2. IFC's Global Trade Finance Program: Objectives and Design

Chapter Highlights

- IFC introduced its current trade finance model in FY05 to support the supply of trade finance to underserved clients globally.
- The program aimed to take advantage of IFC's existing global network of banks and bridge gaps in the supply of trade finance to developing countries.
- The Board raised the authorized ceiling of the program several times, from $500 million in FY06 to $5 billion in FY13.

Program Objectives, Design, and Evolution

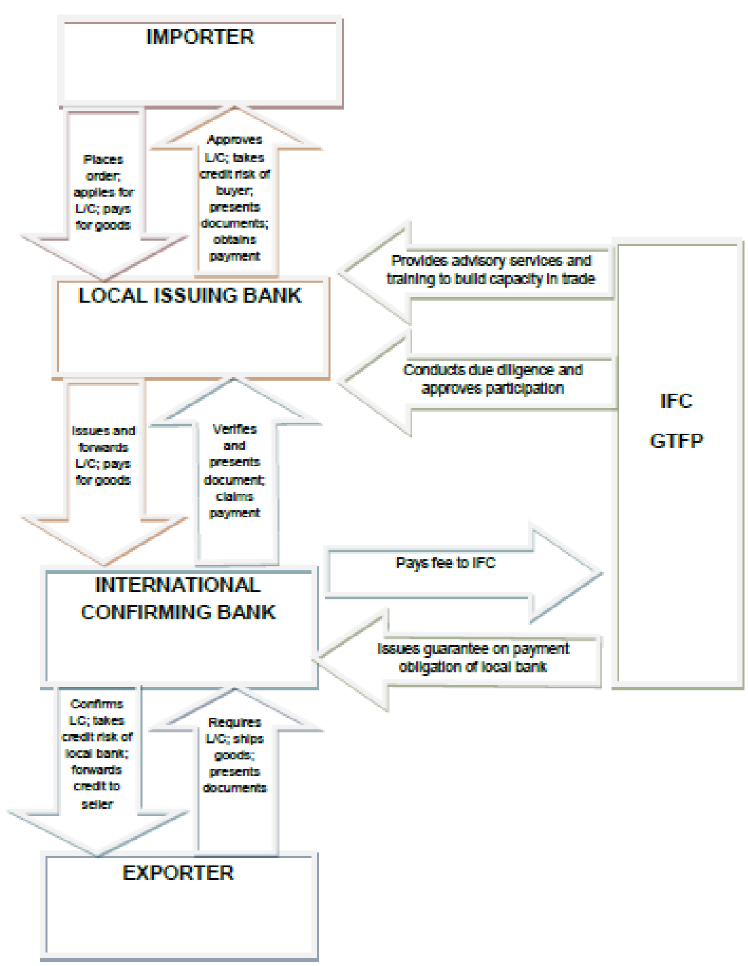
IFC introduced its current trade finance model in FY05. In November 2004, the Board of Directors approved IFC's proposed $500 million Global Trade Finance Program (GTFP I). The objective of the program as stated in an internal IFC Board document was to "support the extension of trade finance to underserved clients globally." Trade in developing countries was not being supported by adequate amounts of trade finance because of "high perceived risks, a lack of guarantors, a lack of capacity among development banks, and limited mandates of national export credit agencies". Under its new program, IFC would assume the trade-related payment risk of local "issuing" banks in developing countries by providing guarantees to their correspondent "confirming" banks (see Box 2.1). The program aimed to enable IFC to respond quickly to support liquidity when and where it was needed; help local banks develop relationships with international counterparts; and enhance trade finance capabilities among local banks through training and technical assistance.

The new model sought to address several weaknesses in IFC's past support for trade finance. Between 1998 and 2004, before the launch of the GTFP, IFC established 24 trade finance facilities for a total committed amount of $652 million. Of these 24 facilities, only 3 were fully disbursed; 10 were partially used; and 11 were never used. Weaknesses with previous programs included their restriction to bilateral agreements, which were designed for use with a single country with a narrow set of eligible parties; cumbersome procedures that undermined the ability to respond to changing market conditions; fixed prices that may not have been in line with market rates; stringent financial reporting requirements that did not follow market practices for trade-related transactions; and high capital charges that were not in line with the lower-risk profile of trade finance and that reduced the profitability of the trade facilities. The GTFP was based on the European Bank for Reconstruction and Development's (EBRD) trade finance model that was introduced in 1999. Key elements of the model included the flexibility to support trade as it shifted with market conditions; a quick response process and documentation in line with the nature of short-term trade transactions; flexible pricing according to market rates; and the ability to take 100 percent of the risk coverage.

