

AID-FOR-TRADE: CASE STORY

ASIAN DEVELOPMENT BANK

ADB's Trade Finance Program (TFP) - Building Partnerships for Trade

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EXECUTIVE SUMMARY

ADB established the Trade Finance Program (TFP) to address the lack of access to trade finance by developing member countries (DMCs). The TFP provides loans and guarantees to commercial bank partners in support of trade, helping banks offer importers and exporters reliable access to trade finance. The TFP helps provide liquidity and stability to the trade finance system and reduces risk to importers and exporters by encouraging the use of trade finance instruments.

ISSUES ADDRESSED

Trade has long been recognized as an important tool for generating economic growth in developing countries and integrating these countries into the global market. Trade enhances a country's access to goods, services, technologies, and knowledge. It stimulates the entrepreneurial activities of the private sector. It creates jobs and attracts private capital. It fosters vital "learning" processes. It increases foreign exchange earnings. Most importantly, it generates the resources for sustainable development and poverty reduction.

Asia's economic success over the past 50 years has been linked to outward-oriented development policies, investment in infrastructure, and trade-support institutions. Trade-led growth focused on least developed countries (LDCs) helps produce economic prosperity and trade finance is an essential ingredient to this effort. But not all countries and regions within Asia have benefited. Asia is home to more than 900 million people who live on less than \$1.25 a day.

Access to trade finance is crucial for developing countries. The absence of such funds has impeded their ability to fully participate in international trade. In the past, few banks in developing countries have had sufficient access to trade finance. Many international banks have been reluctant to work with banks in the more challenging developing countries, even though the risk profile for trade finance is low. This is still largely the case in many Asian countries, countries which are the focus of Asian Development Bank's (ADB) Trade Finance Program (TFP).

OBJECTIVES PURSUED

ADB's objective for the Program is to increase trade in the more challenging Asian countries through the provision of trade finance which provides loans and guarantees through participating banks.

The developmental impact of ADB's TFP is strong and multi-faceted. The Program addresses the following areas and themes:

Support banking sector. The Program supports the banking sector in ADB's developing member countries (DMCs) in a number of ways such as: (i) channeling resources to DMC banks to provide trade finance services to DMC exporting and importing companies. These trade finance services provide DMC banks with a relatively low-risk source of revenue generation; (ii) facilitating partnerships between international banks and DMC banks, which underpins the flow of capital from developed countries to developing countries and strengthens DMC banks; (iii) strengthening DMC banks' knowledge about financial reporting standards, transparency, and governance through ADB's due diligence process on each DMC bank it considers for inclusion in the Program. The TFP has approximately 100 participating banks in its developing member countries.

Support small and medium-sized enterprises (SMEs). The Program supports many SMEs by providing guarantees and loans through DMC banks. SME development is important to an economy and tends to generate high levels of employment. With access to trade finance, SMEs can expand or sustain their imports and exports, thereby increasing employment in DMCs. In 2009 alone, ADB's TFP supported over 240 SMEs.

Regional cooperation and integration. The Program supports intraregional and bilateral trade between DMCs. Access to trade finance is a vital component for developing regional cooperation and integration which improves a DMC's ability to expand joint investment and trade with its neighbors, strengthen transport and information connections, and improve information and communications technology. Over half the TFP's 2009 portfolio supported intra-regional trade transactions and almost half its 2009 portfolio supported trade between ADB developing member countries.

Response to crisis and counter-cyclical environment. In the event of a crisis, access to trade finance is vital to ensure that international trade can help absorb the shock brought by difficult times. Massive sovereign loans are a relatively blunt instrument, which nevertheless may have a place in a range of intervention options, but the TFP provides a precise instrument or mechanism through which efficient and effective support can be channeled directly to the private finance sector and the trade sector of a crisis-stricken DMC. It is ideally suited to address important aspects of a crisis. In addition to growing the TFP exponentially during the financial crisis, ADB's TFP quickly implemented a special flood relief facility for Pakistan in 2010.

Enable partnerships and catalyzes ADB resources. Through its guarantee products, the ADB's TFP enables partnerships between international banks and DMC banks that result in greater access to finance for DMC banks, and by extension more financial support to importing and exporting companies in DMCs. These relationships result in expanded trade finance lines and a mechanism for facilitating knowledge and technology transfer to DMC banks.

Moreover, the TFP attracts significant private sector co-financing. For every dollar invested by ADB in the TFP, a similar amount is attracted from the private sector in co-financing to support trade in the most challenging markets. As such, ADB's support for trade is actually double its investment in the TFP.

