

TRADE FINANCE IN EAST ASIA: POTENTIAL RESPONSES TO THE SHORTFALL

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The crisis of 2008 saw many European banks reduce their provision of trade finance in East Asia. Notwithstanding the actions of the Group of Twenty and other bodies to redress this, a substantial shortfall in trade finance facilities in the region remains. This article explores the development of this shortfall and analyses potential responses to it. These responses range from some much needed further revisions to the Basel III rules, to the deepening of cross-border cooperation, creating a ring-fenced liquidity pool for trade finance, encouraging co-financing among the various providers of trade finance both private and public and establishing a regional trade finance database. In addition, the article ponders the likelihood of China's banks beginning to take a substantial role in providing trade finance to the region. Trade finance offers China's banks a low risk means of expanding into international business and offers China a way to provide the sort of important service to its region that regional leaders typically seek to provide.

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I INTRODUCTION

Trade finance is essential to support global trade, and the region that finances more trade transactions than any other is East Asia.¹ Historically, trade has been

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¹ Thierry Senechal (ed), '2013 Rethinking Trade & Finance: An ICC Private Sector Development Perspective' (Report, International Chamber of Commerce Banking Commission, June 2013) 13.

important in the evolution and development of civilisations.² Today, international trade enhances efficiency and competitiveness within economies and promotes economic development.

Some 80–90 per cent of trade transactions are supported by some form of credit financing, making trade finance an integral part of the world economy.³ Finance for international trade transactions is important for wealthy nations and often critical for developing and emerging markets, where both exporters and importers may be severely constrained by limited working capital.

This paper starts by examining the impact of the global financial crisis on trade finance and how the world responded to the subsequent trade finance shortfall, with a particular focus on the East Asian region. While the response of the Group of Twenty ('G20') proved effective in increasing the availability of trade finance, a substantial trade finance gap has remained in East Asia. The next part of the paper examines the two greatest challenges facing trade finance in Asia today: the withdrawal of credit from European banks and the implementation of the Basel III Regulations.⁴

The second half of the paper moves on to analyse the potential responses to these challenges, including making further changes to the Basel III requirements, deepening cross-border cooperation, encouraging co-finance between public and private institutions and creating a ring-fenced liquidity pool for trade finance. It also suggests the establishment of a regional trade finance database.

Finally, we explore why China has not yet stepped in to address the trade finance gap within the region. Trade finance offers China's banks a low risk means of expanding into international business and it is likely that China will play a role in addressing the trade finance gap in the next few years.

II TRADE FINANCE AFTER THE GLOBAL FINANCIAL CRISIS

The global financial crisis that commenced in 2007–08 sparked a substantial worldwide shortfall in trade finance in a global market which was then estimated

² See K N Chaudhuri, *Trade and Civilisation in the Indian Ocean: An Economic History from the Rise of Islam to 1750* (Cambridge University Press, 1985) 15–20; Pascal Lamy, 'Role of Cities in Trade' (Speech delivered at the World Trade Organization Honour Day at the Shanghai World Expo 2010, Shanghai, 22 July 2010) <http://www.wto.org/english/news_e/sppl_e/sppl163_e.htm>.

³ Marc Auboin, 'Restoring Trade Finance during a Period of Financial Crisis: Stock-Taking of Recent Initiatives' (Staff Working Paper No ERSD-2009-16, Economic Research and Statistics Division, World Trade Organization, December 2009) 1.

⁴ The Basel Committee on Banking Supervision developed the Basel III Regulations after the latest global financial crisis. The reforms aim to improve regulation, supervision and risk management within the banking sector. Basel III's key features include increased capital and liquidity requirements, leverage ratios and liquidity ratio coverage requirements: Basel Committee on Banking Supervision, 'Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems' (Bank for International Settlements, December 2010, revised June 2011).

at USD10–12 trillion a year.⁵ The effects of this contraction were markedly different in different regions.⁶ South Asia, Korea and China were particularly affected, with China experiencing a double-digit decline in the availability of trade finance during 2008.⁷ The G20 responded with its ‘trade finance package’ in April 2009.⁸ In the words of the communiqué:

we will take, at the same time, whatever steps we can to promote and facilitate trade and investment; and we will ensure availability of at least [USD]250 billion over the next two years to support trade finance through our export credit and investment agencies and through the [multilateral development banks]. We also ask our regulators to make use of available flexibility in capital requirements for trade finance.⁹

The package provided a much-needed boost and financial agencies worldwide responded by making substantially more finance available for trade.

Export credit agencies (‘ECAs’) increased credit insurance and risk mitigation capacity by creating programs for short-term lending of working capital and credit guarantees aimed primarily at small and medium enterprises (‘SMEs’).¹⁰ Within the Asian region, the leaders of 11 Asian ECAs formed the Asian Regional Cooperation Group (‘RCG’) of the Berne Union, to meet annually to discuss responses to the global financial crisis.¹¹ The group responded to the crisis with new initiatives to help sustain the trade and investment flow in the region and worldwide.¹² In 2008, members of the RCG supported more than USD268 billion worth of international trade and investment.¹³ Since this time, the RCG has met three times a year to exchange information and views and consider solutions for the unique challenges faced by ECAs in East Asia.¹⁴ Such challenges include the rise of trade protectionism in some countries, stricter foreign exchange restrictions, frequent cases of false trade documents, substantial fluctuations in the economy and local conflicts.¹⁵

⁵ The Centre for Economic Policy Research estimates the global market for trade finance, including both trade credit and insurance, to be roughly 80 per cent of 2008 trade flows, which were valued at USD15 trillion: Marc Auboin, ‘Boosting the Availability of Trade Finance in the Current Crisis: Background Analysis for a Substantial G20 Package’ (Policy Insight No 35, Centre for Economic Policy Research, June 2009) 1. See also Marc Auboin and Martina Engemann, ‘Trade Finance in Periods of Crisis: What Have We Learned in Recent Years?’ (Staff Working Paper No ERSD-2013-01, Economic and Research Statistics Division, World Trade Organization, January 2013) 14–15.

⁶ See Elizabeth Ho, ‘Developments in Banking and Financial Law: 2008–2009 — The Credit Crisis of 2008: XI The International Effects of the Credit Crisis’ (2008) 28 *Review of Banking and Financial Law* 102.

⁷ Wei Liu and Yann Duval, ‘Trade Finance in Times of Crisis and Beyond’ (Alerts on Emerging Policy Changes Issue No 3, Asia Pacific Research and Training Network on Trade, April 2009) 1–2.

⁸ Group of 20, ‘London Summit: Leaders’ Statement’ (Statement, 2 April 2009).

⁹ *Ibid* [22].

¹⁰ Auboin and Engemann, ‘Trade Finance in Periods of Crisis’, above n 5, 17.

¹¹ Berne Union Secretariat, *Asian ECAs Joint Statement* (13 August 2009) Berne Union <<http://www.berneunion.org/asian-ecas-joint-statement/>>.

¹² *Ibid*.

¹³ *Ibid*.

¹⁴ Berne Union, *Berne Union 2013* (Exporta Publishing & Events, 2013) 33.

¹⁵ *Ibid*.

