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Strategies for Success

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Commonwealth Trade Finance Facility: Helping Small States Get Access to Trade Finance

Abstract

The Commonwealth Trade Finance Facility allows Commonwealth small states to access the finance they need to develop trade and sustain economic and social development, by encouraging international banks to make more trade finance available to them. The banks participating in the scheme will receive credit enhancement support through an innovative blended finance programme developed by the Commonwealth Secretariat and supported by India, Sri Lanka, Mauritius and Malta.

Introduction

Trade is the lifeblood of most economies. This is especially true for small countries, whose populations, productive capacity and domestic markets can be limited. Moreover, according to the World Trade Organization (WTO), some 80–90 per cent of world trade relies on trade finance (WTO, 2015). Yet many countries have weak capacity in the financial sector to support trade, and also face challenges in accessing the international financial system. The ability of these countries to use simple instruments such as letters of credit is thus restricted. The impact of these constraints on a country's trading potential can be very significant. Access to trade finance is therefore a critical factor to increase the flow of trade.

Trade finance landscape of commonwealth small states

Commonwealth Small States (CSS) are defined as those member countries of the Commonwealth with a population of 1.5 million people or less. The 31 CSS are highly reliant on trade, and their economies are highly import-dependent, especially

for end-consumer goods and fuels. Issues related to domestic capacity in the financial sector to support trade, and also access to the international financial system, represent key impediments to trade in CSS.

Challenges CSS face in accessing term finance include the following:

- Weak credit ratings;
- Reluctance of global providers to extend term lines;



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- Volatile global market conditions;
- High pricing;
- Short tenures;
- Absence of domestic export credit agencies;
- Immature sector markets; and
- Financiers' wariness of untested goods and services.

CSS are characterised by the small number of locally owned banks as well as branches or subsidiaries of international banks operating locally.

International efforts to enforce sanctions compliance and combat money laundering have resulted in a significant increase in the compliance burden on banks. Operational risk management around anti-money laundering (AML) and 'Know Your Customer' (KYC) issues are becoming increasingly important for banks globally. This is particularly the case in the area of trade finance, where the global supply chain can be extensive, involving many parties. Banks have to divert extra resources and build compliance units to be able to handle the increased regulatory requirements, or risk significant fines and reputational damage for dealing with restricted parties.

A survey conducted by the International Chamber of Commerce (ICC) in 2014 found the following:

- More than a third of bank respondents reported having closed correspondent account relationships in 2013 owing to the increasing cost and complexity of compliance.
- More than two thirds reported that transactions had declined owing to compliance issues.
- More than 40% reported that complying with sanctions and related regulations had restricted trade finance operations in 2013 to a greater extent than in previous years.

In the new regulatory environment, international banks are applying more stringent risk mitigation and commercial opportunity standards in their decision-making, in relation to which correspondent banks to maintain or reduce exposure to. In the face of this, many emerging market banks are confronting constraints in their efforts to expand their international network, and even more so in their attempts to increase their funding lines.

Commonwealth heads of government meeting mandate

The Commonwealth has recognised the importance of trade finance for the development of small and developing Commonwealth countries. In November 2013, the Commonwealth Heads of Government Meeting in Sri Lanka expressed a collective desire to support the economic and social development of CSS by establishing a Commonwealth Small States Trade Finance Facility, to facilitate increased flows of trade and investment to such countries (the Kotte Statement on International Trade and Investment: Commonwealth Secretariat, 2013). During the meeting, the Government of Malta pledged its support to set up and host the initiative. The Commonwealth Secretariat was tasked with developing a pilot project for this the Facility.

In June 2014, the Commonwealth Secretariat set up a Working Group to assess the feasibility of the initiative and to make recommendations on the legal and organisational structure of such a Facility. The Working Group comprised representatives of leading institutions in emerging markets trade finance, including the International Finance Corporation, the Government of Malta, the Central Bank of Malta, the Export Import Bank of India and the Commonwealth Secretariat. It developed a mechanism, in the form of a guarantee facility, support increased access to trade finance for CSS. The objective of the Facility was to encourage international banks to offer increased trade finance lines to financial institutions in CSS by reducing their credit risk through an attractive credit guarantee structure.

