 2012) suggests that perceptions of financial risk are not fully accurate, and that there is perhaps a need and an opportunity for a change in paradigm around the financing of micro and small business ventures. Likewise, it has been suggested (Asia Pacific Trade Facilitation Forum, Trade Finance Panel, 2013) that the value of collateral to banks is negligible in cases of default by an SME, and that non-collateralized finance will better meet the needs of small companies without significantly increasing the lending risk to financial institutions.

Relatedly, while the majority of trade financing capacity rests with banks today, the role of international institutions such as export credit agencies and international financial institutions is clearly growing, and such entities are very much disposed to supporting SMEs in developing markets.

Such institutions, especially international financial institutions, supported by a donor/member community, are less concerned with commercial profitability, and more concerned with social and economic benefit, though also clearly driven to preserve the safety and security of capital. These institutions support local financial institutions and enable international banks to undertake transactions that would otherwise be deemed commercially unacceptable, by providing various forms of guarantee against risks of non-payment, for example. Some such programs have been described as involving onerous restrictions and loan covenants, and in some cases, as being unaffordable due to excessive risk premiums. In the latter instance, public policy initiatives at the national or supra-national level can be effective in balancing the need for appropriate risk pricing and mitigation, with the need to provide affordable financing to SMEs.

There are alternative sources of financing, and there may be opportunity to develop greater trade finance capacity among community banks and credit unions in markets where these institutions exist, for example. Such organizations are typically closer to the SME segment and have a better and more intimate understanding of the business practices and needs of SMEs. In most markets however, such entities are not particularly active in international banking and trade finance.

The experience of international jurisdictions in providing alternate, non-bank sources of trade finance may be instructive, even to the extent of suggesting program characteristics that can be incorporated into bank offerings in OIC Member States.

Table 4: Providers of Trade Finance

Sources	Products/Services	Condition of access	Availability of SME services
Commercial banks			
Universal/Foreign	Wide array of domestic and international financing	Relatively tough: borrower needs to pass credit-scoring and risk-rating	Usually has dedicated units for SMEs
Small/Local	Limited	Easy through relationship lending; flexible	Generally available; highly motivated to get SME business
Development banks	Medium to long-term finance; trade finance	Relatively easy because of developmental interest	Usually has special unit for SMEs
Multilateral development banks	Wide array of banking services plus credit guarantee and insurance at cheaper rates	Usually deals with governments and financial institutions	None
Investment and merchant banks	Fee-based services, e.g., loan syndication for large transactions	Very select clientele	Hardly
Specialized institutions			
Export-Import banks	Wide range of trade payment and finance possibilities on advantageous terms	Varies. Some big exim banks only cater to large transactions	Usually has special programmes for SME exports
Factoring houses	Discounted purchase of receivables	Easy with creditworthy receivables	Has facility for small recurrent transactions
Leasing companies	Leasing	Easy	Some services are for SMEs, e.g., equipment leasing
Non-bank Institutions			
Credit unions	Limited; mostly loans	Easy if SME is a member	Services are usually for SMEs and individuals
Export credit guarantee and insurance agencies	Credit guarantees and insurance	Usually accommodating to SMEs because of developmental interest (especially if government owned)	May have special units/ programmes for SMEs
Government and trade associations	Limited; usually special financing for particular projects	Easy because of developmental considerations	Will seek SMEs
Equity sources			
Stock exchange	Extensive source of equity from the public	Tough disclosure requirements	Usually not available for SMEs.
Venture capitalist	Good source of equity for start-up and expansion	Only for SMEs with fast growth and high potential	Usually seek SMEs with growth potential
Business angels	Same as venture capitalist but management involvement	Same as venture capitalist but smaller transactions are possible	Usually seek SMEs with growth potential

Source: How to Access Trade Finance, UN ITC 2009

While certain jurisdictions in Europe and the Americas have long been known by practitioners and advocates of entrepreneurship to face situations of "under-servicing" of small and medium-sized enterprises, it is encouraging to observe greater focus and emphasis on opportunities related to the financing of SMEs, almost universally across the globe.

The experience of Germany and its positive and committed support of the SME sector, particularly the family-owned enterprises referred to as the "mittelstand" is instructive in its positive effects on the national economy which withstood the global crisis largely on the basis of export-driven economic robustness.

The degree of support and "hand-holding" required by small businesses has been problematic to bankers as providers of finance and trade finance: a significant cost to maintaining customer relationships that are, on the commercial side at least, low-margin and relatively risky. Banks in Europe and the United States have recently been compelled by political authorities to provide enhanced services and better financing to the SME segment as one direct outcome of

the global crisis, however, the longer-term patterns in this respect suggest that it is important to ensure adequate non-bank participation in the provision of liquidity to SMEs.

Recent developments in the financing of international trade suggest that there are evolving opportunities to support SMEs and enable their involvement in international commerce. International financial institutions and banks alike have devised or refined solutions under the umbrella of supply chain finance, aimed at providing financing to small suppliers (even those located in higher-risk developing markets) on the basis of the borrowing capacity of large global buyers. This type of program may be particularly promising in addressing some key needs in OIC Member States, as it touches upon trade, development and the imperative to be responsive to the needs of SMEs.

Relatedly, there is significant pricing and margin compression currently in the business of trade finance, particularly at the top end of the market, where large corporate clients are able to access low-cost financing and are able to apply pressure to their bankers in demanding lower pricing for various kinds of financing, including trade finance. In this context, middle-market clients including larger SMEs are now seen as more attractive to financiers, because pricing can be more profitable. This may be a temporary situation, however, it is clearly the reality of the moment, and combines well with the fact that economic and trade growth rates are stagnant in most OECD economies, and dynamic in emerging and developing markets.

SMEs have long expressed frustration about the difficulty in accessing affordable financing; perhaps evolving conditions will create the circumstance where SMEs need their bankers, but finally also where bankers will need their SME and microfinance client base: an advantageous scenario to which OIC Member States are perhaps closer than other jurisdictions today, and one which could provide the basis for economic development and growth driven by the SME sector.
The impact of inadequate trade financing has observable and quantifiable consequences for businesses – particularly SMEs and businesses engaged at the low end of global value chains, as observed by the IMF in 2009.

> *"…firms lower in the supply chain are more affected as a result of reduced access to credit by final suppliers/customers:*

- *In Indonesia where most firms in the sample produce consumer products and are assemblers of different semi-finished products to be final products, the impact has been large. Exporters were experiencing an increase of up to 37 days in their cash flow cycle.*
- *In India, 60 percent of firms' cash-to-cash cycle time has increased from 15 to 90 days post September 2008; and 80 percent of firms reported overdue payment ranging from 5 to 70 percent of their sales.*
- *Firms in Turkey also complained about overdue payment, in particular when using a direct method of payment rather than safer method of payments such as Letters of Credit (LCs). This may lead some firms to prefer safer methods of payments, provided that banks are willing to work with them."*

Source: Trade and Trade Finance in 14 Developing Countries Post 2008, World Bank, 2009

1.8. Policy Considerations and Framework

Trade finance is provided through a combination of private sector and public sector sources. Given the nature of trade finance, both in terms of the areas of activity impacted, and the nature of the key providers of trade finance, there are numerous opportunities, from a policy perspective, to positively affect the availability and effectiveness of trade finance.

1.8.1. Supra-National Engagement

There are important opportunities for engagement with agencies at the supra-national level, including the International Chamber of Commerce that is a centre of expertise and activity in trade finance, along with organizations such as the ITFC and related OIC-focused organizations, as a means of accessing expertise, aligning policy initiatives and linking to leading international standards and practices around the provision of trade finance. Similarly, linkage to IFI's and international institutions through appropriate levels of representation, to remain current about and to influence developments in the global trade finance environment are well-advised, particularly under persistently challenging market conditions.

1.8.2. Public Policy

The nature of trade finance and its impact in terms of economic value creation (or the opportunity cost resulting from a lack of trade finance) are sufficiently critical to warrant specific attention at the level of national public policy, particularly in nations where trade is central to economic activity or to development efforts.

Public policy can involve the conception and promulgation of appropriate mandates for national export credit agencies, or the creation of such agencies where they do not exist and ECA support would be warranted. Relatedly, the establishment of various guarantee schemes to complement financing and liquidity programs are advisable.

Where a government has a formal trade promotion infrastructure at the national or sub-national levels, such as Trade Promotion Organizations or inward Investment Promotion Agencies, the potential to integrate trade financing programs and advisory support within such entities and programs merits careful consideration.

Awareness-raising among entrepreneurs and business executives can be an effective complement to policy initiatives focused on access to trade finance. Measures aimed at raising the technical competency of bankers and public sector officials (including central bank supervisory authorities) around trade finance are important dimensions of the broader public policy framework.

1.8.3. Capital Adequacy

The regulatory context, in particular around banking entities and export credit programs, likewise, demands attention in its significant, even definitive impact on trade finance – both in terms of market capacity to provide trade finance, and in terms of ultimate access to trade finance for SMEs and for national economies.

The work of the Basel Committee in aiming to assure the robustness and financial health of banks is critical to the health of the international system, however, the treatment of trade finance by the Basel Committee has been inequitable, inappropriate and inconsistent with the quality of trade finance activity and the trade asset class.

At its core, the intent of Basel II and Basel III is to ensure that banks maintain adequate levels of capital reserve in support of the lending and other activities undertaken by said banks, with the intent (perhaps distilled to over-simplified levels) that higher-risk activities require higher levels of capital reserve, and consequently, that such activities become more expensive to undertake.

The current situation is such that reserve requirements imposed on trade finance businesses do not reflect the negligible loan default and loss history that has thus far been demonstrated by industry through the ICC Trade Finance Default Register. The consequence is that banks' capacity to apply capital to support trade finance is restricted, and in the end, trade finance risks becoming more expensive as a result of unnecessarily stringent capital reserve requirements. Standard Chartered Bank has estimated that trade financing cost could increase by as much as 37% or more, as a direct result of the mismatch between the (very high) quality of trade finance assets, and the capital adequacy requirements proposed by the Basel Committee, which may be largely supported and implemented by national regulators.

The cause of this current situation includes ineffectual engagement and advocacy by trade financiers to the Basel Committee as the capital adequacy requirements were being defined; while the industry is now engaging more effectively, and has had marginal success in reversing one or two provisions in the latest Basel Accords, there is much to be done, and the advocacy must now extend into national regulatory bodies and into the political and policy sphere.

A policy framework around trade finance must look at this type of unintended, adverse regulatory impact, and must balance such impact against the adverse consequences for economic value-creation, recovery and growth.

1.8.4. Anti-Money laundering, Boycott and Due Diligence

Additionally, banks are subject to increasingly rigid and costly regulatory demands around monitoring and prevention of money laundering activity, terrorism finance, the use of trade mechanisms to funnel monies to persons or nations under boycott, and the need for banks to undertake significant due diligence (Know your Client, or KYC) activity relative to their own client, but also, to their client's trading partner, potentially located around the world.

These regulatory requirements exist for obvious reasons; it bears mention nonetheless, that banks are subject to such regulatory demands, while non-bank entities are often not subject to such requirements, and, the application of such requirements can vary significantly across jurisdictions, and therefore can create an unbalanced, competitively skewed environment.

II. GLOBAL TRENDS AND PATTERNS IN FINANCING SME EXPORTS

2.1. The State of Global Trade

Trade continues to be seen as one of the major global mechanisms to enable a broadly-based and sustained recovery and a return to growth across the international economic system.

The WTO projects a doubling of trade volumes by 2025, and market observers seem to agree that growth in the medium term must originate from developing and emerging markets in South Asia, parts of the Middle East and Africa. At the same time, the influence of China on both import and export flows (including commodity flows and capital flows linked to foreign investment) is undeniable. The notion of a new “Silk Road” between China and economies like Saudi Arabia has been the subject of some analysis (Cash & Trade Magazine, 2012), and there is evidence in trade evolving corridors of trade, to show that trade patterns and the nature of supply chains are changing.

The increasingly significant role of Turkey as an endpoint in some of these trade corridors is being monitored and responded to by several trade finance institutions, and the expanding influence and impact of trade flows through Dubai, likewise, reflect a reshaping of trade activity, and an expansion of influence of such markets beyond their historical range and scope of influence.

As noted earlier, trade finance continues to be critically necessary to the enablement of trade flows, even as the global liquidity situation moves toward normalization, and trade finance pricing has regained levels more reminiscent of pre-crisis conditions, dropping significantly from the peak levels of 500% or more of normal levels at the peak of the crisis.

2.2. Selected Global Trends in Trade & Trade Financing

Trade finance globally has reached a level of visibility that is unprecedented, certainly in the last thirty years or more, and this development allows for significant additional advocacy and policy influence around accessibility to trade finance. Leaders of international institutions from the WTO and beyond (Lamy and Auboin, 2009-2011) to regional institutions, to political leaders and to other institutions and agencies have been consistently communicating the importance of liquidity and adequate risk mitigation in support of trade flows.

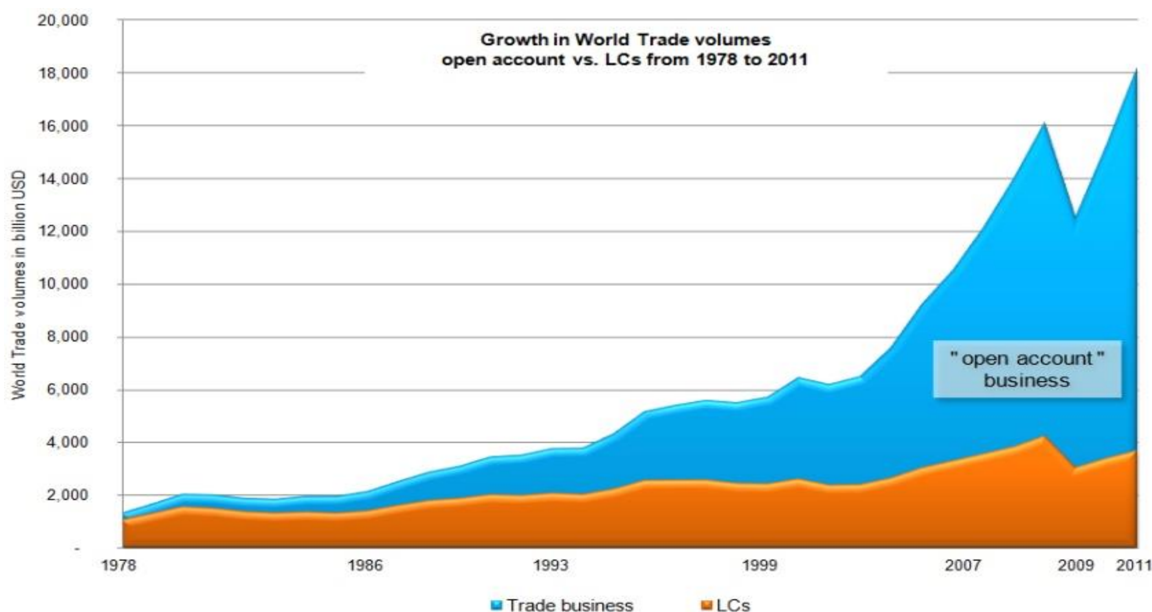
In addition to this qualitative shift, there are several transformational developments in the business of trade finance that bear mention in the context of the objectives of the COMCEC.

2.3. Global Supply Chains and the Rise of Supply Chain Finance

Traditional trade instruments support approximately 10% of trade flows, with a disproportionate concentration in certain markets in the Middle East and North Africa. Globally, importers and exporters are showing a clear tendency to transact on the basis of

open account terms, with only limited (but now increasing) attention to risk mitigation as a complement to the payment and settlement aspects of open account transactions.

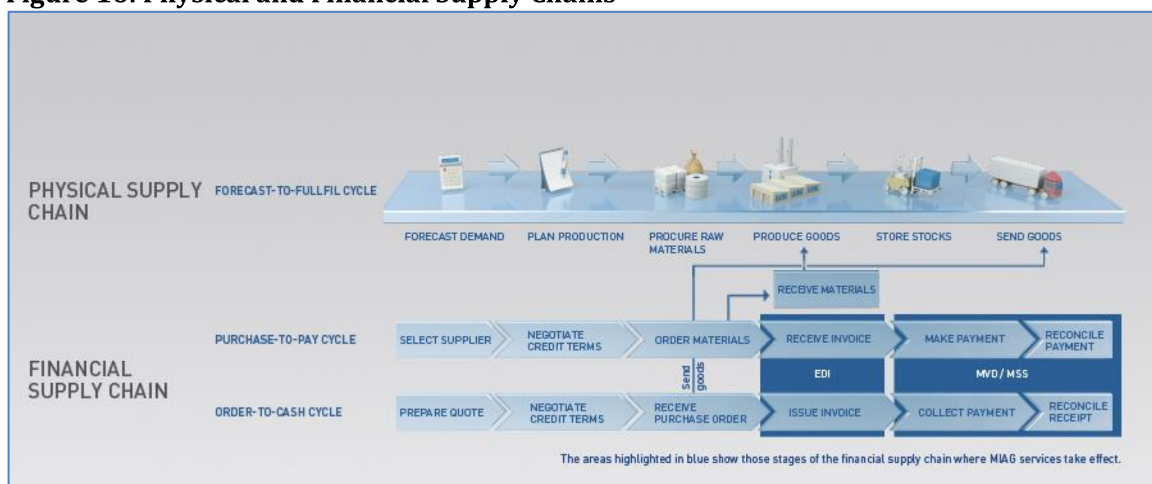
Figure 15: Open Account and Letter of Credit Volume, 1978-2011



Source: WTO Public Forum 2013, UniCredit Group

In this context, banks, as key providers of trade finance, have sought to extend their involvement in open account trade by redefining their proposition to include financing solutions targeted at supply chains and at the collection of commercial relationships that make up such supply chains.

Figure 16: Physical and Financial Supply Chains



Source: WTO Public Forum 2013, UniCredit Group

Perhaps even more notably, the long-standing industry discussion (Trade Card and others 1998) about aligning physical and financial supply chains has matured to the point where the movement of goods has indeed been more closely linked to the relative financial flow. The notion of "Global Trade Management" aims to capture the importance of taking a holistic view of trade activity, from procurement and operations to finance and treasury.