Regional development banks ('RDBs') and the International Finance Corporation ('IFC') responded by significantly increasing the capacity of trade facilitation programs.¹⁶ The Asian Development Bank ('ADB') increased the capacity of its program from USD400 million to USD1 billion.¹⁷ The IFC also established a liquidity pool allowing co-financing operations with banks in developing countries, contributing USD5 billion to jump-start the fund.¹⁸ This amount was matched by USD7.5 billion in commercial bank funding,¹⁹ which has helped to support nearly USD20 billion of trade transactions since its creation.²⁰

Central banks in nations with substantial foreign exchange reserves responded by making portions of those reserves available to finance trade.²¹ Within East Asia, Korea pledged USD10 billion of its foreign exchange reserve to supply foreign currency to local banks and importers through repurchase agreements.²² Indonesia acted similarly.²³ The central bank in Japan opened temporary 'discount windows' for local traders wanting to discount foreign trade receivables and other bills.²⁴ On a much smaller scale, Thailand injected USD140 million worth of THB into the Export-Import Bank of Thailand ('Thai EXIM Bank') to increase export insurance and allocated a further USD85 million to the Small Business Credit Guarantee Corporation so it could increase credit guarantee funds and loans to SMEs.²⁵

The G20 package ended in 2011.²⁶ Trade finance availability and market conditions had improved continuously over the two year period up to this time; prices had fallen and the volume of transactions had increased, though with some volatility around an upward trend.²⁷ However, recovery has not been even across all countries and gaps in trade finance persist. According to the ADB, the global value of trade finance requests received in 2011 by surveyed banks was approximately USD4.6 trillion, of which approximately USD1.6 trillion was rejected.²⁸

¹⁶ Auboin and Engemann, 'Trade Finance in Periods of Crisis', above n 5, 17.

¹⁷ World Trade Organization, *The Challenges of Trade Financing* (2014) <http://www.wto.org/english/thewto_e/coher_e/challenges_e.htm>; United Nations Conference on Trade and Development, *Trade Financing and Regional Financial Institutions from a South-South Perspective*, 4th sess, Provisional Agenda Item 3, UN Doc TD/B/C.II/MEM.2/11 (15 August 2012) 4 [16] ('*Trade Financing*').

¹⁸ Auboin and Engemann, 'Trade Finance in Periods of Crisis', above n 5, 17.

¹⁹ *Ibid.*

²⁰ International Finance Corporation, *Global Trade Liquidity Program* (2014) <http://www1.ifc.org/wps/wcm/connect/Industry_EXT_Content/IFC_External_Corporate_Site/Industries/Financial+Markets/Trade+and+Supply+Chain/GTLP/>.

²¹ Auboin and Engemann, 'Trade Finance in Periods of Crisis', above n 5, 17.

²² World Trade Organization, *Challenges of Trade Financing*, above n 17; Auboin, 'Boosting the Availability of Trade Finance', above n 5, 5-6.

²³ World Trade Organization, *Challenges of Trade Financing*, above n 17; Auboin, 'Boosting the Availability of Trade Finance', above n 5, 6.

²⁴ Marc Auboin, 'Use of Currencies in International Trade: Any Changes in the Picture?' (Staff Working Paper No ERSD-2012-10, Economic Research and Statistics Division, World Trade Organization, May 2012) 13.

²⁵ Liu and Duval, above n 7, 3.

²⁶ See generally Group of 20, above n 8.

²⁷ Auboin and Engemann, 'Trade Finance in Periods of Crisis', above n 5, 20.

²⁸ Committee on the Global Financial System, 'Trade Finance: Developments and Issues' (CGFS Paper No 50, Bank for International Settlements, January 2014) 51.

In 2010 the G20 Leaders in Seoul commissioned a report by the World Trade Organization on existing trade finance gaps and the effectiveness of programs aimed at addressing them.²⁹ The report was presented at the G20 Summit in Cannes in November 2011 and recommended that the multilateral development banks and the World Bank Group expand the risk limits of their trade finance facilitation programs to allow for greater support to countries where local financial institutions cannot adequately support trade.³⁰ The Asian region was identified as a priority area.³¹

III EUROPE'S WITHDRAWAL OF TRADE FINANCE TO ASIA

Efforts to address the Asian trade finance gap have been hampered by the ongoing economic crisis in Europe. European banks traditionally provided substantial trade finance facilities in East Asia and have severely limited their extensions of credit so as to improve their capital ratios.³² Since 2008, the proportion of international credit provided by Eurozone and Swiss banks to emerging Asia-Pacific economies has fallen from 38 per cent to 19 per cent of the region's trade credit.³³ Eurozone banks (excluding German banks) reduced their share of large-ticket Asian trade finance from 43 per cent to just 3 per cent in the 18 months leading up to the first quarter of 2012.³⁴ French and Italian banks reportedly reduced their exposure to major Association of Southeast Asian Nations countries by 50 per cent and 40 per cent respectively in this period.³⁵ The second half of 2011 saw a particularly rapid retreat, with European banks deleveraging their exposures to Asia by 18 per cent, a reduction of USD89 billion.³⁶ This retreat has led to a dramatic increase in trade finance prices in Asian markets.³⁷ According to Kah Chye Tan, 'when European banks started to deleverage due to the Euro crisis [in 2011], trade finance pricing in Asian countries including India and China moved from 100 basis points to 200 basis points in three weeks'.³⁸

The reduction in trade finance by European banks has left a funding gap at a time of increasing demand for finance in Asia. In 2011, a USD1 billion trade contract between the United States and China could not proceed due to the lack

²⁹ Auboin and Engemann, 'Trade Finance in Periods of Crisis', above n 5, 21.

³⁰ *Ibid.* 21–2.

³¹ *Ibid.*

³² Aki Ito and Shamim Adam, 'European Retreat Squeezes Asia Trade Finance as ADB Sees Loan Demand Climb', *Bloomberg* (online), 6 December 2011 <<http://www.bloomberg.com/news/2011-12-05/credit-squeeze-hits-asia-trade-finance-as-adb-loan-demand-soars.html>>.

³³ Adrian van Rixtel et al, 'Highlights of the BIS International Statistics' [2012] (December) *BIS Quarterly Review* 11, 17–18.

³⁴ Huw Van Steenis et al, 'Cross Asset Research: EU Bank Deleveraging and Asian Trade Finance' (Report, Morgan Stanley Research, 1 May 2012) 1.

³⁵ Takehiko Nakao, Vice Minister of Finance for International Affairs, Japan, 'International Regulatory Reform and New Financial Infrastructure in Asia' (Speech delivered at the Asian Financial Forum, Hong Kong, 14 January 2013) <http://www.mof.go.jp/english/international_policy/others/20130114.htm>.

³⁶ Van Steenis et al, above n 34, 4.

³⁷ Michael Bainbridge, 'Basel III Threat to Asian Trade Finance', *Financial News* (online), 29 October 2012 <<http://www.efinancialnews.com/story/2012-10-29/basel3-threat-to-asian-trade-finance>>.

