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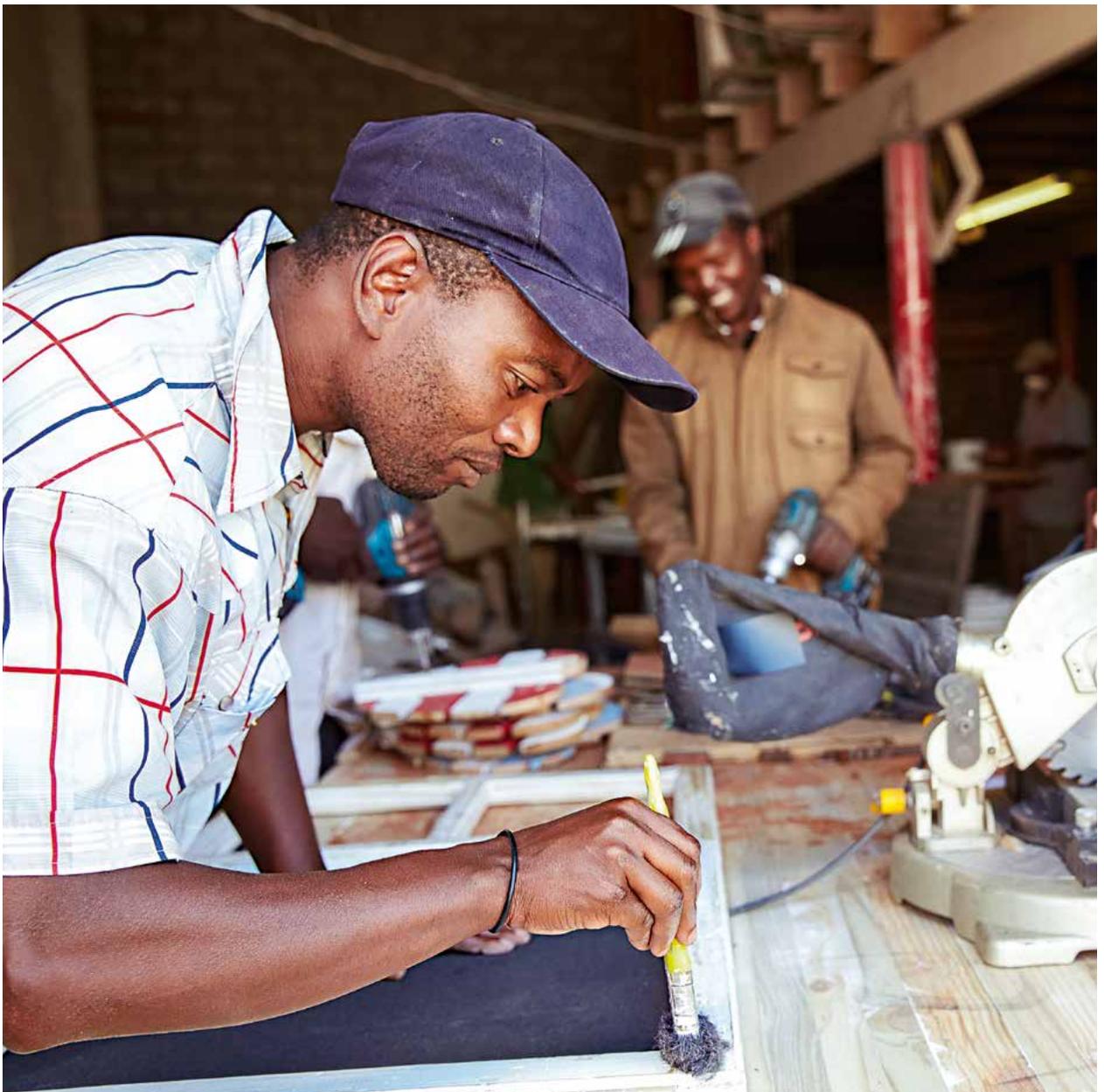


IFC

International
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WORLD BANK GROUP

Trade finance and the compliance challenge

A showcase of international cooperation



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Foreword



Philippe Le Houérou,
IFC Chief Executive Officer



Roberto Azevêdo,
WTO Director-General

In 2017, an IFC report¹ pinpointed the reductions in the network of correspondent banks in emerging markets. In emerging markets, correspondent banking stress and compliance challenges drove some respondent banks to retrench their own businesses. At the time, the trade finance gap was estimated at around US\$1.5 trillion.² It has likely widened since.

Global correspondent banks are reassessing their emerging market strategies. In recent years, both compliance costs and potential regulatory risks have grown exponentially, making it more challenging to stay engaged. Smaller countries, with lower business potential, are particularly vulnerable. Trade finance shortages have been chronic and persistent in the developing world.

Stepping up cooperation in this area is vital to boost global trade, lift economic activity, create jobs and achieve the UN's Sustainable Development Goals.

WTO, IFC, other development banks and the Financial Stability Board (FSB) have come together to mobilize resources to enhance trade finance programmes and develop risk sharing frameworks.

¹ International Finance Corporation, 2017.

² Asian Development Bank, 2017.

We also have started an unprecedented technical assistance effort to train a new generation of trade finance specialists and to build capacity on anti-money laundering and combating the financing of terrorism in developing countries. We have created a network to disseminate international best practice among the global trade community. In addition, the WTO, IFC and FSB are working together to inform trade finance providers about relevant regulatory requirements, promote tools to make compliance more effective and less costly for local banks, and help them attract new correspondents.

This publication, “Trade finance and the compliance challenge: A showcase of international cooperation”, presents the efforts made so far. It provides an explanation of the current global trade finance gaps amid market failures as well as perceived regulatory risk. The publication presents an analysis of the recent trends of de-risking and the reasons for falling correspondent banking relationships. It shows how WTO, IFC and FSB have started working together to respond to this issue since the end of 2017.

Finally, this publication shares real-life experiences in building capacity on trade finance and compliance through a range of illustrative case studies.

We have a long way to go, but we have already made some significant progress. Together, we can ensure that trade finance availability is no longer a barrier but a springboard to trade, economic growth and development. ■



Philippe Le Houérou
IFC Chief Executive Officer



Roberto Azevêdo
WTO Director-General

Co-publishers

The **World Trade Organization** (WTO) is the only global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to help producers of goods and services, exporters, and importers conduct their business.

The **International Finance Corporation** (IFC), a sister organization of the World Bank and member of the World Bank Group, is a global development finance institution focused exclusively on the private sector in developing countries.

Contributing institutions

The **Asian Development Bank** (ADB) is an international development financial institution dedicated to reducing poverty and fostering development in Asia and the Pacific through loans and expertise.

The **European Bank for Reconstruction and Development** (EBRD) is an international development finance institution that invests in projects, mostly in the private sector, and in work on policy reform and provides technical advice to promote sustainable growth.

The **International Islamic Trade Finance Corporation** (ITFC) is a specialized institution that promotes the trade of the member countries of the Organization of Islamic Conference by providing trade finance and engaging in activities, including investment and advisory, that facilitate intra-trade and international trade.

Acknowledgements

Many people have contributed to this publication, either directly by providing written contributions or by participating in the design, editing and reviewing process, or more indirectly by actually reporting on the capacity-building activities that they have been organizing in the field. Special acknowledgment should go to the WTO team including, in alphabetical order, Marc Auboin, Anthony Martin, Heather Sapey-Pertin, Helen Swain and David Tinline; the IFC team, including Hyung Ahn, Kuntay Celik (World Bank), Emmanuel Mathias (IMF), Samantha Pelosi (BAFT), Susan Starnes, Alexei Timofti, and Makiko Toyoda; and the EBRD (Kamola Makhmudova, Rudolf Putz), ADB (Steven Beck, Maria Clarissa A. Laysa, Pinky Rose Lustre, Can Sutken) and ITFC (Anisse Terai).

Executive summary

- Up to **80 per cent of trade** is financed by credit or credit insurance but availability of finance varies across regions. A lack of trade finance is a significant barrier to trade, particularly (but not exclusively) in developing countries.
- Small and medium-sized enterprises (SMEs) face the greatest hurdles in accessing affordable financing. The poorer the country in which they are based, the greater the challenges SMEs face in accessing trade finance. **Seventy-five per cent of rejected requests for trade finance relate to SMEs.** The number of international banks involved in trade finance continues to decline.
- The estimated value of **unmet demand for trade finance** is US\$ 1.5 trillion annually. About 40 per cent of this unmet demand is in developing Asia, and 10 per cent is in Africa. Bridging this gap would unlock the trading potential of many thousands of individuals and small businesses around the world.
- **Gaps in trade finance** provision are widest in developing countries, where opportunities to trade are increasing as global production patterns evolve.
- The **reluctance of the global financial sector to invest in developing countries** after the 2008-09 financial crisis compounds the problem of gaps in trade finance in certain countries because local banks require trade finance transactions to be settled in the currency of the transaction, which requires the participation of banks in the country which issues that currency. Local banks need international correspondent banks to confirm their letters of credit, engage with them in supply chain finance and clear trade-related payments in foreign currency.
- **Some 200,000 correspondent banking relationships**, over about a million in total, **have disappeared** since the end of the financial crisis. Africa, the Caribbean, Central and Eastern Europe and the Pacific Islands are the regions most affected by the termination of correspondent banking relationships. Flows of trade finance are particularly affected.
- In developed countries, there has been **a heightened perception of the regulatory risk of operating in developing countries** since the adoption of new anti-money-laundering and countering the financing of terrorism (AML/CFT) regulations and other regulations involving sanctions (particularly regulations pertaining to trade and financial sanctions). The adoption of these regulations has played a significant role in the decisions taken by many global banks to terminate certain correspondent banking relationships.

- Local banks, in turn, have found themselves faced with **varying levels of demand from foreign jurisdictions in terms of complying with regulations**, and they are often hard-pressed to comply with all of the new requirements. They risk being marginalized within the financial system, with consequences for the economic development of the countries in which they are based.

