Trade Finance: A Catalyst for Asian Growth

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Executive summary
"Up to 80% of global trade is supported by some form of financing or credit insurance", Roberto Azevêdo, WTO Director-General, in opening the seminar on "Trade Finance in Developing Countries" at the WTO on 26 March 2015. WTO estimates global trade around USD18 trillions

Trade and its growth critically depends on access to funding. This is especially true for Asia, the largest trading region and the first market for trade finance.
In this report, we first assess the state of trade finance market in Asia, then we identify the latest trend. We conclude by providing a synopsis of the necessary steps that will help sustain trade growth in emerging Asia and insure its impact on GDP growth. The key points are as follows:

- The impact of trade liberalization on countries 'growth is very short lives in absence of financial deregulations

- Trade in Asian countries relies heavily on letters of credit (L/Cs) which leaves a lot of unmet credit needs, especially for SMEs.
- Several alternatives are slowly emerging, from banks (factoring, supply chain finance), but also from non- banks (Global and Regional Value chains and inter-firm trade credit).

- On the investors' side, trade receivable assets (via securitization or direct investment) is considered as an possibly attractive alternative due to new financial regulation and low interest rate.

- Trade receivable assets offer attractive alpha yield opportunities, consistent returns, low volatility, "real Economy" investment and lower defaults rates than any other interest based asset class, and a behavior uncorrelated to the market.

- Policy recommendations to help expanding lenders and investors/capital pool:
    - Streamlining the trade finance process,
    - Uniformisation of international regulations
    - Strengthening of the institutions helping to mitigate risk
    - Dematerialization of the process (use of technology)

Contents

Introduction

"Up to 80% of global trade is supported by some form of financing or credit insurance", Roberto Azevêdo, WTO Director-General, *in opening the seminar on "Trade Finance in Developing Countries" at the WTO on 26 March 2015.* WTO estimates global trade around USD18 trillions.

The resurgence of international trade treaty discussions confirms the perception that trade is one of tomorrow's engine of growth. However, without a strengthened access to trade finance or trade credit for SMEs, especially in less developed economies, the impact of these treaties will remain limited.

While the main markets have reverted to normal conditions, this return has been uneven. In its latest survey on the subject, the Asia Development Bank (ADB) reports growing rejection rate of funding requests from Asia, especially SMEs. Its estimates the unmet global demand for trade finance for developing Asia could be as high as $1.1 trillion in 2013.[2] Being the largest user of trade finance globally, Asian economy also strongly relies on its SMEs as they generate up to 50% of the Asia-Pacific GDP while employing up to 50% of the labor force. The lack of access to funding is often identified as the reason why SMEs account for only 35% or less of direct exports. From the supply side, the International Chamber of Commerce (ICC) Global Survey 2014 confirms such findings: respondent banks acknowledge a shortfall in global trade finance supply for SMEs and identify increasing compliance and regulatory burden as one of the key impediment to trade finance.[3]

The Asian-Pacific region became the " *biggest trading region in the world, in terms of both imports and exports, overtaking Europe in 2012",* accounting for close to 36% of global merchandise export and import. [4] In 2013, close to half of the trade of merchandise of the Asian-Pacific region was intraregional, while the share of the region in global exports of commercial services was 27.7%. Six countries claim the majority share (67.5%): China; Hong Kong, China; India, Japan, the Republic of Korea and Singapore. The establishment of the ASEAN Economic Community, targeted for December 2015, should strengthen such a trend by lowering trade barriers between countries in Southeast Asia. This single market should ensure free flow of goods, services, investment and skilled labor and capital. This would be the latest of several agreements that took place since 2000 with ASEAN main trade partners such as Australia, China, Indian, Korean, and New Zealand.

However, previous experiences have shown that the impact of trade liberalization on countries 'growth is very short lives in absence of financial deregulations. Peter and Schnitzer(2012) illustrate this with to the North American Free-Trade Agreement, "after the trade agreement,

[2] The Asian Development Bank (2014) estimates that close to 2/3 of that amount can be attributed to China and India.
[3] ICC global survey (2014) is based on data from 298 banks in 127 countries.
[4] UN ESCAP (2014)

Mexico increase its GDP and its exports. However, due to institutional gaps, in particular credit market development, the productivity gap with respect to the USA and Canada did not close". Furthermore, Chang et al. (2009) show that financial and trade liberalization tend to amplify each other impact on growth. In the ASEAN case, the trade integration requires financial integration. The ASEAN Financial Integration Framework (AFIF) has been approved in 2011 and has a target end-date of 2020. However in a recent intervention, Ravi Menon, Managing Director of the Monetary Authority of Singapore expressed his concern regarding the slow development observed in the AFIF.[5]

This report investigates the latest developments in trade finance in Asia, with a focus on ASEAN countries. Asian trade strongly relies on bank intermediated trade finance. However, such tools tend to focus on firms' credit worthiness and are unable to accommodate a large part of the SMEs' requests, especially in the less developed ASEAN countries. As a result, several alternatives such as inter-firm credit or Global and Regional Values Chain are becoming more popular. The financial crisis, its subsequent financial regulations and the US new compliance rules have also a significant impact on trade finance in Asia. The withdraw of European banks allows regional banks to gain market share, yet the fragmented infrastructure and support system (banking, insurance, advice, network) is one of the main concern when it comes to SMEs and less developed countries access to funds. We argue that the regional effort of integration must be combined with procedure standardization and dematerialization. Simultaneously, policy makers should create an international set of criteria to streamline the trade finance process. These proposals will help widening the pool of lenders and investors.

In this report, we proceed as follows. Section 2 provides an overview of trade finance while focusing on the Asia's specificities, especially the reshaping of its banking landscape as a byproduct of new financial regulations. Section 3 discusses trade finance as a class of assets while section 4 concludes on few recommendations tailored to the ASEAN region.