Box 2.1. Operation of a Typical GTFP Letter of Credit Transaction

Most GTFP guarantees have supported letters of credit transactions. Under the GTFP, IFC conducts due diligence and establishes a roster of approved local "issuing banks" in developing countries. It can then guarantee their payment obligations on specific trade transactions. The guarantees are comprehensive, covering both political and commercial risks, and IFC can cover either the full amount or a partial amount of the transaction. Tenors have ranged from 1 day to over 2 years and have averaged 5 months.

The diagram at right illustrates the operation of a typical letter of credit transaction guaranteed by the GTFP. An importer places an order from an exporter. The importer's bank issues a letter of credit though a correspondent bank (usually in the same geographical region as the exporter). The correspondent bank may then request a partial or full guarantee from IFC to cover the payment risk of the issuing bank. Having received the IFC guarantee, the confirming bank then undertakes an obligation to pay the exporter on presentation of relevant documents.



Source: IEG, based on IFC program information.

The GTFP aimed to take advantage of IFC's existing network of banks and bridge gaps in the provision of trade finance. It initially sought to take advantage of the depth and breadth of the network of banks with which IFC had established relationships through its long-term investments. The main target market was local banks in higher-risk markets that regularly reached limits on trade volumes and that had a limited number of relationships with international confirming banks. Introducing banks to each other was expected to help expand trading networks. The program was expected to help expand available financing to local banks in LICs, particularly to support their SME clients. In middle-income countries (MICs), the program would make longer-term tenors (over 360 days) available for import of capital goods. The flexibility of the program was expected to help IFC respond to shifting global needs without delaying implementation or adding costs. Along with issuing guarantees, the program would also provide cash advances where there was no liquidity available. To mobilize confirming banks' use of their own capital, the GTFP would aim to restrict its coverage to 75 percent of the transaction value at the program level.

IFC also introduced the Trade Advisory Program to help local banks build capacity in trade operations. In 2006, IFC established the Trade Advisory Program to help transfer international best practices and improve banker's technical and operational skills in trade finance. Through training and advisory services to banks, the program aimed to (i) transfer capacity to structure basic and complex trade finance transactions; (ii) improve trade finance risk-mitigation techniques; (iii) upgrade trade finance back office skills; and (iv) build capacity to provide trade finance services to local SMEs. The program sought to help local issuing banks fully benefit from participating in the GTFP as well as mobilize additional trade finance in the longer term by establishing relationships with international banks.

In FY07, IFC reported that GTFP volume had surpassed expectations, particularly in Africa, and requested an increase in the program's ceiling. In December 2006, IFC went back to the Board to request a $500 million increase in the GTFP (GTFP II), to bring the program ceiling to $1 billion (see Table 2.1). It reported a "very favorable" market response to the program. In the program's first 14 months, $555 million in guarantees had been issued, compared to projections of $150 million. The program was also mainly supporting trade finance in Africa and other smaller, less-developed countries, as well as trade in goods in the SME sector. The substantial projected volume in Europe and Central Asia had not been realized because of the inability to realize a risk-sharing arrangement with EBRD. However, volume in Africa, which had initially been projected to be 4 percent of the program, had actually been 70 percent. In addition, although the majority of the GTFP volume supported imports into developing countries, some $93 million had supported exports from developing countries.

Table 2.1. Increases in the GTFP Program Limit since FY05

Board date	Amount of increase	New program ceiling	Rationale for increase
November 11, 2004	NA	$500 million	Objective: To increase access to trade finance in underserved markets globally by bridging gaps in the market supply of trade finance.
January 11, 2007	$500 million	$1 billion	Favorable market response, particularly in Africa and smaller, less-developed countries. Continued strong demand seen in Africa.
October 2, 2008	$500 million	$1.5 billion	Increased demand was expected from continued demand in Africa, expansion in the number of confirming banks by 50 percent, broader familiarity with the program; reduced credit appetite among major banks because of tightening credit conditions and reduced liquidity; and higher oil and commodity prices that had increased the value of imports.
December 18, 2008	$1.5 billion	$3 billion	Increased demand as a result of the credit tightening, increased risk aversion, and capital constraints among the major international trade banks; expansion of program to existing client banks that previously did not need the program; risk-sharing arrangements with development finance institutions and private insurers.
September 27, 2012	$2 billion	$5 billion	Larger trade finance gaps caused by withdrawal of some major trade finance banks from business; strong demand as a result of continuing crises and more stringent regulations, especially among European banks; increased demand in Asia.