³⁸ *Ibid.* At the time, Tan was the Global Head of Trade and Working Capital at Barclays.

of trade finance.³⁹ Recent data shows that Chinese exports grew by 25 per cent in the year to January 2013 and imports climbed by 28.8 per cent in the same period.⁴⁰ In 2012, demand for trade finance products increased significantly.⁴¹

Fortunately, Japanese banks and some international banks such as HSBC Holdings plc ('HSBC') and Standard Chartered plc ('Standard Chartered') have stepped in to cover much of the trade finance gap left by the European banks. Figure 1 shows that in the past two years Japanese banks have dramatically increased their share of large-ticket, regional trade finance volumes, growing from 6 per cent in 2010 to an extraordinary 54 per cent in the first quarter of 2012.⁴² As a result, Japan became the largest provider of trade finance globally in 2012, with reported trade finance volumes of USD16.8 billion.⁴³ The Australia and New Zealand Banking Group Ltd ('ANZ') has also capitalised on the European retreat, reporting a 29 per cent increase in trade finance revenue in 2011 and a 58 per cent growth in Asia.⁴⁴

Figure 1: a comparison of the trade finance market share between 2010, the first half of 2011 and the first quarter of 2012. Source: Dealogic and Morgan Stanley Research.

Most trade is financed in USD,⁴⁵ and the retreat of the European banks has been in part due to the rising cost of borrowing USD since the start of the Eurozone crisis.⁴⁶ Given their easy access to the USD, Japanese banks, ANZ, HSBC and Standard Chartered have thus been in a position to benefit from the European retreat.⁴⁷

Despite Japanese and other banks stepping in, there remains a shortfall of finance for trade in East Asia today. A survey conducted by the ADB in March 2013 identified a trade finance gap of USD425 billion in developing Asia.⁴⁸ This finding is serious given the critical role finance plays in facilitating trade. The shortfall particularly affects the Asia-Pacific region as a higher proportion of

³⁹ *Trade Financing*, UN Doc TD/B/C.II/MEM.2/11, 4 [15].

⁴⁰ Sarah Turner and V Phani Kumar, 'China Data Helps Lift Most Asia Stocks; Japan Down', *MarketWatch* (online), 8 February 2013 <http://articles.marketwatch.com/2013-02-08/markets/36970890_1_quarterly-net-loss-sony-corp-china-data>.

⁴¹ See World Trade Organization, 'Report on G-20 Trade Measures: Mid-May to Mid-October 2012' (Report, 31 October 2012) 15 [58]–[59].

⁴² Van Steenis et al, above n 34, 17.

⁴³ 'Japan Tops Trade Finance Charts', *Global Trade Review* (online), 25 January 2013 <http://www.gtreview.com/trade-finance/global-trade-review-news/2013/January/Japan-tops-trade-finance-charts_10637.shtml>.

⁴⁴ Steve Slater, 'Europe's Banks Leave Room for Rivals to Fund World Trade', *Reuters* (online), 16 April 2012 <<http://www.reuters.com/article/2012/04/16/banks-trade-idUSL5E8E1B1P20120416>>; Ito and Adam, above n 32.

⁴⁵ Trade finance is even more dollar denominated than global trade. For example, 80 per cent of letters of credit are in USD: Committee on the Global Financial System, above n 28, 13.

⁴⁶ Francesco Guerrera, 'French Banks Say Adieu to Financing Asian Trade', *The Wall Street Journal* (online), 3 September 2012 <<http://online.wsj.com/article/SB10000872396390443571904577629250952177234.html>>.

⁴⁷ See Van Steenis et al, above n 34, 18–26.

⁴⁸ According to the 106 banks surveyed by the Asian Development Bank, almost USD2.1 trillion worth of trade finance proposals were received in developing Asia, of which USD425 billion was not approved: Steven Beck et al, 'Asian Development Bank Trade Finance Survey: Major Findings' (Brief No 11, Asian Development Bank, March 2013) 3.

trade is financed there than in other regions.⁴⁹ Notably, the majority of trade letters of credit issued globally are issued in Asia.⁵⁰

As well as a simple shortfall of finance, Asian companies have complained that the cost of trade finance is rising, possibly due to the growing pricing power of the few banks in the region willing to extend trade credit.⁵¹ While the top 40 institutions represented 95 per cent of the Asian trade finance market in 2011, only 20 remained in the market for Asian trade finance in 2012.⁵²

IV BASEL III

Apart from the retreat of European banks, the largest challenge on the horizon lies in the implementation of Basel III. While Basel III aims to establish a level playing field across borders, its implementation will not have the same impact worldwide. In the words of Takehiko Nakao, Vice Minister of Finance for International Affairs, Japan:

[The] international standards of financial regulation [comprising Basel III] are based on the experiences of the financial crises in the US and Europe, and do not necessarily reflect the conditions of the financial sectors in Asian emerging countries.⁵³

As Basel III requires larger capital holdings against trade transactions,⁵⁴ its implementation could slow trade financing in emerging and developing economies in the Asian region by substantially raising transaction costs and discouraging trade financing. This would thereby exacerbate the already precarious position of many nations in the region.⁵⁵ According to recent findings by the ADB, 79 per cent of banks surveyed stated that the Basel regulatory requirements had played a significant role in limiting trade finance.⁵⁶ Seventy-five per cent of the banks surveyed indicated that they would reduce trade finance support by five per cent or more if Basel III were fully implemented.⁵⁷ Furthermore, 65 per cent of respondents to the International Chamber of Commerce ('ICC') Global Trade and Finance Survey 2013 said that implementation of Basel III regulations is affecting the cost of funds and liquidity for trade finance to some, or a large, extent.⁵⁸

⁴⁹ See Committee on the Global Financial System, above n 28, 9.

⁵⁰ Bainbridge, above n 37.

⁵¹ Guerrero, above n 46.

⁵² Van Steenis et al, above n 34, 18.

⁵³ Nakao, above n 35.

⁵⁴ Esther Tan, *Trade Finance Impeded by Basel III; Regulators Must Take a Step Back* (18 December 2013) *The Asian Banker* <<http://www.theasianbanker.com/research-notes/trade-finance-impeded-by-basel-iii-regulators-must-take-a-step-back>>.

⁵⁵ Shawn Baldwin, 'Basel Barriers: How Capital Requirements Would Impede Progress in the Sovereign Debt Crisis', *Forbes* (online), 15 October 2012 <<http://www.forbes.com/sites/shawnbaldwin/2012/10/15/basel-barriers/>>. Douglas Elliott calls it a 'dangerous misconception' that raising capital requirements will ensure a safer banking requirement and believes considerably more debate is needed: Douglas J Elliott, 'Higher Bank Capital Requirements Would Come at a Price' (Research Paper, Brookings Institution, 20 February 2013).

⁵⁶ Beck et al, above n 48, 4.

⁵⁷ *Ibid* 5.

⁵⁸ Senechal (ed), 'Rethinking Trade & Finance', above n 1, 13.