Finance trade in Asia

State of the Market

International trade must work around a fundamental dilemma: how to bridge the time gap between when the exporter wishes to be paid and when the importer will pay for the merchandise. Trade finance (letter of credit (L/Cs), documentary collection, import and export loans…), trade credit (cash-in-advance and open accounts) and export credit insurance are key elements in facilitating such transactions. Box 1 lists some useful definitions. These alternatives exist to protect both importer and exporter from the risks, such as non-completion or foreign exchange risk, as well as to provide means of financing.

[INSERT BOX 1 HERE]

[5] Menon (2015)

The lack of uniform data makes the estimation of the trade finance's composition rather difficult and imprecise. So far, the consensus among the IMF, the BAFT-IFSA, the BIS and the ICC is that the bank-intermediated transaction represents between 30% and 50% while inter-firm trade credit funds the rest.[6] Asia Pacific is the region relying the most heavily on trade finance: a measure of the usage intensity, column "percentage of merchandize trade" in Table 1, reports an estimated average between 36% and 40% for the world compared to 47%, 41% and 56% for China, India and Korea, respectively. Furthermore, Asia accounts for more than 50% of L/Cs' usage.[7] This regional specificity has various logistic and economic roots such as long distance trade transactions between partners, level of local market efficiency, weaker legal and contractual systems, less financial development and higher political risk, historical preferences, costs of operating through L/Cs, etc. Ahn (2015) emphasizes that most of the countries in the Asian-Pacific region have foreign exchange regulations or strict banking regulations, and that some governments, such as in China, use explicit policy requirements favoring L/Cs.

[INSERT TABLE 1 HERE]

Heavy reliance on these traditional modes of payment is no longer sufficient to meet market requirements and unmet credit needs: Asia, especially SMEs, cumulates the most unfunded requests.[8] Hence several alternatives are emerging, whether they are provided mostly by banks, such as factoring, or by non-banks such as global and regional chain values and intra-firm trade credit.

Factoring is an asset-based financing method for increasing working capital. A factor (80% of the Factors Chain International are commercial banks) can assist an exporter with financing through the purchase of invoices or accounts receivable: the factor purchases the exporter's short-term foreign accounts receivable for cash at a discount from the face value. It assumes the risk on the ability of the foreign buyer to pay, and handles collections on the receivables. By focusing on the value of the receivables instead of the firm's creditworthiness, factoring is a great alternative to loans for SMEs. It is gaining popularity in Asia-Pacific, representing close to 30% of the global cross-border factoring volume in 2013 compared to 12% in 2007. Figure 1 also shows a change in the Asian key players: Japan which used to be the Asian leader in factoring in 2007 is, in 2013, at the same level than Taiwan while China takes the lead accounting for 12% of the world factoring market and 63% of the Asian market.[9]

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[6] As a share of global trade, the Group's estimate is somewhat lower than what has been reported from surveys conducted by the IMF and BAFT-IFSA (2009, 2010, 2011)). In those surveys, participating banks estimated that about 40% of global trade was supported by bank-intermediated trade finance, with the remainder funded on an open account or cash-in-advance basis. On the other hand, some industry studies put the share of trade covered by trade finance much lower, at around 20%.

[7] See BIS (2014)

[8] See ADB(2014) and Enterprise survey (2014).

[9] *Forfaiting* is another alternative based on receivable discounting, it typically involves medium-term accounts receivables for exporters of capital goods or commodities with long credit periods.

[INSERT FIGURE 1 HERE]

The emergence of preferential trade agreement since 2000 facilitates the development of Global and Regional Value Chains (GCVs and RCVs) in the region, as an alternative to the bank intermediated trade finance.[10] GCVs refers to the full range of cross-border, value-added business activities that are required to bring a product or service from the conception, design, sourcing raw material, and intermediate inputs stages, to production, marketing, distribution and supplying the final consumer. Many regional enterprises have participated in GVCs, especially in the sectors of automotive, electronics, food and apparel/garment. So far, Asia-Pacific SMEs play a limited role due to low value-addiction and lack of proper network.[11]

Finally, inter-firm trade credit is an alternative system relying on business relationship and trust between importers and exporters. It uses either open account or cash-in-advance. While this type of transactions entails lower fees and more flexibility, it has a higher payment risks. As a result, most of the firms using this solution have either well-established commercial relations or, given the expanding role of global multinational companies, are affiliated companies. So far, these flows remain relatively small.

Who are the lenders: regional versus international?

The recent financial crisis as well as the subsequent financial regulations (Basell III, Know You Customer, Dobb-Frank…) forced a deleveraging process, especially for European banks. See Box 2 for a detailed illustration on the impact on the Asian syndicated loan market. The short-term nature of trade finance, 90 days for L/Cs and 105 for loans, makes it an easy target when banks need to reduce rapidly their exposures. Figure 2 shows the withdrawal of European banks allowed regional banks to build market share: the European banks reduce their deal participation from close to 90% in 2007 to 50% in 2014. In contrast, Asian banks led close to 50% (31% of which is Japanese banks) of the deals in 2014 compared to around 10% on 2007. For several regional banks, such a window of opportunity became part their ongoing international expansion in the key emerging market regions, especially with the rise of South-South trade. Besides providing support to the trading activities of domestic corporations, as follow-your-client strategies, trade finance allows new comers to build client relationships and, eventually, to offer a wider range of banking services. American and Australian banks also gain market shares.