This increasingly integrated view has led bankers and financiers to propose solutions aimed at supporting the viability and sustainability of global supply chains, extending the notion to include the importance of large global buyers, for example, to support "strategic suppliers" – suppliers whose commercial and financial health is vital to the effective functioning of the multinational's global supply chain. The imperative of supporting strategic suppliers was brought sharply into focus during the tsunami and nuclear crisis in Japan, for example, when a critical supplier to Apple was impacted by the tragedy, and the Apple production lines ground to a halt.

2.4. Technology in Trade and Payments

The effectiveness and application of technology, in trade management and specifically in trade financing and payments, has gained significant momentum in the last five years in particular. While technology was historically focused on enhancing existing processes, such as the bank-based processing of letter of credit transactions, recent applications of technology have aimed to transform the business of trade finance, rather than just improve its execution.

Current initiatives to move trade finance from paper-based, process intensive models to data-based, process-light and "straight through" processing with significantly reduced manual intervention, are showing success and uptake in the market.

At the same time, related practices and processes such as the realm of international payments, are presenting complementary and competing propositions to the business of trade finance. Electronic invoicing, online payment solutions and web-based trading platforms such as China-based Alibaba are proposing compelling solutions to the needs of importers and exporters, increasingly in the context of electronic transactions.

The growth and increasing acceptance of online payment and settlement solutions bears watching as a trend that may impact mainstream trade, and perhaps eventually mainstream trade financing, once such providers identify an opportunity in the financing space, likely targeted at SMEs; US-based PayPal is illustrative in this respect:

- *PayPal's 2012 annual revenue was $5.6 billion, up 26% year over year.*
- *PayPal's international business accounted for more than half of total revenue in 2012.*
- *PayPal revenues represented 40% of eBay Inc. revenues in 2012.*
- *PayPal's net Total Payment Volume for 2012, the total value of transactions, was $145 billion, up 22% year over year.*
- *PayPal's Merchant Services business processed $97 billion in Total Payment Volume in 2012, up 25% year over year.*
- *Approximately 25% of PayPal's business is cross border trade.*

- *PayPal processed $14 billion in mobile payment volume in 2012 – more than 3 times the mobile payment volume of $4 billion that it processed in 2011.*
- *PayPal expects to process $20 billion in mobile payment volume in 2013.*

Source: PayPal, 2013

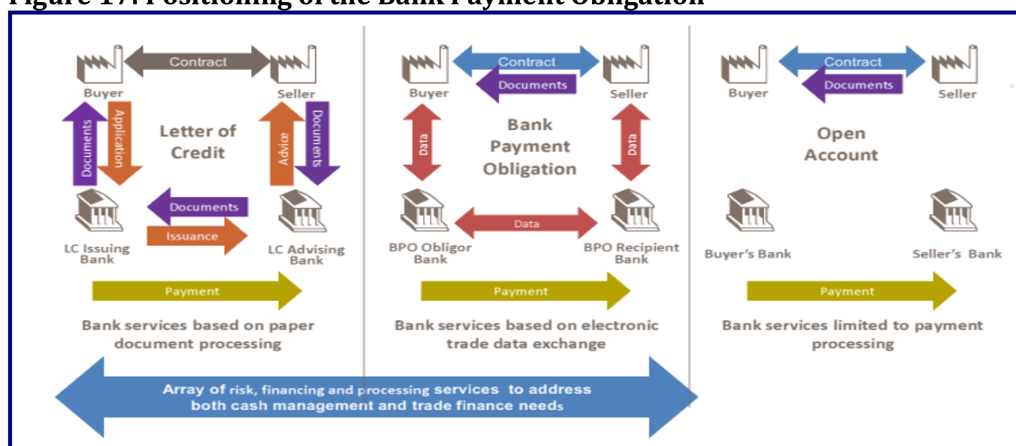
2.5. The Bank Payment Obligation

The Bank Payment Obligation is a new instrument of trade finance, positioned precisely between a traditional documentary letter of credit and an open account transaction. The Bank Payment Obligation (or BPO) has the advantage of being endorsed by the International Chamber of Commerce, and of being subject to a widely agreed and unanimously adopted set of ICC rule called the Uniform Rules for Bank Payment Obligations, or URBPO.

The BPO is a significant innovation at the product and solution level; it represents successful leveraging of leading-edge technology and involves a significant level of industry education and of promotion of the new solution to end-clients and other interested parties. The BPO aims to accelerate and automate transaction processing, and to advance trade financing in significant ways.

A BPO, in contrast to a documentary letter of credit, operates on the basis of an exchange and comparison of data elements, instead of a comparison of physical documents against the terms and conditions stipulated in the documentary credit. An objective, technology-driven process of data-matching which triggers an agreed payment, is not subject to misunderstanding or differing interpretation, and in the normal course, should be significantly faster than a manual document verification process.

Figure 17: Positioning of the Bank Payment Obligation



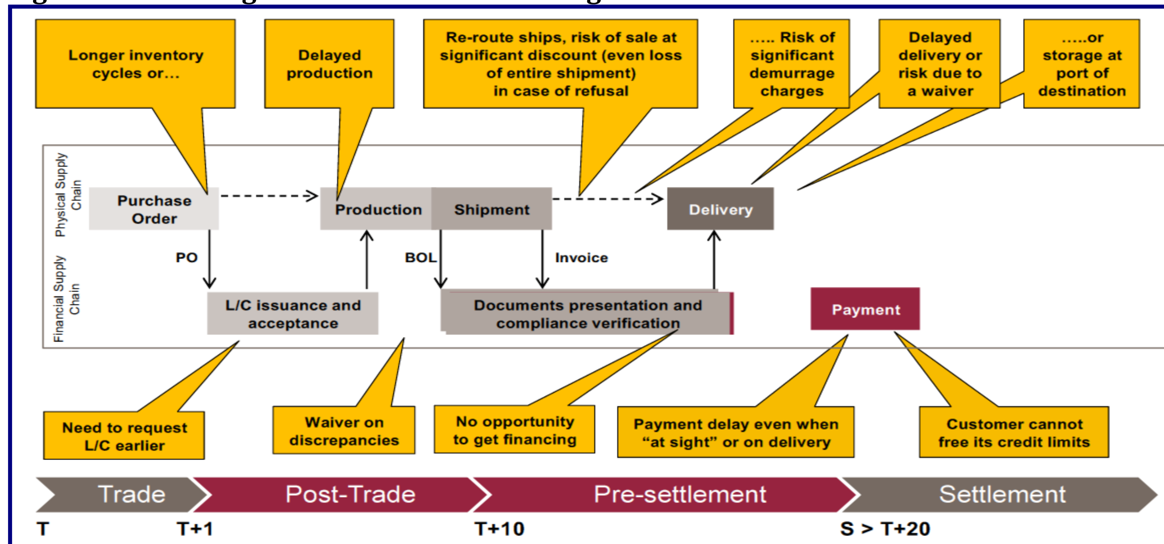
Source: SWIFT/ICC Industry Education Group on the BPO

In the end, the BPO represents a serious and viable attempt to innovate in the trade finance space, targeting a proposition that combines attractive features of both documentary letters of credit, and open account transactions.

Detailed process flows can be reviewed as a step in determining the applicability and viability of the BPO in addressing the trade needs of OIC Member States, and in particular, the needs of SME in the conduct of trade.

Some of the transactional benefits of a Bank Payment Obligation can be identified in comparing this instrument to traditional mechanisms such as the documentary letter of credit.
The degree to which the BPO can serve as an effective instrument of trade finance in transactions involving developing market economies, and SME's located in such markets, is to be determined, but on first view, appears promising.

Figure 18: Challenges and Pain Points in Using Letters of Credit



Source: ICC/SWIFT Bank Payment Obligation Webinar

The Bank Payment Obligation is, currently, a bank-to-bank instrument, and as such, the risk related to a BPO is bank risk – the basis on which numerous trade support programs are currently devised, particularly among international financial institutions.

The BPO is still in very early stages of development and deployment – since the first live transaction in 2010, the volume is limited, numbering in the dozens per year, however, bank adoption is advancing, and is expected to accelerate following the recent adoption of the ICC Rules for Bank Payment Obligations, paralleling the long-established Uniform Customs and Practice for Documentary Credits.

The BPO leverages technology and automation, increases options related to trade and supply chain financing, allowing importers and exporters to improve their respective working capital positions, as well as enhancing processes and efficiencies, improving inventory management and addressing other commercial objectives related to trade activities and trade and supply chain finance.

At last count, over forty banks internationally had signed on in principle to be providers of BPO solutions. There remain numerous issues and transactional details to be ironed out as relates to the BPO, including pricing, accounting and regulatory treatment, and eventual extension of

the BPO proposition, to directly allow for engagement of corporate end-user clients. That said, the BPO exemplifies numerous elements of the industry's attempt to advance the evolution of trade and supply chain finance. Interest and adoption levels related to the BPO are rising, and many of the world's top trade banks have already signed on to the program.

The applicability of the BPO to development-related trade is a notion that merits careful consideration.

Given that the BPO can operate with a single bank acting in support of a transaction, developing markets may, through simple awareness-raising, be able to propose a BPO-based settlement option to a large international buyer, for example, whose bank has signed on to the BPO, has the necessary technology in place, and is prepared to help execute a transaction based upon the BPO.

In the medium-term, developing markets could conceivably designate a local institution to lead the adoption of the BPO, with development funding and technical assistance support aimed at enabling the deployment of the necessary technology and the understanding of the product and its related transaction flows. Developing economies can also quickly adopt the Uniform Rules for Bank Payment Obligations (URBPO), the rules akin to the UCP, that aim to guide the use of BPO instruments globally.

It may be feasible for an IFI to act as a provider of BPO-based solutions, collaborating with international banks to enable access to BPO by stakeholders in emerging and developing markets. It is instructive to note that the first commercial, "live" transaction completed using the BPO involved a transaction between China and Canada, facilitated through the Bank of China and Bank of Montreal.

2.6. SMEs and International Commerce

The increasing focus (initially, from political circles, but now more broadly) on the importance of SMEs in economic value creation and the attractive growth prospects of emerging economies, will both fundamentally influence the evolution of trade finance in the medium term.

The paradox that is the key role of SMEs in many economies around the globe, and their consistent difficulty in accessing affordable financing and liquidity is in full evidence in the context of trade finance, as much due to the limited knowledge of SMEs as due to the limited focus on this segment of business, by trade and commercial bankers. According to the World Bank (2012), about 44% of entrepreneurs and small businesses in emerging markets identify "access to finance" (i.e. lack of it) as a major obstacle to growth. There is undoubtedly a parallel – perhaps even worse – reality in terms of access to trade finance, despite the valuable work of IFIs and multilateral development banks in this respect.

At the same time, it appears from empirical observation and discussion with financiers and government service providers, that small businesses are initiating international activity, earlier in the lifecycles of these companies, and increasingly, even in the earliest phases of operational start up, as entrepreneurs realize the importance of market diversification.

A European Union study completed in 2010, "Internationalization of European SMEs" suggests some findings that may apply to some degree, to SMEs in OIC-Member States, given that some of the commercial experiences of SMEs appear to be fairly consistent across geographies:

In addition to the numbers presenting the state of internationalisation, the study presents fact based evidence of the need to support greater internationalisation which has political consequences:

- *International SMEs create more jobs: Internationally active SMEs report an employment growth of 7% versus only 1% for SMEs without any international activities.*
- *International SMEs are more innovative: 26% of internationally active SMEs introduced products or services that were new for their sector in their country; for other SMEs this is only 8%.*
- *Public support goes largely un-noticed: Only 16% of SMEs are aware of public support programmes for internationalisation and only a small number of SMEs use public support.*
- *European SMEs are more internationally active than US and Japanese SMEs. Overall, European firms are more active than their counterparts in Japan or the US. Even if only extra EU exports are considered they still perform better.*
- *Most often SMEs start international activities by importing. SMEs that both import and export started with import twice as often (39%) than with exports (18%).*

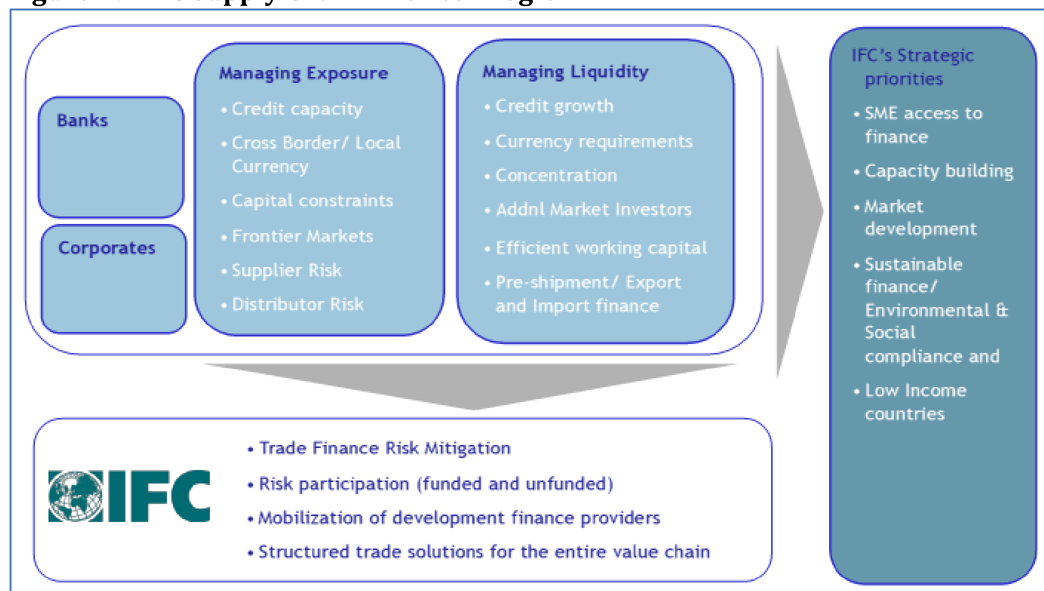
Source: "Internationalization of EU SMEs", 2010

2.7. IFI's and Export Credit Agencies in Support of SMEs

While SMEs are demonstrably under-served by bankers, the focus of public sector export credit agencies and of IFIs and multilaterals is very much on the SME segment. In some jurisdictions, large companies account for the majority of trade flows by value, while SMEs might represent significant transaction volumes, and their servicing is often linked directly to political imperatives mandated by senior public sector leaders.

IFC, for example, proposes a comprehensive proposition around trade finance, with the explicit strategic objective of facilitating SME access to finance, just as the Geneva-based International Trade Centre also does. Every major public sector ECA explicitly incorporates objectives around SME support at the core of their mandate, and it has been particularly evident since the peak of the global crisis, that these avenues of support and access are critically important to SME success.

Figure 19: IFC Supply Chain Finance Program



Source: IFC Short Term Trade Finance

2.8. Risk Mitigation as a Core Element of Trade Finance

The global crisis has refocused attention on risk mitigation as a fundamental element of the value proposition of trade finance, both in the traditional sphere, and in relation to open account and supply chain-related financing.

Emerging solutions such as the Bank Payment Obligation have ensured the incorporation of risk mitigation solutions in their capabilities. Relatedly, there are efforts notably through IFI programs, to assist SMEs in better positioning themselves in their interactions with providers of trade finance. SMEs are perceived as relatively risky by traditional bankers, partly due to the limited technical knowledge of SMEs around credit, financing and trade finance specifically. Technical assistance and support activities include initiatives aimed at helping SMEs to more clearly and effectively communicate and engage with trade financiers, perhaps reducing the perception of risk associated to those SMEs by the banks.

Risk mitigation considerations have taken sufficient priority in emerging solutions in trade finance, that there is a view that the lessons – and features – of traditional mechanisms will ultimately be incorporated into the characteristics and capabilities of these emerging solutions to trade finance. The option to provide a confirmation to a Bank Payment Obligation, which parallels confirmations available under letters of credit, is one illustration of this probable trend in trade finance.

2.9. Capacity: A Common Challenge in Trade Finance

Trade finance, as banking and finance in general, is challenged by capacity constraints, including limitations on the amount of capital and balance sheet capacity that banks – even top-tier trade finance banks – are prepared to deploy in support of trade finance activity.

The reasons for this relate to regulatory pressure linked to capital adequacy, as well as to the realities of internal (bank) competition for capital resources among many lines of business, most of which generate relatively high returns in comparison to trade finance.

Prior to the latest round of updates to the Basel Accords, certain instruments of trade finance might have required zero capital to be held in reserve against such transactions, or perhaps 20% of the amount of capital deployed in other types of trade finance transactions. Post-Basel II, the capital reserve required was increased to as much as 100% of the amount deployed in support of trade finance. In concrete terms, a transaction worth €200,000 might have been approved with zero reserve booked against it, or perhaps €40,000 in reserve (capital) held by the bank against that transaction. Post-Basel II, it is conceivable that a bank would have been expected to match the value of a transaction Euro-for-Euro, needing to hold a full €200,000 in reserve. This reality makes trade finance at least five times more expensive from a capital perspective, than was previously the case, with the effect that senior bankers will look far more critically at the modest returns generated by trade finance, absent the capital cost advantage that existed until relatively recently.

> *The global context of risk aversion and scarcity of finance increase the importance of resource-pooling and co-financing between the existing providers of trade finance, and the mobilization of public-sector actors in order to counteract the reduction of private sector finance.*
>
> Source: Trade Financing and Regional Financial Institutions from a South-South Perspective, UNCTAD 2012

This increased cost of capital leads to reduced capacity to support trade activity, and by extension, makes it less likely that SMEs and emerging markets will access the trade financing support necessary to enable international activity. This is an area where policy and advocacy, including from international organizations, can only benefit the broader objectives of trade facilitation and collaboration.

In addition to capital-related capacity issues, it is a global reality today that trade finance expertise is in demand, but in inadequate supply as senior practitioners retire and a next generation fails to be attracted to this domain.

There are several initiatives related to training and the development of professional skills in trade finance (eBsi Ireland, FITT Canada, CITF UK, COFIT Malta and CDCS, USA). Several of these programs have been in existence for some years; however, there is clear need to motivate further interest in the domain of trade finance, within banking and more broadly in industry. Capacity development and technical assistance programs by the various international institutions (IFC, ADB, EBRD and others) also contribute importantly to these efforts, particularly in the context of developing and emerging markets financial services.