- The international trade, development and financial communities have realised that they must **address the challenges facing trade finance**. For this reason, the WTO Director-General Roberto Azevêdo and IFC Chief Executive Officer Philippe Le Houérou joined forces with the Chair of the Financial Stability Board (FSB) on an incremental strategy, involving improving local capacity-building, promoting tools to reduce the cost of due diligence, and improving the process for identifying trade finance entities. The WTO and IFC have given strong support to the efforts of multilateral development banks to develop their own repositories of information on customers.

- **Joint missions in countries affected by trade finance gaps have involved experts from IFC, the WTO, the FSB and multilateral development banks**, providing guidance on trade finance and regulatory compliance requirements. The dissemination of such knowledge is key to reconnecting local trade finance providers to the rest of the world's network of trade finance distribution.

- At the annual meetings of the International Monetary Fund and World Bank in October 2018 in Bali, Indonesia, DG Azevêdo and CEO Philippe Le Houérou co-hosted a session on **“Financial Inclusion in Trade”**, aimed at discussing future inter-institutional steps to reduce the US\$ 1.5 trillion global trade finance gap and address the regulatory compliance challenges. Heads or senior officials of the IMF, the EBRD, the Islamic Development Bank, the African Export-Import Bank and the FSB also participated in this event.

- More inter-institutional cooperation is needed to address the shortages of trade finance which are hindering the trade opportunities of many developing countries. DG Azevêdo and CEO Le Houérou have supported the publication of this report, which includes a number of **case studies on how best to address regulatory compliance in trade finance**.

Introduction

The availability of trade finance has become an increasingly important issue in the past few years. For merchandise trade flows of over US\$ 18 trillion annually to flow smoothly, there needs to be a well-functioning trade finance market serving the needs of global traders. However, the supply of trade finance does not meet demand in many regions. Even before the 2008-09 global financial crisis, a significant gap existed between the demand and supply of trade finance in emerging markets; since the crisis, this gap has grown, with some regions affected more than others.

A 2014 study by the Bank of International Settlements (BIS, 2014) revealed that a large share of international trade finance was supplied by a relatively small group of about 40 international banks. This group accounted for some 30 per cent of trade finance intermediated by banks, with local and regional banks supplying the remainder. Since the global financial crisis, many of these banks have been downsizing their balance sheets and reducing the network of their correspondent banking relationships with other banks in the world, particularly in developing countries, a phenomenon called “de-risking”.

The International Finance Corporation (IFC) found that over one quarter of the more than 300 emerging market

banks across over 90 countries reported declines in relationships with correspondent banks, reducing their ability to serve customers (IFC, 2017). The Financial Stability Board (FSB) established a work programme in 2015 to address the reduction of correspondent banking relationships. According to the FSB, 200,000 correspondent banking relationships were terminated from 2011 to 2017, out of a pre-crisis total of roughly 1 million.

“The supply of trade finance does not meet demand in many regions.”

The Asian Development Bank (ADB) estimated the global trade finance gap to be close to US\$ 1.5 trillion in 2017. This gap represents the amount of trade finance requests that are rejected. In many developing countries, the alternatives to bank financing are scarce. Consequently, when trade transactions are rejected by banks, most of them are abandoned. A little less than half of the US\$ 1.5 trillion trade finance gap concerns developing countries in Asia. A significant share of the gap occurs in Africa: the estimated gap of about US\$ 100 billion a year accounts for about one third of the trade finance market in the continent.



CEO Le Houérou and DG Azevêdo co-hosted a session on financial inclusion in trade at the IMF/World Bank Group Annual Meeting in Bali, Indonesia in October 2018.

Globally, 60 per cent of all trade finance requests by small and medium-sized enterprises (SMEs) are rejected, against only 7 per cent for multinational companies. According to the 2016 Global Enabling Trade Report of the World Economic Forum,

lack of trade finance is among the top three exporting obstacles for half of the countries in the world.

Since 2017, WTO Director-General Roberto Azevêdo and IFC Chief Executive Officer Philippe Le Houérou have worked with other multilateral institutions, meeting on several occasions to discuss this topic and identified effective remedial actions. Further dialogue with the FSB should help to clarify regulatory expectations, reduce the cost of regulatory compliance, build capacity

“ The ADB estimated the global trade finance gap to be close to US\$ 1.5 trillion in 2017.



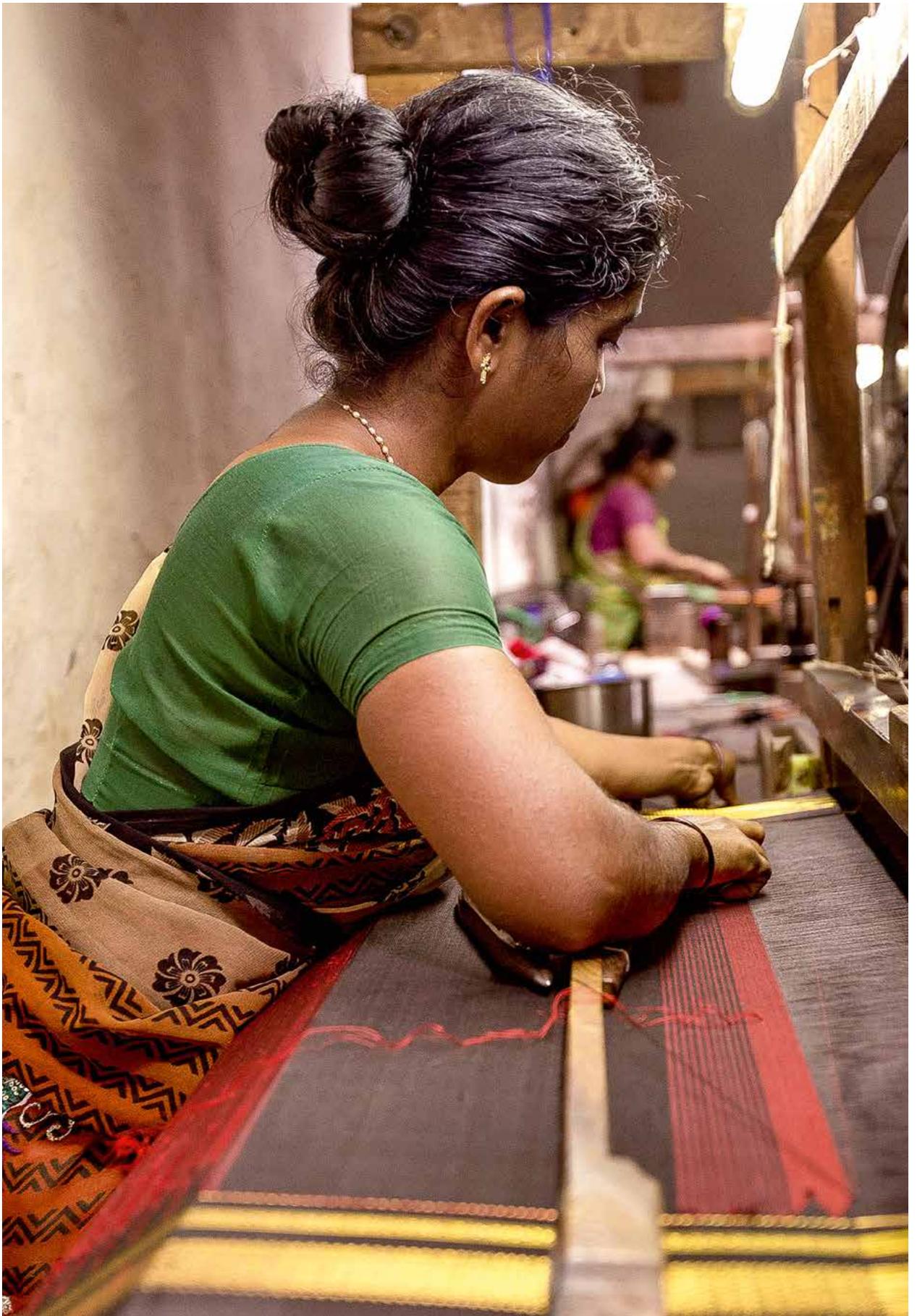
in smaller local respondent banks and encourage larger correspondent banks to return to markets from which they had withdrawn.

Joint technical assistance is needed to build knowledge on both trade finance and compliance requirements. Trade finance support offered by multilateral development banks helps local companies which are having difficulties accessing trade finance and provides risk mitigation for local banks. However, training is required to meet the compliance challenges encountered by financial institutions when supplying trade finance, notably in developing countries.

Looking at best practices in capacity-building, this publication examines current strategies to respond to these

challenges in emerging markets, the work that remains to be done, and the lessons to be learned.

Chapter 1 provides background on the persistent trade finance gaps in developing countries. Chapter 2 looks at how trade finance has been vulnerable to international banks reducing their exposure to trade finance, known as de-risking, which has led international organizations in the trade, development and financial fields (the WTO, IFC and FSB in particular) to engage in dialogue and cooperation. Chapter 3 features a number of case studies provided by several international institutions, highlighting examples of trade finance and compliance capacity-building endeavours in many countries affected by de-risking. ■



Chapter 1

Reasons for persistent trade finance gaps

- Trade finance is a particularly safe form of finance but it is commonly perceived to be subject to high risks.
- Smaller traders dependent on trade finance are more likely to see their requests for trade finance rejected than any other category of firm.
- In two-thirds of cases, traders whose requests for trade finance have been rejected do not attempt to seek alternative financing, simply because it is not available.

The disconnect between perceived and actual risk

There are various causes for the existing trade finance gaps. Among them are the failures of operators to recognize the low risk associated with trade finance (Asian Development Bank Institute, 2017).

While the commercial risks involved in an international trade transaction seem in principle to be larger than those involved in a domestic trade transaction – e.g. non-payment, loss or alteration of the merchandise during shipment, fluctuating exchange rates – trade finance is a particularly safe form of finance, as it is underwritten by strong collateral, is carefully documented

by credit operations, tends to have relatively short tenors, and is often self-liquidating. The low-risk nature of short-term trade finance is supported by data collated by the International Chamber of Commerce's (ICC) *Trade Register Report*, established in 2011. According to the reports from 2013 to 2017, the average transaction default rate on short-term international trade finance (credit and guarantees) was no more than 0.46 per cent, with a recovery rate of 52 per cent, mostly through the re-sale of the collateral, the merchandise.

