AID-FOR-TRADE: CASE STORY

INTER-AMERICAN DEVELOPMENT BANK (IDB)

Trade Finance Reactivation Program

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Trade Finance Reactivation Program

Executive Summary

The recent economic crisis reminded the world of the importance of international trade flows, access to liquidity, and financial sector expertise for robust growth. As the crisis unfolded, the IDB's Trade Finance Reactivation Program (TFRP) ensured the Bank's fast response in the Latin America and the Caribbean (LAC) region. The TFRP, approved by the IDB in 2003, recognizes the importance of multilateral development bank support to mitigate volatility in international capital flows. It is viewed as an essential tool to complement other instruments in support of free trade and regional integration. The IDB leveraged the support and know-how of the European Bank for Reconstruction and Development's (EBRD) Trade Facilitation Program (TFP), which has engaged in similar efforts since 1999.

The TFRP aims to strengthen supply-side capacity and trade-related infrastructure in LAC, given the crucial role that international trade plays in a downturn to create jobs, foster growth, and promote income equality. The TFRP was instrumental in: (1) increasing correspondent credit lines for issuing banks; (2) enhancing small- and medium-sized enterprises' (SME) access to trade financing; (3) strengthening intra-regional transactions; and (4) providing technical assistance to trade finance banks and their SME importer and exporter clients.

1. Issues addressed

The TFRP primarily addresses the shortage of reliable and affordable trade financing in the LAC region. During times of market volatility, international banks often freeze lending activity. This especially impacts small economies, banks, and SMEs, which are more vulnerable to liquidity shocks.

In addition, the TFRP targets transaction and systemic risks. For example, the program responds to evolving "Know Your Client" (KYC) procedures and Basel II regulatory developments, which decrease large banks' appetite to serve smaller clients. Smaller economies face systemic risks related to access to liquidity, market diversification, and regulation.

Finally, the TFRP seeks to minimize costs and risks associated with low-volume transactions. SMEs already struggling to access international markets face additional challenges in negotiations with service providers, transportation companies, and financial institutions (FIs) because low-volume transactions imply higher costs. The TFRP provides financing, guarantees, training, and help building relationships to SMEs, which also helps FIs to identify and execute larger, more efficient trade finance deals.

2. Objectives

The TFRP's main objectives are to:

- Provide a stable, reliable source of financing for banks in the region.
- Mitigate transaction and systemic risks for banks seeking trade deals. Alleviating risk is especially important for smaller countries and smaller banks in times of economic downturn. It can in turn impact SMEs' access to trade financing.

- Spur regional integration by prioritizing South-South trade deals to reduce reliance on developed markets; address market failures preventing SMEs from accessing new markets; increase trade transaction volume; and diversify small economies' goods and services.
- Build a network of issuing and confirming banks[1] that reacts quickly to financing and technical needs, especially in times of market volatility.

3. Program Strategy Design and Implementation

Underscoring the importance of SMEs and helping the region's more vulnerable clients gain access to finance during times of uncertainty is at the core of the IDB's TFRP. Based on this rationale, the IDB sought to design instruments and products for implementing the program. Consequently, the Bank engaged in discussions with the European Bank for Reconstruction and Development (EBRD), local and international banks, other multilateral development banks (MDBs), export credit agencies (ECAs), insurance companies, and other relevant parties in international trade finance. Trade finance thus became an important tool for achieving the key objectives of the Bank's trade and integration agenda for the region. Discussions to assess the demand for trade finance in LAC were held with over 50 FIs in most borrowing member countries and over 40 international banks. This comprehensive approach assessed demand, surveyed the market, and generated key transactions in the short-term, while simultaneously developing new products to enhance the Bank's response capacity in the medium-term.

Initially, the Bank focused on using an established product, such as A/B loans,[2] to extend credit lines to sound FIs in LAC. Later, the IDB focused on the developing new products to target market failures related to short-term trade credit. As a result, the following components were developed:

- **Trade Finance Facilitation Program (TFFP):** Approved in 2004 and in operation since 2005, the TFFP is a highly efficient and fast-delivery vehicle that provides guarantees and loans that allow importers and exporters to reduce systemic and transaction risks, access new capital sources, and strengthen competitiveness. The TFFP subsequently launched an A/B loan product designed specifically to target the liquidity shortage by directly funding clients' trade-related activities, while guarantees enabled the LAC network of issuing banks to access a larger number of international confirming banks. The program issues guarantees in order to cover confirming banks' trade finance risk and to provide trade finance loans to issuing banks in LAC so that they can continue to finance export and import clients.

- **IDB-Financed Trade Funds:** Trade Funds seek to mobilize equity investors for short-term trade finance for medium-sized exporters. These funds provide access to finance for smaller clients who would otherwise face unaffordable or limited financing from traditional banks.

- **Specialized Trade Finance Training:** This technical cooperation program was offered to issuing banks and their SME clients in order to further enhance the effectiveness and inclusiveness of trade finance. Training held in 2007 focused on supply- and demand-side barriers, knowledge-sharing, and developing competitive advantages.

