Knowledge makes the world go round: why education matters in international trade finance

Produced by:

China Council for the Promotion of International Trade (China Chamber of International Commerce)

Training Centre (CCPIT Training Centre)

The London Institute of Banking & Finance

Forward by Mr Ling Fengjie: Director, CCPIT Training Centre

The London Institute of Banking & Finance, a long-term partner of the China Council for the Promotion of International Trade (China Chamber of International Commerce) Training Centre (CCPIT Training Centre), has long been dedicated to cultivating international financial professionals and promoting developments in global banking and finance.

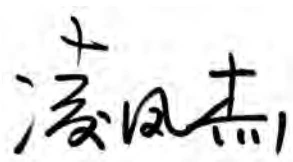
2019 marks the centenary of ICC and 140th anniversary of the Institute. On the occasion of the ICC Banking Commission annual spring meeting in Beijing, it is a great pleasure for me to introduce and recommend this report, which is being jointly launched by The London Institute of Banking & Finance and CCPIT Training Centre to trade and finance practitioners around the world.

Against the background of global economic integration and trade digitalisation, international trade and finance rules and regulations have undergone great change. There is, however, little public awareness of how these rules and regulations, anti-globalization, trade protectionism, new technologies and other factors challenge the use of traditional trade finance instruments. There is an urgent need for practitioners to adapt to and implement new rules and regulations. Meanwhile, how to help practitioners adapt to the new era, meet the new demands and strengthen their professional capability is exactly what we have been, and continue to be, dedicated to. It is also an area and in which, we believe, we have a unique advantage.

This report shows that The London Institute of Banking & Finance has kept pace with the ever-changing trade finance environment by launching additional professional qualification programmes tailored to industry needs, including international payments, supply chain finance, and trade finance compliance. These are in addition to the existing certifications in the field of documentary and standby letters of credit, demand guarantees and trade finance. Together they provide effective and comprehensive channels for practitioners to update their knowledge.

In any organisation, the most important resource is its human capital. It is the mission of educational and training institutions like The London Institute of Banking & Finance and CCPIT Training Centre to help practitioners understand and make good use of international rules and regulations. From a global perspective, this report reflects the positive influence of how education in rules and regulations around the world can bolster the development of international trade finance sector.

I believe this report can offer guidance for both Chinese and global practitioners. It should provide employers at banks and financial institutions with knowledge of efficient solutions for training their talent and ultimately play a positive role in promoting the development of the international trade finance sector.



Introduction by Ouida Taaffe: Editor, Financial World

International trade is a thorny topic precisely because of its importance to economic growth and productivity. Recent political developments, and protectionist measures, make clear how contentious an issue trade can be. Consumers want the many benefits that trade bring – such as access to cheaper goods, to new ideas and innovative design – but can fail to understand the role it actually plays in the global economy.

The financial system that underpins trade is, of course, even less understood than the bare facts of global trade itself. In theory, what bank-intermediated trade finance does is simple: it provides the working capital that oils global trade and it helps cut payment risk. What it does in practice is complex: tailored to individual deals; involving detailed due diligence and compliance work; and demanding deep expertise of the banks who carry the financing risk.

Trade finance has existed in various forms for hundreds of years and much of it is still paper-based. Because it has grown up with world shipping and is specifically designed to mitigate risk and help companies manage their working capital it is a bit like clean drinking water: noticed only when it is not there. And who, after all, would take the risk of turning off the liquidity taps for global trade? As it turns out, the collapse of Lehman Bros triggered just that. The sudden lack of trade finance (which was quickly remedied) was responsible for around 20% of the decline in trade volumes seen during the worse of the financial crisis, according to the Bank for International Settlements.

The vital importance of trade finance is also, of course, also a responsibility. Regulators want to ensure that large, international transfers of money cannot be used to launder funds or finance terrorism. Developing and middle-income countries that are increasingly cut off from global trade finance because of the compliance and reporting costs at banks want to be re-admitted. All parties would like to have digital trade systems that are secure, easily updated and synced with all of their other processes.

Those challenges to trade finance come at the same time as global economic growth looks set to cool and rhetoric over trade tariffs is heating up. That means that properly-conducted trade finance will only become more important. Companies will need help in navigating the road ahead, and not least when it comes to ensuring that their documentation and financing arrangements meet international standards.

There has rarely been a better moment in time to increase understanding of the importance of expertise in trade finance and to set standards of excellence that will help ensure that global trade continues to benefit the world over the next several hundred years.