DESIGN AND IMPLEMENTATION

The TFP is ADB's first region-wide program aimed at helping banks in DMCs provide trade finance products to importers and exporters. With its AAA credit-rating, ADB enhances the ability of banks to offer importers and exporters access to financial services by providing capacity, liquidity, and stability to the trade finance system.

The TFP offers three products:

- (i) a Credit Guarantee (CG) through which ADB issues guarantees within 24 hours on a transaction-by-transaction basis to participating international and regional confirming

- banks to guarantee risk of non-payment from DMC banks in support of trade;
- (ii) a Revolving Credit Facility (RCF) through which ADB provides trade-related loans within 24 hours to DMC banks in support of trade; and
 - (iii) a Risk Participation Agreement (RPA) under which ADB shares risk, primarily on a 50/50 basis, on a portfolio basis with international banks to support and expand trade in challenging and frontier markets.

In addition to its three products, ADB has signed a Risk Distribution Agreement with the Dutch bi-lateral entity FMO under which ADB's capacity to support transactions in Bangladesh is enhanced. Additional Risk Distribution Agreements are currently under discussion with other entities, including an export credit agency.

The TFP has been implemented in the following 14 countries: Afghanistan, Azerbaijan, Bangladesh, Bhutan, Cambodia, Indonesia, Mongolia, Nepal, Pakistan, Philippines, Sri Lanka, Tajikistan, Uzbekistan, and Viet Nam. In 2011, TFP implementation will take place in 5 additional (or more) countries: Armenia, Georgia, Kazakhstan, Kyrgyzstan, and the Pacific Islands.

PROBLEMS ENCOUNTERED

ADB's TFP is demand driven and results-oriented. The exponential increase in the number of participating banks as well as the mandate of international commercial banks to reduce their exposure has led to a strain on the initial limits approved. TFP capacity in markets such as Bangladesh, Mongolia, Pakistan and Viet Nam has been limited against the demand, but through increasing limits and risk sharing arrangements (Risk Distribution Agreements), the TFP is working to acquire sufficient capacity to meet demand.

FACTORS FOR SUCCESS / FAILURE

The primary factor in the TFP's success has been its quick 24-hour response times to clients. Also important in the TFP's success has been its focus on the market's needs; namely its inclusion of issuing banks in challenging countries that are in most demand to clients.

A market-based strategy has been important as demand for trade finance is purely dictated by the market. Close coordination with issuing banks in DMCs and international commercial banks allows the team to have a good understanding of market trends and to proactively meet market needs in a very timely manner.

RESULTS ACHIEVED

The TFP achieved the following results:

- From January 2008 through to October 2010, TFP supported \$4.3 billion in trade. Over the same period, TFP supported 1,517 separate transactions.
- In 2010, TFP supported \$2.8 billion in trade and 783 transactions (of which 270 are small and medium enterprises, 440 support intraregional trade and 386 support trade between DMCs). Of the \$2.8 billion in support, \$1.2 billion was pure ADB exposure and \$1.5 billion was co-financing in TFP transactions
- Bangladesh, Pakistan and Sri Lanka were the TFP's most active markets.
- TFP supported over 350 SMEs over the past 22 months.
- Approximately 50% of the TFP's portfolio has supported intra-regional trade, most of which between ADB developing member countries.
- The TFP operates in 14 countries and has almost 200 participating banks.
- ADB's TFP won two industry awards (from *Trade Finance Magazine* and *Global Trade Review*) in 2010, one of which was for "best development bank in trade"

LESSONS LEARNED

ADB has learned a number of lessons during the Program's operations and incorporated them into the operational strategy for the Program. The primary lessons learned were as follows:

- A market-based strategy has been important for the success of the TFP. This has resulted in exponential growth for the TFP and therefore greater support for trade in the most challenging markets.
- The TFP must respond within hours to client requests and must issue guarantees and disburse loans in 24 hours. To enable this kind of rapid response, the TFP has worked internally to create unique internal procedures to accommodate this unique business within ADB's operational procedures.

CONCLUSION (applicability to other programs)

Overall, the TFP has achieved significant results in providing loans and guarantees to commercial bank partners in support of trade, thereby helping banks offer importers and exporters reliable access to financial services. In doing so, the program has also provided liquidity and stability to the trade finance system and reduced the risks to importers and exporters – in particular SMEs in DMCs. The broader development impacts of the TFP also include targeted support to regional cooperation between DMCs, a quick response to crisis and counter-cyclical environment and the creation of partnerships between international banks and DMCs facilitating access to trade finance and technology transfer.

A key lesson learned, is that a market-based strategy is important to the success of a trade finance program.

ANNEXES AND/OR REFERENCES

Asian Development Bank. *ADB Trade Finance Website*. <http://www.adb.org/tradefinance/>.