Table 1 (see page 14) provides more detailed data across specific categories of short-term trade finance instruments.

Table 1: Risk characteristics of short-term trade finance products, 2008-17

Category	Default rate	Implied maturity (days)	Recovery rate
Import and export letters of credit	0.22%	80	71%
Loans for import/export	0.8%	120	45%
Performance guarantees	0.36%	110	18%
Total	0.46%	90	52%

SOURCE: WTO, based on the ICC *Trade Register Report* averages, from 2013 to 2017.

As evidenced in ADB's 2017 Trade Finance Gaps, Growth, and Jobs Survey, one of the main reasons for the rejection of trade finance, when it is requested in certain regions, is the perception of high risk. Yet, as shown by the *Trade Register Reports*, the underlying transaction default rates for transactions are very small (0.39 per cent in Africa compared to 0.38 per cent in Europe and 0.5 per cent in Latin America) (ICC, 2016). The gap between the perception and actual level of risk of the transactions is clearly one of the main causes for the lack of trade finance in certain regions.

One way to reduce the "confidence" gap is to continue disseminating information regarding the low risk of trade finance and to work at maintaining a strong database supporting this. The latest ICC *Trade Register Report* (ICC, 2017) is based on data collected from 25 global banks on 20 million trade finance transactions,

worth a total of US\$ 11 trillion in trade transactions/flows.

Small and medium-sized enterprises (SMEs) in developing countries

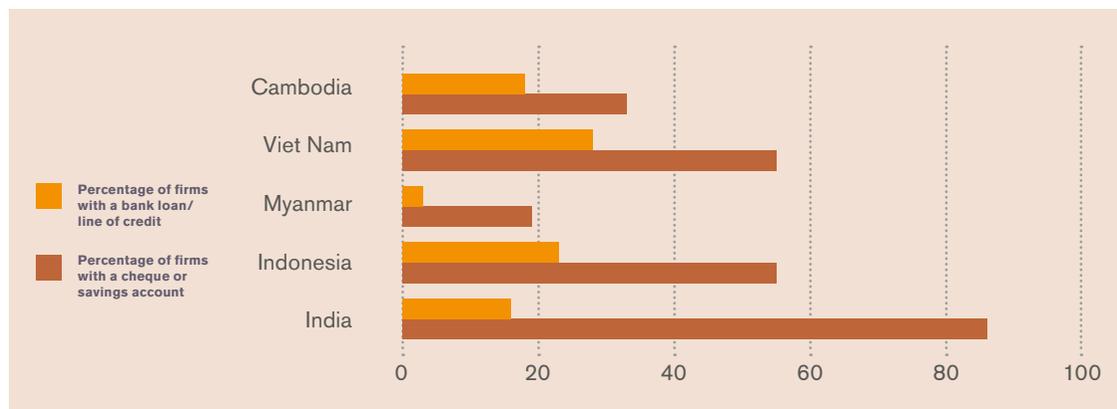
Trade in low-income countries is more likely to be undertaken by SMEs, as the size of trading companies is by and large proportionate to the size of their economies. As reflected in ADB (2017), trade-lending to SMEs in developing countries is severely constrained by their lack of credit history, limited knowledge and experience of trade finance, and absence of collateral. SMEs are also likely to be subject to greater selectivity from local banks when providing finance and more reliant on local currency financing to finance their trade.

As highlighted by the African Development Bank's survey on trade

finance in Africa (AfDB, 2017), bank-intermediated finance is concentrated in customers with whom they have a long history. SMEs account for only 15 per cent of banks' total trade finance portfolio. The relatively low share is attributed to the higher risk perception associated with these clients, despite a default rate on SME loans of less than 3 per cent across the continent. The ADB survey reveals similar findings in Asia. As shown by Figure 1, only a limited share of SMEs uses banking services. Moreover, according to ADB (2017), companies whose requests for trade finance were rejected were likely, in a quarter of such cases, to resort to the informal sector, suggesting that the transaction has sufficient potential value for the firm to be willing to borrow expensively or/and informally.

The most recent ADB trade finance gap surveys (ADB, 2016; 2017) confirmed that smaller traders' requests for trade finance were more likely to be rejected than any other category of firm. While about half of their requests for trade finance were rejected by banks, in two-thirds of cases they sought no alternative financing, simply because it was not available. Thus, persistent gaps in trade finance could mean the exclusion of such firms from the trading system. This is of concern because SMEs are the backbone of many economies and act as major employers. As outlined above, there is no question that access to trade finance represents a significant obstacle to the economies of developing countries. ■

Figure 1: Low bank density and low SME coverage in selected developing countries, 2014-16 (per cent)



NOTE: The share of small enterprises that have financial accounts varies by country but only a very small share obtains loans.

SOURCE: World Bank Enterprise Survey.



Chapter 2

De-risking and inter-institutional responses

- Since the global financial crisis, many international banks have been reducing their trade finance activities, particularly in developing countries.
- “De-risking” is driven partly by concerns over complying with regulations related to money-laundering and terrorism financing, but it is also motivated by concerns related to compliance costs.
- The WTO, IFC and the Financial Stability Board, along with multilateral development banks, are working with the trade finance community to improve awareness of compliance requirements.

Trade finance is vulnerable to de-risking

Since the 2008-09 global financial crisis, a number of international banks have been de-risking, i.e. reducing their guarantees to banks in developing countries in particular. Several publications have debated the extent of the role of retrenchment of correspondent banking and other post-crisis downsizing in limiting access to trade finance for traders (see BIS, 2014; ICC, 2017).

Trade finance is particularly vulnerable to de-risking, despite its very small loss history and high recovery rate. Trade

finance instruments, intermediated by commercial banks, are premised on an existing credit relationship between counterparty banks. International banks, which are, for example, required to “confirm” the future payment to the exporter, take on the reimbursement risk related to local emerging market banks. Thus, for goods to be shipped, a confirming bank must be willing to take the payment risk of the local bank. This may not be possible if the trade finance transaction causes that international confirming bank to exceed its client or country exposure limits. In many cases, a letter of credit

may not be confirmed because the potential return on this exposure does not merit the risk taken.

As indicated above, the trade finance market is relatively concentrated (BIS, 2014), although very large banks have been recalibrating their global network as a result of needing to comply with various regulatory and business parameters. These include the new Basel III standards (an internationally agreed set of measures developed by the Basel Committee on Banking Supervision in response to the 2007-09 financial crisis, which aims to strengthen the regulation, supervision and risk management of banks) and KYC (i.e. “Know Your Customer”, a process of regularly verifying a customer’s identity with a view to eliminating bribery, corruption and other illegal financial activities – a requirement of the international anti-money-laundering (AML) regulations).

In the compliance process, some business models have been more affected than others. The claim that the termination of correspondent banking relationships has been linked to compliance costs was examined by multilateral institutions following a request by the G20. The BIS (2015) and the World Bank Group (2015) delivered reports to the G20 Summit in Antalya, revealing nuanced views as to what was driving the reduction in correspondent banking relationships. They acknowledged the concerns

over possible sanctions relating to anti-money-laundering and countering the financing of terrorism (AML/CFT) but also recognized that the withdrawal of international banks was motivated by concerns about costs.

The FSB designed a four-point action plan to address the decline in correspondent banking: better understanding this decline, clarifying regulatory expectations on ML/CFT obligations, increasing domestic capacity-building in countries that host local respondent banks, and strengthening the tools for customer due diligence. Since 2016, the FSB has reported regularly to G20 finance ministers on its progress in implementing this plan.

High perception of regulatory risk hinders trade finance

Robust regulation of international banking and financial flows is needed to prevent criminals from abusing the financial system. Since the tightening of international guidelines and the imposition of high fines by national authorities to banks for non-compliance, there has been a heightened perception of the AML/CFT risk affecting trade finance. Requirements or perceptions of requirements related to AML/CFT are said to compound the global unmet demand for trade finance, reducing financial inclusion in regions and markets that need it most.

Part of the problem is that perceived regulatory requirements may lead banks to exceed guidance provided by international and national regulatory bodies, with the effect of reducing access to trade finance. Instances of over-compliance with regulation by banks, either by choice or due to misinterpretation, can be minimized by enhancing the clarity of regulatory requirements, talking to regulatory authorities, developing “tools” and compliance “utilities”, and disseminating best compliance practices.

Also, in some jurisdictions, there may have been a perception that trade finance was a high-risk area for money laundering. Early reports on “trade-based money laundering” (FATF, 2006) highlighting the risks that trade might be used as a channel for criminal activities (the drugs and arms trade, for example), may have bolstered the idea that trade activities carried high and specific risks. Several more recent reports by international regulatory bodies (FATF, 2017) have offered a more detailed, nuanced and mature risk approach. For example, it is acknowledged that trade finance transactions are highly documented. The trade documentation (customs, transport and insurance documents) provides for substantial visibility and transparency of the related payment. There is no evidence that the US\$ 18 trillion in trade transactions

and related payments are subject to significant amounts of fraud.

The FSB-WTO-IFC dialogue and action plan

The dialogue between the FSB, the WTO and IFC seeks to address the issues highlighted above. The FSB’s correspondent banking relations group made a commitment to the G20 to consider how its work could be adapted or expanded to better address the trade finance component of correspondent banking. Its correspondent banking progress report, delivered to the G20 in March 2018, stated that: “the reduction in correspondent banking relationships may affect trade finance transactions that rely on correspondent banking arrangements to be processed and may thereby impact some countries, especially those that depend on trade for their development or the access to basic supplies. The FSB, with inputs from the World Trade Organization and the International Financial Corporation, will therefore explore whether and how some of the solutions already developed can be further elaborated to better capture the trade finance components of correspondent banking”.

In concrete terms, this means that the three organizations, along with other multilateral development banks, are working to improve awareness by the trade finance community

of the new AML/CFT contexts and clarifications, in a more cost-effective and decentralized way.