Most experts expected that Basel III would considerably increase trade finance pricing worldwide if implemented in its original form.⁵⁹ In January 2013, the Basel Committee on Banking Supervision bowed to longstanding pressure from the banking industry to modify the liquidity coverage ratio ('LCR') for trade finance products.⁶⁰ The Basel Committee also delayed full implementation of the LCR requirements until 2019.⁶¹

The LCR requires banks to hold enough liquid assets to be able to withstand a 30 day liquidity crisis.⁶² The original rule was drafted narrowly and limited what banks could count as liquid assets to only include money and government bonds.⁶³ The Basel Committee has now extended the rule to include less traditional assets, such as residential mortgage-backed securities, to satisfy up to 15 per cent of the LCR.⁶⁴ Additionally, banks are now only required to hold 30 per cent of the funds they would theoretically lose access to in a crisis — a significant decrease from the 100 per cent originally required.⁶⁵ While the initial rule assumed that banks would lose 5 per cent of their retail deposits during a theoretical 30 day crisis, the modified LCR assumes a loss of 3 per cent.⁶⁶ Furthermore, banks will now only have to be partly in compliance by 1 January 2015, the date at which the original rule was supposed to be implemented.⁶⁷ The modified LCR will now be gradually phased in over the further four years leading to 2019.⁶⁸

The decision to relax the LCR in January 2013 has generally been regarded by the industry as positive.⁶⁹ However, some banks have criticised part of the amendment, which states that the LCR requirement should be based on collateral calls caused by market valuation changes, calculated by the highest collateral outflow during the preceding 24 months.⁷⁰ Critics argue that the amendment could significantly increase the volatility of bank liquidity requirements, which in turn will force banks to hold much higher levels of liquidity to ensure compliance.⁷¹ This could affect a bank's capacity to provide trade finance. Even

⁵⁹ See, eg, Bainbridge, above n 37. Some believe Basel III could increase trade finance pricing by up to 40 per cent: Gilles Thieffry, 'The Impact of Basel III on Commodity Trade Finance: Legal and Regulatory Aspects' (2011) 26 *Journal of International Banking Law and Regulation* 455, 457. See also Viren Vaghela, 'Basel III Threatens to Throttle Trade Finance', *Asia Risk* (online), 9 July 2012 <<http://www.risk.net/asia-risk/feature/2190078/basel-iii-threatens-throttle-trade-finance>>.

⁶⁰ David Enrich, Geoffrey T Smith and Andrew Morse, 'Rules for Lenders Relaxed — Regulators Agree to Ease Requirements for Meeting Guideline on Liquidity', *The Wall Street Journal* (New York), 7 January 2013, C1; Basel Committee on Banking Supervision, 'Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools' (Bank for International Settlements, January 2013).

⁶¹ Enrich, Smith and Morse, above n 60.

⁶² *Ibid.*

⁶³ *Ibid.*

⁶⁴ *Ibid.*

⁶⁵ *Ibid.*

⁶⁶ *Ibid.*

⁶⁷ *Ibid.*

⁶⁸ *Ibid.*

⁶⁹ See *ibid.*

⁷⁰ Michael Watt, 'Banks Round on LCR Approach to Derivatives Collateral Flows', *Risk Magazine* (online), 27 June 2013 <<http://www.risk.net/risk-magazine/feature/2277631/banks-round-on-lcr-approach-to-derivatives-collateral-flows>>.

⁷¹ *Ibid.*

if the amendment to the LCR eases pressure on trade finance, the longer-term impact of Basel III as a whole is still likely to increase the cost of financing trade.

V POTENTIAL RESPONSES TO THESE CHALLENGES

Further Adjustments to the Basel III Rules

Trade finance rates of default and loss have historically been very low, even during crises. In 2009, the ICC and ADB initiated a trade finance default register to collect performance data on trade finance products.⁷² The register collects data from 21 global banks that provide more than USD2 trillion in short-term export-related credit, roughly 65 per cent of the world's total.⁷³ The data collected by the project supports the claim that trade finance is much less risky than other parts of banking. Between 2008 and 2011 the ICC Trade Finance Register recorded fewer than 1800 defaults in a dataset of 8.1 million short-term trade finance transactions.⁷⁴ During the same period the rates of default for off-balance sheet trade products were particularly low, with only 947 defaults recorded in a sample of 5.2 million transactions.⁷⁵ The data collected determined the probability of loss as just 0.02 per cent.⁷⁶ By contrast, the average rate of default for corporates rated by Moody's Investors Service Inc between 2008 and 2011 was 2.41 per cent.⁷⁷ This comparison highlights the fact that trade finance has a low level of risk.

Until recently, there was no differentiation between trade finance and other forms of finance in credit conversion factors ('CCFs') for calculating the leverage ratio.⁷⁸ Under the proposed rules, banks were required to apply a CCF of 100 per cent for all off-balance sheet items when calculating a leverage ratio.⁷⁹ An exception that attracted the application of a CCF of 10 per cent was where, without prior notice to the beneficiary, the claim was unconditionally cancellable.⁸⁰

⁷² Thierry Senechal (ed), 'Global Risks — Trade Finance 2011' (Report, International Chamber of Commerce Banking Commission, 26 October 2011) 2 ('Global Risks 2011').

⁷³ Brooke Masters, 'Push to Cut Trade Finance from Basel III', *Financial Times* (online), 16 April 2013 <<http://www.ft.com/intl/cms/s/0/5b8b9f1c-a678-11e2-885b-00144feabdc0.html#axzz2XU9DFw8g>>.

⁷⁴ Thierry S  n  chal (ed), '2013 Global Risks Trade Finance Report' (Report, International Chamber of Commerce Banking Commission, April 2013), 15 ('Global Risks 2013').

⁷⁵ Senechal (ed), 'Global Risks 2011', above n 72, 16.

⁷⁶ Vaghela, 'Basel III Threatens to Throttle Trade Finance', above n 59; S  n  chal (ed), 'Global Risks 2013', above n 74, 15.

⁷⁷ S  n  chal (ed), 'Global Risks 2013', above n 74, 17.

⁷⁸ Garima Chitkara and Aaron Woolner, 'Revised LCR Falls Short on Ending Basel III Concerns over Trade Finance', *Asia Risk* (online), 6 February 2013 <<http://www.risk.net/asia-risk/news/2242693/revised-lcr-falls-short-on-ending-basel-iii-concerns-over-trade-finance>>.

⁷⁹ Laurence Neville, 'Euromoney Trade Finance Survey 2012: Trade Not Getting the Credit', *Euromoney* (online), January 2012 <<http://www.euromoney.com/Article/2959489/Euromoney-Trade-Finance-survey-2012-Trade-not-getting-the-credit.html?Type=Article&ArticleID=2959489>>.

⁸⁰ Chitkara and Woolner, above n 78.

Trade credit traditionally attracted a low risk weighting of 20 per cent under the first iteration of the Basel Accord⁸¹ for two reasons: first, because of the historically low default rates and second, because trade finance facilities are typically secured against the goods or commodities being financed. Under a typical trade finance facility, the bank extending the credit has the bills of lading or other title documents to the goods or commodities pledged to it and only releases this pledge when it is either paid or another security interest is put in place.⁸² Accordingly, if the bank is not paid it should be able to recover much of the credit it has extended by selling the goods or commodities.