Source: IEG based on IFC GTFP Board Documents, 2004, 2008a, 2008b, 2012.

Several modifications to the program were proposed, and IFC planned to expand the program beyond its existing network of client banks. To further enhance use of the program, four modifications were proposed: (i) expand eligibility to include nonbank financial institutions (ii) expand eligible transactions to include intra-country trade; (iii) permit undisclosed guarantees in which the issuing bank would not be aware of the guarantee (silent confirmations); and (iv) allow 100 percent guarantee coverage on transactions with financial institutions that were appraised on a desk-based basis as long, as they did not exceed 10 percent of the program total. IFC also identified a shift in the program's emphasis away from IFC's existing network of banks. At that point, many of IFC's existing client banks were large banks in their respective markets and did not need guarantee support from the GTFP. Instead, IFC would engage a "wide universe" of second-tier and smaller banks. Given the strong demand seen in Africa, that region was identified as the strategic focus of the program. The "vast majority" of new issuing banks added to the program were expected to be in frontier markets.

A further $500 million increase in the program ceiling was requested in early FY09. In September 2008, shortly before the full effects of the emerging global financial crisis took effect, IFC requested a further increase in the GTFP ceiling to $1.5 billion (GTFP

III). The program had seen continued rapid growth. Africa continued to represent a major focus of the program, with one-third of issuing banks in the Africa Region. IFC also emphasized the program's reach among confirming banks in developing countries and its support for South-South trade.

IFC noted that the risk-sharing proportion of the program had declined (from 34 percent in 2007 to 23 percent in 2008) because of tightening liquidity, a decline in the secondary markets, and decreased risk appetite in international markets. Increased demand for the GTFP was expected from the continued demand in Africa; expansion in the number of confirming banks; broader awareness and familiarity with the program; reduced credit appetite among major banks because of tightening credit conditions; and higher oil and commodity prices that had increased the value of imports. In this context, the higher ceiling would enable IFC to continue to support trade finance in markets such as agriculture, IDA countries, South-South, and Africa.

In December 2008, the GTFP's authorized ceiling was doubled as part of IFC's response to the global financial crisis. Three months later, the Board approved a further $1.5 billion increase in the program size, bringing its ceiling to $3 billion. The increase was part of several initiatives proposed by IFC in response to the global financial crisis. These included a bank recapitalization fund, an infrastructure crisis facility, and refocusing advisory services to help clients through the crisis. The additional increase in the GTFP was based on increased demand seen as a result of the credit tightening, increased risk aversion, and capital constraints among the major international trade banks ensuing from the global financial crisis. IFC also planned to expand the program to existing client banks that previously had not needed the program, as well as to enter into risk-sharing arrangements with other development finance institutions and private insurers. As part of its crisis response, in May 2009, IFC also introduced the Global Trade Liquidity Program (GTLP) to support liquidity among international banks engaged in trade finance in developing countries during the crisis (see Box 2.2).

In FY13, the program's ceiling was increased to $5 billion. In September 2012, the Board approved a further $2 billion increase in the GTFP to bring the program's ceiling to $5 billion. The program had continued to grow, and in June 2012, outstanding guarantee commitments had reached $2.9 billion, its highest ever. Further expected growth was also expected because of aggravation of the gaps in trade financing caused by the deleveraging by some European banks that were traditionally large players in trade finance, increased demand from Asia, and increased costs of regulatory compliance. No changes were proposed to the program's design. Key elements of the program achievements highlighted by IFC include its high-reach, low-risk profile; reach in IDA and fragile countries; ability to provide "first-touch" investment opportunities for IFC; and support for strategic sectors such as agriculture and clean energy.

Box 2.2. IFC's Trade and Supply Chain Products

Global Trade Finance Program

- Established in FY06, the GTFP is IFC's flagship trade finance program that developed a new, more flexible, quicker-response means to support trade finance.
- GTFP aims to support access to trade finance in underserved markets worldwide. Its authorized ceiling has grown from $500 million in FY06 to $5 billion in FY13.

Global Trade Liquidity Program

- Established in FY09, the GTLP is a multipartner initiative of governments, development finance institutions, and private sector banks that aims to help address the shortage in trade finance resulting from the global financial crisis.
- Using both funded and unfunded instruments, the program has sought to increase access to trade finance in emerging markets by providing liquidity and risk mitigation to some international banks with large trade networks.

Global Trade Supplier Finance

- Established in FY11, this program is a combined investment and advisory program that provides short-term financing to exporters in emerging markets that sell to large international companies on open account terms.
- The program seeks to increase direct access to short-term finance for exporters in developing countries, reduce the costs of finance for exporters, and increase local supplier sales to large international firms in the program.