One of the key issues is related to how the standards for AML, CFT and KYC are adapted and implemented at the national level. The emergence of a decentralized standard-setting process across jurisdictions has generated significant variance in implementation, often leaving financial institutions to interpret application and ultimately to “over-comply”. The lack of harmonization, the complexity, the additional scrutiny and the risk of significant potential penalties for violations has made the financial effects of “compliance risk” material for banks for the first time.

Accordingly, in 2017 the Financial Action Task Force (FATF – an intergovernmental body whose objectives are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system), in cooperation with the Basel Committee on Banking Supervision’s (BCBS) AML/CFT Expert Groups, issued revised guidance (FATF, 2017). The FATF and BCBS conducted follow-up surveys of their membership to assess

the effectiveness of such revised guidance. The surveys revealed that a large proportion of private sector entities had received communication from their regulators/supervisors, although some correspondent banks did not receive any communication from supervisors and were not aware of any of the revised 2017 guidance documents. Also, some large providers of correspondent banking services did not observe changes in the supervisory approach following the communication of the guidance. This was a sign that some national authorities needed to do more. Clarification of regulatory AML/CFT requirements and their effective implementation remain crucial elements for addressing the concentration of correspondent banking relationships.

At the country level, the FSB is looking at how the above-mentioned clarifications have been embodied in national approaches in the context of trade finance. It is also identifying any remaining implementation issues. As a preliminary step, the FSB Secretariat is working with multilateral institutions and relevant industry bodies to seek a description of the potential issues related to the clarity of regulatory expectations specific to trade finance in correspondent banking that they identify (if any).¹

¹ Relevant bodies would include the Wolfsberg Group, the International Chamber of Commerce (ICC) and the Banking Association for Finance and Trade (BAFT).

In the meantime, multilateral institutions have been stepping up capacity-building activities, for instance, by identifying jurisdictions where a reduction in the number of correspondent banks has a potential impact on trade, notably in poor countries (e.g. Africa, developing Asia, the Caribbean, etc.) or in heavily trade-dependent countries (e.g. which rely on imports for critical goods and infrastructure development or exports for GDP and foreign exchange).

Capacity-building activities include actions specific to trade finance, or which target a trade finance audience, such as outreach events and industry dialogues. There is a significant appetite from the industry to conduct outreach activities that specifically target a trade finance audience, for instance to disseminate the Wolfsberg Due Diligence Questionnaire, which aims to establish an enhanced, reasonable standard for cross-border correspondent banking due diligence in order to simplify and clarify data requirements. IFC and the WTO support such activities, combined with the dissemination of recent guidance by FATF and BCBS.

As part of its trade finance institutional capacity-building activities, IFC has executed many training events that focus on promoting improved AML/CFT compliance in its network of emerging market banks. IFC can

contribute to improved AML/CFT in developing countries, given its ability to reach relevant banking participants directly. Some large banks, traditionally very active in trade, have also organized local respondent bank training to help these banks in developing countries better understand and apply existing AML/CFT requirements.

In 2018, IFC published a guidebook (IFC, 2018a): “Navigating Essential Anti-Money Laundering and Combating the Financing of Terrorism Requirements in Trade Finance: A Guide for Respondent Banks”. This guide is intended to help clients identify the proper references for guidance, provide an overview of this guidance and begin to consider how to give effect to this guidance in their businesses and countries. The guide provides an overview of regulatory guidance on AML/CFT, including information and updates from the FATF as well as the BCBS and other institutions. A separate overview on trade-based money laundering is included. The guide presents global banks’ perspectives related to a customer’s due diligence considerations in onboarding and maintaining bank customers in higher-risk jurisdictions. Finally, the guide considers third-party technology solutions that have arisen in response to the need to better manage the problem of rising AML/CFT-related costs. ■



Chapter 3

Showcasing capacity-building in trade finance and regulatory compliance

- IFC and the multilateral development banks have undertaken a number of capacity-building activities for banks involved in trade finance.
- Training programmes are intended to bring banks up to speed with new regulations and with how to comply with these regulations.

This chapter describes recent capacity-building activities undertaken by IFC and multilateral development banks, designed to provide guidance to banks on new regulatory requirements for anti-money-laundering and countering the financing of terrorism (AML/CFT) and to introduce tools that facilitate compliance with these requirements. The efforts that have been made by multilateral institutions are significant, and have entailed the participation of many players, including professional associations, and of course the local financial institutions receiving the training.

Multilateral development banks and the WTO have, for some years, been increasing their efforts in training a new generation of trade finance

professionals. The 2016 WTO publication *Trade finance and SMEs: bridging the gaps in provision* (WTO, 2016) highlighted that more needed to be done to improve the awareness of trade finance instruments, to enhance the ability to select the best products and to train trade finance specialists. Over the past two years, multilateral development banks have boosted their trade finance capacity-building work in collaboration with the WTO and ICC. Collectively, these institutions trained more than 4,000 professionals from 85 countries in 2017 and 2018, far exceeding the initial objective of training 1,000 trade financiers annually.

Per chapters 1 and 2, capacity-building in trade finance has

increasingly had to address regulatory compliance challenges and to focus not only on front-office professionals, who deal with exporters and importers, but also on back-office professionals, who must deal with compliance with international standards such as AML/CFT and “Know Your Customer” (KYC). The case studies presented in this chapter highlight the significant



Multilateral development banks and the WTO have, for some years, been increasing their efforts in training a new generation of trade finance professionals.

efforts by international agencies active in trade finance facilitation and capacity-building to design and implement training programmes focused on compliance with trade finance regulations. These programmes focus on questions such as what AML and CFT standards are, how to implement a risk-based approach to AML/CFT and KYC, what the country-specific risks are, how to join customer due diligence information-sharing or shared service platforms, and where to get information on sanction regulations.

The first four case studies focus on an IFC programme and collaborative

programmes undertaken with the World Bank, the International Monetary Fund and the Bankers Association for Finance and Trade. Three further case studies spotlight programmes led by the European Bank for Reconstruction and Development, the Asian Development Bank and the International Islamic Trade Finance Corporation.

IFC's approach to de-risking

IFC surveyed over 300 private-sector bank clients across 92 countries, adding their voice to the global dialogue on correspondent bank de-risking (IFC, 2017). IFC's survey examined the relationship between correspondent bank de-risking, correspondent banking stress and compliance challenges, among other external challenges, and banks' abilities to serve their customers. The survey also identified what emerging market banks would find most helpful as they navigate these new challenges. The resulting publication has been complemented by several notes (IFC, 2018a; 2018b; 2018c).

Along with their global peers, emerging market banks are tackling multiple AML/CFT compliance challenges including:

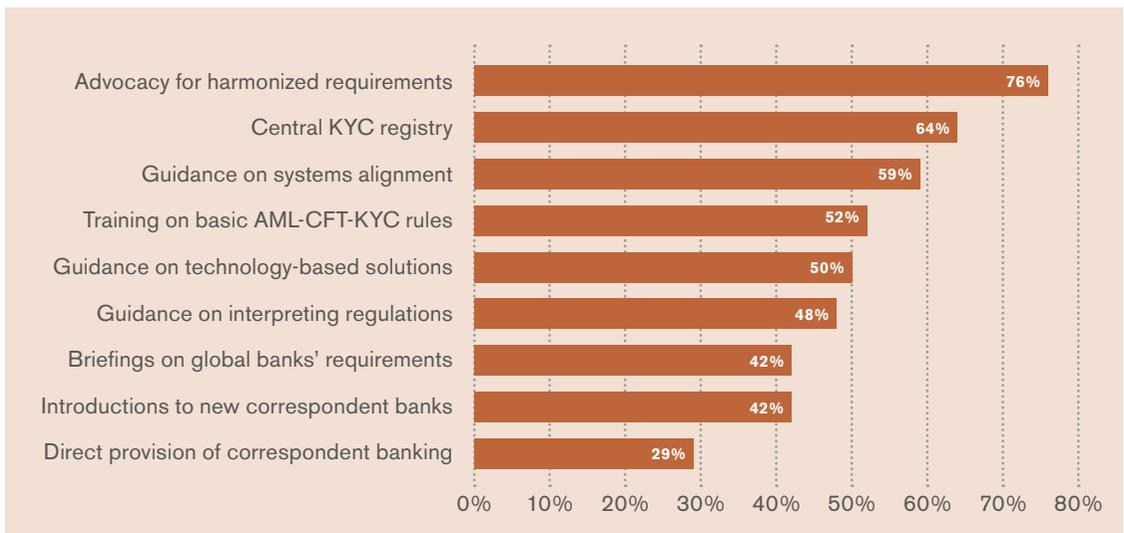
- expensive implementation of software or system upgrades;
- lack of harmonization and clarity in global, regional and local regulatory requirements;
- varied data requests from multiple cross-border correspondent banks;

- limited local client information;
- resources and expertise required for implementing AML/CFT; and
- challenges in updating client information needs and training.

IFC's survey results offered an in-depth perspective on which actions to address de-risking would be most valued by private-sector financial institutions in emerging markets. An organized, focused response is necessary to address de-risking challenges effectively. There are a number of actions that the international community might consider to help emerging market banks address de-risking challenges. Each participant in this global solution can identify areas where it will be most effective in its contribution.

IFC has designed its contribution to a de-risking solution strategically, prioritizing activities that support banking clients as they address the challenges discussed above. IFC's clients play an invaluable role in their countries' stability and development. IFC has identified specific preliminary actions that can help them, based on its global private sector footprint with financial institutions (over 1,700 financial institutions and their subsidiaries worldwide). In addition, IFC's established advisory services delivery channel, expertise with correspondent banking challenges and financial institution risk management best practices innovation capacity provide for a unique contribution. While multiple solutions are under consideration, IFC prioritized its initial efforts based on what clients said they needed most, as presented in Figure 2.

Figure 2: Banks identify compliance-related solutions that could help



SOURCE: International Finance Corporation.