[INSERT FIGURE 2 HERE]

[INSERT BOX 2 HERE]

[10] Since 2000, more than 70 preferential trade agreements have been signed so far, the bulk being bilateral but a growing share is plurilateral. See Baldwin and Kawai (2013).
[11] See ESCAP(2007) and WTO(2013), Global value chains in a change in world

Trade Finance Assets

Securitization

Banks' lending capacities are under pressure mainly for two reasons. First, the growth of trade generates a growth in demand in trade finance that is not compensated by the introduction of new financial intuitions. Second, Basel III regulatory demands (raised capital requirements, reduced leverage and placed liquidity requirements on banks) provide a new incentive for banks to either reduce trade finance exposure or to find an alternative to remove them for their balance sheet. The later may explain the recent surge of securitization deals as reported in Table 3. By establishing an origination and funding platform for trade banks with global market position, securitization programs can help them addressing challenges such as capital management, liquidity, increased credit constraints and the new capital requirements. Banks have the ability to fund their originated trade finance assets in a capital and balance sheet efficient manner through issuances of medium- term asset backed securities, enabling them to increase the efficiency of their capital dedicated to trade.[12]

[INSERT TABLE 2 HERE]

Global trade finance assets are estimated around at $14-16 trillions, only a small bit of which has been securitized. In comparison, the size of the U.S. mortgage loan market is about $13 trillion, 65% of which are securitized into either agency or non-agency MBS.[13] The potential for securitization is reinforced by the record low default rate of trade finance assets: the average default rate on short-term international trade credit ranges from 0.03% to 0.2%, with a recovery rate of 60%, when comparable corporate bond default rate ranges from 0.5% to 4.6%. (See Table 3) Although investors are attracted by the low-risk nature of trade finance assets, they also require granularity and diversity in the underlying reference pools to avoid cases such as the BNP Paribas Lighthouse vehicle: focusing on energy commodities from Eastern Europe, it ended early due to the Ukrainian crisis, as it lacked the trade finance deals needed to support the structure.

[INSERT TABLE 3 HERE]

As things stand, the Citibank-Santander issuance, MAPS 1, is the first to use a joint-origination model, allowing great scale and country diversification in its underlying pool of trade assets, as well as better access to dollar funding for participating banks. (see Table 4)[14] The creation of a much larger inter–bank securitization pool, larger than any single bank can possibly provide, increases diversity and lowers concentration risk for investors. Yet, the average loan size of the MAPS 1 securitization is rather large, above $140 million. More recently, the IIG Trade Finance

[12] Citigroup (2011).

[13] Agency MBS are securitized or guaranteed by Government-Sponsored Entities (e.g. Fannie Mae, Freddie Mac, Federal Housing Administration, etc.), while non-agency MBS are securitized by private mortgage conduits.

[14] Santander has a strong presence in Latin America and Europa whereas Citibank provided the United States and Asia exposure.

proposes an alternative program, the first to use a pool of trade finance loans structured by a non-bank, openly interested in including small and medium sized trade-oriented enterprises: up to 85% of the notes are backed by short-term trade finance loan advances to small and medium-size enterprises engaged in the processing/export of physical commodities, such as cotton, frozen beef, frozen shrimp/seafood, powdered milk and soybean meal.[15]

[INSERT TABLE 4 HERE]

Finally, yield is a key factor for investors. To achieve higher yields than traditional trade finance business can normally offer, the collaterized loan obligations are sliced into tranches, allowing a 'high yield' piece. Hans Krohn, Head of Trade Products at Commerzbank, describes the CoTrax deal as follows: the pool of assets was sliced into a senior tranche, a first loss piece, which Commerzbank kept, and a US$27 million mezzanine tranche; US$22 million of which was successfully placed with intuitional investors. Similarly, in the Citi MAPs structure, a total of four classes of notes publicly rated by Standard & Poor's and Fitch Ratings were sold. The investment grade tranches were floated at one month Libor + 70-225 bps, while the B/BB tranche was priced at one month libor + 500 bps. By comparison, the average floater spread of AAA global bond instruments was one month Libor + 37 bps, and one month Libor +178 bps for BBB-rated instruments.[16]

Potential and challenges of trade finance investments

Regulatory and compliance arbitrages as well as yield-search, especially in the current low interest rates environment, have moved trade finance and its multi trillion market into sights of institutional investors. As previously discussed, trade finance instruments range from direct to securitized investments, while most trade finance loans have a short duration and are sponsored by large corporations or B2B and Supplier network. Some long-term options, 10 to 12 years, also exist to finance large-scale trade among firms like Airbus SAS, Boeing Co. and General Electric Co.

In today's short-term fixed income environment, trade finance and trade receivable assets offer several interesting features: attractive alpha yield opportunities, consistent returns, low volatility, "real Economy" investment (that is tied to specific commercial transactions) and lower defaults rates than any other interest based asset class. Furthermore, its low duration provides great diversity benefits as its risk is more contract than market related, making it mostly an uncorrelated asset class. However, several challenges stand in the way of a full democratization of such assets among a broader pool of investors.

First, most investors lack exposure to and understanding of these assets. Traditionally, trade finance is a bank dominated world where the products are focused on the origination side of

[15] IIG trade Press release, February 10th, 2014

[16] Aggregated Bloomberg data from SRCH and LSRC between 1/1/2014 and 6/24/2015. Aaa to Aa3, and Baa1 to Baa3 used, assuming a one-year default probability of 0.20%.

the business. As a result, it lacks standardized procedures: required documentation can vary enormously from deal to deal as trade involves multiple parties across a wide range of jurisdictions, bankruptcy laws, tax regimes, and sovereign risk ratings. Many institutional investors are currently building the necessary in-house expertise and sector knowledge in order to take advantage of this asset class.

Second, there is the need of streamlining the overall procedures. The lack of consistency in terms of due diligence under law, from country to country combined with the increasing cost of compliance to regulations, such as Anti-Money Laundering/ Know Your Costumer, call for an international standardization and simplification of procedures as well as uniformization of financial regulations, bankruptcy rules and payment systems. In other words, while banks should aim to implement master agreements for trade finance deals that providing yield, security, and granularity in the asset reference pool, policy makers and regulators should help standardizing the documentation required.

Improved document standardization and increased investor awareness of the benefits of trade finance assets may have several beneficial consequences. First, it will help in strengthening the resilience and in reducing the fragmentation of access to trade funding. Second, the *originate to distribute* trade finance model will help mitigate the issues linked to new banks' capital requirements issues. And third, it will offer investors an uncorrelated and safe/stable asset class. However, all this rely on a key and costly element: to put in place the required infrastructure (custodians, asset managers, risk mitigation mechanism, etc...).