The CCF of 20 per cent in the first Basel Accord remained largely unchanged under Basel II.⁸³ However, on 10 January 2010 the Basel Committee proposed the introduction of a flat 100 per cent CCF to certain off-balance sheet items in an attempt to reduce incentives for ‘leveraging’.⁸⁴ This proposal included letters of credit and similar trade finance facilities.⁸⁵ Given that the objective of the leverage ratio is to prevent the build-up of excessive leverage in the banking sector, subjecting trade finance to a 100 per cent CCF was utterly excessive; because trade finance underpins the movement of goods and commodities, it does not lead to the sort of leveraging that may endanger real economic activity.⁸⁶

Data collected by the ICC and ADB supports the view that the leverage ratio in its proposed form did not reflect market realities and may have significantly limited banks’ ability to provide affordable financing to businesses in developing countries and SMEs in developed countries.⁸⁷ As indicated by the ICC in its report ‘Global Risks — Trade Finance 2011’, the leverage ratio proposed by Basel III could have adverse effects on global trade and growth by:

- (a) curtailing banks’ ability to provide affordable financing to businesses in developing and low-income countries and to SMEs in developed countries;
- (b) increasing the cost of trade, with banks raising their prices to pay the costs associated with the more stringent regulatory requirements;
- (c) encouraging banks to move high-quality trade assets and contingents into non-bank sectors and higher-risk, unregulated markets such as hedge funds, thereby defeating the purpose of strengthening the resilience of the banking sector; and
- (d) re-defining the banking map because inconsistencies in the implementation of the regulatory regime at the national level can create competitive arbitrage opportunities in some financial markets and can have an impact on the domiciling of banks.⁸⁸

⁸¹ See Basle Committee on Banking Supervision, ‘International Convergence of Capital Measurement and Capital Standards’ (Regulations, July 1988).

⁸² See Carole Murray, David Holloway and Daren Timson-Hunt, *Schmitthoff: The Law and Practice of International Trade* (Sweet & Maxwell, 12th ed, 2012) 249–51.

⁸³ Marc Auboin, *The Prudential Treatment of Trade Finance under Basel III: For a Fair Treatment* (7 March 2010) Vox <<http://www.voxeu.org/article/fair-treatment-trade-finance-under-basel-iii>>.

⁸⁴ *Ibid.*

⁸⁵ *Ibid.*

⁸⁶ BAFT-IFSA, ‘Trade Finance — Key Concerns and Recommendations for the Basel Framework’ (Talking Points, 2011) 1.

⁸⁷ Senechal (ed), ‘Global Risks 2011’, above n 72, 4.

⁸⁸ *Ibid* 7–8.

When implementing the Basel III guidelines, the European Union recognised that the proposed 100 per cent CCF was disproportionate to the level of risk posed by trade finance.⁸⁹ Realising the importance of trade finance for growth, the EU decided to introduce regulations to reduce the capital required to be held for trade finance products.⁹⁰ The Basel Committee has since followed suit, amending its guidelines for trade assets in January 2014.⁹¹ Short-term trade letters of credit will now once again attract a 20 per cent CCF, which will be applied to both issuing and confirming banks.⁹²

As with its relaxation of the LCR requirement, this latest decision by the Basel Committee is a positive step that will no doubt assist with the availability of trade finance over time. Nevertheless, there are still further important changes that should be made.

At present, Basel III uses a standard asset value correlation ('AVC') for corporate banking, imposing a treatment for trade finance that does not reflect its short-term, low risk nature.⁹³ The current rule requires the AVC to be multiplied by 1.25 in respect of exposures to financial institutions whose assets exceed USD100 billion and to all unregulated financial institutions, regardless of size.⁹⁴ The increase in AVC applies to all sources of credit risk exposure.⁹⁵ The rule is based on the assumption that such exposures present greater default correlations than others.⁹⁶ This assumption ignores the indisputable fact that trade finance rates of default are substantially lower than rates of default in other banking sectors.

While Basel III subjects corporate banking to a blanket AVC, consumer banking is granted several product-specific default curves.⁹⁷ Under Basel III, separate AVCs are applied to retail mortgages, credit cards and other retail exposures.⁹⁸ Like retail banking, corporate banking products should be distinguished from one another to accurately reflect their level of risk. Applying a standard AVC is likely to increase the cost of providing trade finance, and may prompt smaller banks to pursue other, more profitable areas of banking.⁹⁹ In the words of the international banking industry association BAFT-IFSA:

⁸⁹ Marc Auboin and Isabella Blengini, 'The Impact of Basel III on Trade Finance: The Potential Unintended Consequences of the Leverage Ratio' (Staff Working Paper No ESRD-2014-2, Economic Research and Statistics Division, World Trade Organization, 20 January 2014) 2.

⁹⁰ *Ibid.*

⁹¹ *Ibid.*

⁹² Basel Committee on Banking Supervision, 'Basel III Leverage Ratio Framework and Disclosure Requirements' (Bank for International Settlements, January 2014) 19.

⁹³ BAFT-IFSA, 'Trade Finance — Key Concerns and Recommendations for the Basel Framework', above n 86, 2.

⁹⁴ Citi Transaction Services, 'Basel III — Sailing the Trade Winds of Change' (Citibank, 2012) 3; Australian Prudential Regulation Authority, 'Implementing Basel III Capital Reforms in Australia — Counterparty Credit Risk and Other Measures' (Discussion Paper, August 2012) 19.

⁹⁵ Australian Prudential Regulation Authority, above n 94, 19.

⁹⁶ Chitkara and Woolner, above n 78.

⁹⁷ *Ibid.*

⁹⁸ BAFT-IFSA, 'Key Concerns regarding Trade Finance and Transaction Banking' (copy on file with authors).

⁹⁹ Citi Transaction Services, above n 94.

The AVC proposals recommended by the Basel Committee could increase the cost of providing credit for trade transactions and limit their availability, particularly in emerging markets that rely on sustained and affordable access to trade finance to support commercial activities.¹⁰⁰

Recent changes to the LCR and leverage ratio under Basel III came about after sustained pressure from the trade finance industry.¹⁰¹ At present, making further changes to the rules will be difficult for the Basel Committee given the public sentiment towards banks.¹⁰² While trade finance is crucial for world trade, it is currently seen as a minor issue in comparison to the ongoing Eurozone crisis and other problems in the banking sector.¹⁰³ Furthermore, the Basel Committee is faced with the challenge that if they make concessions for one type of financing, others might make such claims as well.¹⁰⁴ This would greatly strain the whole regulatory system and potentially undermine its objectives.¹⁰⁵

Given that statistical information demonstrates that trade finance is less risky than other forms of finance, there is a strong case for the industry to continue lobbying the Basel Committee to modify the Basel III rules. Without changes to the AVC, it is highly likely that the price of trade finance will increase, with damaging consequences for global trade and thus global growth.

A Crisis Contains within It an Opportunity — For China

The idea that the Chinese character for ‘crisis’ contains within it the character for ‘opportunity’ is such an elegant idea that it is often used by authors.¹⁰⁶ Sadly it is not the case¹⁰⁷ — but it is such a nice, elegant idea that it should be.

Matters of calligraphy aside, this crisis of inadequate trade finance in the East Asia region would seem to present an opportunity for Chinese banks which we are somewhat surprised they have not seized. At the Loan Market Association’s syndicated loan conference in London in 2012, there was a general consensus among panel members that Chinese banks were preparing themselves to fill the void left by the French banks in the commodity finance market.¹⁰⁸ According to Simon Tyler, head of corporate banking for China Construction Bank Corporation in London:

Banks such as Industrial and Commercial Bank of China ..., Agricultural Bank of China, and China’s Bank of Communications are already in talks about their

¹⁰⁰ BAFT-IFSA, ‘Key Concerns regarding Trade Finance and Transaction Banking’, above n 98.

¹⁰¹ Enrich, Smith and Morse, above n 60.

¹⁰² Neville, above n 79.

¹⁰³ See *ibid.*

¹⁰⁴ Chitkara and Woolner, above n 78.