Global Warehouse Finance Program

- Established in FY11, the program aims to increase working capital financing to farmers and agriculture producers by leveraging their production stocks.
- The program provides banks with liquidity or risk coverage backed by warehouse receipts, which can be used to provide short-term loans or guarantees to agricultural producers and traders ahead of export.

Critical Commodities Finance Program

- Established in FY12, the Critical Commodities Finance Program supports the movement of agricultural and energy products to and from developing countries by promoting commodity-backed finance.

Source: IEG, based on IFC documents.

Other Trade Finance Initiatives

The GTFP is the flagship product among several other trade and supply chain programs introduced by IFC in the last few years. In May 2009, IFC established the GLTP to address liquidity constraints and temporarily support trade finance flows to developing countries. The $1 billion program was a collaborative effort among bilateral and multilateral development finance institutions and governments to disburse funds to global and regional banks with extensive trade networks. The program was enhanced in January 2010 with a further $1 billion in unfunded guarantee support. As a temporary crisis response measure, the GTLP was scheduled to be phased out in 2012, but has since been extended because of continued weaknesses in global financial markets. A review of the GTLP is presented in Appendix A. In FY11, two additional trade and supply chain programs were initiated: the Global Trade Supplier Finance Program and the Global Warehouse Finance Program. These two programs seek to enhance trade by supporting access to working capital for suppliers in developing countries and for farmers and SMEs in the agriculture sector (see Box 2.2).

The GTFP has become a major part of IFC's activities. Since its establishment in 2005, the GTFP has grown from 5 percent of IFC's total annual commitment volume to 39 percent in 2012 (Table 2.2). In 2012, the GTFP accounted for 48 percent of IFC commitments in the Latin America and the Caribbean Region and 53 percent of commitments in the Sub-Saharan Africa Region. GTFP commitment volume has grown by an annual average of 75 percent a year since FY06 compared with 10 percent a year for long-term finance. As discussed in Chapter 4, however, IFC's method of reporting its trade finance products may overstate their relative size in IFC's business.

Table 2.2. Annual GTFP Commitments as a Proportion of Total IFC Commitments (percent)

Region	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY06–08	FY09–12
East Asia and the Pacific	0	0	2	13	22	31	43	1	27
Europe and Central Asia	1	3	2	9	18	29	34	2	23
Latin America and the Caribbean	3	12	16	32	40	49	48	10	42
Middle East and North Africa	2	9	15	40	36	49	40	9	41
South Asia	2	2	2	9	16	28	24	2	19
Sub-Saharan Africa	29	27	44	36	32	43	53	33	41
Total	4	9	13	23	27	38	39	9	32

Source: IEG, based on IFC data.

This evaluation focuses on the GTFP in the period FY06–12. This is the Independent Evaluation Group's (IEG's) first comprehensive evaluation of an IFC trade finance program. It therefore pilots an evaluation approach and methodology. During the approach paper stage, the evaluation proposed to cover the GTFP, the GTLP, and IFC's trade finance Advisory Services. During the preparation phase of the report, IEG determined to focus primarily on the GTFP because of the differences among instruments and the need to adequately develop and test a methodology prior to applying it to other trade and supply chain products. The focus of this evaluation is therefore on the GTFP, with lesser coverage of the Trade Advisory Program and the GTLP (a review of which is presented in Attachment II). The other trade and supply chain products such as the Global Warehouse Finance Program and Global Trade Supplier Finance were introduced recently and do not have adequate data and experience to be evaluated as yet. IEG will prepare additional evaluations that will build on the methodology introduced in this report and cover other trade and supply chain products in the future.

Summary

- IFC introduced GTFP in FY05 with a ceiling of $500 million to help enhance the supply of trade finance in underserved markets.
- The main target market for GTFP was local banks in higher-risk markets that regularly reached their limits on trade volumes and that had a limited number of relationships with international confirming banks.
- The GTFP ceiling was increased to $1 billion in FY07. In FY08, the GTFP ceiling was further increased to $1.5 million. In FY09, the ceiling was doubled to $3 billion because of increased demand during the financial crisis. Most recently in FY13, the GTFP ceiling was increased to $5 billion.
- The GTFP is the flagship product among several other trade and supply chain programs introduced by IFC in the last few years. It has increased substantially to 39 percent of total IFC commitments.
- This evaluation introduces a methodology for IEG to evaluate IFC's trade finance programs and focuses on the GTFP in the period FY06–12.

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