IFC's survey found that emerging market banks require assistance in understanding basic AML/CFT concepts, interpreting and implementing regulatory guidance, correspondent bank reporting and systems alignment, interpreting US/EU regulatory requirements, and technology-based solutions. In addition, 64 per cent of respondents seek ways to share data and mutualize their efforts, with a view to making AML/CFT compliance more efficient for both emerging markets respondents and cross-border correspondents, along with upgrading the consistency of information quality. These results informed IFC's first set of efforts, which focused on five solutions channels. These were capacity-building in AML/CFT standards and trade compliance, tangible guidance for AML/CFT risk management, AML/CFT technology applications, extended financial support, and a solutions marketplace implemented through partnerships with a multitude of stakeholders with case examples.

IFC's future engagement

Beyond tangible guidance and technical assistance processes, the majority of IFC's client survey respondents recognized the importance of employing technology-based solutions, e.g. a shared "Know Your Customer" (KYC) utility. Multiple recent achievements in technology have contributed to improving the capacity for transmitting, storing and

analyzing larger or less organized sets of sometimes incomplete or otherwise complex data in more effective ways. These innovations are also facilitating technologies for joint KYC utilities, potentially reducing KYC costs and improving due diligence for AML/CFT efforts. There is great potential in the AML/CFT field for the deployment of more advanced analytics and automatic learning capability (such as artificial intelligence), which can provide more information and a clearer signal.

Successful systemic applications of this technology could help financial institutions and countries know more about activities in their market faster, and potentially for less cost. IFC has an opportunity to invest heavily in knowledge and carefully structure its approach to master these areas, partner with industry winners, and systematically deploy investments and advice to help both clients and countries improve.

IFC sees opportunities to invest in and connect markets (both banks and regulators) to competent providers of full service, end-to-end data management, customer due diligence, transaction monitoring, suspicious transaction reporting and other relevant customer and transactional data. There are best practice players in this field, and banks around the world recognize the potential for both cost efficiency and risk management quality that is created by the mutualization of information and services. Connecting

consortiums of private sector banks or other bodies to these players suggests value, and IFC is potentially capable of both convening and financially supporting such connections.

The need for IFC's core investment business is emphasized by the multitude of clients that have expressed a need for capital, foreign currency liquidity or additional trade finance support. IFC's core business is investment. Since 1956, IFC has provided capital and liquidity to private sector firms in emerging markets. IFC continues to augment trade finance volume and liquidity through existing network channels, and to support the emergence of new ones. With its global coverage, IFC is playing a leadership role in supporting global trade flows to emerging markets, including the poorest and most fragile countries, at a time when trade finance corridors are under significant pressure.

To date, IFC has supported close to US\$ 160 billion in global trade since the inception of its trade department in 2004, which makes IFC the largest trade finance provider of all the multilateral development banks. IFC's Global Trade Finance Program (GTFP), which has executed over US\$ 65 billion in trade guarantees, booked US\$ 6.5 billion transactions in 2018, which was one of the highest levels in its 15-year history. As the de-risking trend endures, the need for IFC's emerging market trade finance support increases. In response to

an increasing need, IFC intends to implement new initiatives, including a joint investment and advisory programme called the Trade Inclusion Platform.

Finally, IFC continues to build on collaboration opportunities for stakeholders to optimize areas of expertise and feasibility across multiple institutions. IFC continues to support, enhance and augment the work that correspondent banks are already doing. IFC will also continue to identify additional private sector partners capable of and interested in bolstering existing networks, in some cases by providing alternatives, particularly where limited cross-border network bandwidth creates significant gaps.

De-risking solutions will continue to evolve. The way forward will require that all stakeholders – multilaterals, regulators and bankers alike – are responsible for working together toward a comprehensive solution. IFC continues to study market intelligence, identify opportunities and assess additional alternatives. It continues to consolidate both the challenges and opportunities that remain in the emerging market private financial sector. By being consistently present and active in multilateral discussions regarding de-risking and compliance, IFC will continue to engage in this space, given its footprint, expertise and investment capacity. ■

Case study 1

IFC's AML/CFT guidance for trade finance



In May 2019, IFC and the World Bank launched a workshop in Zimbabwe, which was funded by the Government of Japan.

Training publications produced by IFC

In 2018, IFC developed a training guidebook for emerging market banks called “Navigating Essential Anti-Money Laundering and Combating the Financing of Terrorism Requirements in Trade Finance: A Guide for Respondent Banks” (IFC, 2018a, hereafter called “the Guide”).

IFC’s Global Trade Finance Program connects a broad network of correspondent banks with emerging markets’ respondent banks. For these banks to benefit fully from this network, their “Know Your Customer” (KYC) compliance information should be ready, updated and available to confirming banks around the world with which they would like to transact trade and develop wider relationships.

The Guide provides an analysis of KYC compliance issues and offers recommendations to help expedite compliance information exchanges between emerging market

respondent banks that issue trade finance instruments, such as letters of credit, and correspondent banks that confirm those instruments. It updates the core KYC requirements common to a strategically selected set of international banks, representative of the industry’s best practices, after the interviews with respondent and correspondent banks.

The Guide also develops and delivers a best practice reporting package that participating emerging markets’ respondent banks can use for information-sharing with correspondent banks.

IFC is preparing a “know-your-customer” package to accompany the Guide’s training module, which can be delivered to respondent banks in emerging markets, supporting their efforts to draft internal AML/CFT manuals.

Efforts also include the publication of IFC’s Good Practice Note, entitled “Anti-Money Laundering and Countering Financing of Terrorism Risk Management in Emerging Market

Banks”, along with IFC’s “Navigating Essential Anti-Money Laundering and Combating the Financing of Terrorism Requirements in Trade Finance: A Guide for Respondent Banks”.

The Note seeks to assist banks in emerging markets with compliance with AML/CFT international standards. The Note presents an in-depth guide for banks in emerging markets, including information on:

- (i) the emergence of AML/CFT requirements;
- (ii) the importance of a strong risk management framework;
- (iii) detailed elements of a sound AML/CFT programme;
- (iv) working with cross-border correspondent banks; and
- (v) a framework for self-assessment.

It summarizes multilateral regulatory developments for AML/CFT, initiatives undertaken by international institutions, and the most relevant regulatory documents, among other material.

To complement this Note, IFC is piloting the development of a diagnostic assessment tool to help clients assess their AML/CFT capacity, and to chart a course for improvement. This tool includes a detailed set of questionnaires and instructions, as well as relevant guidance memos for information on specific topics. The tool's outputs would help banks identify strengths, weaknesses and steps for improvement to achieve a higher level of compliance.

Collectively, these products are intended to help banks in emerging markets to improve AML/CFT compliance and to address effects unique to emerging markets' respondents.

IFC has also launched multiple training events, embedding relevant material into existing emerging markets' respondent bank training channels.

IFC's capacity-building programmes

IFC has supported capacity-building in trade finance by training more than 6,400 professionals from 71 countries in recent years.

In 2018 alone, IFC provided 10 training programmes in countries such as Cambodia, Côte d'Ivoire, Haiti, the Lebanese Republic, Pakistan, Rwanda, Senegal and Tanzania, and in 2019, it has already provided training in the Democratic Republic of the Congo, Madagascar, Tanzania, Uganda, Zambia and Zimbabwe.

In the rest of 2019, IFC plans to conduct up to 20 programmes in countries including Cameroon, Ethiopia, Ghana, Guinea Conakry, Liberia, Malawi and Mauritania.

Together with partners including the World Bank (WB), International Monetary Fund (IMF), and Bankers Association for Finance and Trade (BAFT), and with participation from the World Trade Organization, IFC plans to expand the capacity-building programmes in the field of AML/CFT compliance in trade finance, as demonstrated in the following cases.

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Case study provided by International Finance Corporation.

Case study 2

Joint IFC/World Bank AML/CFT capacity-building programmes



In November 2018, IFC and the World Bank launched a pilot workshop in Rwanda, which was partnered by the National Bank of Rwanda and local private sector banks and funded by the Government of Japan.

Joint IFC and World Bank training in anti-money-laundering and countering the financing of terrorism (AML/CFT) has proved effective at the country level, where both regulators and private sector financial institutions interact and learn together.

Capacity-building in Rwanda

In November 2018, the IFC and the World Bank's Finance, Competitiveness and Innovation Global Practice worked together to build capacity on AML/CFT associated with trade finance to launch a pilot workshop in Rwanda. The National Bank of Rwanda and local private sector banks partnered the initiative that was funded by the Government of Japan. The WTO and FSB participated in the event by video-conference.

While the Financial Action Task Force's (FATF) recommendations are well accepted and recognized, correspondent banks have to be cognizant of and manage institutional and

country risks as well. Country risk is assessed via a "mutual evaluation"¹ of that country's adherence to FATF's recommendations. The World Bank's Financial Market Integrity Unit has engaged with many countries to support central banks and national regulators to better prepare for mutual evaluations, including national risk assessments, a key component of the FATF risk-based approach. Mutual evaluations cover both regulatory requirements and implementation of AML/CFT practices by local respondent banks, and provides information for banks to build and refine their own risk-based approach to AML/CFT policies and practices.

To both educate and support collaboration between emerging markets regulators and financial institutions, IFC and the World Bank designed a workshop in Rwanda. The primary idea was to build on synergies between the World Bank's support of emerging market regulators and IFC's support

¹ The FATF conducts peer reviews of its 38 members on an ongoing basis to assess levels of implementation of its recommendations and analyses of each member's system for preventing criminal abuse of the financial system.

of individual financial institutions. The joint effort helped key participants in Rwanda's financial system to understand what they can do to reduce their de-risking probability.

In preparing for its first mutual evaluation, Rwandan officials noted the need for thorough preparation, and ways to improve their approach to AML/CFT. The country will go through the Eastern and Southern Africa Anti-Money Laundering Group's AML/CFT Mutual Evaluation in 2021.