[1] An issuing bank is a bank that writes a letter of credit, especially on behalf of an exporter; it operates in the country of the importer, and facilitates trade between the importer and exporter by providing credit for the transaction. A confirming bank is the one that makes assurances to the relevant party that a letter of credit from another bank is genuine.

[2] Under this program, the IDB offers the A portion of the loan from its own resources, while it partners with other FIs to provide the B loan.

- **Integration into TFFP and technical assistance for smaller FIs:** The IDB recognizes that the trade finance market is dominated by a relatively small number of big financial players. To maximize its impact in the region, in 2007 the IDB launched a program to incorporate smaller FIs, selected through technical consultations, into its TFFP program. These FIs have relatively fewer assets and smaller trade finance portfolios in their local markets and tend to have more SME clients, as the larger banks in the region focus primarily on larger trade finance clients. With the aim of reaching and supporting the region's SMEs, the IDB provided technical assistance not only to the trade finance departments of smaller financial institutions, but also to the importer and exporter clients of these institutions. The IDB also conducted credit analysis and monitored FIs' compliance with TFFP requirements.

4. Problems Encountered

As with any new and innovative program, much time was required to conduct due diligence, build relationships with banks, and promote trade finance internally and externally. The IDB is interested in developmental impact and requires that all programs provide clear and recognizable social, environmental and financial benefits for the target beneficiaries, specifically FIs and the SME importer and exporter clients. Collecting and analyzing information related to such benefits is time-intensive and challenging, but provides payoffs in the long-term. In addition, global data on trade finance continues to be difficult to gather. Since the financial crisis, there have been significant efforts to consolidate and strengthen the collection and quality of data by organizations such as the WTO, the Society for Worldwide Interbank Financial Telecommunication (SWIFT), the Bankers' Association for Finance and Trade (BAFT), the International Monetary Fund (IMF). To this end, trade surveys are periodically carried out in an effort to encourage more systematic and reliable data collection

5. Results Achieved

Below is a brief sample of some TFRP highlights:

- As of the end of 2010, the TFRP has approved over USD 1.2 billion in credit lines and issued guarantees worth over USD 800 million in support of more than 1,000 individual international trade transactions totaling over USD 1.1 billion.

- The TFFP has built a network of 72 issuing banks in 19 countries, 73 percent of which count SME lending as their main business focus. In 2010, all 13 of the issuing banks approved to be part of the program are dedicated to the SME market. Through the IDB's network of international confirming banks, the program is now present in 53 countries worldwide with 240 confirming banks belonging to 88 banking groups. Banks that were already confirming banks are now re-joining as B Lenders – furthering the virtuous cycle and maintaining a constant source of trade financing.

- The IDB supports its network of issuing banks by using its TFRP clients to seek additional financing for their projects and clients that are well aligned with IDB's core business areas. In the last two years, 19 projects and USD 520 million in IDB funding have been approved to finance activities such as green building construction, clean and renewable energy production, affordable housing, trade, sustainable infrastructure, and SME capacity-building.

- Trade funds financed more than USD one billion in trade activity in 2009 alone. Extensions to existing funds will further increase access to trade finance across diverse countries, industries and collateral types.

The impact on the region from this increased trade activity is substantial and will continue to ripple throughout the supply chain, especially among SMEs. The TFRP has thus facilitated the following:

- **Increase in credit lines:** BICBANCO of Brazil, for example, began its relationship with the TFFP in 2005, increasing its trade portfolio from USD 176 million to over USD one billion as of 2010. This has increased the availability of financing for Brazil's mid-sized companies – the target market for BICBANCO. Another remarkable case is that of Banco Pine, also in Brazil. At the time of joining the TFFP, Pine had a portfolio USD 11 million, but soon increased it to over USD 400 million. While both banks have benefited from other MDB support and IPOs that increased their capital base, both acknowledge the importance of the TFFP to catalyze their growth and increase credit lines. In fact, belonging to a list of IDB-approved banks is often seen as a seal of approval. This has been the catalyst for networking with new international banks, and, in many cases, it has helped smaller, lesser-known banks obtain direct credit lines and in larger amounts. This has positively impacted the reliability of trade flows in LAC, especially financing for SME import and export clients.

- **Contribution to intra-regional trade:** About 10 percent of the trade guarantees issued by the TFRP support intra-regional trade. Intra-regional trade is traditionally backed by Reciprocal Credit Agreements under the Latin American Integration Association (ALADI). While numerous transactions have been closed under ALADI, its limited capacity often creates bottlenecks. The IDB's TFRP has offered a competitive alternative to allow transaction volume to grow significantly.

  For example, the Bank has supported the import of Argentine hydroelectric turbines to Paraguay, the export of Brazilian turbo generators to Peru, and the import of Argentine automobiles to Honduras. The Bank also provided Banco de Comercio Exterior de Colombia (BANCOLDEX) with USD 4.1 million to support several transactions with Ecuador's Banco de Guayaquil, S.A. for exportation of heavy commercial vehicles.