¹⁰⁵ *Ibid.*

¹⁰⁶ John F Kennedy famously used the idea during a campaign speech in 1959: see Yahia Lababidi, ‘Crisis’ (2009) 73 *Philosophy Now* 24; Editorial, ‘Many Deserve Kudos for Confronting PDO’s Funding, Staffing Issues’, *American Press* (online), 17 June 2013 <<http://www.americanpress.com/AP-Editorial-6-18-13>>.

¹⁰⁷ Victor H Mair, *How a Misunderstanding about Chinese Characters Has Led Many Astray* (September 2009) Pinyin <<http://pinyin.info/chinese/crisis.html>>.

¹⁰⁸ ‘Asian Banks Stand by to Fill the Commodity Financing Gap’, *Global Trade Review* (online), 21 September 2012 <http://www.gtreview.com/trade-finance/global-trade-review-news/2012/September/Asian-banks-stand-by-to-fill-the-commodity-financing-gap_10284.shtml>.

moves over to London and are very keen on developing relationships with the top players. Although it will be a while before this presence is fully realised, partly because they are being very cautious. But slowly and surely as this happens we'll see them competing with each other as much as with international banks.¹⁰⁹

One reason for Chinese banks to be cautious is the rapid growth of credit in China, which has been increasing at a rate of 22 per cent a year.¹¹⁰ In 2012, credit in China grew more than twice as fast as its gross domestic product.¹¹¹ The Chinese government is now taking measures to tighten liquidity levels and limit risky lending, in what some analysts say could be Beijing's most drastic clampdown on credit in two decades.¹¹² In late June 2013, China's central bank temporarily stopped lending money in an attempt to reduce the reliance of banks on credit.¹¹³ China's other banks are now following the government's orders by reducing lending, impacting the availability of finance for certain commodities such as gold, rubber and base metals.¹¹⁴ For example, in May 2013 two banks stopped issuing letters of credit with long maturity dates to jewellers importing gold into the mainland for export processing.¹¹⁵

In addition to the Chinese government's crackdown on lending, other challenges exist that may delay China's entry into the trade finance space. One example is the difficulty faced in opening branches in London and wider Europe due to licensing requirements.¹¹⁶ It may also take time for China to establish the requisite 'back office' needed to compete consistently in the trade finance industry.¹¹⁷ Trade finance document checking is very technical and requires very substantial and detailed training of staff, which takes some considerable time.¹¹⁸

While China has not yet stepped into the regional trade finance gap left by the Europeans, it seems likely to do so in the next few years. At the end of 2013, the CNY surpassed the EUR and JPY to become the second most used currency in

¹⁰⁹ Ibid.

¹¹⁰ 'China Crunch to Hit Commodities', *Global Trade Review* (online), 26 June 2013 <http://www.gtreview.com/trade-finance/global-trade-review-news/2013/June/China-crunch-to-hit-commodities_10986.shtml>.

¹¹¹ Ibid.

¹¹² Joe McDonald, 'China's Campaign to Clean Up Risky Bank Lending Threatens Credit for Entrepreneurs', *Star Tribune* (online), 28 June 2013 <<http://www.startribune.com/politics/national/213445171.html>>.

¹¹³ 'China Finds "Violations" in Lending by State-Owned Banks', *BBC News Business* (online), 28 June 2013 <<http://www.bbc.co.uk/news/business-23093552>>; 'China's Cash Crunch: Bear in the China Shop', *The Economist* (online), 29 June 2013 <<http://www.economist.com/news/leaders/21580144-not-countrys-lehman-moment-it-does-herald-change-momentum-bear-china>>.

¹¹⁴ Fayen Wong and Polly Yam, 'China Banks Curb Loans to Commodities Firms in Hot-Money Battle', *Reuters* (online), 5 June 2013 <<http://www.reuters.com/article/2013/06/05/china-commodity-credit-idUSL3N0DY0IZ20130605>>.

¹¹⁵ Ibid.

¹¹⁶ 'Asian Banks Stand by to Fill the Commodity Financing Gap', above n 108.

¹¹⁷ 'China Banks behind on Commodities', *Global Trade Review* (online), 23 May 2013 <http://www.gtreview.com/trade-finance/global-trade-review-news/2013/May/China-banks-behind-on-commodities_10920.shtml>.

¹¹⁸ See generally Ross P Buckley, 'The 1993 Revision of the Uniform Customs and Practice for Documentary Credits' (1995) 28 *George Washington Journal of International Law and Economics* 265.

trade finance after the USD.¹¹⁹ However, while use of the CNY by importers and exporters for financing agreements almost doubled during 2013, the currency was mostly used within China.¹²⁰ Globally, the CNY was only used to pay for 0.8 per cent of the world's transactions.¹²¹

Though rigorous training will be required, China has proven itself very adroit at acquiring expertise in a wide range of technical and scientific fields and the trade finance industry should be no exception. In addition, providing trade finance would seem to be a clever move for a government wanting to cut back on risky lending, given the exceptionally low rate of default on trade credits.¹²² In 2012, 73 per cent of all export transactions took place in the Asia-Pacific, and the region received the most letters of credit.¹²³ There is an opportunity for China to make a considerable impact should it choose to step into the regional trade finance industry.

Deepening Cross-Border Cooperation

Deepening regional cooperation on trade finance would be beneficial to all parties.¹²⁴ By pooling resources and expertise, the Asian region would be better equipped to tackle bottlenecks in trade financing.¹²⁵ The cost of providing trade finance would also likely decrease.¹²⁶ Cooperation within the region would reduce reliance on foreign finance, which tends to be heavily procyclical and often destabilising.¹²⁷ This is particularly significant given the current trade finance gap caused by the retreat of European banks from Asia.

In the past, several developing countries with well-developed trade finance institutions have tackled bottlenecks in South–South trade finance by opening branches of their institutions in other countries within the region.¹²⁸ An example is the Thai EXIM Bank, which opened a branch in Moscow in 2009 to facilitate the financing of exports from Thailand to Russia.¹²⁹

In March 2012 the export–import banks of Brazil, Russia, India, China and South Africa ('BRICS') signed two agreements to extend credit facilities to each other in local currencies.¹³⁰ It is expected that the move will reduce the demand for fully convertible currencies for transactions among the BRICS, which should help to reduce transaction costs.¹³¹ The initiative will also assist to shield the

¹¹⁹ Nicole Hong, 'Yuan Hits Milestone in Trade Finance Deals', *The Wall Street Journal* (online), 4 December 2013 <<http://online.wsj.com/news/articles/SB10001424052702303670804579236081045015184>>.

¹²⁰ *Ibid.*

¹²¹ *Ibid.*

¹²² Senechal (ed), 'Global Risks 2011', above n 72, 16.

¹²³ Chito Santiago, 'Shortage of Trade Finance Continues', *The Asset* (online), 24 June 2013 <<http://www.theasset.com/article/24575.html>>.

¹²⁴ Liu and Duval, above n 7, 3.

¹²⁵ *Ibid.*

¹²⁶ See generally *Trade Financing*, UN Doc TD/B/C.II/MEM.2/11.

¹²⁷ *Ibid.* 3 [12].

¹²⁸ Liu and Duval, above n 7, 3.

¹²⁹ *Ibid.*

¹³⁰ *Ibid.* 5 [19].