2.10. Islamic Trade Finance

Recent developments in risk mitigation linked to Islamic Trade Finance provide one example of the evolutionary nature of the sector – and of the opportunity to leverage learning and experiences from one sector (conventional) to the other (Islamic). Shari'ah-compliant hedging and risk mitigation techniques have now entered the landscape, and Islamic institutions are looking at ways to engage in the financing of trade beyond the use of traditional instruments such as documentary letters of credit. This includes extending offerings into emerging supply chain finance solutions, currently under assessment in terms of Shari'ah compliant models and options.

It is notable that the evolution and adoption of Shari'ah compliant trade finance covers not only the nature of the product and the transaction flow, but also requires certification of compliance of the various banking systems and accounting practices used in support of Islamic Trade Finance. The evolution of capabilities in delivering Shari'ah-compliant trade and supply chain financing solutions links directly to the ability of financiers to tap into and to enable trade flows in high-growth markets, and in markets where trade is and will remain critical to economic development, poverty reduction and overall increase in prosperity.

2.11. Political and Policy Context around Trade Finance

Post-crisis efforts to champion the importance of trade finance to global recovery; regulatory issues, the drive to assure SME access to trade finance, the role of public sector entities and international institutions in responding to the global funding gap in trade; consideration of the role of finance within a broader context of policy-driven trade promotion; capacity development and technical assistance efforts in support of trade finance.

The political momentum around support for trade finance globally since the eruption of the global crisis has been addressed earlier in this paper, and the need for and opportunity in championing and promoting trade within banks and financial institutions, likewise, has been noted. The key trend in this respect is the ongoing engagement of public officials and the increasing visibility of industry bodies and associations in promoting and supporting the development of trade finance capacity. This includes, specifically, the contributions of national and international entities, and the emerging trend in developing markets to include an explicit trade finance component to broader trade facilitation and promotion strategies and efforts.
UNCTAD (2012) and others have argued that fast-paced financial and trade liberalization has been damaging to developing economies, and that the absence of local infrastructure has led to expensive, cyclically influenced capacity in trade finance in addition to broader adverse impacts on trade and capital markets. Such a situation argues for targeted policy measures aimed at offsetting such adverse consequences, though it is noted that markets like Korea and Brazil have had only limited success in applying unilateral measures aimed at curbing negative impacts from the reliance on foreign capital and financing. Regional monetary and financial arrangements have also been linked to attempts to resolve or offset such dynamics.

> *Limitations in the availability of trade finance have traditionally placed developing country producers at a disadvantage compared with their competitors based in the advanced economies. There are several reasons for this, but two are especially*

significant: the lack of specialized and well-resourced financial institutions in the South, and the consequent reliance of producers based in these countries on foreign finance, which tends to be heavily pro-cyclical and, often, destabilizing. In addition, sophisticated supply chain operations have in recent years become crucial to global trade, and their financing poses specific challenges to participating countries and the international financial system.

Source: Trade Financing and Regional Financial Institutions from a South-South Perspective, UNCTAD 2012

In sum, the political and policy context stretches from high-level macro-economic policy and financial policy, to considerations specifically linked to the availability and accessibility of trade and supply chain finance, and this reality is observed as a global situation, particularly material in the context of developing and emerging markets.

III. MAIN COMMON CHALLENGES FOR THE SMEs OF THE OIC MEMBER STATES IN TRADE FINANCING

3.1. SME Access to Trade Finance: A Near-Global Challenge

SMEs globally, with only a few notable challenges, report and experience challenges in accessing financing, including trade finance in support of their international commercial aspirations. Germany may provide a unique example in the effective support of SMEs in a variety of dimensions, including the success of SMEs in competing internationally and in being demonstrably key to economic growth and value creation through trade.

The nature of trade finance is such that its mechanisms and practices are highly consistent on a global basis. Leading providers of trade finance operate across borders, across regions, and very often, on a global basis, or at minimum, with clear linkage to global networks of providers such as correspondent banks, international institutions and various government agencies.

Accordingly, much of the preceding sections describing trade finance, its mechanisms and the relative policy issues and challenges, will apply broadly to OIC Member States, to varying degrees and with individual nuances. SME access to finance is arguably a universal challenge across much of the international system, and it is in this universality that there is the basis for political leverage, competitive advantage and differentiation, as individual States make the determination that the linkages demonstrated earlier, between SMEs, trade success and economic value and growth apply to their own circumstances.

Trade finance flows globally; the trade financing gap – the difference between available trade finance, and the estimated amount of trade finance required – is estimated to be between $1.6 to $2 trillion annually or over 11% of global merchandise trade. SME challenges in accessing trade finance are the result of global market dynamics and the flow of (limited) capital to higher-return activity.

As described earlier the issue of insufficient capacity in global trade finance has been recognized and is at the root of momentum in several areas:

- Greater engagement of export credit and other public sector entities in addressing the “market gap” in trade finance
- Increased involvement of international financial institutions in addressing gaps in access to finance in developing and emerging markets in particular
- Initiatives by banks and private sector providers aimed at attracting greater capital from new sources, to provide additional liquidity and capacity in support of trade finance
- Proactive attempts across a range of economies (US, UK, Germany, UAE and others) to take policy measures in support of SME competitiveness in international markets, including specific efforts to facilitate access to financing and trade finance

The nature of trade and supply chain finance, and the opportunities and challenges described in the earlier sections are very directly relevant and applicable to OIC Member States, by the nature of trade finance itself. OIC Member-specific issues will be nuanced variations of the

same core issues, with obvious differences in degree and emphasis in countries and regions where extreme circumstances prevail. Even in such circumstances however, it is notable that there is an awareness of the international nature of trade finance and cross-border partnerships.

Azizi Bank, based in Afghanistan, was represented at a major international banking conference recently (Sibos 2013, Dubai), and seeks to grow its network of partner banks, explicitly indicating a trade finance capability headed by the Chief Credit Officer of the bank, even as the institution builds out its core banking offerings and national branch network under the most difficult of circumstances (Source: Azizi Bank).

The challenges around SME access to trade finance may be universal across a wide range of markets, but the need for access to more trade finance among SMEs in particular, is also common among jurisdictions, even when SMEs make up the majority of commercial ventures in a given jurisdiction, country or region.

3.2. Current State Highlights

Table 5: OIC Member States

Arab Group	Asian Group(*)	African Group
Algeria	Afghanistan	Benin
Bahrain	Albania	Burkina Faso
Comoros	Azerbaijan	Cameroon
Djibouti	Bangladesh	Chad
Egypt	Brunei	Cote d'Ivoire
Iraq	Indonesia	Gabon
Jordan	Iran	Gambia
Kuwait	Kazakhstan	Guinea
Lebanon	Kyrgyz Republic	Guinea-Bissau
Libya	Malaysia	Mali
Mauritania	Maldives	Mozambique
Morocco	Pakistan	Niger
Oman	Tajikistan	Nigeria
Palestine	Turkey	Senegal
Qatar	Turkmenistan	Sierra Leone
Saudi Arabia	Uzbekistan	Togo
Somalia	Guyana	Uganda
Sudan	Suriname	
Syria		
Tunisia		
United Arab Emirates		
Yemen		

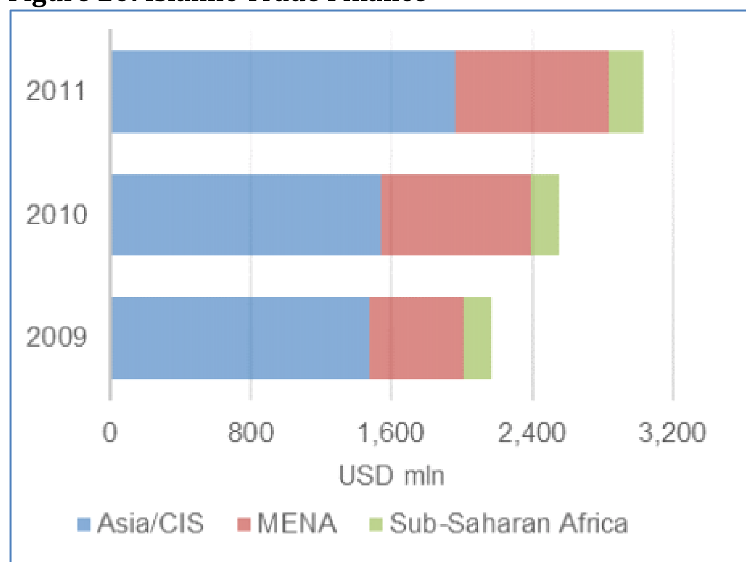
(*) Guyana and Suriname which are geographically located in Latin America are included in Asian Group.

Source: Trade Outlook 2013, COMCEC

Given the geographic scope and the number of OIC Member States, and the fairly consistent nature of challenges and issues around trade finance, including trade finance needs and issues related to SMEs, it has been deemed appropriate to consider the issues related to OIC Member

States in aggregate, rather than attempting to address such issues on a country-by-country basis.

Figure 20: Islamic Trade Finance



Source: Insights: Islamic Trade Finance, MIIFC, 2013

This approach will ensure identification of the major issues, while avoiding the significant overlap and repetition that would arise in an individual country consideration of the state of trade finance.

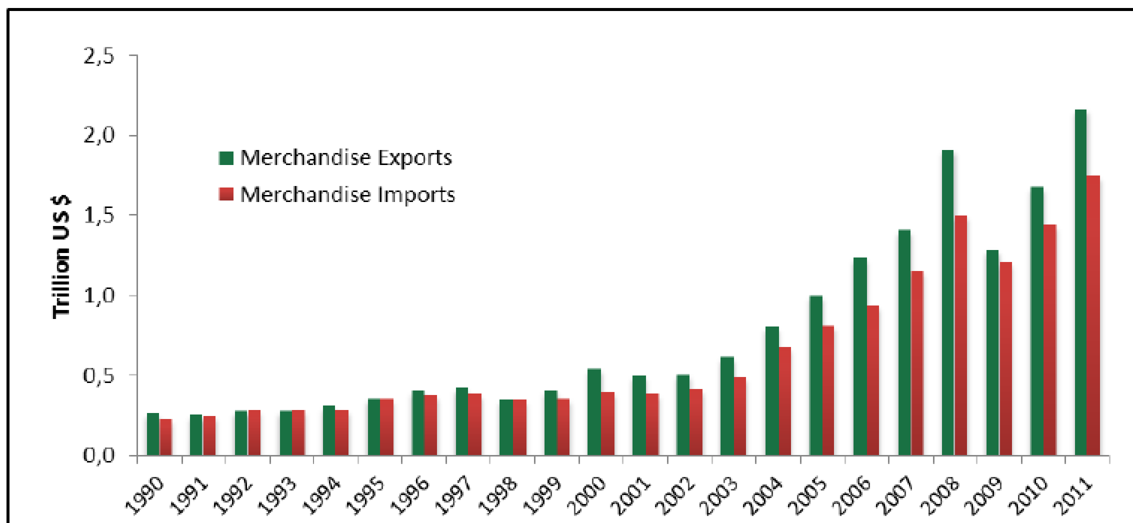
> *Member States' Trade increased from US$ 3.2 trillion in 2010 to US$ 3.9 trillion in 2011, an increase by 22%. Trade of the OIC Member States accounted for 10.8% of world trade in 2011. The Actors of the world trade of the OIC Member States in 2011 were: Saudi Arabia (US $458 billion), the UAE (US $455 billion), Malaysia (US $415 billion), Indonesia (US $381 billion), Turkey (US $376 billion), Iran (US $222 billion), Nigeria (US $166 billion), Qatar (US $131 billion), Kuwait (US $110 billion) and Algeria (US $105 billion). These ten countries accounted for 72.7% of world trade of the OIC Member States in 2011. […]*
>
> *The net intra-OIC trade ((intra-OIC exports + intra-OIC imports)/2) in 2011 reached a value of US$ 340.8 billion against US$ 269.5 billion in 2010, an increase by 26.5%. Despite the effects of the global economic crisis, the share of intra-OIC trade in the total trade of Member States increased from 17.03% in 2010 to 17.80% in 2011, i.e. an increase by 4.5%.*
>
> Source: Annual Report on Trade Between the OIC Member States, Islamic Centre for Development of Trade, 2013.

Relatedly, access to objective data and metrics is limited at best across the global trade finance landscape, and even more so in certain markets and economies that do not typically track such data points. Despite this, the high level themes and challenges – as well as the opportunities are perhaps surprisingly repetitive and consistent, particularly where the needs and gaps

related to SMEs are concerned. Political authorities, business leaders and academics across the globe speak of the importance of SMEs and the need to assure their access to adequate levels of finance, yet, whether the political context is market-driven or centrally managed, whether SMEs are the primary drivers of commercial activity or seen as “second tier” commercial entities, the themes repeat.

The Islamic Centre for Development of Trade identifies several significant obstacles to the development of intra-OIC trade flows, ranging from tariff and non-tariff barriers, to infrastructure challenges such as the lack of adequate logistics and transport infrastructure (“Annual Report on Trade Between the OIC Member States, 2013”). Additionally, the Centre explicitly notes “Inadequate and insufficient financing instruments especially, for the benefit of SME-SMI” as a further obstacle to the development of trade between OIC Member States.

Figure 21: Total OIC Imports and Exports



Source: COMEC Trade Outlook 2013/SESRIC

Despite these various obstacles, merchandise trade flows involving OIC Member States have shown clear growth trends over the last two decades. That said, it has been noted that the value of trade flows has trended upward in part due to the influence of oil exports and the rising price of oil over the course of a protracted commodity boom. Notably, the most internationally active OIC Member States account for the vast majority of trade flows, as noted earlier; likewise, OIC trade evidences a significant degree of concentration in terms of the markets with which leading OIC Member States engage in trade activity, and currently, significant positive impact involving trade with partners in Asia.

Table 6: OIC Export Markets

Countries	(Billion $)			Share %		
	2009	2010	2011	2009	2010	2011
Total (1)	**1,279**	**1,695**	**2,110**	**100.0**	**100.0**	**100.0**
China	125	194	274	9.8	11.4	13.0
Japan	138	178	239	10.8	10.5	11.3
USA	136	175	213	10.6	10.3	10.1
India	94	128	176	7.3	7.6	8.3
Republic of Korea	80	107	152	6.3	6.3	7.2
Singapore	66	84	103	5.2	5.0	4.9
Italy	59	78	90	4.6	4.6	4.3
France	47	55	72	3.7	3.2	3.4
Germany	46	55	69	3.6	3.2	3.3
Spain	37	46	58	2.9	2.7	2.7
Total of Top Ten Countries(2)	828	1,100	1,446	64.7	64.9	68.5
Other Countries (1)-(2)	451	595	664	35.3	35.1	31.5

Source: COMCEC Trade Outlook 2013/ITC TradeMap

In addition to the overarching desire among OIC Member States to champion and enable greater collaboration and increased trade flows, the data suggest a need to diversify trade activity on several levels:

- Engaging a larger number of OIC Member States in a greater share of global and intra-OIC trade flows
- Expansion of trade activity beyond oil and oil-related products and services
- Active pursuit of new trade markets, particularly in light of ongoing sovereign crisis issues in Europe and ongoing economic issues in the United States

GCC and other Arab states have worked actively to diversify economic activity and to develop new markets internationally, and such efforts must clearly continue. The availability of adequate levels of trade finance link directly to the above objectives, as does the success and sustainable activity of SMEs across OIC Member States.

OIC Member States engaged in oil export include: Algeria, Azerbaijan, Cameroon, Chad, Cote d'Ivoire, Egypt, Gabon, Iran, Iraq, Kazakhstan, Kuwait, Libya, Malaysia, Nigeria, Qatar, Saudi Arabia, Sudan, Syria, Turkmenistan, U.A.E, Uzbekistan and Yemen. Those not involved in oil exports include: Afghanistan, Albania, Bahrain, Bangladesh, Benin, Brunei, Burkina Faso, Comoros, Djibouti, Gambia, Guinea, Guinea-Bissau, Guyana, Indonesia, Jordan, Kyrgyz, Lebanon, Maldives, Mali, Mauritania, Morocco, Mozambique, Niger, Oman, Pakistan, Palestine, Senegal, Sierra-Leone, Somalia, Suriname, Tajikistan, Togo, Tunisia, Turkey and Uganda.

The top ten leaders in intra-OIC trade account for a significant share of intra-Member trade flows, with the UAE long serving as a regional re-export hub, but also more recently extending its influence and reach as a global hub for logistics, transport and trade activity. The early adoption of emerging trade financing solutions such as the Bank Payment Obligation, by Dubai Trade on behalf of its member companies, provides one illustration of the linkage between the

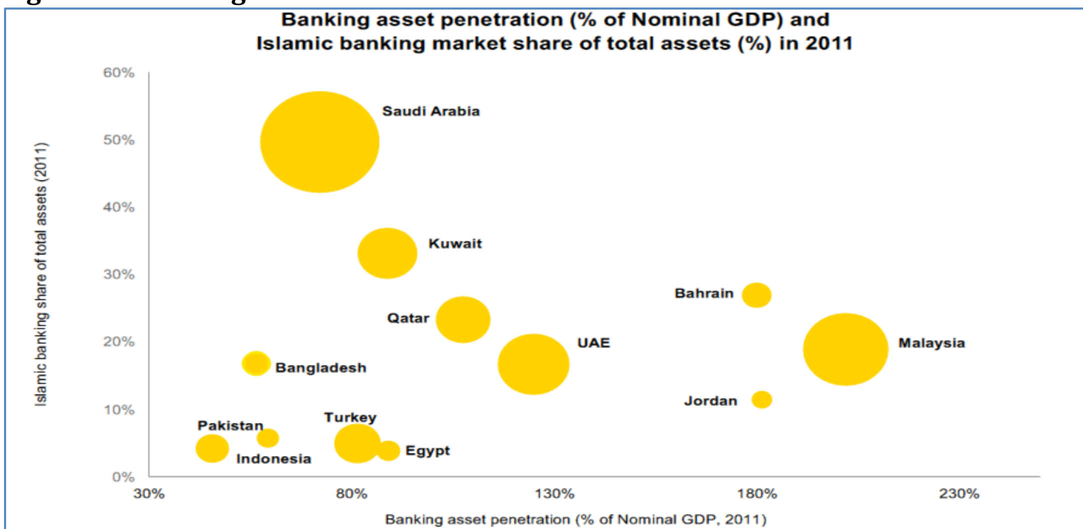
successful pursuit of commercial activity in international markets, and the contribution to such success, that can be made by effective and affordable trade financing, particularly when it extends into the SME segment of business.