Concluding remarks

Access to finance is often identified as the most important obstacle in business operations, especially for SMEs. This is particularly true in Asia, where SMEs are a key player in implementing a growth strategy that is geographically and sociologically shared. The infrastructure discussed previously meets some specific challenges in the ASEAN region due to its heterogeneous degree of economic and financial developments. Figure 4 shows the countries' financial depth (size of the core liabilities over GDP), maturity (fraction of total liability held by non-depository financial institutions) and the risk classification provided by the OECD, dictating fix the minimum premium rates for credit risk.[17] These challenges can be sorted around three mains axes of improvements.

Strengthening and broadening pool of lenders and instruments: Figure 3 suggests that most of ASEAN countries strongly rely on banks to have access to funding; hence a resilient and well geographically implemented banking network is key. Similarly, corporations are becoming more interested in supply chain finance programs as they must insure access to funding to all its suppliers, especially in a period of enhanced regulatory burden and in a highly fragmented

[17] Core liabilities are retail deposits of domestic household and business while non-core liabilities encompasses the other major forms of funding such as lending between banks or foreign lending and include sources for banks and other financial intermediaries.

region, in terms of currencies, legal jurisdiction, regulations, languages etc… The establishment or the strengthening of government-backed export credit insurance and guarantee intuition or export-import banks (EXIM) would help mitigating risk and facilitate access to affordable funding by reassuring current lenders and attracting more trade finance providers. Similarly, international institutions, such as ADB should be supportive of non-bank intermediated trade finance instruments. Narain (2015) suggests the creation of an Asia-Pacific Trade Development Fund that would provide a collateral-free guarantee mechanism to companies.

[INSERT FIGURE 3 HERE]

Technology assisting trade finance: Dematerialization of trade finance is necessary and new technology can ease that process. As an illustration, on-line procurement mechanism and electronic repository for information required for trade transactions may help expending geographically the network of providers, reducing their costs while enhancing transaction transparency. Even B2B direct lending may provide a solution for affordable trade finance access to SMEs but the suitable infrastructure need to be created (custodians, legal and regulatory framework, better monitoring and risk rating of the markets…).

Broadening the pool of capital: streamlining the process, that is better infrastructure, more reliable risk assessment and easiness to do business, will automatically attract more investors. While securitization is at its early stage, it may be the easiest channel to democratize trade finance investment.

Finally, the ASEAN region needs to complement its trade integration with a financial one. Yet the later one requires some degrees of economic convergence. A broader participation to GVCs may help achieving a shared GDP and employment growth. More specifically, the future engagement of SMEs in GVS strongly relies on the existence of an adequate infrastructure: access to institutional funding for new or riskier market out of banks' network, business developments services and incentives for larger firms to include SME in their supply chains.

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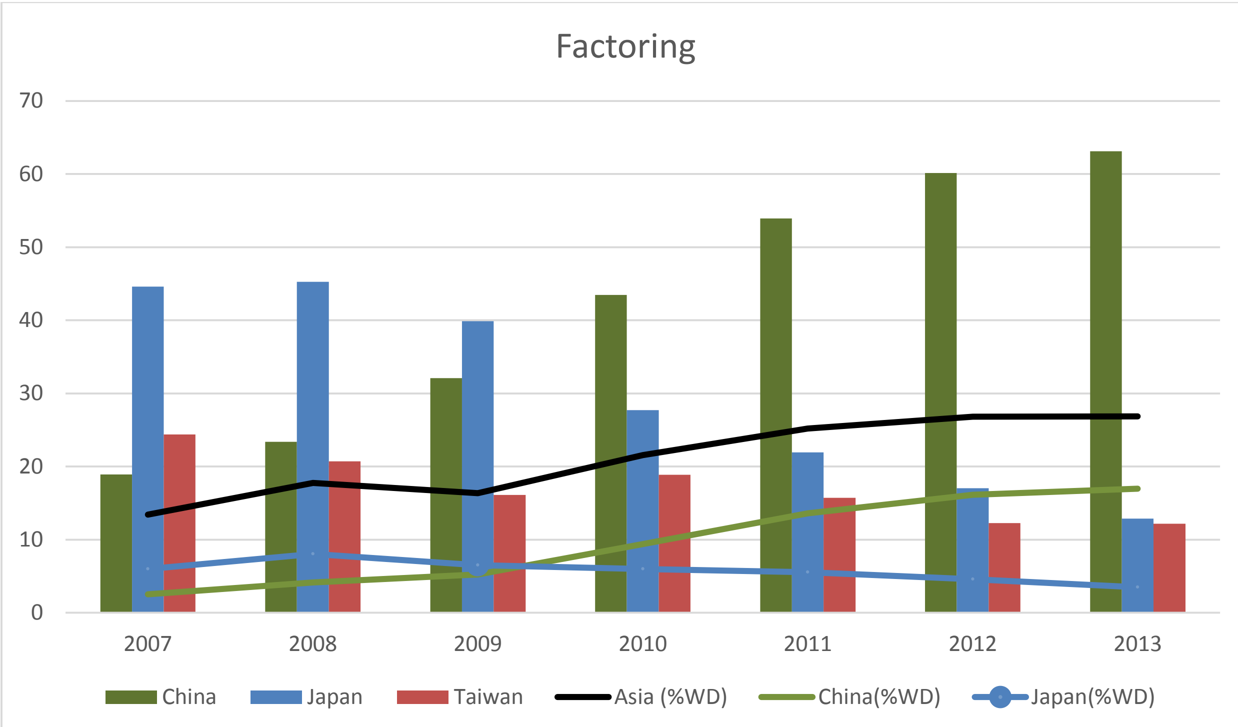
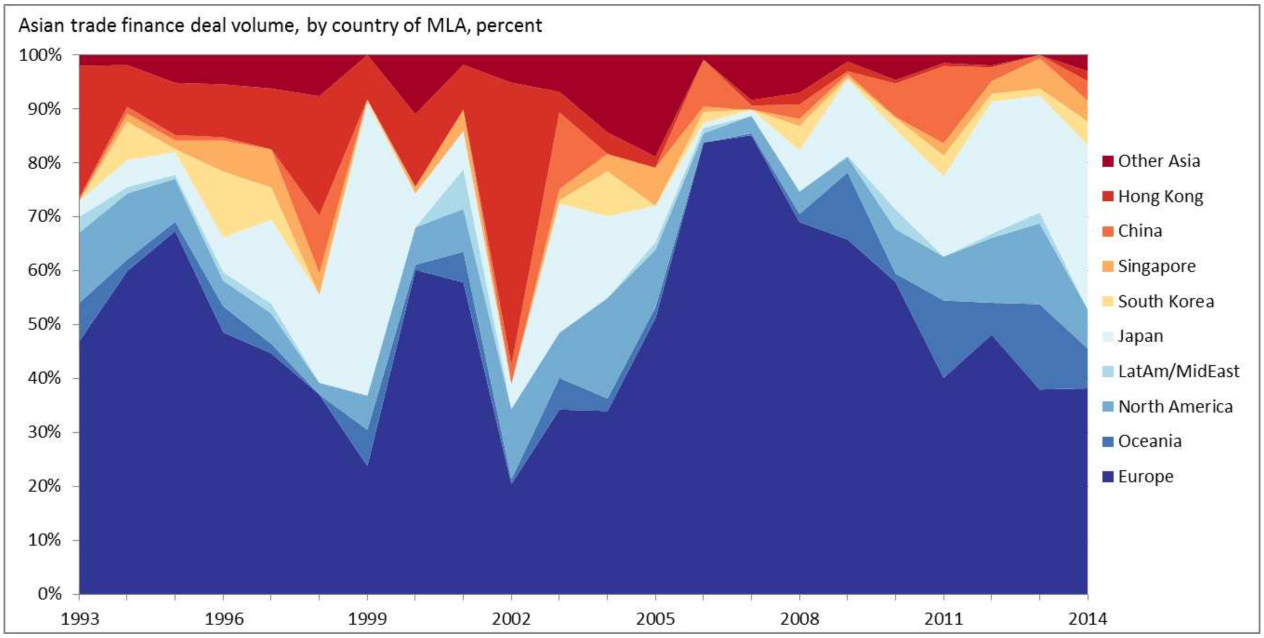
FIGURE 1: ASIAN BANKS STEP IN TO LEAD ASIAN TRADE FINANCE DEALS