The workshop served as a kick-off for future collaboration between the National Bank of Rwanda and the financial sector. Participants included compliance and risk management staff, trade and credit officers from private sector banks as well as from a state-owned bank, and representatives from the National Bank of Rwanda and regulatory agencies, including the national risk assessment process coordinator. The workshop modules included an overview of global de-risking trends and management evaluation processes, including the consequences for countries with a poor rating, relative effectiveness of addressing potential deficiencies proactively and prior to the management evaluation, which would ultimately result in higher ratings. World Trade Organization (WTO) and Financial Stability Board (FSB) experts were part of the training faculty.

It was noted that poor compliance ratings tend to increase the risk of losing correspondent banking relationships. The agenda covered information on the importance of partnerships between the National Bank of Rwanda and the private sector through the development of the National Bank of Rwanda and subsequent guidance from the central bank to inform risk assessments carried out by private sector financial institutions. It also covered the role of the financial institutions during mutual evaluations, given the increased importance of effectiveness and outcome measures (reliant on the quality of implementation of AML/CFT by the bank). Obligations of financial institutions with respect to AML/CFT

were also presented, including responsibilities on institutional risk assessments, customer due diligence and suspicious transaction reporting. The course included specific information on trade-based money laundering, including examples of the types of trade transactions that have been used for money laundering purposes.

Finally, the workshop incorporated input from outside companies with services that are designed to support more efficient, accurate and cost-effective customer due diligence through "KYC [i.e. "Know Your Customer"] utilities". There was a session by SWIFT (the Society for Worldwide Interbank Financial Telecommunications), explaining their KYC Registry, which is specific to correspondent banking relationships. There was another session by Thompson Reuters covering their KYC utility for corporates and banks currently in operation in South Africa.

Participants from both the banking sector and regulatory authorities noted that this first joint workshop in Rwanda was extremely valuable. Representatives from the National Bank of Rwanda indicated that it was very helpful to understand the risks from the business side, and banks appreciated the need for clearer guiding principles from the National Bank of Rwanda as they develop their own institutional risk assessments. Attendees expressed interest in organizing periodic and regular meetings between the National Bank of Rwanda and compliance officers going forward. The banks requested further elaboration of the AML/CFT obligations of financial institutions, as well as more case examples on trade-based money laundering. They also expressed interest in a deeper and more thorough overview of KYC utilities, which had been introduced to them for the first time.

Other capacity-building programmes

Based on the positive feedback of all attendees, the joint IFC and World Bank team delivered a similar training programme

in the Democratic Republic of Congo and in Madagascar and are currently planning to deliver the programme in several countries in Sub-Saharan Africa and beyond.

Case study provided by International Finance Corporation and the World Bank.

International Finance Corporation,
International Monetary Fund



International
Finance Corporation
WORLD BANK GROUP

Case study 3

Joint IFC/IMF outreach initiatives

IFC and the International Monetary Fund (IMF) are conducting joint outreach initiatives to facilitate the dialogue on anti-money-laundering and countering the financing of terrorism (AML/CFT) between regulatory bodies and private sector banks.

IMF webinar initiative

The pilot, a global webinar, attracted over 90 participants from all over the world. Country-specific local outreach is also scheduled to take place in the summer of 2019.

The objective of the session was to explore the IMF's AML/CFT-related initiatives, which aim to address correspondent banking relationship (CBR) challenges, including market analysis, technical assistance and public-private sector dialogue. After the WTO Secretariat provided an overview of the global trade finance gap, the session was followed by a module on the IMF's AML/CFT assistance framework, challenges in correspondent banking relationships (CBR), the importance of AML/CFT for financial stability, financial integrity, and the relevance of effective AML/CFT frameworks. The IMF also shared details of its work in supporting countries' capacity development in designing solutions to address correspondent banking relationship pressures.

Factors leading to global banks' withdrawal of CBRs generally reflect correspondent banks' assessment of the profitability and risk of the relationships. In this regard, the IMF Board has endorsed, and staff is implementing, a multi-pronged approach to address CBR pressures, the primary pillars being:

- (i) to monitor trends to understand and assess the trend of issues on CBR;
- (ii) to monitor risks and drivers;
- (iii) to facilitate dialogue. Due to lack of good communication between global banks and correspondent banks, IMF staff introduced regional roundtables on CBR where high level representatives of global banks and correspondent banks deliberate to understand issues better and find practical solutions;
- (iv) tailored capacity development, including by building capacity on AML/CFT; and
- (v) to engage in cases involving tail-risk scenarios when a country is financially cut off from the international network, which has not materialized yet.

IMF regional initiatives

The IMF's regional initiatives started with the Caribbean, and were expanded to other regions: Africa, Central Asia, the Middle East and the

Pacific. The nature and diversity of the risks and reasons for pressures on correspondent banking relationships vary across different regions. In the Caribbean, challenges may relate to the ability to mitigate risks from off-shore financial sectors. On the other hand, in the Pacific Island countries, the lack of identification documents creates challenges to monitoring small-scale transactions originating with seasonal workers, and such remittance could involve high risk.

Country-specific initiatives

Two examples of country-specific capacity development are summarized below:

- Guinea: Since the Central Bank of Guinea (Banque Centrale de la République de Guinée) has experienced correspondent banking relationship pressure, IMF staff are helping develop compliance policies and procedures by strengthening AML/CFT

internal controls for the Central Bank and revisions to AML/CFT law and regulations.

- Jamaica: The sector of “cambios” (money service businesses) was affected due to the termination/restriction of services offered by commercial banks. The IMF-supported capacity development on risk-based supervision of the central bank for deposit-taking institutions/cambios was strengthened.

The IMF provides capacity development assistance to central banks, authorities and regulators. Within their respective mandates, IMF and IFC can further collaborate and arrange outreach activities jointly to strengthen the dialogues between the public and private sector.

Case study provided by International Finance Corporation and the International Monetary Fund.

International Finance Corporation,
Bankers Association for Finance and Trade

Case study 4

Joint IFC/BAFT capacity-building programme



International
Finance Corporation
WORLD BANK GROUP

IFC and the Bankers Association for Finance and Trade (BAFT) are working together to build the capacity of local private sector banks in Sub-Saharan Africa. The goal is to help these banks obtain and maintain correspondent banking relationships through further development and demonstration of AML/CFT capacity. BAFT is the leading global trade association for the transaction banking industry and has just published the “Respondent’s Playbook”.

Best practices for respondent banks

BAFT’s “Respondent’s Playbook” explains the challenges associated with correspondent banking relationships and provides related best practices for consideration and adoption by respondent banks. The Playbook outlines the actions that may be taken by respondent banks that are ultimately unable to obtain or maintain a relationship. Special considerations for money services businesses and fintech¹ companies are also provided.

¹ i.e. financial technology.

The Playbook concludes with a series of helpful answers to questions frequently asked by respondent banks. Within this context, IFC and BAFT are hosting joint workshops, designed to build on the synergies between BAFT's expertise in correspondent banking and financial crime compliance, and IFC's efforts to support local private sector banks in emerging markets, to reduce the probability of a decline in correspondent banking relationships, so that those banks can continue to support the trade finance needs of their markets.

IFC/BAFT workshop

IFC and BAFT have developed a replicable workshop structure to train respondent banks on international anti-money-laundering and countering the financing of terrorism (AML/CFT) standards and recommended actions that may improve their ability to obtain and maintain correspondent banking relationships by using the BAFT "Respondent's Playbook". The workshops are geared toward private sector banks, primarily toward compliance, risk management, and transaction banking business line (trade finance and cross-border payments) staff, as well as credit officers.

The two-day workshop begins with a discussion of a correspondent bank's considerations when establishing a new correspondent banking relationship. The programme continues with a detailed description of a correspondent bank's assessment of the financial crime exposure and compliance risk associated with a potential respondent. The presentation includes an in-depth discussion of a correspondent's risk assessment, initial and refreshed due diligence, and transaction monitoring and screening process. Best practices for respondents are discussed in each section.

The workshop concludes with special considerations for money service businesses and fintech companies. The workshop also incorporates short video segments from external companies with services that are designed to support more efficient, accurate, and cost-effective customer due diligence. IFC and BAFT plan to roll out this joint workshop in Cameroon, Ethiopia, Ghana, Guinea Conakry and Malawi in 2019.

Case study provided by International Finance Corporation and the Bankers Association for Finance and Trade.

Case study 5

EBRD framework to build capacity in trade finance compliance

The European Bank for Reconstruction and Development (EBRD) has launched its new capacity development programme with the aim of promoting international standards in financial crime prevention, trade-based AML, "Know Your Customer" (KYC) and customer due diligence in

trade finance. It is available for all EBRD partner banks and will address underlying drivers for reduced correspondent banking activities. This new three-year programme will enable EBRD partner banks to access financial services and facilitate trade in the economies where the EBRD invests.



In October 2018, in Ukraine, workshops were organized jointly by the EBRD and the International Compliance Association and hosted by the National Bank of Ukraine.

EBRD partner banks have lost a great number of correspondent banking relationships in the past years, which hinders international trade in the EBRD regions of operation. Smaller banks are particularly dependent on such relationships to be able to offer payment and clearing services in foreign currencies.

The EBRD will support local banks in the EBRD regions to create KYC profiles and documents, collaborating with KYC utility providers such as SWIFT,¹ Accuity² and the Wolfsberg Group.³

The EBRD offers specialist training in trade finance, compliance, sales and risk management in its partner banks. All training is extended to local regulators.

The training is delivered online, face-to-face and in examination, as well as certified format.

Introducing KYC and AML utilities

The EBRD has started to engage with SWIFT and Accuity to encourage EBRD partner banks to establish KYC profiles on the only database provided by these two institutions. This initiative supports EBRD partner banks in standardizing and reducing the costs of compliance, reporting and monitoring. In addition it gives access to

comprehensive data and innovative software to control risks in compliance operations. Joint training courses will be launched with SWIFT and Accuity to help EBRD partner banks create strong profiles on KYC and AML utilities and implement good practice in global standards compliance operations.