Objectives of the facility

The aim of the Facility is to promote and facilitate enhanced flows of trade and investment to and from CSS and to improve international trade finance access by financial institutions and business enterprises. The Facility is expected to increase and sustain such trade flows and also to address the risk of smaller banks and smaller countries being excluded from standard trade finance facilities owing to increased regulatory costs and higher perceived risk.

Core principles of the facility

- **Intra-Commonwealth support:** The Facility is based on financial support from Commonwealth member countries;

- **Financial sustainability:** The Facility is designed to be self-supporting over the long term.
- **Professional management:** The Facility will be managed by competitively selected trade finance banks (facility managers) with expertise in, and commitment to, emerging market trade finance, as per their policies and guidelines.
- **Participatory oversight:** A Supervisory Board representing stakeholders will exercise oversight.
- **Scalability:** The Facility is designed to be scalable to meet demand from small states if the pilot project is successful. The Facility will initially be launched as a three-year pilot project involving the setting-up of a special purpose entity in Malta.
- **Ease of implementation:** The Facility is designed to achieve timely implementation and will benefit from lessons from similar programmes already put in place by some multilateral organisations.

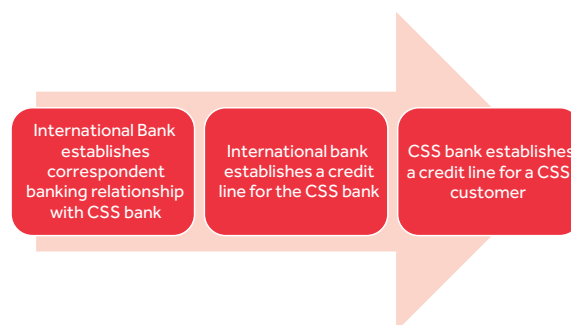
Key elements of the facility structure

- Appropriate reporting and oversight features have been set up to ensure proper governance; donor governments and agencies have the right to determine the nature of reporting and oversight requirements.
- The Facility will encourage leading trade finance providers to improve trade finance access for banks in CSS by reducing their risk exposure.
- Risk reduction will be achieved by the willingness of the Facility to bear some of the potential losses that may be incurred in lending to banks in CSS.
- The Facility will also defray some of the incremental expenses involved in doing business with banks in CSS, where low business volumes and low revenues render trade finance business relationships economically unattractive.
- The Facility has been set up as an independent legal entity, the Commonwealth Trade Finance

Facility Limited, which was incorporated in Malta in March 2017.

- The programme will run for three years initially.

Operation mobility of the facility



Guarantee facility pledged donor support

The Governments of India, Malta, Mauritius and Sri Lanka have signed a Declaration of Intent expressing their support for the proposed Facility and committing to providing the initial contributions to facilitate its launch. To date, respective governments have contributed US\$5 million to the Facility. It is expected that CSS will have access to up to US\$300 million of incremental trade finance over a three-year period through this program. Standard Chartered Bank and the Bank of Baroda of India are the managers of the Facility.

Piloted countries

- The Bahamas
- Botswana
- Brunei
- Dominica
- Fiji
- Mauritius
- Namibia
- Seychelles

Governance and transparency

The Supervisory Board will provide fiduciary oversight, to reassure donors that the Facility is being run in a manner that will ensure that its objectives are being fulfilled. The Supervisory

Board is composed of representatives of donor governments and has oversight of the running of the Facility, to not only to ensure sound governance and but also to support the periodic updating of policies and procedures as required.

Innovative blended finance scheme

The blended finance contributions made by donor governments of the Commonwealth will enable leading international banks Standard Chartered and Bank of Baroda to substantially increase their trade finance lending to their correspondent banks in CSS. The contributions back/guarantee potential first losses that these banks may incur, and this reduces their risk substantially, enabling them to lend much larger amounts of trade finance than would otherwise be possible. What is truly ground-breaking about this programme is that official resources are being used very efficiently in a market-based financing structure to leverage private sector funding for the benefit of the small states. The programme is using standard trade finance instruments and procedures but making it possible for CSS to achieve greater access through increased lending by these two global trade finance players.