Additionally, a recent announcement indicating that Dubai seeks to become a hub of Islamic Finance reinforces the integrated and strategic approach taken by the Emirate in its view of the potential for and complementarity of Islamic and conventional finance models.

> *"Transforming Dubai into a global center for Islamic sukuks is intended to cement confidence in our economy among international financial circles," [Sheikh Mohammed bin Rashid al-Maktoum] carried on to say. Sheikh Mohammed stressed the importance of activating the role of Islamic economy in the UAE's national economy. "Today, Dubai possesses all the potential and privileges that qualify it to achieve its goal of becoming a global center for Islamic sukuks. We will work on completing the necessary organizational framework and mobilize efforts and energies, national cadres and experts to give this sector the anticipated momentum." The new initiative will encourage organizations to issue sukuks instead of bonds and builds on Sheikh Mohammed's January declaration to create an Islamic finance council to regulate Shariah-compliant equity — and his desire to integrate Islamic economy as part of the overall Dubai economy.*
> Source: Al Arabiya, 2013

According to the Ernst & Young Islamic Banking Competitiveness Report, 2013, Islamic Banking assets reached about US $1.3 trillion in 2011, and exhibited growth rates averaging 19% annually over the past four years. The top four markets globally account for 84% of Islamic Banking assets, with markets like Saudi Arabia, Malaysia, Qatar, Turkey and Indonesia deemed to present high potential as centres of Islamic Finance.

Figure 22: Banking Asset Penetration



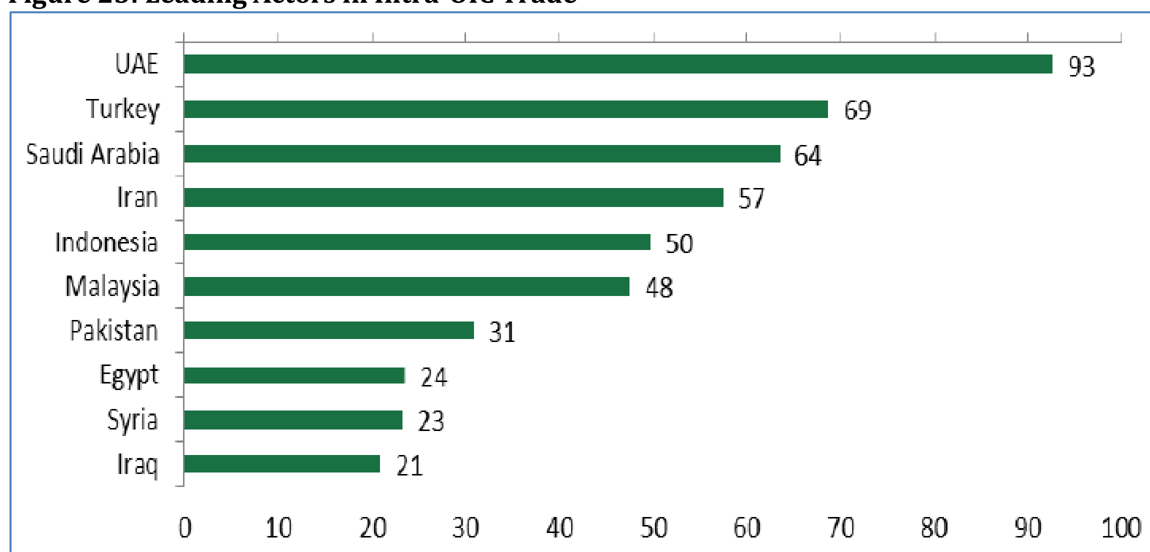
Source: Islamic Banking Competitiveness Report Ernst & Young, 2013

As noted earlier, the growth and impact of Islamic Trade Finance will correlate directly to the evolution and broader leveraging of Islamic Finance practices, the growth of Islamic Finance assets and the wider – and more coordinated/aligned governance of Islamic Finance practice across OIC Member States, and across other jurisdictions where such activity has attracted significant interest.

> *"…the establishment of International Islamic Trade Financing Corporation (ITFC) in 2008 has catalyzed increased trade financing interventions. The cumulative net trade financing approvals for OIC member states has increased by 63 percent from $ 24.4 billion in 2005 to $ 39.9 billion in 2011."*
>
> Source: Arab News, 2013

While there is significant focus globally on the opportunities linked to involvement and engagement with global supply chains, it has been observed that OIC Member States have perhaps a more compelling and immediately achievable opportunity in linking to regional supply chains and value chains, in line with the OIC intention of promoting greater and more diverse trade flow among Member States.

Figure 23: Leading Actors in Intra-OIC Trade



Source: COMCEC/SESRIC

> *Research shows that most value chains still tend to be regional, despite growing internationalization. Baldwin has called this Factory Asia, Factory North America, and Factory Europe. Some of the inter-regional FTAs currently under negotiation such as the Trans Pacific Partnership (TPP) or the EU-US FTA covers the areas where Global Value Chains are concentrated. Such agreements might lock out non-parties and prevent their participation into existing value chains located within those regions.*
>
> *Growing demand in Organization of Islamic Cooperation (OIC) member countries make these markets lucrative for other OIC member countries. These markets can also be friendlier for producers based in OIC member countries in particular for small and*

medium sized enterprises (SMEs), compared with developed country markets. They might impose fewer requirements and less stringent standards than developed countries. OIC member countries also share common relationship networks and cultural norms that can facilitate trade.

Source: Connecting to Global Value Chains, 2013IDB Group

3.2.1. Middle East

The Middle East is unique in its continued favouring of traditional trade finance mechanisms, particularly documentary letters of credit, as the means of conducting international commerce.

Senior bankers in leading markets describe a persistent affinity for the use and handling of documents, and a preference for established practice that is also linked to international standards and guidelines such as the ICC's Uniform Customs and Practice for Documentary Credits, and the related counterparts for other trade finance instruments.

Senior bankers have drawn parallels between enduring social practices such as the central role of the Majlis in Arab society, and the ongoing preference for the use of long-established mechanisms of trade finance (Cash & Trade Magazine, 2013), noting that he importance of personal integrity and trust, and an abiding focus on the principles of Islamic Finance and Islamic Trade Finance are both complementary and highly consistent. Similarly, the attention to managing reputational risk remains at the core of commercial conduct.

The nature of traditional trade instruments and their linkage to new versus established commercial relationships is also consistent with this overall view: documentary credits typically apply in the context of new trading relationships, or ones that require significant levels of risk mitigation, where documentary collections, involving far less in the way of bank intervention, reflect a progression of commercial relationships to levels of trust and confidence, in both cases, surrounded and supported by long-established and internationally accepted practice, very much in line with the precepts of Islamic Finance and Trade Finance.

Interestingly however, recent developments in trade finance, such as the launch of the new ICC Rules for Bank Payment Obligations (2013) and a regional launch event in Dubai, garnered significant interest, and the Dubai Chamber of Commerce is quickly adopting this mechanism on the basis of enhanced process and financial efficiency for its members (Dubai, September 2013).

The persistent political tensions in parts of the Arab World, and the more serious crises involving civil war or other military action, including the outcomes so far related to the Arab Spring present complex challenges on a variety of levels that are beyond the scope of this analysis, but they also very directly impact the pursuit of commercial activity, and the risk assessment linked to the markets directly affected, along with immediate neighbouring economies.

3.2.2. Asia

The undeniable pull exercised by Asia currently in terms of both import and export trade flows, as well as bi-directional foreign investment flows have now has now extended well beyond the activities of China and India, to encompass, impact and benefit numerous OIC Member economies, including Indonesia and Malaysia among others.
While the role of Islamic Finance and Trade Finance cannot be understated in major markets in Asia, and the longer-term tendency to gravitate to Shari'ah compliant mechanisms will be equally observable in those markets, it is worth noting the increase regional influence of China, including in the promotion of the Renminbi in regional trade flows. The internationalization of the Chinese currency and the convergence of the on-shore and off-shore exchange rate (CNH and CNY) are progressing apace, and the RMB is a credible third option as an international reserve and trade currency, after the US Dollar and the Euro.

Figure 24: RMB-Denominated Trade Flows

Source: Standard Chartered Bank, 2011

In addition to the striking rise of the RMB as a regional currency of trade finance, Asia exhibits a clear preference for the use of open account trade and for adoption of new modes of conduct of international commerce. The Bank of China was one of the two first institutions to complete a live Bank Payment Obligation transaction in 2010, and recent developments in the region are very much reflective of a desire to be at the leading edge of international commercial practice.

While there are several reasons noted as motivation for the use of the Renminbi in the conduct of commercial activity, trade and trade-related considerations figure prominently in this respect, and the growth of the RMB as an international currency will be managed very conservatively by Chinese authorities, continuing to focus initially on markets and trading partners in Asia, including several OIC Member States.

Table 7: RMB Adoption

Primary Reasons for Executing Payment Transactions to China in RMB	
Customer demand	82%
Offering services to meet corporate clients' needs	67%
Settlement of trade	41%
Accelerated payments	10%
Diversifying FX risks	10%
Price	8%
Regulatory issues	6%
Terms	2%
Expectations on Future Use of RMB	
Trade transactions	84%
Treasury settlement	37%
Remittances	31%
Low value payments	18%

Source: FI Metrix, 2013

The evolution of the RMB will certainly be a key influence on the development of intra-Asia trade flows over the coming medium term, taking on increasingly global character and influence as acceptance of the RMB and confidence in the underpinning economic and political fundamentals continues to grow.

As with other markets around the globe however, the broader engagement of Asia-based businesses in pursuit of international opportunities will be directly relevant to the objectives and priorities of the COMCEC and of OIC Member States. Already, trade flows between Saudi Arabia and China and between China and the UAE are the subject of attention. Additionally, the long-standing commercial relationships between India and Indian expatriates, and business partners across the MENA Region remain important.

> *There are increasing trade and investment flows between countries worldwide, especially between Asia and the Middle East, which offer substantial opportunities for the Islamic trade finance sector. Trade between the two economic blocks has grown from USD804.9bln as at end-2010 to just under USD1.2tln as at end-2012.*
>
> Source: Insights: Islamic Trade Finance, MIIFC 2013

Similarly, the Asia-centric magnetic pull is in evidence in the trade and investment flows between China and Africa – focused on commodities and on infrastructure-related import activity, are reshaping the current reality and the evolutionary direction of the African continent.

The linkages between Asia and Africa and the growing focus on intra-Africa collaboration, from trade to regional integration, are transforming a continent and stand in stark contrast to the colonial experiences of many African economies, apparently exhibiting an unfamiliar flavour of collaboration that is, if not fully accepted at face value, nonetheless welcome.

3.2.3. Africa

Africa is identified as a continent with tremendous long term potential provided certain systemic issues, like the level of economic engagement of the population and issues of corruption can be mitigated or addressed in the medium term. Without seeking to overstate the case, Africa is making serious attempts to some degree at least, to foster regional and perhaps continental collaboration in several respects.

Whether one looks at the SADC, COMESA, ECOWAS or other initiatives aimed at enabling some form of economic integration, these initiatives evidence a desire to overcome historical challenges and to look forward in terms of economic activity, development and growth, including trade.

Africa, like Asia and the Middle East, is anything but homogenous in character and includes within its sphere, economies that currently exhibit significant potential, while at the same time, counting among its member economies some jurisdictions that face the harshest of conditions, amounting in one or two cases, to chaotic failed states. At the same time, other economies have shown significant potential at various points in the last fifty years – from Ethiopia and its pre-drought characterization as the “bread basket of Africa” to Ghana that went from desperate conditions to once being held up as a model of successful development, or Rwanda that is recovering from the horrors of its recent past.

Investment flows into Africa, and GDP growth rates at the continental level have compared favourably with similar metrics linked to the BRIC economies, as illustrated in the graphic below.

Figure 25: Africa Foreign Investment Flows

Source: UNCTAD/AfDB and IMF, 2011

Private sector development and inclusion initiatives are important aspects of an overall development approach to Africa, and trade, as well as support to SMEs and micro-enterprises, is a dimension of these key areas of focus.

> *A healthy, efficient and stable financial sector remains the cornerstone of a private sector–led development strategy. African firms need affordable trade credit. In response to the collapse of commercial financing since the global financial crisis, the Bank piloted a trade finance initiative. Its lessons, and those of other multilateral institutions with similar initiatives, have informed an operational trade finance program focusing on agriculture, smaller enterprises and higher risk markets as primary beneficiaries.*
>
> Source: African Development Bank Group Strategy 2013-2022

Aid for Trade initiatives in Africa are an area of significant focus and elements of these programs relate directly to the need for liquidity and trade finance.

> *"…with sound infrastructure, transport costs could be reduced by 40% for coastal countries and by 60% for land-locked countries. They also estimate extent to which transport costs reduce trade volumes. An increase of 10% in transport costs has been estimated to result in a 20% reduction of trade…"*
>
> Source: Global Review of Aid for Trade, UNECOA, 2009 (Extract)

Several large-scale projects co-funded by the African Development Bank cite as expected benefits, the creation of local supply chains to which SMEs and micro-enterprises can link up, as a means of generating revenue and creating local economic value. This notion of active development of supply chain connections is common to the thinking of leading financiers across the globe, particularly as a means of facilitating SME access to trade flows and trade

finance, the latter on the basis of buyer-centric supply chain finance programs designed specifically for this purpose. As noted earlier, many of the core issues and opportunities around trade finance are common across a wide range of jurisdictions, despite some local nuances.

It is worth noting that the impact of the global crisis of 2007/2008 was projected to have significant adverse impact on numerous OIC Member States, particularly those in the LDC category and already suffering from significant levels of poverty. Analysis at the peak of the crisis projected lasting adverse consequences for developing economies, with particularly harsh impact in certain markets in Asia.

> *Recent estimates suggest that the food crisis has caused 130-155 million people to fall back into poverty and global financial and economic crisis will trap 53 million more people in poverty in developing countries, which will need an additional $38 billion to lift the incomes of the poor to the poverty line. The sharp slowdown in economic growth in 2009 will substantially expand the resource requirements to put hard hit member countries back on track. According to the latest estimates by the UN (May 2009), between 73 and 103 million more people would fall into poverty due to financial crisis.*
>
> Source: Impact of the Global Economic and Financial Crisis on OIC Member Countries, 2009

While the observations are now dated, several of the underlying concerns identified by the Islamic Development Bank in the above-quoted analysis remain relevant today and merit further consideration in the context of SME access to finance and trade finance.

The IDB study points to internal factors (within OIC Member States) that were expected to exacerbate the adverse consequences of the externally-originated global crisis. Among these factors, IDB lists "weak linkage" between the financial sector and the real sector, and weak corporate governance in the financial sector.

These observations clearly apply to different degrees in different OIC Member States, however, they are mentioned here due to direct relevance to SME access to finance and trade finance, and as a matter of contrast to the widely held view that Islamic financial institutions did well in weathering the global crisis, precisely due to the close connection between Shari'ah-compliant (trade) financial structures and the underlying flow of goods: real economy activity.

IDB indicated in 2009 that inclusiveness in terms of economic recovery and growth needed to be a priority, and identified "re-regulation" of the financial sector to assure its stability and responsiveness to priority sectors.

The urgency of providing access to financing and trade finance to LDC Member States is well-recognized and acknowledged.

> *Although some Member Countries are better positioned with regards to liquidity and access to funding, lack of access to trade finance still remains a major hindrance in many Member Countries, particularly the least developed member countries (LDMCs). As such, it remains one of ITFC's priority areas to continue its efforts to increase direct operations and enhance implementation of 2-Step Murabaha Lines for Banks in LDMCs.*

In 1433H, the financing to LDMCs increased from US$1,495 million in1432H to about US$2,264 million.

Source: ITFC Progress Report on Enhancing Intra-OIC Trade, 2013

Asia and the CIS Member States have received the majority of support from ITFC in terms of trade finance, with 64.6% of the total approvals in 2011, followed by the MENA region with 29.0% and Sub-Saharan Africa at 6.4%.

ITFC has included in its plans, initiatives aimed at supporting strategic sectors, such as cotton trade, that impact the economies of numerous OIC Member States. Relatedly and as part of a broader capacity development and support program ITFC is also looking at competency development among SMEs through advisory support and the establishment of centres of expertise, including a trade centre in Africa to assist in the development of country level competencies, and SME-level skills in trade and trade finance.

3.3. Trade Finance Today in OIC Member States

OIC Member States share a commercial demographic that is heavily weighted towards SME and micro-enterprises, and by extension, also share a common challenge in seeking to facilitate access to trade finance for their SME constituents – a reality that applies equally in the context of conventional trade finance as it does in relation to Islamic Trade Finance.

The market for Islamic Trade Finance has been estimated to range from about $540 billion to $1.5 trillion annually, based on an extrapolation of the proportion of Islamic Finance relative to conventional finance. That is, with Islamic Finance representing between 1-3% of global conventional finance, the same proportion is taken, to estimate the potential size of the Islamic Trade Finance market relative to the size of conventional trade finance globally (al Baraka Bank, 2011).

A stark finding is reflected in the analysis of access to finance, including Islamic Trade Finance, in a recent analysis by a specialist from the Islamic Research and Training Institute, this despite the observation in the same analysis that SMEs contribute over 65% of employment and about 55% of GDP to the economies of Member States.

The findings of this study show- that despite of the recent growth of the Islamic institutions and the development of new Islamic financing products, still there is no favorable environment for Islamic finance to play vital role in the development of SMEs in the IDB member countries. The main reasons might be due to the weakness in the development of trade and the Islamic financing infrastructures.