Training courses

For the first time, the EBRD and the International Compliance Association (ICA) have joined forces to develop an enhanced training course on compliance, with the EBRD joining the ICA Technical Advisory Board and ICA's investment in the EBRD's compliance capacity development through the launching of a jointly funded first pilot qualification in 2018 on:

- 1) "Trade-based money laundering";
- 2) "Know Your Customer and customer due diligence" foundation course. Two hundred trade finance professionals in EBRD partner banks and regulators/supervisors in Belarus, Morocco, Ukraine and Uzbekistan have been trained and certified. There are plans to roll out the training in Egypt, Georgia, Greece and the Republic of North Macedonia in 2019.

¹ SWIFT is the Society for Worldwide Interbank Financial Telecommunications.

² Accuity offers solutions for payments and compliance professionals – see <https://accuity.com/what-we-do/overview>

³ The Wolfsberg Group is an association of 13 global banks with the aim of helping to manage financial crime risks – see <https://www.wolfsberg-principles.com>

Two more joint training courses with ICA on:

- 1) “Financial crime prevention” and
- 2) “Correspondent banking” will be launched in 2019.

The EBRD launched an e-learning module, “Trade-based financial crime compliance”, jointly with the London Institute of Banking and Finance. Two hundred and fifty scholarships are now available for EBRD partner banks in all the economies in which the EBRD invests. As of February 2019, a total of 121 students and 33 banks from 10 countries had been registered.

The EBRD will be engaging with the Wolfsberg Group and the ICA to develop two comprehensive training workshops for the new Wolfsberg Due Diligence Questionnaire (DDQ). These two-day workshops will be launched in 2019 for all partner banks active in trade finance and respective regulators. In addition, the EBRD plans to work with the Bankers Association for Finance and Trade (BAFT) and the International Chamber of Commerce (ICC) to develop a handbook/manual for correspondent banks to improve the quality of due diligence in those countries where the EBRD operates.

Compliance workshops held in 2018

In September 2018, in Morocco, KYC/customer due diligence (CDD) and trade-based money laundering (TBML) workshops were organized and arranged jointly by the EBRD and International Compliance Association and hosted by Banque Centrale Populaire (BCP). There were 50 attendees in total from BCP, Morocco.

In September 2018, in Belarus, KYC/CDD and TBML workshops were organized and arranged jointly by the EBRD and International Compliance Association. There were 50 attendees in total from Belarusian EBRD partner banks.

In October 2018, in Ukraine, KYC/CDD and TBML workshops were organized and arranged jointly by the EBRD and International Compliance Association and hosted by the National Bank of Ukraine. There were 50 attendees in total from Ukrainian EBRD partner banks and regulators.

In November 2018, in Uzbekistan, KYC/CDD and TBML workshops were organized and arranged jointly by the EBRD and International Compliance Association. There were 50 attendees in total from Uzbek EBRD partner banks and regulators.

Customized advisory services

The EBRD will offer individual correspondent banking advisory services to its partner banks as part of the Compliance Services Framework. The goal of the programme is to help partner banks to optimize and standardize required KYC documents and enhance their correspondent banking relationships with the EBRD trade finance facilitation networking platform of over 800 confirming banks. The EBRD will help design and implement new improved compliance functions and processes in accordance with international standards such as ISO 19600.⁴

At a glance (as of February 2019)

Training courses

- ICA Certificate in KYC and CDD
- ICA Specialist Certificate in Trade Based Money Laundering (TBML)
- ICA financial crime prevention
- Trade-based financial crime compliance
- ICA correspondent banking
- Training on the Wolfsberg Questionnaire

⁴ ISO 19600 provides guidance for establishing, developing, implementing, evaluating, maintaining and improving organizational compliance management systems – see <https://www.iso.org/standard/62342.html>

Collaborating institutions

- International Chamber of Commerce (ICC)
- International Compliance Association (ICA)
- SWIFT KYC Registry
- The Wolfsberg Group
- Bankers Association for Finance and Trade (BAFT)
- Accuity

Case study provided by the European Bank for Reconstruction and Development.

Asian Development Bank



Case study 6

ADB's Trade Finance Program and AML/CFT initiative



In November 2018, ADB's Trade Finance Program held a workshop as part of the annual meeting of the Association of Development Financing Institutions in Asia and the Pacific in Suva, Fiji.

This case study describes the Asian Development Bank's (ADB) Trade Finance Program, an effort to address money laundering and the financing of terrorism in the financial system, while ensuring that companies, particularly smaller ones in vulnerable economies, have access to finance. This effort was funded by the Government of Australia.

Background

Preventing criminals and terrorists from exploiting the global financial system is critically important. However, measures to prevent crime

in the financial system can unintentionally undermine financing to small and medium-sized businesses (SMEs), especially in developing countries. These unintended consequences can create market gaps that dent developing markets' ability to generate the growth and jobs that lift people out of poverty.

ADB's "Trade Finance Gaps, Growth, and Jobs" survey confirmed the existence of a significant global trade finance gap in the range of US\$ 1.5 trillion annually. Unmet demand for trade financing is particularly acute for SMEs and is especially persistent in

developing and emerging markets. The United Nations' (UN) Addis Ababa Action Agenda of the Third International Conference on Financing for Development identifies sufficient trade finance as critical to achieving the UN's Sustainable Development Goals (SDGs).

Creating, implementing, and complying with global measures to prevent illegal activity in the financial system is challenging. While bankers can determine relatively easily that a large company is not involved in crime, getting the same assurances from small and medium-sized businesses, particularly in developing countries, can be difficult and costly.

In addition to banks' reluctance to finance SMEs, banks are increasingly reluctant to support each other due to similar concerns. This trend, wherein banks sever relationships with each other, is commonly referred to as "de-risking". There is widespread concern that entire countries may be shut out of the global financial system due to de-risking, leaving countries without banks capable of transferring money abroad or clearing currencies, due to a lack of correspondent banking relationships.

Recent data show that global international banks continue to reduce their correspondent banking relationships with the jurisdictions and financial institutions that have weaker anti-money-laundering and countering the financing of terrorism (AML/CFT) controls. The Pacific region is among those most impacted by this de-risking trend. These important and well-intentioned regulations designed to stop crime in the financial system have made it more expensive and onerous for financial institutions outside the Pacific to maintain relationships within the region, particularly with lesser-known entities such as money transfer operators and small banks. Many of these relationships have been lost.

This hurts Pacific nations in multiple ways. Relationships between financial institutions

are essential conduits for money flows. Without them, remittances are more difficult to process and the costs of moving money in and out of the region are high, depriving families, especially those in remote and poor areas, of an essential financial lifeline.

On average, remittances represent 10 per cent of the gross domestic product in the Pacific. In Tonga and Samoa, the figure is more than 20 per cent. Today, remittance costs in the Pacific average more than 8 per cent, against the 3 per cent recommended by the United Nations Sustainable Development Goals. If remittance costs climb any higher, the finances of poor households will come under further strain.

The ability of trade finance to help small companies grow and create jobs is also compromised by a lack of relationships with overseas financial institutions.

In deciding whether to maintain or cut their relationships, correspondent banks evaluate respondent banks according to how well they follow the Financial Action Task Force (FATF) risk-based approach and their customer due diligence requirements. Correspondent banks consider country-level risks related to AML/CFT, which are assessed via the mutual evaluation process, measuring compliance with FATF's 40 recommendations.

Stopping crime in the financial system while prudently financing SMEs in developing countries is a big challenge. There is room to improve efforts on both fronts: stopping crime and closing market gaps. This two-pronged effort is at the heart of the ADB Trade Finance Program's AML/CFT initiatives.

Workshop 1: Roundtables in Australia and New Zealand

ADB, together with the International Monetary Fund, held roundtables in Sydney on 5 February 2018 and in Auckland on 7-8 February 2018

to identify practical solutions to address the costs and risks of transferring remittances to countries in the Pacific region and difficulties in undertaking cross-border trade transactions. The events were financially supported by the governments of Australia and New Zealand. The roundtables brought together banks, money transfer operators and regulators from Australia, New Zealand and the Pacific, senior officials from international financial institutions, and training providers to discuss the issue and focus on practical solutions. The Financial Stability Board (FSB) also attended. Finding solutions will require concerted action by all parties. Participants agreed that the roundtables were a first step to addressing issues.

The meetings reached four conclusions.

First, Pacific banks, bank regulators and money transfer operators would benefit from more training in due diligence to uncover financial crimes. This would spur confidence among international banks and encourage a higher level of compliance among institutions in the Pacific. A coordinated and targeted programme of peer-to-peer training has proved most effective in the past and should be expanded.

Second, there is a need for clearer regulations and regulatory expectations. Regulators can be more explicit about what they expect from financial institutions on matters such as what constitutes compliance with due diligence and monitoring to prevent financial crimes. Regulatory harmony is also lacking. International bodies such as the FSB and the Financial Action Task Force develop guidance for national regulators. But this is often not followed, resulting in different regulatory requirements in different countries and confusion among financial institutions, making compliance costlier and riskier. Coordinated efforts to ensure greater regulatory harmony would help in the fight against crime and in closing market gaps.

Third, consolidation of business in the Pacific would help to bolster trade finance. Business

volumes among banks in small Pacific countries are negligible, which makes it difficult to attract correspondent banks. Pooling trade finance business, such as the issuing of letters of credit, from several small banks into one would ease profitability challenges that have ended relationships between banks and led to de-risking. As business functions are aggregated, issues around “Know Your Customer” rules will need to be addressed so that transparency is maintained. For this reason, national and international bank regulators need to be consulted and involved in implementing such a model.

Finally, money transfer operators should form an association to set industry standards and make representations to governments and regulators. Currently the industry seems to lack a single voice, which complicates efforts to build scale and introduce efficiencies. Tighter regulation of money transfer operators should also be considered. This would boost confidence and underpin stronger relationships with banks. As industry-led regulations are often the most potent, sustainable and relevant, the money transfer operators’ community as well as Pacific banks would benefit from the development of common positions on issues.

Workshop 2 in Fiji

To discuss implementing one of the key conclusions of Workshop 1 – pooling of trade finance business – ADB’s Trade Finance Program held a one-and-a-half-day workshop as part of the annual meeting of the Association of Development Financing Institutions in Asia and the Pacific in Suva, Fiji, on 20-21 November 2018.