Source: Factors Chain Annual review (2014)

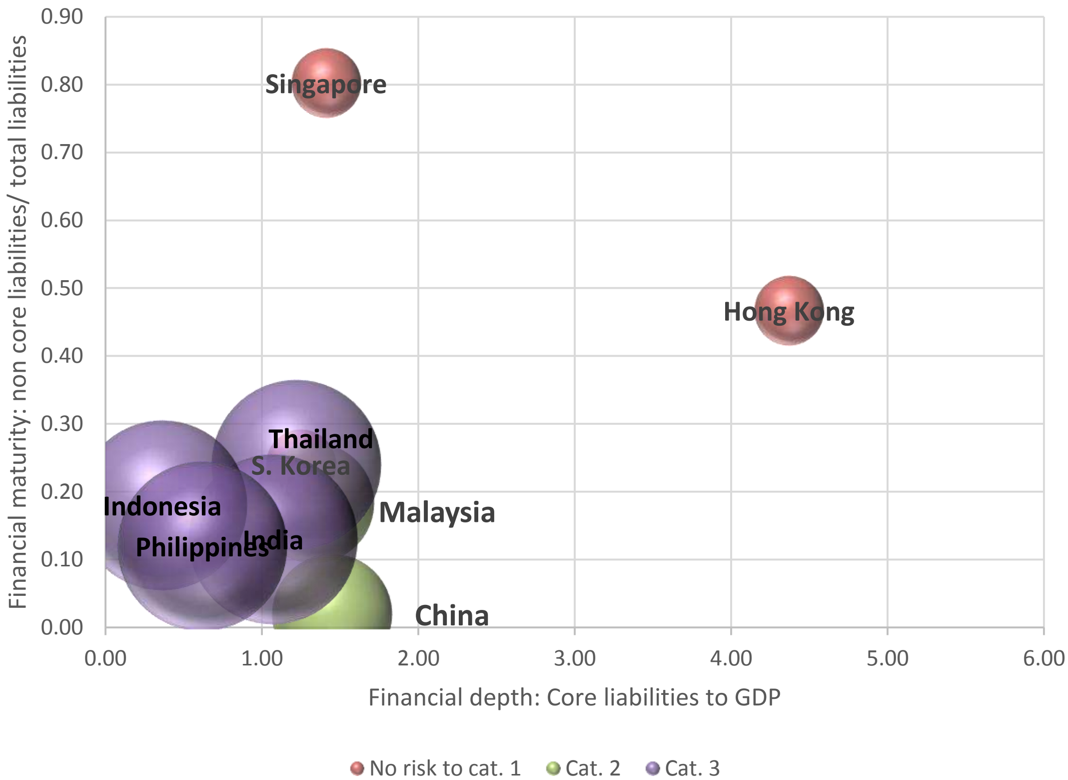
FIGURE 2: ASIAN TRADE FINANCE DEAL VOLUME, BY COUNTRY OF MANDATED LEAD ARRANGER



Source: Dealogic.

Note: Credit for deal is assigned by the country of the mandated lead arranger, and not of bookrunner or lender involvement.

FIGURE 1: COUNTRY FINANCIAL DEVELOPMENT AND RISK ASSESSMENT[18]



Source: Lopez, Markwardt and Savard (2015)

[18] While the liability information is not available for all ASEAN countries, we can still report the country's risk classification for the remaining ASEAN countries: Brunei(2), Cambodia(6), Laos(7), Myanmar(7), Vietnam(5). The scale is from non-rated, for the safest countries to 7 for the riskiest.