Source: The Challenges of Islamic Trade Finance in Promoting SMEs in IDB Member Countries, 2013

Interestingly, the paper argues that IDB Member States and their SMEs have been impacted by the global crisis, and that the relative resilience of Islamic financial institutions in the face of the crisis "put more burdens on the shoulders of Islamic financial institutions in and outside the borders of the IDB member countries to support the growing demand for the emerging financial system." At the same time, this analysis suggests that Islamic Trade Finance "becomes

the legitimate alternative to provide SMEs with the required working capital, shrink the liquidity gap, reduce the risks of insolvency and may help in improving their competitiveness."

At its core, the paper concludes that the challenges facing SMEs in IDB Member states are fundamentally similar to those facing SMEs that operate in markets financed through conventional mechanisms, aligning well with our own view that the issues and challenges linked to trade finance and to enabling the international engagement of SMEs are consistent across many jurisdictions.

The view among trade finance practitioners is that the resilience of institutions governed by Shari'ah Law relates directly to the prudential and conservative nature of the guidelines followed by these institutions, and that the direct link to "real economy" trade flows helped Islamic Financial Institutions to avoid the risks and adverse impacts of ill-advised financial engineering that effectively led to the nationalization of several previously top-tier European and American financial institutions.

One factor specific to Islamic Finance and Trade Finance (though it does arise to some degree in the context of conventional finance) is the necessity for efficient and timely movement of goods and transfer of ownership between parties involved in trade activity. In this respect, there is a direct link between trade finance, and the imperative for OIC and IDB Member States to ensure adequate infrastructure and logistics capabilities, as a factor influencing not only the ultimate conduct of trade, but to a greater degree than in conventional finance, the availability of trade financing.

The local realities in parts of Africa bring this notion very much to life.

> *[The time]…it takes for the typical 20-foot container to reach the most accessible port. In Bangui, Central African Republic, it takes 116 days for such a container to be moved from a factory in the city to the nearest port in the Gulf of Guinea. It takes 71 days to move such container from Ouagadougou, Burkina Faso, to the nearest port. On the contrary it takes 5 days from Copenhagen, 6 days from Berlin and 20 days from Shanghai, Kuala Lumpur and Santiago de Chile. Same studies find that a delay of one day reduces trade by more than 1%.*
>
> Source: UNECA Aid for Trade Review 2009

The timeframes for the movement of goods calculated above have very direct implications in the financing sphere. First, SMEs facing these types of timeframes will have very urgent need of working capital and liquidity support, in a world where finance and treasury executives seek to extract working capital be shortening transaction cycles by as little as a day or two, the notion of having to wait up to four months for goods to transit to a port, is striking, and suggests a reality that is unsustainable for an SME, particularly in the absence of access to financing and trade finance.

While businesses in developed economies worry about the speed with which goods arrive at destination – sometimes days ahead of the arrival of documents of title that are sent through the banking system – SMEs in certain markets clearly have concerns that are much more about the physical movement of goods, than the related financial flows.

The risk profile of markets in Africa, including several OIC Member States, has been and remains such as to have very direct impact on both the availability and cost of trade finance, and of related risk mitigation options.

> ATI was created to fill a market gap in trade and investment risk mitigation in Africa. In the late 90's, risk mitigation tools for credit and political insurance were not available for many African countries, and where the cover existed, it was very costly. In addition, the relatively small volumes of trade and investments into these countries did not justify the establishment of national export credit agencies. The only viable solution was to form a multilateral agency that would provide more cost-effective use of underwriting capital, reduced over-head costs and the ability to encourage private sector insurers to assume risk in Africa.
>
> Source: African Trade Insurance Agency

It is clear that the movement of goods and the movement of money are interrelated, and in some markets, critically so: logistics challenges create an imperative for adequate risk mitigation and financing, though often, such challenges arise in markets where financing and risk mitigation are simply not available, or are available only at significant cost.

The creation of the African Trade Insurance Agency represents a collaborative solution to a multi-country challenge, supported by an appropriately mandated IFI. The ATI model is meant to grow in membership to include non-African participants, and therein may lie a proposition for OIC Member States: the development of institutions or solutions that initially target a high-need subset of OIC Member States, while ultimately seeking to grow and become more inclusive across OIC States.

As with other jurisdictions, the role of relationships in trade is very important across OIC Member States, so much so, that trade finance continues to be available in some of the most challenged markets in the OIC family despite the fact that standard risk assessments would preclude such availability. One senior banker noted that his institution is explicitly targeting growth in "difficult" markets in the MENA Region in particular, despite the pullout of leading financial institutions, and that the success of this effort so far, comes down to an intimate knowledge of the markets, and important and trusted local relationship that can provide insight, support and other forms of assistance critical to the viability of the conduct of business in those markets.

Looking at total MT 700 messages [Documentary Letter of Credit] sent in 2012 in the top 15 importing countries, the largest in descending order were: China, South Korea, Bangladesh, Hong Kong, and India. Also, the highest annual growth in import traffic came from Bangladesh (+42%), Indonesia (+11%) and the United Arab Emirates (+6%). The steepest declines in import traffic were France (-8%), Algeria (-7%), Taiwan (-6%) and Japan (-6%).

These countries registered the fastest export growth (with a yearly volume higher than 10,000 trade messages MT 700 received).

- *Bangladesh: +118%*
- *Saudi Arabia: +11%*
- *Turkey: +9%*
- *Vietnam: +6%*
- *Indonesia: +6%*
- *Pakistan: +4%*
- *Singapore: +4%*

Source: Rethinking Trade Finance 2013, ICC

Even a high-level and aggregated view of the state of trade and trade finance in OIC Member States confirms that the issues faced by SME's often involve commonalties that cross borders, as well as the boundaries between conventional and Islamic Finance.

While the recognition of the importance of trade finance seems broadly-based today, this is not the first time a counter-cyclical business like trade finance is acknowledged as an important enabler of trade and value creation.

The objectives of the [Tanzania] Trade Finance Clinics were to: 1) increase knowledge of African policy makers, exporters/importers and financial institutions on trade finance products, services and tools, 2) create business links between foreign and African business communities, and 3) increase trade and investment in Africa. The Clinics had four back-to-back events including; a one-day workshop on Trade Finance in Africa, one-day Women in Trade Forum, six buyer seller meetings and a 12-day walk-in information and knowledge center.

Source: Scaling Up Capacity Development in Trade Finance, World Bank, 2005

That said, some observers and industry specialists observe that the evolution of Islamic Trade Finance has not reached a tipping point in terms of its potential and in terms of maximizing its contribution to the development of intra-OIC trade flows.

Similarly, while the critical importance of the contribution of export credit agencies to robust trade, particularly for SMEs and in emerging markets, has been widely recognized, the presence of export credit entities at the national level within OIC Member States is far from universal.

While there are several multilateral agencies which can directly, or indirectly support the trade aspirations of OIC Member States, and it may be possible in some cases to access private sector solutions on a case-by-case basis, the absence of national ECAs suggests a compelling opportunity to advance trade, economic growth and development through the establishment of ECA-type entities where the need is deemed most urgent, and where the economic benefit can be the most immediate.

Whether such initiatives can be supported by supra-national entities is a question worth considering, and one that might be defined as part of the scope of a cross-OIC best practices

analysis. A multi-shareholder model such as the one applied to the African Trade Insurance Agency, where Uganda is a part owner, or the ICIEC, can prove effective in facilitating the development of ECA entities in a larger number of OIC Member States.

The critical role of ECAs and IFIs is reflected in their support of trade development in the most difficult of contexts, globally and among OIC Member States.

> *"An early success was signing agreements with 17 of the largest Export Credit Agencies around the world. Another was the fact that TBI was one of the first Iraqi banks to receive lines of credit from major international financial institutions."*
>
> Source: Trade Bank of Iraq Website, 2013

Table 8: ECA's in OIC Member States

Country	ECA	Country	ECA	Country	ECA
Algeria	CompagnieAlgerienned'Assurance et de Garantie des Exportations http://www.cagex.dz/index.htm	Afghanistan		Benin	
Bahrain		Albania		Burkina Fasso	
Comoros		Azerbaijan		Cameroon	
Djibouti		Bangladesh		Chad	
Egypt	Export Credit Guarantee Company of Egypt www.ecgegypt.net	Brunei		Cote d'Ivoire	
Iraq		Indonesia	PT AsuransiExpor Indonesia (PERSERO) www.asei.co.id	Gabon	
Jordan	Jordan Loan Guarantee Corporation www.jlgc.com	Iran	Export Guarantee Fund of Iran www.egfi.ir	Gambia	
Kuwait		Kazakhstan	KazExportGarant Export Credit Insurance Corporation www.keg.kz	Guinea	
Lebanon	The Lebanese Credit Insurer s.a.l. www.lci.com.lib	Kyrgyz		Republic Guinea-Bissau	
Libya		Malaysia	Export Import Bank of Malaysia Berhad www.exim.com.my	Mali	
Mauritania		Maldives		Mozambique	
Morocco		Pakistan		Niger	
Oman	Export Credit Guarantee Agency of Oman www.ecgaoman.com	Tajikistan		Nigeria	
Palestine		Turkey	Export Credit Bank of Turkey www.eximbank.gov.tr	Senegal	
Saudi Arabia	Saudi Export Program www.sep.gov.sa	Turkmenistan		Sierra Leone	
Qatar	Qatar Export Development Agency (TASDEER) www.qdb.qa	Uzbekistan	Uzbekinvest National Export Import Insurance Company www.uzbekinvest.uz	Togo	
Somalia		Guyana		Uganda	African Trade Insurance Agency www.ati-aca.org
Sudan	National Agency for Insurance and Finance of Export www.naife.org	Suriname			
Syria					
Tunisia					
United Arab Emirates	Export Credit Insurance Company of the Emirates www.ecie.ae				
Yemen					

(Shaded cells: Non-Berne Union ECA, or None)

Source: Berne Union Yearbook 2013

Perhaps equally importantly over the longer term, ECAs and IFIs can be the source of or the drivers behind, important innovations in the financing of international commercial activity.

Table 9: Services Export Finance

1. What is this product about?
Export Of Services facility is available to Malaysian owned and controlled companies, engaged in the provision of services for the global market, such as Information Technology Service, Engineering Architecture and other professional services.
2. What does the facility offer?
• Margin of financing is up to a maximum of 70% of the contract value • Tenor is up to a maximum of 5 years

Source: Export-Import Bank of Malaysia Berhad, Product Disclosure Sheet, 2013

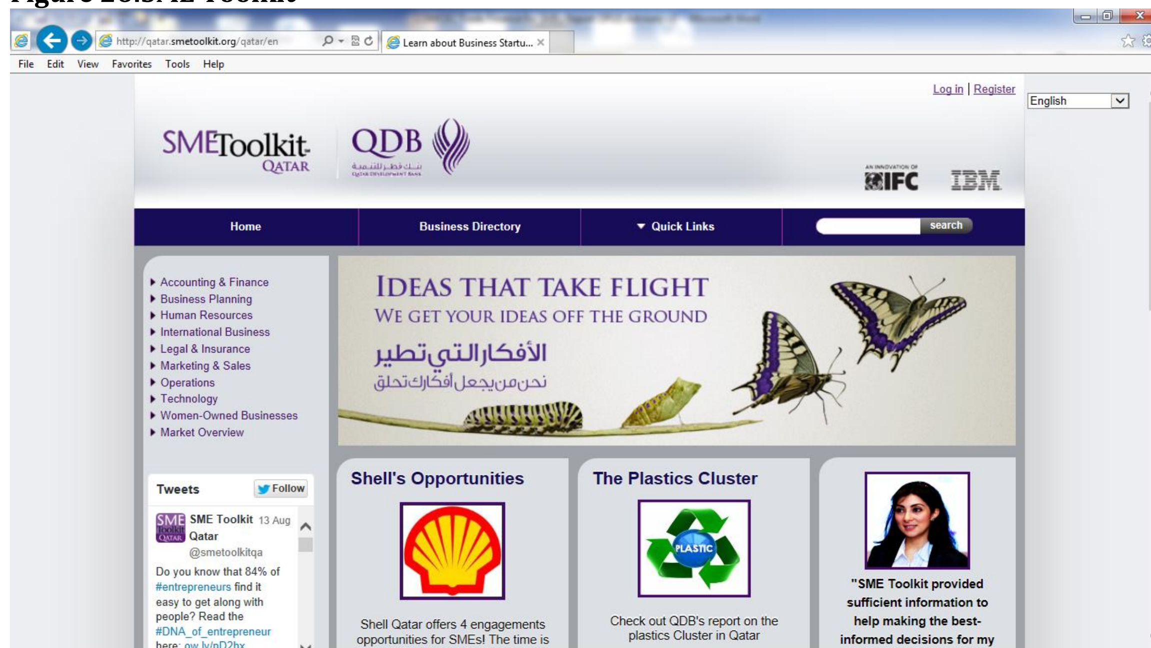
While private sector providers of trade finance wrestle with the demand for service sector trade finance, and the absence of collateral in support of such financing, the Malaysian ECA is offering attractive solutions in support of high-value and typically high margin professional services exports. Such initiatives and the innovative products and structures that support them, can assist exporters – and nations – to move successfully upward along the global value chain, and in so doing, support economic development and growth.

The breadth of the mandates and ranges of activity among OIC Member institutions also varies significantly, with certain jurisdictions defining a relatively focused and narrow scope of activity for their institutions, and others taking a rather more holistic approach, placing trade financing and risk mitigation in the broader context of international trade, market development and pursuit of new opportunities.

While some institutions and jurisdictions focus primarily on solutions and services related to payment, financing and risk mitigation, others look more broadly at the need for and opportunity in developing commercial competencies, and in acquiring knowledge and skills important to success in international markets.

The Qatar Export Development Agency takes a broad view of its mandate, having developed an SME Toolkit in collaboration with the IFC and with IBM, which includes a variety of resources addressing key issues faced by SMEs and entrepreneurs, from fundamentals of management to country reports to sector-level analyses and beyond. The Toolkit also appears to identify opportunities for Qatari SMEs to engage in international and global supply chains.

Figure 26:SME Toolkit



Source: Qatar SME Toolkit Website

In similar fashion, Turk Eximbank places emphasis on supporting SMEs as well, but adds the ability to "indirectly" channel the financial resources of Turkish commercial banks to export finance, as a result of the ECAs funding being partially made up of borrowings from the commercial bank sector.

Channelling of Commercial Bank Resources…

A proportion of Turk Eximbank's funds arise from borrowings from commercial banks and Turk Eximbank is able to indirectly channel part of the Turkish commercial banks' reserves to export financing. Discount programs are another tool used to achieve this aim. In addition, in offering guarantee schemes to commercial banks, Turk Eximbank is creating a risk free environment for the banking sector to encourage them to engage directly in export financing.

Increased Focus on Small and Medium Scale Enterprises…

Turk Eximbank aims to increase the focus of its programs on helping small and medium scale enterprises (SMSEs). Such enterprises play an important role in the Government's strategy, particularly since the establishment of the Customs Union with the EU. SMSEs usually experience difficulties in passing the rigid qualification tests for loans, even if they are fully capable of complying with the terms of their export contracts. Turk Eximbank, therefore, has placed special importance on SMSEs in its strategy.

Source: Turk Eximbank

The Turkish ECAs mandate is linked directly to public policy and covers the promotion of trade as well as the international activities of Turkish investors, with Turk Eximbank noting that it is one of a relatively few ECAs in existence that also engages in direct lending activity in pursuit of its objectives. Senior leaders at the ECA are said to participate in and influence the development of policy: a notable observation, exhibiting a clear recognition of the importance of trade finance and risk mitigation – and the relative domain expertise – in the broader context of trade and foreign policy.

Certain ECAs, including multilateral institutions, explicitly aim to support and facilitate the conduct of trade on the basis of Shari'ah compliant structures, and have included Islamic Trade Finance specifically in their mandates and value propositions. PT Asuransi Ekspor Indonesia (PERSERO), for example, created an affiliate entity on the basis of a public/private partnership, to enable the development and delivery of a wider range of products. Additionally, the ECA devised another affiliate aiming specifically to meet the financing and risk mitigation requirements of businesses and banks seeking to do business on the basis of Islamic Finance and commercial principles.

The current state of trade finance in OIC Member States covers a wide range of circumstances. It is worth noting that well-established entities in mature jurisdictions all appear to recognize the importance of considering trade and supply chain finance in the wider context of international commerce, policy and economic growth and value-creation.

While policy positions across 57 OIC Member States cannot practically be reviewed in detail, the positions, mandates and areas of focus of various ECAs provide a view of the priorities of national governments and help in identifying opportunities for other jurisdictions to evolve their own activities and value propositions.

3.4. Implications for OIC Objectives and Member States

The most significant linkages arising from the challenges related to SME access to trade finance, both conventional and based on Shari'ah Law, relate to the capital markets and trade facilitation objectives of the COMCEC.

It is evolving to be the case, that trade development and promotion initiatives, including trade promotion capacity development through international and multilateral efforts, are recognizing the imperative to include access to trade financing as an element of the broader trade facilitation effort. This is both appropriate and applicable in the context of the needs and opportunities linked to OIC Member States.

Similarly, efforts to assist in the evolution and in some level of alignment in capital markets and financial services can, and should, link directly to considerations around providing adequate trade financing resources to SMEs across OIC Member States.

This dimension can cover regulatory and central bank supervisory policy and mandates related to trade finance, as well as the facilitation of access to trade finance through non-bank capital, as is currently an area of critical importance under consideration by leading international trade finance banks (London Group Initiative, BAFT-IFSA).

In the end, measures aimed at supporting and enabling greater access to trade finance will have their effect within a broader context: at one level, within the trade and supply chain activities of OIC Member State-based SMEs, and on another level, within the wider macroeconomic context, the broader capital markets and within the context of public policy that extends beyond focus on trade-related priorities. In this respect, the decisions and actions related to the provision of adequate levels of trade finance will be more effective if they are linked and aligned with other priorities and streams of activity, including efforts around capital market development and trade promotion.