The main theme of the workshop was the amalgamation and pooling of Pacific banks’ trade finance business to create economies of scale. While trade finance volumes in the Pacific are very low, this initiative could be a pilot, which if successful could expand to other forms of finance dependent on correspondent banking.

Numerous banks were keen on the idea and one among them, a Fijian bank, volunteered to be a “amalgamating/pooling bank”. The workshop concluded with agreement to proceed with the concept. To move forward, one of the many issues that need to be addressed concerns “nesting”, whereby a pooling bank has a role in relaying letters of credit messages issued by Pacific banks to other financial institutions.

Nesting refers to when a respondent bank provides downstream correspondent services to other financial institutions and processes these transactions through its own correspondent account. The correspondent bank is thus processing transactions for financial institutions on which it has not conducted due diligence. How can a bank know that the transaction it is supporting, on behalf of a different bank’s client, is legitimate? While this is a normal part of correspondent banking, it requires the correspondent bank to ensure that the bank it is representing in the transaction has in fact conducted appropriate due diligence on its customer to ensure that crime or terrorism are not being supported.

Coordination with the regulatory community will be critical to managing these issues and to exploring the full potential of this initiative. In parallel, participants in the workshop agreed to conduct enhanced AML/CFT training, and to consider potential technology solutions to help ensure transparency throughout the entire chain of transactions among the banks.

Three key takeaways; next steps

ADB’s Trade Finance Program is continuing its AML/CFT initiative in 2019 to strengthen the fight against crime and reduce market gaps. It will undertake three initiatives this year.

First, as agreed with Pacific banks in 2018, the trade finance pooling concept is being developed and implemented by ADB. The first pilot transactions are anticipated by the third quarter of 2019.

Second, ADB’s Trade Finance Program convened a workshop in Singapore in March 2019. The aim was to develop concrete solutions to persistent AML/CFT challenges: for example, standardization of Suspicious Activity Reporting (SAR) and to develop solutions to verify the identity of parties. A broad range of participants was present including regulators, the Financial Stability Board (FSB), the World Trade Organization (WTO), and commercial banks.

Third, ADB’s Trade Finance Program will undertake AML/CFT technical assistance and training initiatives for banks and bank supervisors.

By working together, banks and regulators can find cost-effective and efficient ways – including with use of technology – to ensure that the global financial system is not facilitating crime, while providing support to legitimate businesses to fuel growth and job creation.

Case study provided by the Asian Development Bank.

Case study 7

ITFC trade finance technical assistance event in Tashkent, Uzbekistan



In January 2019, in partnership with the Uzbekistan Banking Association and the Uzbek Industrial and Construction Bank, the ITFC organized an Islamic trade finance training course for financial institutions in Uzbekistan.

The International Islamic Trade Finance Corporation (ITFC), a member of the Islamic Development Bank (IsDB) Group, is active in the member states of the Organisation of Islamic Cooperation, in policy advancement, trade finance and trade development. In January 2019, as part of its trade finance technical assistance programme, the ITFC organized, in partnership with the Uzbekistan Banking Association and the Uzbek Industrial and Construction Bank, a four-day intensive Islamic trade finance training course, covering all relevant topics, including compliance issues, for financial institutions in Uzbekistan.

Background

The Commonwealth of Independent States (CIS) has been impacted, as have many countries, to different degrees, by the reduction of correspondent banking relationships. This has impacted mainly the smallest financial institutions, as the costs and operations to run the required anti-money-laundering and countering the financing of terrorism (AML/CFT) and “Know Your Customer” (KYC) processes

have been difficult for them to bear. In this context, and while reinforcing the compliance functions of the CIS financial institutions, it is imperative to diversify partnerships and sources of financing. In this regard, with almost US\$ 3 trillion in annual global transactions, Islamic finance is a valuable and new source of financing for CIS countries.

Uzbekistan is a good case study of how the ITFC has deployed its expertise to accompany the local financial sector both technically and financially. Starting in 2018, the ITFC has been conducting a series of workshops on international trade and trade finance, in order to build the necessary capacity to ensure proper due diligence and participation in the financing of international trade, including for SMEs.

A first workshop was conducted in May 2018 in partnership with the United Nations Development Programme (UNDP) to highlight the importance of international trade, create the right incentives and set expectations in this sector for financial institutions, and explain why

the subsequent workshops on trade finance and related compliance matters were crucial.

Workshop in Uzbekistan

The objective of the four-day workshop (22 to 25 January 2019) was to train participants in:

- (i) Islamic finance
- (ii) trade finance instruments
- (iii) related documentation and compliance issues.

The workshop was delivered in English with simultaneous translation into Russian to ensure that all participants benefited equally from the training.

Over the four-day workshop, the beneficiaries were instructed on the main principles of Islamic finance applied to international trade transactions. They were trained to analyse traditional collection and documentary credits. They were taught how to examine the compliance of the documentation and how to ensure it throughout the credit cycle. Furthermore, they were exposed to the structures of Islamic trade finance instruments, such as Murabaha letters of credit and like instruments.¹ Finally, they had the opportunity to learn, through case studies and concrete examples, about Islamic finance applied to pre-export finance, export finance, manufacturing and shipping guarantees.

A total of 43 banking and financial services professionals attended the workshop, with a majority of women and young professionals. They represented 16 different institutions, including the Central Bank of Uzbekistan, 12 commercial banks, two leasing companies and Islamic Development Bank representatives, as well as representatives of the Uzbek State Committee for Investments. The strongest participation was credited to the six staff of the Central Bank of Uzbekistan. The programme was delivered by an international expert as well as by senior staff of the ITFC. Collectively, they covered all of the relevant

activities and functions related to Islamic finance, including credit analysis, compliance, back office activities, risk management, middle office activities, and other specifically Islamic finance topics.

Key takeaways and next steps

Thirty-seven participants successfully completed the workshop and were awarded completion certificates. The feedback received from them was very positive, as the trade finance technical assistance programmes initiated by the ITFC in 2018 had been the first of their kind in Uzbekistan to tackle Islamic finance and related topics, including compliance, credit and risk management. The Central Bank of Uzbekistan was very thankful; it has been looking forward to deepening the partnership with ITFC on technical assistance and financing. Following the delivery of various workshops and the approval of lines of financing, the Government of Uzbekistan decided to reinforce its participation in the ITFC capital.

After the successful implementation of the technical assistance programme on trade finance in Uzbekistan, other CIS countries have expressed their interest in benefitting from similar programmes. In this regard, ITFC is adopting a dual operational approach through country-focused programmes to offer both basic information and a CIS regional programme for advanced content. The ITFC is contemplating delivering the CIS regional programme in cooperation with partner institutions, to ensure that the delivery of the advanced programme is realized with the best experts in each field and for the benefit of a wide audience from within the CIS region. Similar programmes are already under implementation in other countries of the Organisation of Islamic Cooperation, notably in Sub-Saharan Africa, Asia, and the Middle East and North Africa regions.

Case study provided by the International Islamic Trade Finance Corporation.

¹ Murabaha letters of credit are letters of credit issued by a bank in favour of an exporter on behalf of an importer, in which the bank's creditworthiness replaces that of the applicant.

Conclusions

Since the heads of multilateral institutions met at the 2018 Annual Meeting of the International Monetary Fund (IMF) and the World Bank, shared efforts to resolve the challenges of the trade finance gap have been increased significantly – particularly through capacity building. This publication presents best practices, as well as a “return from experience” from training already provided by IFC, the EBRD, ADB and the ITFC on the topic of trade finance and compliance.

Over 300 professionals took part in the seminars described in the case studies, which took place between the end of 2018 and the beginning of 2019. The 2019 programme of on-site seminars and online training for multilateral development banks is likely to reach close to 1,500 participants in priority countries, with the human and/or financial resources

for these courses provided by the WTO, IMF and International Chamber of Commerce. This mobilization is necessary to help traders and their financial institutions to respond to current trends and challenges in anti-money-laundering (AML), compliance and know-your-customer (KYC) regulations, and to outline possible solutions to support the free flow of trade in developing countries.

Adapting to the new regulatory environment improves the ability of trade finance providers to create new correspondent banking relationships and promote trade through these channels. Sustained efforts will be necessary for some time to ensure that the trade finance flow will return to countries which have been deserted, or de-risked, in recent years. International institutions will continue to cooperate in this field in the months to come.

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Abbreviations

AML	anti-money-laundering
ACP	African, Caribbean and Pacific group of states
ADB	Asian Development Bank
AfDB	African Development Bank
BAFT	Bankers Association for Finance and Trade
BCBS	Basel Committee on Banking Supervision
BIS	Bank of International Settlements
CBR	correspondent banking relationship
CIS	Commonwealth of Independent States
CFT	Combating the Financing of Terrorism
EBRD	European Bank for Reconstruction and Development
FATF	Financial Action Task Force (OECD)
FSB	Financial Stability Board
GDP	gross domestic product
ICC	International Chamber of Commerce
IDB	Islamic Development Bank
IFC	International Finance Corporation
ITFC	International Islamic Trade Finance Corporation
IMF	International Monetary Fund
KYC	know-your-customer(s)
LIC	low-income country
MDBs	multilateral development banks
OECD	Organisation for Economic Co-operation and Development
SME	small and medium-sized enterprise
SWIFT	Society for Worldwide Interbank Financial Telecommunications
WTO	World Trade Organization



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Trade finance and the compliance challenge

A showcase of international cooperation

The availability of trade finance has become an increasingly important issue in the past few years. As international banks have become less willing to provide trade finance guarantees, particularly in developing countries, this has reduced the capacity of local banks to provide credit to businesses wishing to trade, leading to a significant gap between the demand and supply of trade finance. Small and medium-sized enterprises have been especially hard-hit by this trade finance gap.

This publication delves into the global trade finance gap and the reasons for the growing reluctance of the global financial sector to engage in this form of financing. It examines the challenges of regulatory compliance and describes the efforts of international organizations, such as the World Trade Organization and the International Finance Corporation, to respond to this issue. It also presents case studies of the capacity-building programmes organized by multilateral development banks which aim to improve the availability of trade finance.

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