TABLE 1: BANK-INTERMEDIATED TRADE FINANCE MARKETS IN 2011

Country	Trade finance (US$ billions)		Percentage of merchandize trade
	stock	annual flows	
Global estimate	1625-2100	6500-8000	30-35
L/Cs (SWIFT)		2782	15
ICC trade register		1958	11
China	218	871	47
Hong Kong SAR	44	131-175	29-38
India	82	164	41
Korea	76	304	56

source: BIS(2014)

TABLE 2: ANALYSIS OF SHORT-TERM TRADE FINANCE PRODUCTS - RISK CHARACTERISTICS

	Customer default rate (%)	Moody's rating with same default rate	Transaction default rate (%)	Global Corporate Bond Default Rate[19]
Export L/C	0.03%	Aaa-Aa	0.00%	0.49%
Import L/C	0.12%	Aa	0.04%	0.99%
Performance Guarantees	0.16%	Aa-A	0.03%	2.73%
Loans for Import/Export	0.24%	A-Baa	0.04%	4.61%

source: ICC(2014)

[19] Average Cumulative Moody's 10-Year Default Rate.

TABLE 3: MAIN SECUTITIZATION DEALS SINCE 2006

Date	Vehicle	Issuing Banks	Type	Details
2006	Trade CABS I	Citibank	Synthetic	$199 mln, 5 tranches.
2007	Sealane I	Standard Chartered	Synthetic	$3 bln, 4 tranches, $120 mln equity tranche, 85% of borrowers from Asia Pacific and MENA.
2011	Sealane II	Standard Chartered	Synthetic	$3 bln, 4 tranches, $180 mln equity tranche; metal and mining, energy, oil and gas, and food and beverage, with 88% of portfolio from Asia, India, and MENA.
2012	Trafigura	RBS	True sale	$430 mln, 2 tranches, oil, metal, coal.
2013	Lighthouse	BNP Paribas	True sale	$132 mln; 4 tranches; oil, metal, energy; backed by assets originated by Geneva office to mostly commodities sourced from Eastern Europe.
2013	CoTrax II-1	Commerzbank	Synthetic	$500 mln, 3 tranches, $22 mln mezzanine tranche, 74% of portfolio (18 countries total) from Asia, Latin America, and Russia.
2013	Trade MAPS I	Citibank, Santander	True sale	$1 bln; 4 tranches; top borrowers include financial intermediaries, agriculture, transportation, oil & gas; backed by assets originated by both banks' branches or entities in Asia, Latin America, Europe, Middle East and North America.
2014	TFF I	IIG Trade Finance		$220 mln; 3 tranches, $33 mln income tranche; backed by non-bank trade finance loans; soft commodities (i.e. cotton, agriculture, seafood); borrowers from Latin America.

Sources: Bank press releases and prospectuses, Structured Finance News, Trade Finance Magazine, Trade and Forfaiting Review.

TABLE 4: MAPS I AND COTRAX II-1 UNDERLYING LOAN DISTRIBUTION

Country of Exposure	% of Loans MAPS I	Country of Exposure	% of Loans CoTrax II-1
United States	86.2	**Brazil**	23.0
Latin America	1.0	**China**	22.0
Asia	10.9	**Panama**	12.0
Europe	1.7	**Russian Federation**	7.0
Other	0.1	**Other**	36.0

Source: MAPS I prospectus and Krohn (2014).

Box1: Definitions[20]

Letters of credit (L/Cs) have short-term tenors (less than 90 days). An *import L/C* is a commitment by a bank on behalf of the importer that payment will be made to the exporter, provided that the terms and conditions stated in the L/C have been met, as verified through the presentation of all required documents. The importer pays his bank a fee to render this service, while the goods that are being transacted serve as the bank's collateral. The exporter, in turn, may engage its own bank to provide an *export confirmed L/C*, which would guarantee the payment from the importer's bank. An L/C is useful whenever reliable credit information about a foreign importer is difficult to obtain, but the exporter (or its bank) is satisfied with the creditworthiness of the importer's bank. The L/C protects the importer because no payment obligation arises until the goods have been shipped or delivered as promised, removing the risk of shipment of goods other than those ordered.

Documentary collections is a transaction whereby the exporter entrusts the collection of payment to the remitting bank (exporter's bank), which in turn sends documents to a collecting bank (importer's bank), along with instructions for payment. Funds are received from the importer and remitted to the exporter through the banks involved in the collection in exchange for those documents. The banks' liability is limited to the forwarding and release of documents against payment and acceptance or promise of payment by the importer.

Import and export loans, which may entail the bank advancing cash to the importer or exporter on presentation of appropriate documentation. This type of financing may also be linked to an L/C.

Supply chain finance (SCF) is a relatively new and expanding business area for banks that entails combinations of technology and services to facilitate processing and financing of payables and receivables within a global supply chain. The supply chains are typically anchored around the global purchases and sales of a major retailing or manufacturing firm. The financial services within the SCF platform may involve many elements of traditional trade finance (eg pre-shipment or post-shipment finance, receivables purchases or discounting), with the notable exception of letters of credit. Attractions for participants include the possibility of optimising payment and financing terms to suppliers and improving working capital both for suppliers and sellers. Because the supply chain funding centers on purchase commitments by the buyer, SCF offers the possibility of funding rates based on the buyer's credit worthiness or rating rather than on the supplier.

In **open account** transactions, the exporter extends credit to the importer by shipping and delivering goods before payments are due (which is usually within 30 to 90 days). This option is the most advantageous to the importer in terms of cash flow and cost, and consequently presents the highest risk for the exporter, who is exposed to the risk of non-payment.

In **cash-in-advance transactions**, the importer pays the exporter upfront, and the associated cash flow and settlement risks are reversed. This option is less frequently used.

[20] See BIS(2014), Appendix 2.

Export credit insurance enable exporters to mitigate the risk of non-payment. They can buy the insurance from private insurance firms (typically for shorter-term financing) or obtain guarantees from public export credit agencies or ECAs (typically for export loans of two years or longer). These firms typically insure against default by the importing firm and political risk. Banks may also seek ECA guarantees for particular international trade transactions to mitigate risks of non-payment from other banks or from customers.