¹³¹ *Ibid.*

BRICS from the Eurozone crisis and boost trade despite the slow growth of developed country markets.¹³²

Strengthening the regional network of export-import banks and development finance institutions within Asia would assist the region to achieve the aims of the BRICS agreements. As the Eurozone crisis continues, European banks may well continue to withdraw credit from the Asian region. Deepening cross-border cooperation within Asia will reduce the cost of trade finance within the region, tackle current trade finance bottlenecks and help to insulate Asian economies from the crisis in Europe.

Despite the benefits that could be derived from regional cooperation, previous initiatives to improve financial cooperation within Asia have not always received support. In 2010, an East Asia Summit ('EAS') Trade Finance Workshop was held in Sydney and brought together trade finance officials from 13 nations to exchange views on trade finance proposals that could advance regional trade.¹³³ Though financial cooperation was given special attention at the workshop, Australia's idea of establishing an EAS Trade Finance Network was not supported by other members.¹³⁴ Nonetheless, the creation of a trade finance network within Asia is something that regional countries should continue to pursue. Its potential benefits to the region, given the ongoing demand for trade credit in the region, mean it would be very worthwhile.

Creating a Ring-Fenced Liquidity Pool for Trade Finance

Since the global financial crisis, banks have become more risk averse and prefer to work with large, sound multinational firms.¹³⁵ Consequently, SMEs and new exporters have been especially vulnerable to the tightening trade finance conditions.¹³⁶ SMEs typically have a weaker capital base and bargaining power in relation to global buyers and banks, and have been subjected to large increases in trade finance costs.¹³⁷ This is especially true of emerging firms that often face higher interest rates, higher fees on letters of credit and higher capital requirements than established firms.¹³⁸ In addition, firms in developing countries with underdeveloped financial systems and weak contractual enforcement systems are particularly affected by a lack of affordable trade finance as they need it the most.¹³⁹ The lack of available trade finance for SMEs in developing countries impacts economic growth and job creation in those countries.¹⁴⁰

¹³² Ibid.

¹³³ Parliamentary Secretary for Trade (Cth), 'East Asia Summit Trade Finance Workshop Helps Advance Regional Trade' (Media Release, 14 May 2010) <<http://www.trademinister.gov.au/parlsec/releases/2010/ab100514.html>>.

¹³⁴ Eko N M Saputro, 'The East Asia Summit and Regional Financial Cooperation', *East Asia Forum* (online), 18 August 2011 <<http://www.eastasiaforum.org/2011/08/18/the-east-asi-a-summit-and-regional-financial-cooperation/>>.

¹³⁵ Jean-Pierre Chauffour and Mariem Malouche, 'Trade Finance during the 2008–9 Trade Collapse: Key Takeaways' (Economic Premise No 66, Poverty Reduction and Economic Management Network, World Bank, September 2011) 5.

¹³⁶ Ibid.

¹³⁷ Ibid.

¹³⁸ *Trade Financing*, UN Doc TD/B/C.II/MEM.2/11, 4 [13].

¹³⁹ Chauffour and Malouche, above n 135, 5.

¹⁴⁰ Senechal (ed), 'Rethinking Trade & Finance', above n 1, 11.

Assisting SMEs to access trade finance is especially crucial in Asia, as SMEs account for 80–90 per cent of Asian businesses.¹⁴¹

Establishing a small, targeted liquidity pool run by international financial institutions would be useful to assist smaller segments of the market that are more vulnerable to the contraction of trade credit supply.¹⁴² After the global financial crisis, much of the increased liquidity support provided by central banks was used to ease money market conditions and improve liquidity ratios.¹⁴³ As a result, trade transactions did not benefit greatly from the liquidity support, despite having remained a safe haven during the banking crisis.¹⁴⁴ Creating a ring-fenced liquidity pool for trade finance would ensure that adequate funds remain available to assist trade by SMEs and new exporters, even during times of crisis when banks may prefer to direct funds elsewhere.

For banks, the downside to ring-fencing is that liquidity is prevented from being used for other purposes at times when those other purposes might be more pressing.¹⁴⁵ Holding liquidity centrally and directing it to locations where it is most needed is a more efficient and cost effective process from which large cross-border banking groups can benefit.¹⁴⁶ Nonetheless, any disadvantages of a ring-fenced liquidity pool for trade finance could well be outweighed by the benefit of ensuring that trade finance is still available for SMEs and new exporters when economic crises occur and trade finance conditions tighten.

Encouraging Co-Finance between the Various Providers of Trade Finance, including Public Sector-Backed Institutions

The majority of trade finance is provided by the private sector. In 2009, private banks accounted for about 80 per cent of all trade finance lending operations.¹⁴⁷ Such reliance on banks leaves trading firms vulnerable in times of crisis, as seen with the recent drop in trade credit within Asia. To reduce the impact of crises on trade finance flows, public sector actors, such as ECAs and RDBs, should share jointly some of the private sector risk.¹⁴⁸ In the words of Pascal Lamy:

One clear lesson from the Asian financial crisis is that in periods prone to a lack of trust and transparency, and herd behaviour, all actors — including private

¹⁴¹ Ng Chow Soon and Li Sai Yau, 'Securing Trade Finance for Asia's Future Growth' (Finance Issue Brief No 2013/13, Fung Global Institute, November 2013) 2. See also Louella D Desiderio, 'SME Contribution to Asia Economy Limited — Google', *The Philippine Star* (online), 18 April 2013 <<http://www.philstar.com/business/2013/04/18/931832/sme-contribution-asia-economy-limited-google>>.

¹⁴² Auboin, 'Boosting the Availability of Trade Finance', above n 5, 5.

¹⁴³ Auboin and Engemann, 'Trade Finance in Periods of Crisis', above n 5, 19.

¹⁴⁴ *Ibid.*

¹⁴⁵ Viren Vaghela, 'Asian Regulators Get Tough on Liquidity Ring-Fencing', *Asia Risk* (online), 1 April 2011 <<http://www.risk.net/asia-risk/feature/2041993/asian-regulators-tough-liquidity-ring-fencing>>.

¹⁴⁶ *Ibid.*

¹⁴⁷ Pascal Lamy, 'Restart Trade Finance: Rebooting the Engine' [2009] 1 *International Trade Forum* 9.

¹⁴⁸ Auboin, 'Boosting the Availability of Trade Finance', above n 5, 5.

banks ..., export credit agencies and regional development banks — should pool their resources, as far as practicable.¹⁴⁹

An example of a successful private/public partnership was the introduction in 2009 of the Global Trade Liquidity Program by the IFC which allowed an agreement between the IFC and commercial banks for 40–60 per cent co-lending.¹⁵⁰ The program allowed banks to continue to support clients with trade finance.¹⁵¹ It also enabled the IFC to revitalise trade flows by using the banks' vast networks to channel liquidity and credit into emerging markets globally.¹⁵² Within the Asian region, the ADB's Trade Finance Program ('TFP') provides guarantees and loans to commercial banks to support trade, particularly in developing countries. In 2012, the TFP supported USD4 billion in trade, benefiting 1577 SMEs.¹⁵³ When surveyed by the ADB, local banks indicated that without the TFP, their trade finance support to companies would have declined by at least 13 per cent.¹⁵⁴

Mobilising both private and public sector institutions to form a partnership during times of crisis would help to ensure that the needs of those with insufficient funds could be met by institutions with excess capacities.¹⁵⁵ However, co-financing between the two sectors need not only occur in times of crisis. In poor countries, closing structural market gaps requires longer-term public involvement.¹⁵⁶ Furthermore, ongoing risk sharing between the public and private sectors should reduce the impact of any future financial crisis on the availability of trade finance.