The Facility will be market-based and its use will be demand-driven. It will generate a strong impetus

for more active trade flows, as additional financing will become available on market terms for essential import inputs to CSS. The up to US\$300 million in incremental trade finance that the Facility will mobilise over a three-year period for CSS is a very large contribution to the trade volumes for these countries.

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Trade Competitiveness Section

The Commonwealth Secretariat's Trade Competitiveness Section (TCS) of the Trade, Oceans and Natural Resources Directorate provides technical assistance (TA) to member countries in order to improve their trade competitiveness in global markets. Recognising the limited size of the domestic market in many member countries, TCS focuses on export development, with interventions targeted at the national level and where requested, escalated to the regional or international level. The section recently has been given responsibility for implementing the Commonwealth Secretariat's Trade Finance Facility in its work programme.

TCS's specific areas of expertise include:

1. **Market Access** – Interventions in this area of work aim to secure sustainable market access for priority exports. The section is helping member countries in identifying 'New Products and New Markets' and developing schemes around them to diversify their exports. TA is being provided to many countries on targeted action plans for linking into regional and global value chains. The section is also helping member countries in their multilateral, regional and bilateral trade negotiations.
2. **Export Development Strategies** – This initiative supports member countries to design and implement strategic plans for trade competitiveness and export development, underpinned by mechanisms for effective dialogue with governments and non-state actors. National Trade Policies and National Export Strategies have been designed for many member countries.
3. **Enhancing the development and exports of services** – Exports of services can create employment, diversify exports, enhance productivity and empower low skilled workers. This area of work supports member governments to benefit from the new opportunities created by globalisation and trade liberalisation.
4. **Trade Facilitation** – Trade facilitation encompasses the process of identifying and addressing bottlenecks imposed by weaknesses in trade related logistics and regulatory regimes that prevent the timely and cost-effective movement of goods. To deliver this short-term outcome, interventions focus on assisting member countries to reduce the costs of doing business and, as signatories to the WTO, meet their international obligations in this area. Interventions are made through the development of strategic action plans, benchmark studies and reports, and capacity-building in trade facilitation.

TCS works in response to the requests received from the governments or apex institutions and provides technical assistance to address the competitiveness issues cited above. Areas of expertise include export diversification strategies; gender sensitisation of trade policies; implications of trade agreements and related policy advocacy; implications and compliance to WTO agreements; GATS and Trade in Services Agreements; Mega FTAs like Trade in Services Agreement (TiSA), Economic Partnership Agreements (EPAs), etc; trade facilitation measures and Trade Facilitation Agreement (TFA) along with cost of compliance to the TFA. For 2018/19, the section is providing TA to 13 countries with 23 projects.

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Trade Express shares information and lessons learned from recent Commonwealth Secretariat interventions. Articles discuss design and implementation processes; in particular, practical solutions for the perennial problems surrounding appropriate trade policy design, implementation capacity gaps, advocacy and strategic trade interventions.

Forthcoming issue

Issue 10: Developing an E-Commerce Strategy for Cameroon

E-commerce accounts for a growing percentage of global trade and is predicted to increase exponentially given the digital revolution. It is an important driver of innovation, competitiveness and growth and holds huge potential for entrepreneurs and SMEs worldwide. The Cameroon e-commerce strategy will identify the sectors in which Cameroon can participate in e-commerce value chains and expand its market share of global e-commerce trade and recommends mechanisms to facilitate digital trade, protect the interests of consumers and businesses, while maintaining regulatory policy space for government to achieve its development objectives.

Previous issue

Issue 8: Botswana 'Aid for Trade' – matching donor disbursement to national development priorities

Issue 7: Sierra Leone's Packaging Industry

Issue 6: Developing Robust Export Credit Agencies to Promote Exports

Issue 5: Outsourcing: Putting Belize on the Map

Issue 4: India's Global Value Chains

Issue 3: International Transit Scheme to Improve Trading Environment across the East African Community

Issue 2: Jamaica's National Export Strategy 2015–2019

Issue 1: Revitalising the Services Sector in Barbados



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