Box2: Overall Financing Landscape in Asia since the 07-08 crisis:

Prior to the crisis, Asian countries, especially in the ASEAN region, had been dependent on European and US loans, and financing in general. In 2006 $18 billion of the total $24 billion of syndicated loans to Singapore were originated outside of Asia, an almost ubiquitous pattern throughout the ASEAN group (see Figure B1).

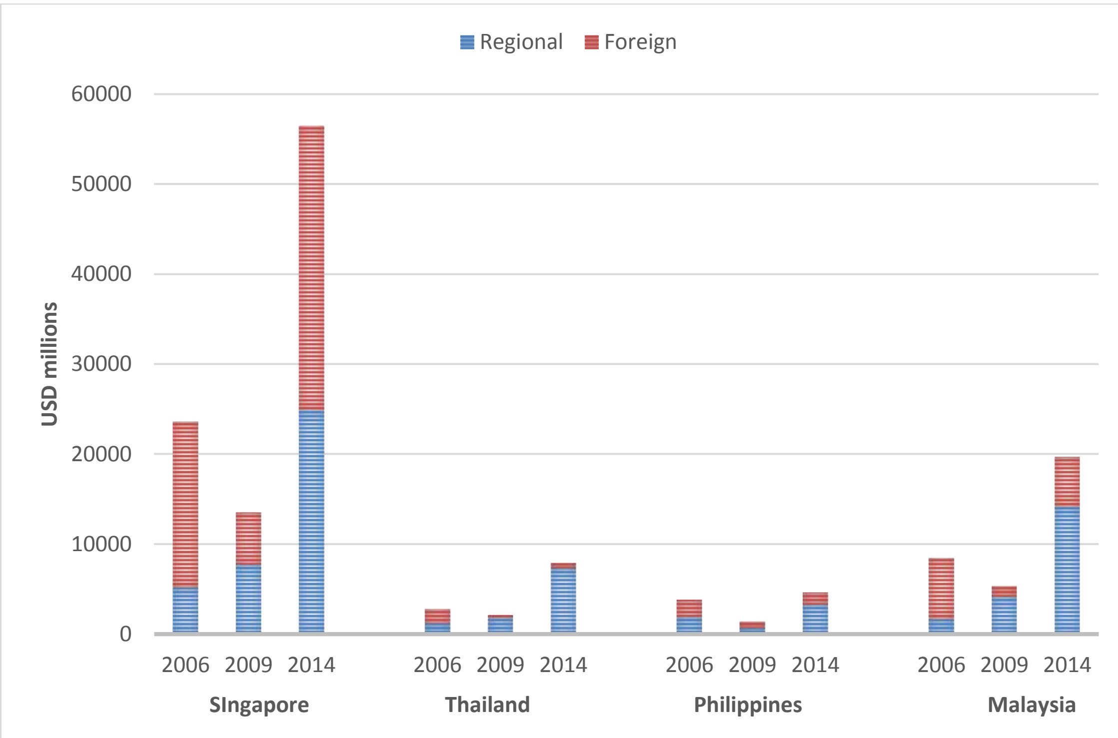


FIGURE B1 : SOURCE OF SYNDICATED LOANS IN 2006 AND 2009. SOURCE: BLOOMBERG.

With the unfolding of the financial crisis, however, most European and US banks started a deleveraging process that reduced their positions in many ASEAN countries. The change in the origin of lenders however was not only limited to a reduction of the foreign banks reducing their share of syndicated loans: regional banks provided additional loans in comparison to the pre-crisis era. Meaning that regional banks took over, or stepped in, to fill the liquidity gap as foreign banks withdrew their engagement.

During the deleveraging process foreign banks prefer to reduce foreign loans rather than those extended to domestic borrowers. Commercial banks, the main providers of syndicated loans, seemed to have based the decision on their engagement in the specific countries. The deleveraging process, therefore, was most marked in regions where they possessed no established subsidiaries or partnerships. Figures B4 and B5 summarizing syndicated loans. It is worth noting that subsidiaries of foreign banks are mostly accounted for in the foreign share of loans.

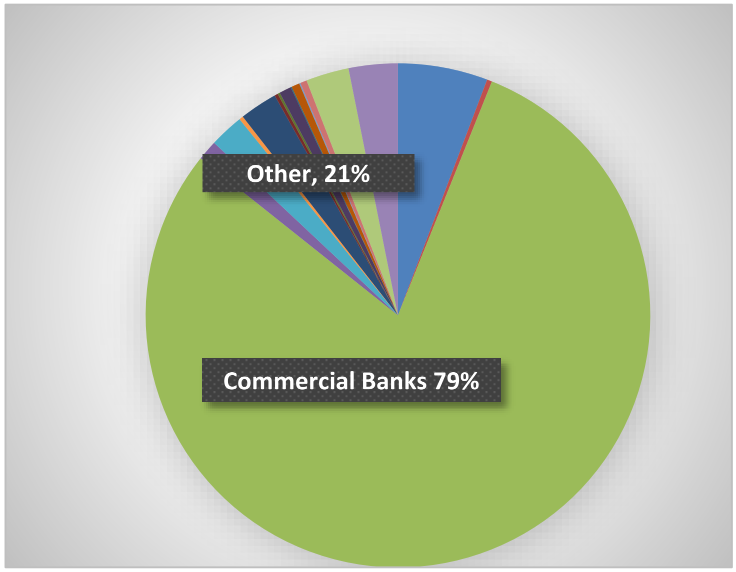


FIGURE B2: LOAN PROVIDER (2014) BY SPECIALIZATION. SOURCE: BANKSCOPE.