- **Strengthened knowledge and capacity:** TFRP's trade finance trainings taught trade finance institutions and SME clients about trade finance instruments, their implementation, and risk mitigation. Training overwhelmingly outperformed expected results: with an initial goal of training 10 issuing banks and SME clients comprising 150-200 people, as of 2010, a total of 22 banks, 500 bank staff and 300 SME clients had been trained in seven countries. To support ongoing training, an e-learning platform is being developed. This will allow the IDB to expand outreach, especially to SME end-beneficiaries, and teach sustainable, organic and fair trade practices.

6. Lessons Learned

- **Importance of small and medium FIs:** The IDB's market-friendly approach recognized the demands of small- and medium-sized FIs, which traditionally work with smaller importers and exporters. The Bank quickly adapted its products and services to their needs. These FIs were targeted given their difficulty accessing international markets, coupled with their critical role in deepening intra-regional trade, stimulating employment, and reducing poverty during economic downturns.

- **Relationship-building:** Developing long-term relationships with issuing banks is critical to fostering efficient trade finance transactions. The IDB's implementation of the TFRP stressed the importance of maintaining close relationships with these banks in order to facilitate future transactions, especially important for high-social-impact investments in housing, SMEs and education.

- **Working with IFIs and WTO:** Coordination and communication between international institutions supporting international trade is essential. The IDB actively collaborates with other international institutions to increase knowledge of trade finance. In particular, the IDB works with the World Trade Organization and the International Chamber of Commerce to gather data and knowledge of the region's trade financing activities. With this information, institutions across the globe can better recognize and meet the trade needs of the region.

- **Holistic approach:** As a result of the TFRP, the IDB recognized the added value it could bring by employing a more a holistic approach to its original trade finance loans and risk mitigation products. The IDB realized that by combining financing with training, technical assistance, and enhanced networks, it could more successfully increase capacity, expertise and access to new markets in LAC.

7. Conclusions

With its strong client relationships and expertise in the LAC region, the IDB is uniquely positioned to uncover innovative and sustainable ways to reduce risks and expand opportunities for regional FIs and their clients. Through trade finance loans, guarantees and capacity-building, the IDB will continue to further trade integration, job creation and poverty reduction in the years ahead.

In 2011, the Bank will further stabilize funding sources, reach out to more FIs, develop new products and continue to support trade finance funds. The IDB is currently negotiating alliances with financial institutions and development organizations in Asia, Europe and the United States, making the TFRP more competitive, efficient and targeted. One example is the recent Memorandum of Understanding signed by IDB and the Export-Import Bank of China during the China-LAC Business Summit in Chengdu, China in October 2010. Another is a recent partnership between the IDB and Standard Chartered Bank, a recognized leader in trade finance, to co-lend to local financial institutions needing trade finance.

Annex

TFFP Issuing Banks

Argentina
- BBVA Banco Francés
- Banco Santander Río
- Banco Municipal de Rosario
- Banco Supervielle
- Banco Patagonia
- Banco Finasur
- Banco Galicia
- Banco Macro
- Banco CMF

Belize
- Atlantic Bank

Bolivia
- Banco de Crédito de Bolivia
- Banco BISA
- Banco Nacional de Bolivia

Brazil

- Banco Industrial e Comercial – BicBanco
- Banco Pine
- Banco Industrial do Brasil
- Banco Indusval
- Banco Sofisa
- Banco Daycoval

Colombia
- BBVA Colombia
- Banco de Bogotá
- Banco Davivienda
- Bancolombia

Costa Rica
- Banco Nacional de Costa Rica
- Banco de Costa Rica
- Banco Improsa
- Banco LAFISE
- Banco Promerica
- Banco Cathay

Dominican Republic
- Banco BHD
- Banco Popular Dominicano
- Banco de Reservas

Ecuador
- Banco Guayaquil
- Banco Pichincha
- Banco de la Producción–Produbanco
- Banco de Bolivariano
- Banco Internacional

El Salvador
- Banco Agricola
- Banco HSBC Salvadoreño

Guatemala
- Banco G&T Continental
- Banco Industrial
- Banco Agromercantil
- Banco Internacional

Honduras
- Banco Ficohsa
- Banco LAFISE
- Banco de los Trabajadores
- Banco del Pais S.A.

Jamaica
- First Global Bank
- FirstCaribbean Bank

Mexico
- BBVA Bancomer

Nicaragua

- Bancentro
- BanPro
- Banco de Finanzas

Panama

- Banco Aliado
- Global Bank Corporation
- Banco General
- Multibank
- Tower Bank
- Banco BBVA

Paraguay

- Banco Itau
- BBVA Paraguay
- Banco Regional
- Sudameris
- Vision Banco
- Banco Continental

Peru

- Banco Internacional del Perú – Interbank
- Banco Interamericano de Finanzas – BIF
- Banco BBVA Continental

Suriname

- De Surinaamsche Bank

Uruguay

- BBVA Uruguay
- Nuevo Banco Comercial

For more information on the TFFP, please visit:

http://www.iadb.org/aboutus/departments/home.cfm?dept_id=SCF

Figure 1: Trade Finance Transactions

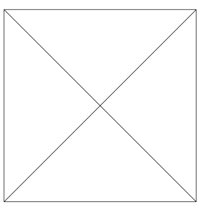

Figure 2: TFFP Transaction Amounts