> *The true state of the Islamic trade finance sector as such is difficult to gauge because of a lack of reliable statistics and data; and poor reporting and disclosure cultures. This is true for both the multilateral development banks (MDBs) such as the IDB Group and for the commercial and specialised Islamic banks.*
>
> *Yet the few reliable statistics that are available suggest that the potential for Islamic trade finance is huge given that the 56 IDB member countries are some of the world's largest exporters of strategic commodities such as oil, gas, petrochemicals, palm oil, phosphates, timber, cotton, selected manufactured products and electronics. They are also some of the world's largest importers and consumers of products such as foodstuffs, livestock, wheat and other soft commodities, white goods and a host of electronic, transport, IT and other machinery and equipment.*
>
> Source: Cash & Trade Magazine, 2011

As noted earlier, key issues and challenges facing OIC Member States as related to trade finance, are very consistent with and similar to systemic issues encountered globally by stakeholders and experts monitoring the state of trade and supply chain financing.

Risk aversion (perceived or objective), insufficient support of SMEs, credit and resource capacity constraints and the apparent need for, but absence of, innovation are all identified as relevant in the context of OIC Member States, just as they are relevant, and have been discussed earlier, in the broader global context. The demands for collateral in support of SME finance and trade finance, likewise, has been identified as disadvantageous and impractical given the limited assets typically available to SMEs. For some specialists, the requirement for collateral is seen as nearly pointless, given the difficulty of converting assets taken as collateral, in times when the SME borrower encounters difficulty in meeting its financial obligations.

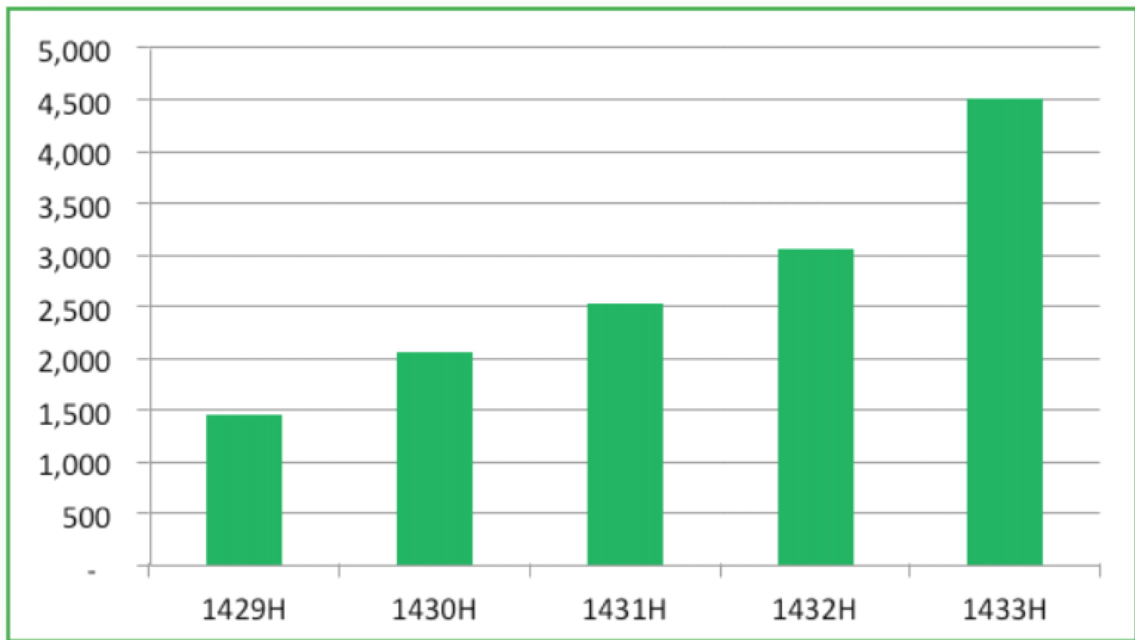
Similarly, the absence of useful data, metrics and benchmarking has been observed in OIC Member States and their supporting institutions, just as it is a reality within the wider trade finance community. Just as there are systemic issues in accessing or deploying financial resources in support of trade, globally, there are several observable challenges in doing so within and between OIC Member States. These include:

- Limited payment and settlement infrastructure in OIC Member States, forcing the use of (expensive) international centres of finance
- Limited availability and uptake of ECA support and risk insurance
- Limited trade finance product innovation beyond basic structures
- Systemic risk aversion

- Absence of capacity management through syndications and other forms of risk-sharing, or development of additional capacity

It must be noted in terms of product innovation however, that the various support and enabling institutions around trade and trade finance are increasingly looking to leverage and promote the use of leading techniques, certainly in the context of conventional trade finance, with bankers and trading companies showing increased interest in supply chain finance mechanisms, despite a long-standing preference among MENA Region countries and parts of sub-Saharan Africa, for traditional mechanisms like documentary letters of credit.

Figure 27: IDB Trade Finance Operations



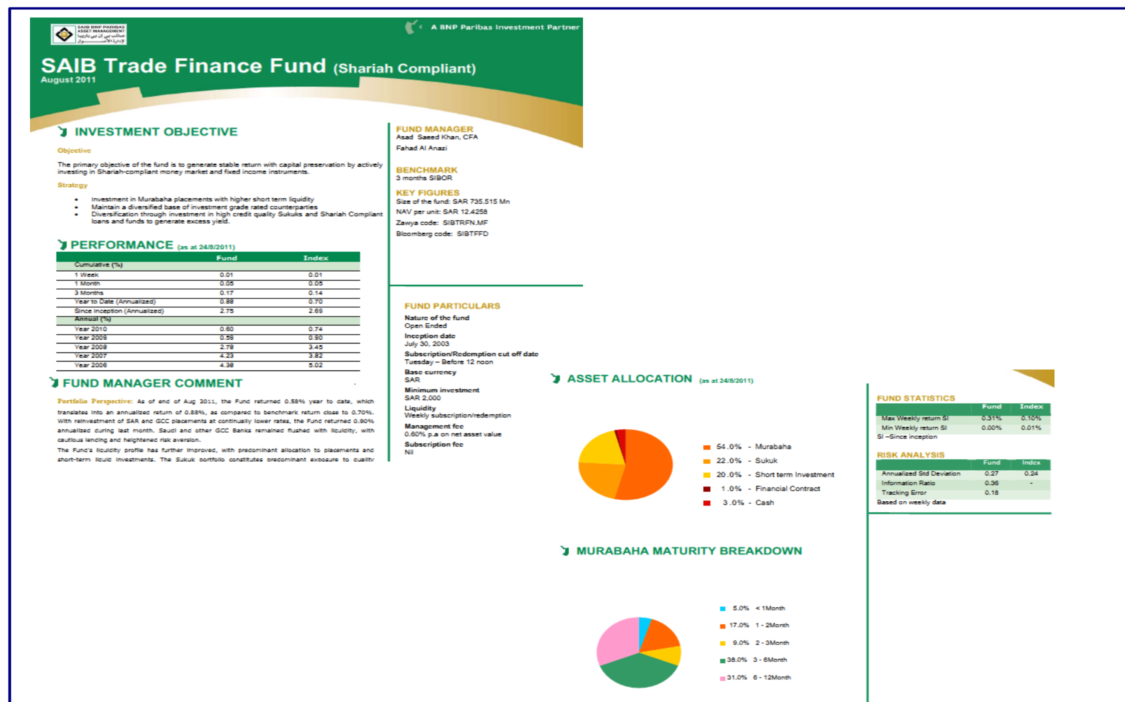
Source: Connecting to Global Value Chains, IDB 2013

While the trade finance operations conducted by ITFC, ICIEC and other key institutions engaged in trade support is clearly on a growth trajectory, these institutions are required to exercise appropriate caution in their lending and financing activity, and do operate in a resource-constrained environment. The growth and development of Islamic Finance is integral to the related growth of Islamic Trade Finance, and both require adequate levels of liquidity and balance sheet (or funding) capacity to be able to respond to gaps in financing, and to be able to adequately support projected growth rates in trade, including intra-OIC trade flows.

One means of assuring adequate levels of capacity, is to attract additional non-bank and non-IFI capital to support the conduct of trade. This issue of capacity has been discussed in the context of the global state of the trade finance market, and exists to some degree today in the context of OIC Member States. The development of trade finance funds, and the attraction of non-bank investors and capital pools (including sovereign wealth funds) to the trade finance asset class, is fundamental to the global sustainability of trade and supply chain finance activity, and will become increasingly central to considerations around trade and supply chain finance in OIC Member States.

One such example is the SAIB Shari'ah-Compliant Trade Finance Fund:

Figure 28: SIAB Trade Finance Fund



SAIB BNP PARIBAS ASSET MANAGEMENT

A BNP Paribas Investment Partner

SAIB Trade Finance Fund (Shariah Compliant)
August 2011

INVESTMENT OBJECTIVE

Objective

The primary objective of the fund is to generate stable return with capital preservation by actively investing in Shariah-compliant money market and fixed income instruments.

Strategy

- Investment in Murabaha placements with higher short term liquidity
- Maintain a diversified base of investment grade rated counterparties
- Diversification through investment in high credit quality Sukuks and Shariah Compliant loans and funds to generate excess yield.

PERFORMANCE (as at 24/8/2011)

	Fund	Index
Cumulative (%)		
1 Week	0.01	0.01
1 Month	0.05	0.05
3 Months	0.17	0.14
Year to Date (Annualized)	0.88	0.70
Since inception (Annualized)	2.75	2.69
Annual (%)		
Year 2010	0.60	0.74
Year 2009	0.59	0.90
Year 2008	2.78	3.45
Year 2007	4.23	3.82
Year 2006	4.38	5.02

FUND MANAGER COMMENT

Portfolio Perspective: As of end of Aug 2011, the Fund returned 0.58% year to date, which translates into an annualized return of 0.88%, as compared to benchmark return close to 0.70%. With reinvestment of SAR and GCC placements at continually lower rates, the Fund returned 0.90% annualized during last month. Saudi and other GCC Banks remained flushed with liquidity, with cautious lending and heightened risk aversion.

The Fund's liquidity profile has further improved, with predominant allocation to placements and short-term liquid investments. The Sukuk portfolio constitutes predominant exposure to quality

FUND MANAGER
Asad Saeed Khan, CFA
Fahad Al Anazi

BENCHMARK
3 months SIBOR

KEY FIGURES
Size of the fund: SAR 735.515 Mn
NAV per unit: SAR 12.4258
Zawya code: SIBTRFN.MF
Bloomberg code: SIBTFFD

FUND PARTICULARS
Nature of the fund
Open Ended
Inception date
July 30, 2003
Subscription/Redemption cut off date
Tuesday – Before 12 noon
Base currency
SAR
Minimum investment
SAR 2,000
Liquidity
Weekly subscription/redemption
Management fee
0.60% p.a on net asset value
Subscription fee
Nil

ASSET ALLOCATION (as at 24/8/2011)

MURABAHA MATURITY BREAKDOWN

FUND STATISTICS

	Fund	Index
Max Weekly return SI	0.31%	0.10%
Min Weekly return SI	0.00%	0.01%

SI –Since inception

RISK ANALYSIS

	Fund	Index
Annualized Std Deviation	0.27	0.24
Information Ratio	0.36	-
Tracking Error	0.18	

Based on weekly data

Source: SAIB/BNP Paribas, 2011

> *Amid a challenging environment for short term Money market and Trade Finance, the Fund is well positioned to achieve an attractive return for the unit holders in FY 2011, as the Manager aims to proactively manage the credit, duration and liquidity risk, through prudent credit controls, market conditions and substantial allocation to liquid instruments. The Fund's return is reflective of its superior performance over the comparable term deposit opportunities, with capital preservation and weekly liquidity.*
>
> Source: SAIB Fund Manager Commentary, 2011

A more recent initiative in this space, launched by Kuwait-based Asiya Investments, aims to support trade flows with Asia, and specifically targets supporting SMEs engaged in trade, seeking to fill a gap left by the retreat of international banks from the trade finance market, as perceived by Asiya.

> *Kuwait-based Asiya Investments has launched an Islamic trade finance fund with $20 million in seed capital, aiming to cater to small Asian manufacturers. Asiya, whose largest shareholder is sovereign wealth fund Kuwait Investment Authority, aims to fill a gap left by Western banks that are scaling back their trade finance business, making credit scarce for small and medium-sized firms.*

> *"We engage those companies that are already banked but whose credit lines are limited - we are complementing their financing," said Sulaiman Alireza, executive director of Asiya's investment management arm in Hong Kong. Despite strong growth in Islamic finance globally over the last few years, the industry has neglected merchandise trade, leaving trade finance for conventional banks to dominate. But conventional banks are retreating because of the world financial crisis and higher capital requirements under upcoming Basel III regulations, which could open up about 20 percent of the business to non-bank institutions, Alireza said.*
>
> Source: Reuters, 2013

Overall, the criticality of trade, and hence of trade finance, is mirrored in OIC Member States, just as it has come to the forefront on a global basis, as a direct outcome of the global crisis. OIC Members States do however represent the full spectrum of national political and economic conditions, from the most wealthy, stable and advanced, to the most challenging, in terms of political instability, economic hardship and poverty. In either extreme, it is widely understood that robust trade flows are important to on-going economic health, and to long-term, sustainable growth.

Additionally, the role of trade in international development and in poverty reduction is highly relevant in the context of numerous OIC Member States, and certainly in the context of the partnership and collaboration model being developed by OIC Member States.

Trade finance is clearly an important input in the overall enablement of trade flows; however, the realization of this importance and priority is relatively recent at least at the level it has reached in a post-crisis environment. What has been missing, and what is now urgently necessary is well-considered, strategic and proactive action to create the context necessary for provision of adequate trade finance for SMEs.

The proactive approach is even more important in the context of a multi-country alliance like that supported by the COMCEC, and it is clear that there have been vital positive steps in that direction. It remains true however, that there are opportunities to create a more supportive environment at the national and regional levels and across OIC Member States.

Ernst & Young have estimated that a “turnaround” and evolution of global Islamic Finance is likely to take 2-3 years, even on the basis of a purposeful, focused approach to the enablement of that evolution. Similarly, the challenge of facilitating SME access to finance, across OIC Member States, is not a matter to be resolved in the very short term, but important progress can be made quickly.

It is equally clear that there are numerous issues and opportunities in comparing the state of trade finance in OIC Member States, with the state of the market globally, including with reference to conventional trade finance. The issues encountered by stakeholders in the OIC Member States are consistent – if not largely identical – to the issues encountered by others seeking to better leverage trade finance in pursuit of economic recovery and growth, or in support of trade aimed at international development and poverty reduction.
Even taking into account the unique characteristics of OIC Member States, the common realities around trade and supply chain finance, particularly SME access to trade finance – almost globally – will lead to comparable conclusions and recommendations aimed at accomplishing some strikingly similar objectives.

IV. CONCLUSIONS AND RECOMMENDATIONS

4.1. Conclusions

Trade finance has clearly been recognized as being critical to the successful conduct of international commerce, and it is widely acknowledged also that the role of SMEs globally, and specifically within OIC Member States, is critical to the creation of economic value, the creation of sustainable employment and growth and the recovery and prosperity of nations at all stages of development.

Relatedly, the challenges faced by SMEs in accessing financing and trade financing, whether in conventional form or in Shari'ah compliant form, can be identified and are often quite similar, irrespective of the degree of advancement of an economy, or of the demographic or sector focus of a country's SME segment. Risk assessment and perception, technical competency among SMEs as borrowers, limited capacity among lenders and numerous other challenges identified in the literature around SME finance seem to be very broadly relevant. Policy issues related to financial regulation, including capital adequacy, will be relevant to different degrees in different markets, and will relate directly to the rollout of Basel III, for example, however, the relevance remains, and the need (and the opportunity) to prepare is relevant across a wide range of jurisdictions.

The raised profile and priority around trade finance, both in terms of access to this type of financing and in terms of the need to develop competencies and capacity related to trade finance comes at an opportune moment in the history of the international economic system and the global system of trade. This is a moment when the critical importance of trade is universally acknowledged, and thus a time when efforts to secure support, resources and appropriate priority around trade finance initiatives will have maximum likelihood of success.

Trade finance is a domain that has historically been the purview of practitioners. Limited academic rigour or analysis was applied to this area, and data or benchmarking insight has been very scarce and difficult to source, in part because of the proprietary nature of such information in the private sector and in part because of the veil of mystery and complexity that has long surrounded the financing of international commerce.

This situation has changed significantly and for the better as a direct result of the global crisis, and there is now significantly more data, analysis and thoughtful energy being directed at trade finance, across commercial, political and academic and IFI circles. AT the same time, practical and commercially viable and compelling innovations such as supply chain finance and the Bank Payment Obligation provide concrete opportunities to shift from analysis of the SME access to trade finance issue, to the planning and execution of concrete steps aimed at resolving the issue.

4.2. Recommendations

There are numerous opportunities to address the challenge of enhancing SME access to trade finance, some relatively immediate, some that have significant dependencies and will likely involve longer timeframes for planning, execution and for the impact or outcomes to be felt among OIC Member States. The observation linking trade and logistics infrastructure development to the question of cost of and access to trade finance is one such scenario.

Approach and High-Level Considerations

Recommendation 1: Undertake complementary short and long term initiatives to facilitate SME access to trade finance

There are opportunities to undertake long-term policy and financial sector development initiatives that will ultimately facilitate access to trade and supply chain finance for SMEs, however, these longer-term opportunities ought not to preclude more immediate action aimed at addressing this objective.

The establishment of country-level guarantee programs, of the development and delivery of bank-targeted training programs around trade finance can be accomplished with limited coordination, limited resources, and the support of international institutions such as the IDB and its various affiliates.

The approach to developing a strategy around SME access to trade finance should include multiple work streams, some aiming at immediate progress and at medium and longer-term opportunities with more complex dependencies and a more complex coordination effort across OIC Member States. The achievement of short-term opportunities and objectives ought not to be hampered by the complexities of opportunities that will require longer-term effort.

The opportunity to create a pool funding aimed at supporting trade finance ought not to be delayed pending the full alignment of financial regulatory requirements across OIC Member States

The improvement of access to trade finance for SMEs should include parallel and independent streams of activity, one short-term, aimed at creating immediate value, and ideally involving few external dependencies and a second linking to the broader context, including to longer-term efforts in infrastructure development and enhancement. Opportunities to generate immediate progress and benefit ought not to be hampered by the existence of equally legitimate but longer-term activity which will demand greater coordination, more stakeholder consultation and by definition, a larger number of dependencies to be managed.