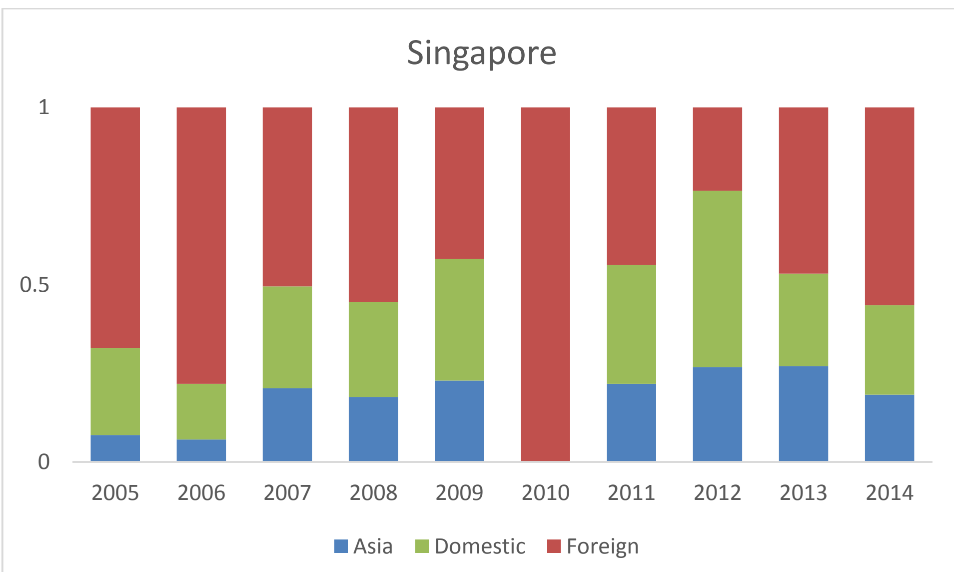
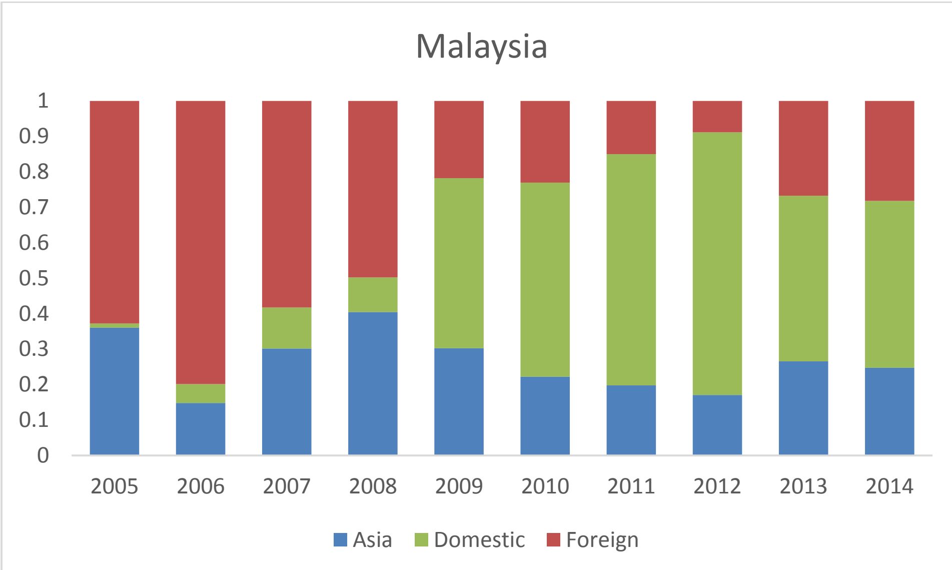


FIGURE B2: ORIGIN OF SYNDICATED LOANS AS SHARE OF TOTAL AMOUNT. SOURCE: BLOOMBERG

Overall, countries with a lower percentage of foreign banks, such as Thailand and Malaysia, with 20% and 40% of foreign banks respectively, were more affected by the deleveraging process of banks. Local banks had to step in to buffer the withdrawal of foreign loans. The main reason being the missing link of a subsidiary or network in the specific local to the foreign lending bank. In the case of Malaysia the percentage of syndicated loans provided by national banks increased from 11% in 2007 to 48% in

2009, a total increase of $1 billion. Yet, foreign banks remained in financial hub such as Singapore.



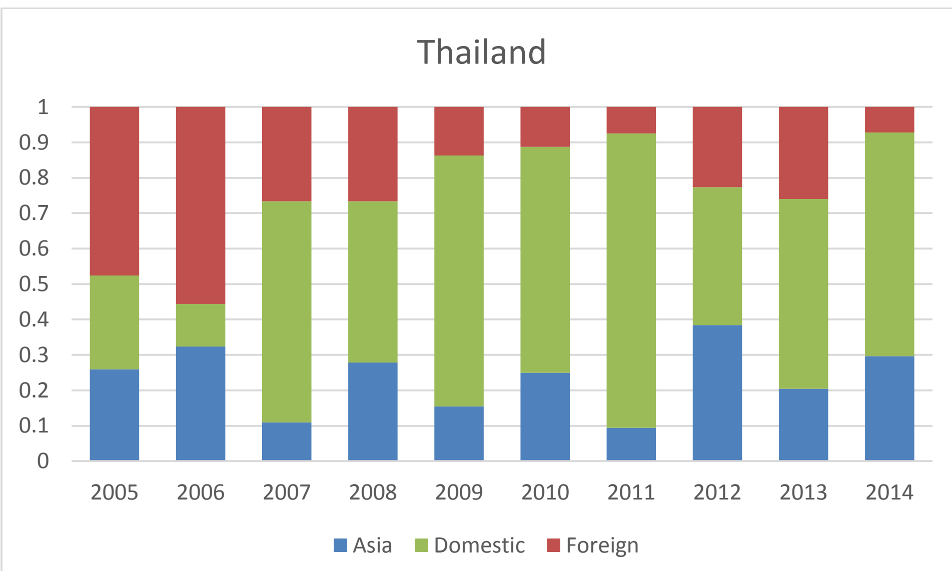


FIGURE B3: ORIGIN OF SYNDICATED LOANS AS SHARE OF TOTAL AMOUNT. SOURCE: BLOOMBERG.