Establishing a Regional Trade Finance Database to Facilitate the Collection and Exchange of Information

Filling information gaps between public and private institutions is of great importance, particularly during times of economic crisis. While responding to the financial crisis that commenced in 2008, members of the Bankers' Association for Trade and Finance complained that a series of measures announced by ECAs and RDBs were hard to track.¹⁵⁷ They also lacked access to critical information, such as who was providing what finance and based on what criteria.¹⁵⁸ Such information gaps affect the ability of both the public and private sectors to respond to trade finance challenges, particularly in developing countries.¹⁵⁹ It is thus crucial that information is collected and shared among trade finance stakeholders within the region.

The ICC Trade Register established by the ICC and ADB in 2009 was a significant step towards increasing the sharing of trade finance information. As

¹⁴⁹ Lamy, 'Restate Trade Finance', above n 147.

¹⁵⁰ Auboin and Engemann, 'Trade Finance in Periods of Crisis', above n 5, 17.

¹⁵¹ International Finance Corporation, above n 20.

¹⁵² Ibid.

¹⁵³ Beck et al, above n 48, 2.

¹⁵⁴ Ibid.

¹⁵⁵ Auboin and Engemann, 'Trade Finance in Periods of Crisis', above n 5, 13.

¹⁵⁶ Ibid 3.

¹⁵⁷ Lamy, 'Restate Trade Finance', above n 147.

¹⁵⁸ Ibid.

¹⁵⁹ Ibid.

of November 2012, the database had recorded over 15 million transactions worldwide, reflecting 70 per cent of global transactions.¹⁶⁰ At the time of writing, it is the most comprehensive database available on trade and export finance.¹⁶¹ Nevertheless, the register only records data provided from participating banks¹⁶² and gaps in the data remain. For example, in 2011 the 21 banks participating in the ICC Trade Register provided only a quarter to a third of global trade finance.¹⁶³ Within the Asian region, much more information is needed as to how SMEs in particular finance their trade and the challenges they face.

While the ICC Trade Register provides useful information regarding trade finance transactions, it is not released immediately. The ICC released the latest trade finance report in April 2013,¹⁶⁴ nearly two years after its prior report.¹⁶⁵ This information is crucial for the development of policy regarding trade finance, but it does not provide stakeholders with up-to-date information about the type and amount of trade finance being provided at the present time. In times of crisis, such information is needed to allow trade finance institutions to respond rapidly.

In order to address gaps in trade finance information, a regional database should be created that disseminates relevant information to both public and private institutions, such as the development of programs by ECAs. Such a database should include all trade finance stakeholders within the Asian region, not just commercial banks. It is important that the information gap between the public and private sectors is filled so that both sectors can respond quickly when shortfalls in trade finance arise.

VI CONCLUSION

Trade is essential to the health and growth of economies worldwide. The availability of trade finance is crucial as most trade transactions are supported by some form of credit financing.¹⁶⁶ There is also a strong link between trade finance, economic growth and job creation, which is particularly important in the Asian region. In a survey conducted by the ADB in the fourth quarter of 2012, 138 companies said that a 5 per cent increase in trade finance support would result in a 2 per cent increase in their business and a 2 per cent increase in their staffing needs.¹⁶⁷ The same companies said that a 10 per cent increase in trade finance support would result in 5 per cent increase in production and jobs.¹⁶⁸ These statistics show how crucial trade finance is to East Asia.

The financial crisis of 2007–08 sparked a global shortfall in trade finance and, while the G20 and financial agencies worldwide responded in a significant way,

¹⁶⁰ International Chamber of Commerce Banking Commission, 'The ICC Trade Register' (Report, November 2012).

¹⁶¹ See generally *ibid.*

¹⁶² Sénéchal (ed), 'Global Risks 2013', above n 74, v.

¹⁶³ Committee on the Global Financial System, above n 28.

¹⁶⁴ See generally Sénéchal (ed), 'Global Risks 2013', above n 74.

¹⁶⁵ See generally Senechal (ed), 'Global Risks 2011', above n 72.

¹⁶⁶ Auboin, 'Restoring Trade Finance', above n 3.

¹⁶⁷ Asian Development Bank, *\$425 Billion Gap in Trade Finance Hits at Growth and Jobs in Asia* (12 March 2013) <<http://www.adb.org/news/425-billion-gap-trade-finance-hits-growth-and-jobs-asia>>.

¹⁶⁸ *Ibid.*

a substantial trade finance gap remains. A recent survey by the ADB shows that in 2011, banks responding to the ADB survey received trade finance requests amounting to nearly USD4.6 trillion and had to reject USD1.6 trillion of these requests.¹⁶⁹ This figure indicates that a significant proportion of global trade is unable to be financed. Given global trade totalled USD18 trillion in 2011,¹⁷⁰ it is likely that the actual trade finance gap is very substantial indeed.

The shortfall has particularly affected the Asia-Pacific region, as a higher proportion of trade is financed there than in any other region. The ADB survey suggests a trade finance gap of at least USD424.72 billion in developing Asia,¹⁷¹ which has arisen in part due to the rapid reduction in finance provided by European banks struggling with the ongoing economic crisis at home. While international and Japanese banks have stepped in, the amount of trade finance provided in Asia is still insufficient and the cost has increased considerably.

The impending full implementation of Basel III poses a further challenge to trade finance in the Asian region. While the relaxation of the LCR requirements in January 2013 and changes to the leverage ratio in January 2014 eased the pressure on trade finance, these amendments did not eradicate it. Further adjustments are required to ensure that the longer-term impact of Basel III does not increase the cost of financing trade. In particular, changes to the AVC are necessary to prevent rising trade finance prices impacting on global growth. With respect, the proposal to increase the risk weighting on trade finance to 100 per cent must have been the work of people without experience in these markets. No one who understands the finance of international trade could perceive it as a risky industry or as a source of unwanted leverage in the system. The Basel Committee's most welcome recent decision to reduce the CCF used in calculating the leverage ratio back to 20 per cent supports this view.

A number of strategies could be implemented to address a lack of affordable trade finance in the Asian region. These include strengthening cross-border cooperation, encouraging co-financing between the public and private sectors, establishing a regional trade finance database to share information and creating ring-fenced liquidity pools for trade finance. In times of crisis, it is essential that all stakeholders work together and share information and resources to address trade finance needs efficiently and effectively.

It is a little curious that China has not yet seized the opportunity presented by Europe's rapid retreat from trade finance in Asia to step into the gap. Given the low risk nature of trade finance, it would seem an attractive way for Chinese domestic banks to expand into conducting international business. Nevertheless, the substantial size of the current trade finance gap suggests there is still space for China to make a move. Trade finance offers China a very low risk field into which its banks could expand. Such a move would help to address the ongoing trade finance gap and support the further development of economies in the Asian region.

¹⁶⁹ Beck et al, above n 48, 3.

¹⁷⁰ Senechal (ed), 'Rethinking Trade & Finance', above n 1, 36.

¹⁷¹ Beck et al, above n 48, 3.