This recommendation is about process, and about the advisability of managing multiple, concurrent and independent streams of activity aimed at generating demonstrable progress and value in the short term.

The advantage of such an approach is intuitively clear: it allows for the achievement of early successes, the possibility of devising tailored priorities for each OIC Member State, and reduces the risk of unduly accelerating longer-term initiatives to accomplish the more immediately achievable outcomes.

From a resource and financial cost perspective, there may be some incremental overlap and some degree of duplication of effort, but a well-planned strategy and project/task plan will include effective management of such considerations.

Recommendation 2: Consider SME access to trade finance with reference to conventional and Islamic Finance, broader trade facilitation activity and related COMCEC workstreams.

The significant promise and potential of Islamic Finance and Islamic Trade Finance have been clearly demonstrated, and the expected evolution of intra-OIC trade flows increase the probability of robust demand for Islamic Trade Finance options and solutions in the medium term, however, industry specialists clearly perceive the need for further maturation in Islamic Finance capabilities across OIC Member States and beyond.

Conventional trade finance must remain a part of the capabilities supporting intra-OIC trade flows and between OIC Member States and other trading partners. Conventional trade finance is evolving to include supply chain financing solutions and to new solutions like the SWIFT/ICC Bank Payment Obligation. At the same time, Islamic Trade Finance is developing more effective risk mitigation capabilities in line with international practice and is wrestling with challenges around consistency of interpretation and the risk of non-conformity with Shari'ah requirements.

In similar fashion, trade finance and its availability to SMEs must be assessed and developed with appropriate reference to other trade facilitation initiatives, such as "single window" access to new markets and their infrastructure, or initiatives around transport and logistics infrastructure development. OIC Member States like Indonesia, the UAE and others are taking significant measures in such areas, and it will be important to the extraction of maximum value from any trade finance initiatives, to consider such broader activities when looking at trade and supply chain finance.

It is increasingly a form of "Best Practice" in international and economic development, to consider financing, including SME access to liquidity, in the broader context of trade facilitation efforts. OIC Member States requiring priority focus on trade facilitation as part of their development approach will extract additional value from facilitation programs when a financing and liquidity dimension is included in such programs.
COMCEC initiatives around financial sector and capital markets evolution also merit careful scrutiny and consideration as stakeholders consider solutions and opportunities aimed at enabling SME access to trade finance. As with the preceding recommendation, this one is a matter of process and approach – ensuring appropriate consideration with and leveraging of concurrent priorities and initiatives.

The benefits of seeing SME access to trade finance within several high-influence contextual realities are primarily that appropriate levels of financing will be enabled through better alignment of regulatory regimes, capital markets models and financial sector reform, including evolution of both conventional and Islamic forms of finance and trade finance.

Enhancing access to trade finance facilities for SMEs is useful, but the impact of such measures is amplified when delivered together with targeted trade facilitation programs and measures ranging from market access support to training to various forms of capacity development among SME beneficiaries of such programs. A holistic and complementary approach presents not only an opportunity to access financing, but the greater likelihood of having SMEs pursue international opportunities, and the higher probability of success and economic value-creation.

The advantage of seeing trade and supply chain finance access for SMEs in a broader context is in the opportunity to maximize the value and impact of financial resources directed at SME trade financing. As collaboration and partnership between OIC Member States evolves and extends across participating nations, there is the probability of generating multiples of value for SMEs and for the economies in which they are based.

There is no specific cost associated with a particular approach that accounts for the broader context in and of itself, however, in taking such an approach, the scope of eventual programs, projects and activities is likely to expand, and thus indirectly imply a need for larger budgets. The extent to which this may be true is difficult to estimate without estimating the impact of specific initiatives.

Recommendation 3: Link policy initiatives directly to economic value and to the creation of economic value for OIC Member States individually and as a Group.

Policy initiatives that are opted into by OIC Member States such as the option of creating a national export credit agency should be linked as directly as possible to the expected creation of economic value, including employment and increases to GDP or even incremental business tax revenue as a result of increased trade flow.

The Asian Development Bank Trade Finance Survey of 2013 provides a preliminary framework for linking the availability of trade finance to job-creation and increased production; while ADB will admit that this is an initial attempt that requires refinement and the application of a more robust methodology in future iterations, this is an important contribution to advancing the understanding of the importance of trade and trade finance.

In addition to taking proactive steps to link the development of SME-focused solutions to the challenges of access to finance, it is recommended that OIC Member States either collaborate with the ADB to enhance the robustness of the current framework and data-gathering process, or, undertake its own analysis across OIC Member States. The ultimate objective is to create a strong and objective business case to support initiatives that will facilitate SME access to trade finance.

The advantage of this approach is in the ability of stakeholders to argue objectively and on the basis of demonstrable benefit and value-creation, in favour of initiatives that facilitate greater SME access to trade and supply chain finance. Whether the COMCEC decide to pursue collaboration with the ADB or to devise a process aimed specifically at OIC Member States, the opportunity to shape a rigorous process and to influence the selection of metrics aimed at quantifying the value of trade finance is of some importance and priority.

Policy initiatives at the national and sub-national levels should be mandated to take into account, opportunities to address the challenge of SME access to finance and trade finance,

linking this consideration directly to economic value-creation as one means of ensuring appropriate levels of political support.

The advantage of linking economic value to the availability of trade finance is to provide an objective, compelling and economic basis upon which to base requests for investment, deployment of resources and requests for political support, as relates to SME access to trade finance. Just as practitioners have long known the low default and loss rates associated with trade finance, but have only recently been driven to demonstrate this using industry data, specialists are well aware of the economic engine that is trade and trade finance, but will greatly benefit from being able to demonstrate this reality through objective data.

Initially, the cost related to this recommendation is likely to revolve around data-gathering and analysis, either directly with OIC Member States, or, as noted, in collaboration with the Asian Development Bank.

Given the potential scope of the initial analysis required, it is reasonable to expect that an investment in the order of US $75,000 to $125,000 might be required, to cover a short engagement aimed at conducting interviews and secondary research, and an assessment of the ultimate findings.

Tactical and Operational Considerations

Recommendation 4: Map OIC Members to comparable jurisdictions to identify applicable lessons and mutual challenges

As noted earlier, OIC Member States cover a wide spectrum of experiences, circumstances and positions on a continuum of development, wealth and sophistication as relates to trade finance and international engagement more broadly.

Given the breadth of individual circumstances and the differences in immediate priorities among OIC Member States, COMCEC should undertake a process of mapping OIC Member States to other international jurisdictions facing similar circumstances, with a view to leveraging lessons learnt.

Additionally, it may prove valuable to develop a “twinning” program, creating mentorship links between advanced OIC States and those in earlier stages of development as relates to trade finance and as relates to the maturity of their respective SME segments and international engagement. Such a program will combine practical commercial outcomes, with a concrete step contributing to the high-level OIC/COMCEC objective of fostering greater collaboration among Member States.

While such a program might also be designed purely with OIC Member States linking together, it is suggested that a “twinning” type program be designed that specifically involves linkages to other international jurisdictions.

This approach will have the advantage of broadening the sources of insight and shared experience, while perhaps eventually serving as a conduit for the opening of new trade markets, based on enhanced mutual understanding.

The mapping exercise may be dynamic – map one jurisdiction to another for six months, the change the twinning criteria based on a shift in priorities or a change in the element of trade and trade finance that is being assessed or developed.

This recommendation involves an initial step of analysis and matching of jurisdictions, followed by the formalization or relationships and dynamics in the form of collaborative and mutually supportive twinning programs. The initial study, covering all OIC Member States, and identifying twin jurisdictions for each, could be completed on the basis of a fixed-price research engagement, for perhaps $40-60,000.

Recommendation 5: Undertake an IFI and ECA Best Practices Study

The critical importance of the role of IFIs and ECAs has been discussed in some detail, both with reference to the global system and with reference to OIC Member States specifically.

Not all OIC Member States have developed an export credit agency, nor are all OIC Member States equally conversant with or active in the trade finance programs of international financial institutions, including ITFC.

It is recommended that specific analysis be undertaken to determine the key success factors of the leading IFI trade finance programs, with a view to incorporating best practices into the activities of ITFC, ICIEC and others. Consider the value of undertaking a program review around the Aman Union, to determine whether there are opportunities to replicate and enhance this credit risk initiative with a complementary union focused on the collaborative provision of liquidity and financing.

There is urgency in developing a robust infrastructure and support network around trade finance in OIC Member States, and the role of ECAs and IFIs in such areas is expanding. OIC Member States will benefit from a structured analysis of ECA and IFI best practices both within OIC Member States and more broadly among leading trading nations and users of ECA credit and cover.

As above, the initial step in this recommendation involves study and analysis. An IFI/ECA Best Practices study can leverage some degree of existing material, but it is clear that a custom view will be necessary, and that primary interaction with key stakeholders will be facilitated to the degree possible.

An assessment of this type, with the probable significant scope of comparative analysis might be completed by domain experts for $200,000.

Recommendation 6: Training and Competency Development

Knowledge gaps among policy makers, SMEs and mid-market businesses, and bankers, motivate the need for significant focus on training, on the development of competencies and capabilities in trade and supply chain finance.

It is recommended that OIC Member States undertake targeted capacity and competency development training initiatives, even at a high level initially, with invited bankers, policy

specialists and SMEs, in the latter case perhaps through industry associations in a "train-the-trainer" mode, covering both Islamic and conventional trade and supply chain finance.

The precedent for – and value of – such initiatives is well established in the context of IFI trade capacity development programs with bankers in emerging and developing markets, and every indication is that the competency gap in evidence in most markets across the globe is also present in many OIC Member States.

The value of this recommendation is in the translation of expertise, to greater access to financing for SMEs and commensurate increase in trade flows and economic value-creation across OIC Member States.

Practices and programs are well established and it should be quite feasible to design an appropriately tailored set of training programs for delivery in OIC Member States, leveraging the learning of program to date.

The cost of trade finance training can be significant given the lack of domain experts globally. Ten week-long programs might be developed, designed and delivered for US $75,000 to 150,000.

Recommendation 7: Analysis of the Bank Payment Obligation

It is important for OIC Member States to look at leading edge solutions in trade and supply chain finance, certainly to keep pace with developments in the market, but also, and more importantly in the short term, to explicitly assess the potential of the BPO as a cost-effective, operationally efficient solution for the trade needs of SMEs in Member States.

It is recommended that analysis be initiated and aimed at identifying ways to apply innovations such as the Bank Payment Obligation to the challenge of SME access to finance, based on existing case studies, and on the recent engagement by the Dubai Chamber of Commerce in facilitating access to the BPO for its members.

The analysis phase of this recommendation could be completed for US $25,000 or so, while the cost of actually deploying the BPO has been described as very affordable, even for developing and emerging market economies. Cost elements include a SWIFT fee depending on the deployment and configuration of the system, along with technology investments that may need to be made, to bring this solution online.

Recommendation 8: Increasing Trade Finance Capacity

As indicated earlier in this document, limitations on capacity related to trade finance are already impacting the ability of companies to access trade finance, and it is expected that several developments in the market, globally, will constrain the availability of trade finance, or at a minimum, raise the cost of trade finance activity to levels that are no longer commercially viable for SMEs.

OIC Member States must take proactive and prompt decisions related to whether OIC Member States might require additional trade and supply chain finance, and if so, on what basis.

It is recommended to initiate discussions about the need for an appropriate process for attracting non-bank capital to the provision of trade finance liquidity, in order to prepare this capability ahead of the need for it that will eventually arise. OIC Member States may opt to link their deliberations to the current efforts by the London Group under the auspices of Washington-based BAFT-IFSA, or might prefer to initiate direct and tailored consideration of the needs of OIC Member States in terms of trade finance capacity. This recommendation includes discussion and assessment of the value of non-bank capital in supporting trade flows, and a determination about the advisability of joining ongoing discussions in the public domain, or taking a more discreet and OIC-specific approach.

Initially, this recommendation envisions industry taking a proactive step in anticipating and reacting to a looming shortage of trade finance capacity – on the basis that the lack of trade finance may trigger some serious reactions in selected markets. This recommendation envisions a coordinated effort across OIC Member States in attracting non-bank capital to the area. The cost of engaging in industry-focused dialogue is negligible however; eventual progress may lead to the notion that some form of trade asset distribution capability needs to be developed, to assist in the creation and accessibility of additional liquidity and trade finance. The development of some form or technology "hub" might imply a cost in the range of USD $250,000 to $ 1 million plus, depending on the required complexity.

Recommendation 9: OIC Best Practices Study

The planning and conduct of an OIC-focused trade finance best practices study appears to offer significant promise in terms of medium and long term trends and developments. While certain instruments and practices linked to trade finance have been around for a very long time, and some are very well understood, it is nonetheless advisable to facilitate and promote periodic "state of the market" discussions with selected participants. An outcome of such discussions would be to share findings and observations among OIC Member States, updating the analysis periodically as needed.

OIC Member States should conduct a best practices analysis of the trade and supply chain finance activities of leading banks in OIC Member States, making the findings available through an OIC Trade Finance Knowledge Centre, and update the analysis every 2-3 years as OIC Member States progress their capabilities at different rates.

The advantage of such analysis is in promoting alignment in bank practice, and commonality in interpretation of relative rules and common practices, and in the updating of shared understanding and best practices, based on the frequency with which such analysis is conducted. An OIC-focus study of this nature might be feasible on the basis of an investment of $50,000.

V. APPENDIX A: BAFT-IFSA PRODUCT DEFINITIONS

Working Definitions of Traditional and Open Account Trade Finance

(Quoted with Permission from BAFT-IFSA, Washington DC)

Traditional Trade Finance: Industry Product Definitions
Global Trade Industry Council, BAFT-IFSA, February 2012

Traditional Trade Finance products have existed in some form for hundreds of years. Generally speaking, banks have served as intermediaries to facilitate the flow of documents (information) and payments related to the flow of goods in international trade or to provide assurance relating to the performance or financial obligations of a person or company to another. Different products provide importers and exporters with varying levels of risk mitigation and/or financing.

1. Collections

Collection refers to the handling by banks of documents, in accordance with instructions received, in order to obtain payment and/or acceptance or deliver documents against payment and/or against acceptance or deliver documents on other terms and conditions (Source URC 522).

Specifically,
(i) A Collection that is payable at Sight is known as **Documents against Payment (D/P).** The documents are sent to the presenting/drawee bank and delivered to the drawee against payment. (ii) A Usance Collection is known as **Documents against Acceptance(D/A).** The documents are sent by the principal/drawer to the presenting bank and delivered to the drawee against the buyer's commitment to pay at a future date. Such commitment is usually evidenced by a bill of exchange, issuance of a promissory note, or an undertaking to pay at a future date, which, when accepted by the drawee/buyer for payment at a future date, is known as a trade acceptance.

Unlike a letter of credit there is no explicit undertaking by a bank to make finance available, however, the Remitting bank may choose to finance the exporter at the bank’s own risk with or without recourse, by purchasing the bill or by discounting the unaccepted bill before despatch to the presenting or collecting bank. The remitting bank may also discount the advice of the drawees acceptance without cognisance of the presenting or collecting banks co-acceptance. If the presenting/collecting bank is requested to co-accept or avalize the accepted bill it may do so. In some circumstances the presenting/collecting bank may also offer finance to the remitting bank by discounting its own acceptance, or in response to the request of the drawer through the presenting bank, provide a discounted advance payment.

2. Letters of Credit (LCs)

A letter of credit is an arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honor a complying presentation. There are two main types --- a Commercial (or Documentary) Letter of Credit

and a Standby Letter of Credit. Commercial Letters of Credit typically are used to assure payment for a transaction involving the movement of goods and involve the presentation of commercial documents that usually transfer title of the underlying goods, while Standby Letters of Credit are typically used as performance or financial assurances and are payable against a simple demand or a demand and a statement. These are defined in greater detail below.

A. Commercial (Documentary) Letters of Credit

A Commercial (Documentary) Letter of Credit is a written undertaking given by a bank (Issuing Bank), at the request of a buyer (Applicant), to pay the seller (Beneficiary) of goods or services provided that the seller strictly fulfils a defined set of documentary terms and conditions specified in the letter of credit. Any amendment of the LC requires the consent of all participants. Such credits are normally governed by the International Chamber of Commerce (ICC)'s Uniform Customs and Practice (UCP). UCP 600 came into effect in July 2007.

(i) **Commercial (Documentary) Letters of Credit---Availability**

The Commercial LC will specify how and when the payment/proceeds will be made available:

a. **Sight** indicates the Letter of Credit is payable upon presentation of documents in compliance with the terms and conditions of the LC and may or may not include a Draft/Bill of Exchange.

b. **Usance** indicates the Letter of Credit is payable on some future date after presentation of documents in compliance with terms and conditions of the LC.

i. **Deferred Payment** is a promise of the Issuing Bank to pay a certain sum of money on a future fixed date. No Draft/Bill of Exchange or other negotiable instrument is required.

ii. **Acceptance** of Draft(s) drawn on the Issuing Bank (or Nominated Bank) represents a promise of the accepting bank to pay a certain sum of money on a fixed date. Such future date may be a pre-determined fixed date or based on a period of time after shipment date or presentation date

c. **Negotiation** indicates that the LC may be negotiated either by any bank of the beneficiary's choosing (freely negotiable), or, by a specifically nominated bank.

(ii) **Commercial (Documentary) Letters of Credit --- Risk Mitigation**

1. Unconfirmed Letter of Credit - The Issuing Bank is obligated to pay upon presentation of conforming documents and at the designated time specified within the letter of credit. There is no obligation on the part of the Advising Bank should the Issuing Bank not pay. The Advising Bank is solely responsible for the authenticity of the letter of credit.

2. Confirmed Letter of Credit - A Commercial Letter of Credit in which the Issuing Bank requests and nominates a second bank (often the Advising Bank) to add its payment undertaking to the letter of credit in addition to that of the Issuing Bank. The confirming bank becomes a participant of the LC and their consent to any amendment or cancellation is also required. Such commitment from this second bank provides additional comfort to the seller who wishes to mitigate the country and bank risk of an Issuing Bank.

3. "Silently" Confirmed Letter of Credit - A Silent Confirmation is typically undertaken at the request of the Beneficiary instead of the Issuing Bank, and without the knowledge of the Issuing Bank. A bank that adds this type of confirmation undertakes to honor or negotiate compliant documents by direct arrangement with the beneficiary. The 'Silent' Confirming Bank's obligation is evidenced by a separate undertaking document which is outside the terms of the letter of credit and this distinct bilateral arrangement is not covered by the ICC rules. By contrast to an "open" confirmation, the silently confirming bank is not a participant in the LC according to UCP.

4. Reimbursement Undertaking - Irrevocable guarantee by the reimbursing bank to a nominated bank/claiming bank (to whom documents under a letter of credit would be presented for payment) to honor their reimbursement claim. An IRU can be based upon the request of an issuing bank or can be silent to the issuing bank.

(iii) Commercial (Documentary) Letters of Credit - Special characteristics

a. **Revolving Credit** – A commitment on the part of the issuing bank to automatically restore the credit value to the original (or other) amount after it has been drawn upon. This is typically used for instalment or multiple delivery contracts and may revolve around time or value.

b. **Transferable Credit** – The original letter of credit allows the beneficiary to transfer all or part of the originally issued letter of credit (Master LC) to another party (one or more second beneficiary) and specifically states that the LC is transferrable.

c. **Back-to-Back Credit** – A separate letter of credit is issued at the request of the beneficiary of an original letter of credit using the original letter of credit as a model and/or collateral for the bank issuing the second letter of credit.

d. **Front-to-Back or "To Arrive" Credit -** The second letter of credit is issued without the benefit of the original Master credit beingavailable. In some markets this is also known as an "Export will Buy" credit where the master credit leg is replaced with a commitment to discount or purchase an export collection to pay out the import credit.

e. **Red Clause** – A clause authorizing the nominated bank to make advances to the beneficiary (usually by simple receipt) prior to the shipment of goods or presentation of documents.

f. **Green Clause** – A green clause credit is the same as a "Red Clause" credit except that pre-shipment advance is made against beneficiary's presentation of title document to the goods made to the order of the bank or its nominated agent, evidencing storage of the goods in a warehouse in the exporter's country.

g. **Assignment of Proceeds** – A beneficiary may assign all or part of the proceeds of a letter of credit to another party (assignee). The original beneficiary maintains sole rights to the letter of credit and the payment to the assignee is contingent upon payment under the original letter of credit.

B. Standby Letters of Credit

A Standby Letter of Credit is a written undertaking given by a bank (Issuing Bank), at the request of an Applicant, which can be a bank, to provide assurance to a Beneficiary regarding the Applicant's (or a third party's) performance or financial obligations, that promises to pay the Beneficiary against presentation of a documentary demand conforming with the terms and conditions specified in the letter of credit. Unlike a commercial letter of credit, which is expected to be the means of payment in the underlying transaction, a standby letter of credit is typically not drawn unless there is some manner of default in the underlying transaction. Such credits are normally governed by the ICC rules (UCP or ISP 98).

(i) Standby Letters of Credit --- Risk Mitigation

a. Confirmed Standby Letter of Credit --- A Standby Letter of Credit in which the Issuing Bank requests and nominates a second bank(often the Advising Bank) to add its undertaking to the Standby Letter of Credit, in addition to that of the Issuing Bank, to honor a compliant claim without recourse to the Beneficiary. Generally governed by ICC rules, such confirmation provides additional comfort to the Beneficiary who wishes to mitigate the bank risk of the Issuing Bank, or to credit enhance the undertaking of the Issuing Bank.

b. "Silently" Confirmed Standby Letter of Credit --- A Silent Confirmation is typically undertaken at the request of the Beneficiary instead of the Issuing Bank. A silently confirming bank undertakes to honor a compliant claim made under a Standby Letter of Credit. The Silent Confirming Bank's obligation is evidenced by a separate undertaking document which is outside the terms of the Standby Letter of Credit and this distinct bilateral arrangement is not covered by the ICC rules.

(ii) Standby Letters of Credit --- Categories

a. **Performance Standby Letters of Credit (or Performance Bond)** --- is issued to guarantee performance of the Applicant (or a third party) under a contract. It is considered a show of "good faith" and is not normally expected to be drawn upon. Advance Payment and Bid Bonds are also generally considered to be similar in nature to Performance Bonds. Performance standby LCs are related to underlying commercial trade transactions.

b. **Financial Standby Letter of Credit** --- is issued to guarantee future payment obligation(s). The Financial Standby LC will only be drawn upon should the Applicant (or a third party) not make the payment(s) as expected. This instrument may also be used in lieu of cash collateral. Financial standby LCs are NOT related to underlying commercial trade transactions.

** Financial standby LCs may NOT be considered Trade products where there is no underlying trade transaction.*

(iii) Standby Letters of Credit – Special Characteristics

a. **Evergreen Clause** – Allows the letter of credit to be automatically extended until the issuing bank informs the beneficiary of its final expiration date.

3) Letters of Guarantee

A bank guarantee is an irrevocable promise of a bank to compensate the beneficiary under clearly prescribed conditions fully, immediately, and without failure for damages suffered. To be utilized in the event of default by the applicant of the letter of guarantee. Guarantees are usually governed by local law and different ICC rules (URDG 758 and others).

a. Letter of Guarantee issued on behalf of another bank - Issuing Bank issues a Letter of Guarantee at the request of another bank, which issues a counter guarantee in favour of the Issuing Bank.

b. "Silently" confirmed Letter of Guarantee issued by another bank - Issuing Bank adds at the request of its customer a silent guarantee to a L/G issued by another bank in favour of said customer

Section 3: Trade Finance Definitions - Traditional Financing Products

Trade Finance lending also uses traditional products that have existed in practice for a long period of time, but are not necessarily governed by the same structured ICC rules that traditional documentary products use. Nevertheless, industry practice and standards have demonstrated these instruments to be fairly widely used, fairly consistent in structure and application, and consistently low-risk. These are funded assets that in some cases originated as contingents. The key differentiating component of these financing methods are that they all support identifiable trade transactions.

1. Trade Loans

Trade loans occur when a lender grants a loan to a corporate or bank client to finance clearly defined trade transactions. The proof of the underlying trade transaction comes either from local regulatory practice (e.g. currency control), documentary evidence, or from the way the transaction is structured. Such evidence may include shipping documents or other documents that demonstrate the financing to be consistent with the goods or services imported/exported (e.g. tenor of loan is consistent with goods being financed).Loans typically come from a flexible short-term borrowing facility and may facilitate a pool of trade transactions (e.g. bank loans) or be linked to single transactions. Loans may be made against either corporate risk or bank risk.

A. Import Loans – provide financing for the importation of goods or services. These loans are often a bridge to enable importers to pay suppliers on a timely basis, while providing additional time to convert imported goods into cash receipts. Import loans are often made against evidence of shipment and/or supplier invoices.

B. Export Loans – provide financing for the exportation of goods or services. Export loans are typically needed to fund activities required prior to shipment. Loans may be made to banks to enable them to fund pre-export activity on behalf of their customers. Some banks may consider LC discounting a form of export loans, while others measure LC discounting separately.

2. LC Financing

Letters of credit are contingent instruments, that are payable only at such time as the terms of the letter of credit have been complied with. Nevertheless, there are instances when banks choose to advance funds during the course of the life cycle of the letter of credit, and certain events trigger the contingent liability to become on-balance sheet.

A. Negotiation - the purchase by the nominated bank of drafts (drawn on a bank other than the nominated bank) and/or documents under a complying presentation, by advancing or agreeing to advance funds to the beneficiary on or before the banking day on which reimbursement is due to the nominated bank. Banks often deduct the cost of advancing funds from the proceeds based on the expected time between the negotiation and reimbursement from the Issuing Bank.

B. Acceptance – the accepted draft under the LC becomes a negotiable instrument. The holder in due course can hold until maturity, or receive discounted funds in advance.

C. Bills of Exchange / Promissory Notes – a bill of exchange is a written order from the drawer to the drawee to pay the payee on demand or at a fixed date. A promissory note is a written unconditional promise to pay the payee (or bearer) on demand or at a date in the future. In negotiable form, these instruments also function similar to acceptances in that the holder in due course can hold until maturity or receive discounted funds. The difference being when the maker of a note pays the payee directly, rather than ordering a 3rd party to do so.

D. LC Refinancing / Post-Shipment Financing – through the wording of the LC, the issuing bank requests the presenting bank to pay the exporter through a loan granted to the issuing bank. At final maturity, the issuing bank repays the presenting bank the principal plus interest.

E. LC Financing by Reimbursement Bank - The Issuing Bank opens a Commercial LC and nominates a Reimbursement Bank which agrees to pay the reimbursement claim of an entitled claiming bank and grant a pre-agreed loan to the Issuing Bank. The Issuing Bank repays principal plus interest to the reimbursing bank at maturity.

3. Trust Receipts

When issuing a Trust Receipt, the bank enables the importer to obtain goods and/or shipping documents while retaining title/ownership. The importer that obtains the goods (or proceeds from sale of the goods) is obligated to identify and maintain them separate from other assets.

Payment is made by the importer by the Trust Receipt due date. Trust receipts may be set up as specific facilities, or may be treated as import loans.

4. Shipping Guarantees

A Shipping Guarantee is an indemnity that the bank executes jointly and severally with its customer in favour of a shipping company, enabling the importer to obtain goods without the actual title documents (e.g. bills of lading). This is used when the goods arrive prior to the actual title documents, and the buyer wish to obtain the goods so as to avoid demurrage charges or losses due to deterioration of goods (esp. Perishables).Settlement occurs upon

receipt and processing of the documents. Release of the Guarantee occurs after the surrender of the original bills of lading to the Steamship Company.

5. Forfaiting

Forfaiting is the sale of an export receivables transaction to a 3rd party for immediate payment at a discount. It includes a number of different underlying instruments including:

- Bills of exchange/promissory notes – negotiable instruments which provide for payment of a fixed sum on a fixed future date and which can be transferred to third parties through endorsement, assignment or novation. These instruments can also be used in other Traditional Trade Finance solutions.
- Deferred payment letters of credit
- Loans and payment undertakings/receivables including open account receivables
- Any other trade finance instrument that has a fixed value and maturity date

Forfaiting differs from factoring in that it is transaction-based as opposed to pool-based, and typically has relatively large transaction sizes. Forfaiting instruments may also carry the guarantee of a bank or foreign government. Transactions normally have a tenor of 6 months to medium-term (3-5 years), but may range from less than 6 months to upwards of 10 years. Forfaiters may hold the assets to maturity or trade them in a well-established secondary market.

Product Definitions for Open Account Trade Finance
BAFT-IFSA, December, 2010

Section 1: Introduction

Banks have provided trade finance services such as processing purchase orders and managing shipping information and associated documentation and have provided financing through traditional trade finance products (namely letters of credit) for centuries. With the advent of the internet and new technologies, the way buyers and sellers interact has evolved. More and more, trade transactions are handled on Open Account terms yet the need for Open Account transaction processing, servicing and financing (that build on the core trade services that banks have long provided) remains.

Open Account is a common trade term generally used by buyers to pay their suppliers for the purchase of goods without necessarily requiring 3rd party payment guarantees. New technologies facilitate collaboration among supply chain partners and provide more precise information, and thus allow banks to provide processing and financing services at various points throughout the life cycle of a trade transaction. These products and services are beneficial to buyers and sellers who have been developing deeper and more collaborative relationships to strengthen their supply chains to gain competitive advantage.

Given the rapid growth of Open Account trade there is a need for common understanding of the terminology used in these transactions. BAFT-IFSA, as part of its mandate to evaluate and guide standardization, improve risk management and enhance the role and relevance of financial institutions, has established the following definitions to provide clarity on Open Account-related products and services. They describe Open Account life cycles and identify

related trade service processing and financing services a bank may provide. Additionally, these definitions provide the necessary flexibility to encourage service customization and differentiation, factors critical to ongoing trade services and trade finance evolution and development.

Based on market feedback, BAFT-IFSA will build upon these definitions and will further international standards and documentation to govern Open Account transactions among financial institutions.

Section 2: Processing/Servicing Definitions

Open Account Processing leverages the existing trade services processing capabilities of financial institutions. It can include purchase order upload to create transactions, document examination and/or data matching, tracing and follow up for payment and payment services. An important activity in Open Account transaction Processing is the exchange and sharing of documents and document data which can be sent to a bank via a number of methods, including paper documents and electronic records hereafter referred to collectively as documents.

These processing activities which are further defined below can trigger Supply Chain Finance opportunities. A bank may engage in some or all of these activities and/or financing opportunities.

1. Purchase Order Advice

A purchase order specifying the goods and terms is created by the buyer. The seller is then notified of the purchase order and other shipping instructions through a collaboration platform, fax, email, portal or other method. Once notified, the buyer may require the seller's acknowledgement.

2. Document Checking and/or Data Matching

Documents are created and presented by the seller. Matching criteria under Open Account are defined by the buyer. They may consist of simple checking for the presence of all the required documents or detailed checking of specific data values within or among documents in an automated, semi automated, or manual fashion.

3. Discrepancy Handling/Dispute Resolution

If the matching results include discrepancies between the buyer's matching criteria and the presented document data, the buyer is typically notified to determine if the documents will be rejected or approved. For efficiency purposes, the buyer can preauthorize the bank to pay documents where there are no discrepancies. Dispute resolution enables buyers and sellers to resolve disputes related to Open Account activity on-line or via other methods of communication.

4. Management of Approved Invoices/Drafts

The bank manages the approved documents process with respect to potential financing and the scheduling of transaction settlement.

5. Document Payment

The buyer pays at maturity (usually the document due date) and the seller is paid or seller's financing (if any) is repaid with any remaining proceeds going to the seller.

6. Documents/Payment Reconciliation

When payment is received, the bank may, on behalf of the buyer and the seller, reconcile payment to the documents' value (usually the invoice/draft value) and keep track of PO balances.

Section 3: Trade Finance Definitions

Supply Chain Finance

As applies to Open Account transactions, Supply Chain Finance (SCF) solutions encompass a combination of technology and services that link buyers, sellers, and finance providers to facilitate financing during the life cycle of the Open Account trade transaction and repayment. The below financing opportunities fall within the overall definition of Supply Chain Finance.

1. Purchase Order Commitment to Pay

The buyer's bank issues its commitment to pay the seller (at sight or at maturity) once the seller ships and makes available the required documents that match the purchase order and other stipulated conditions. This service allows the seller to take the risk of the bank issuing its commitment to pay instead of that of the buyer.

2. Pre-Shipment Finance

Pre-Shipment Finance, also known as Purchase order financing, is made available to a seller based on a purchase order received from a buyer. This financing can cover all the related working capital needs of the seller including raw materials, wages, packing costs and other pre-shipment expenses. Once the goods are ready, refinancing or repayment can occur.

3. Warehouse Finance

Warehouse financing is a form of trade finance in which goods are held in a warehouse for the buyer, usually by the seller, until needed. At a minimum, warehouse receipts are commonly required as evidence for the financing.

4. Post-Shipment Finance

Post-shipment financing is provided to a seller using the receivable as collateral. The seller presents shipping documents as evidence of a receivable and the bank may also require a bill

drawn on the buyer for the goods exported. The bank may prefer to purchase and discount a bill drawn on the buyer for the goods exported.

5. Approved Payables Finance

Approved Payables Financing allows sellers to sell their receivables and/or drafts relating to a particular buyer to a bank at a discount as soon as they are approved by the buyer. This allows the buyer to pay at normal invoice/draft due date and the seller to receive early payment. The bank relies on the creditworthiness of the buyer.

6. Receivables Purchase

Receivables Purchase allows sellers to sell their receivables/drafts relating to one or many buyers to their bank to receive early payment. The bank may require insurance and/or limited or full recourse to the seller to mitigate the risk of the pool of receivables.

VI. APPENDIX B: SELECTED SOURCES AND REFERENCES

[Listed in Order of Citation]

Trade Finance During the Great Trade Collapse, IBRD/World Bank, 2011

Forum for International Trade Training (FITT), International Trade Finance Textbook, 2005

International Trade Procedures, Wells Fargo Bank

Rethinking Trade & Trade Finance, International Chamber of Commerce, 2013

The Challenges of Islamic Trade Finance in Promoting SMEs in IDB Member Countries, AbdelrahmanElzahiSaaid Ali, Islamic Research & Training Institute, 2013

Trade & Forfaiting Review Islamic Trade Finance Supplement, 2013

Islamic Finance in Europe, European Central Bank, 2013

ITC/UNESCAP Trade Finance Infrastructure Development Handbook, 2005

Trade Finance During the Great Trade Collapse, World Bank, 2012

Berne Union Yearbook, 2013

Trade and Trade Finance Developments in 14 Developing Countries Post September 2008, World Bank, 2009

International Trade Statistics, WTO, 2012

Supply Chain Finance: From Myth to Reality, McKinsey, 2010

World Bank Independent Evaluation Group: IFC GTFP Evaluation, 2013

Asian Development Bank Trade Finance Survey, 2013

Export Credit Agencies Product and Services Comparison, ECGD 2010

US Exim Bank ECA Competitiveness Report 2012

Turning the Crisis to Advantage in Structured Finance, McKinsey 2010

How to Access Trade Finance: A Guide for Exporting SMEs, UN ITC, 2009

SWIFT/ICC Industry Education Group on the Bank Payment Obligation, 2013

Internationalization of EU SMEs, European Union, 2010

Short Term Trade Finance Program (Presentation) IFC, 2010

Trade Financing and Regional Financial Institutions from a South-South Perspective, UNCTAD 2012

Insights: Islamic Trade Finance, MIIFC, 2013

Islamic Centre for Development of Trade, 2013

Annual Report on Trade Between the OIC Member States
Islamic Centre for Development of Trade, 2013

Trade Outlook 2013, COMCEC

Islamic Banking Competitiveness Report
Ernst & Young, 2013

Connecting to Global Value Chains, IDB Group 2013

African Development Bank Group Strategy 2013-2022

Global Review of Aid for Trade, UNECA, 2009 (Extract)

ITFC Progress Report on Enhancing Intra-OIC Trade, 2013

Scaling Up Capacity Development in Trade Finance [Africa], World Bank, 2005