The world of trade finance

International trade finance can appear complex. Mostly, it is just different to other finance specialisms. It has its own terminology, which can be intimidating to those new to trading internationally and, so, sometimes, a barrier to exporting or to sourcing goods abroad. Lucrative new markets can remain untapped or suppliers ignored through ignorance or perhaps the fear of the unknown.

Fear created by high profile political exchanges on tariffs and quotas using confrontational, emotive phrases such as 'trade war' doesn't help. What prudent business is going to invest both time and money in developing new products and markets only to find that there are additional artificial barriers to navigate that, in extreme cases, are insurmountable?

But for those that relish a challenge the potential benefits of trading internationally are well worth the effort. Perhaps having a few extra hurdles to clear makes the achievement all the more rewarding. With any new subject, of course, there is much to learn but it is worth spending a little time on research to be able to reap the full benefits of trade finance.

This is not an exhaustive list but is illustrative of the additional considerations when an order is unexpectedly received from a buyer in another country:

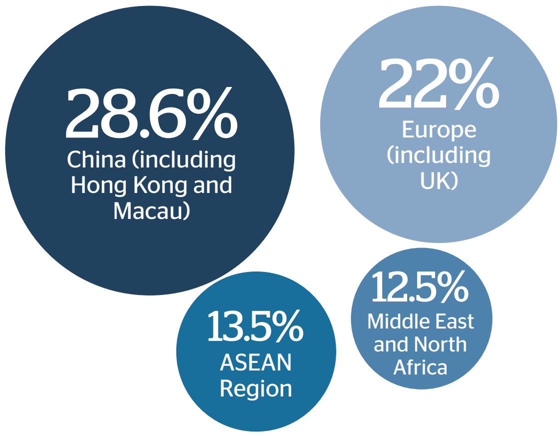
- Completing the necessary checks on a new buyer – due diligence – is good practice but are there other issues that will need to be considered both cultural and regulatory? Are there, for example, sanctions in place?
- Is the ability of the buyer to pay a concern? Are there political risks associated with the buyer's country? Could credit insurance be purchased to mitigate such risks?
- The use of Incoterms® in the sales contract will give clarity as to who is responsible for freight costs and insurance at given stages of the shipment and will help avoid unwelcome disputes.
- How is the sale to be paid for? What are the alternative methods of settlement and what are the features, benefits and associated risks of each?
- What currency will the used for the sale? If different from the home currency how are foreign exchange risks to be managed?
- For major capital equipment and infrastructure projects contract bonds may be called for; are the implications understood and how may risks be mitigated?
- Will the sale need specific financing? What are the alternatives?

Help is at hand from a number of sources to answer all of those questions. The International Chamber of Commerce (ICC) is an excellent first point of reference. It describes itself as: "*the world's largest business organisation, representing more than 45 million companies in over 100 countries. Our core mission is to make business work for everyone, every day, everywhere.*" In many countries the ICC operates effectively through its national operations: ICC China is a perfect example. Internationally active banks also provide both advice and operational support. All naturally depend on training whether it be 'on the job', structured internal, self-contained on-line modules as offered by ICC Academy and Coastline Solutions or formal qualifications as provided by The London Institute of Banking & Finance (LIBF).

LIBF's qualification for those looking to achieve a wide understanding of trade is its Certificate in International Trade and Finance (CITF®). The text has just been fully revised and includes the latest on supply chain finance, trade based financial crime and sustainability. Digitisation in trade is given additional focus as this is beginning to get real traction. The wide adoption of CITF illustrates the hunger for knowledge around the world. No doubt other education providers can paint a similar picture.

The continued growth of international trade is to be welcomed. Ultimately we all benefit and the world prospers as a result. But it doesn't just happen by itself. Inspiration, imagination, foresight and hard work naturally are all key to success and that success also demands knowledge of how trade works.

CITF holders as % of world total



Documentary letters of credit – the exporter's friend

World trade is estimated at US$20tn annually and is projected to grow at 4% per year. The use of letters of credit – L/Cs - as a means of settlement, however, appears static and in some areas is in decline. But whilst overall usage is estimated at just 10%, that still means that, in absolute terms, US$2tn is settled each year using L/Cs. It remains a vital tool for exporters that need certainty of payment.

So why are volumes in decline? The reasons are many and varied ranging from faster shipments compressing the time available to collate the necessary documentation, to alternative ways of mitigating financial risks such as credit insurance and standby credits. For exporters perhaps the major disadvantage of L/Cs has been the difficulty in preparing the required documentation to the required standard. Remember an L/C is an irrevocable undertaking given by a bank to honour a presentation of documents *submitted in accordance with the L/C terms and conditions and in compliance with the governing rules UCP 600*. Failure to present complying documents means that the bank does not have to honour its undertaking to pay: the irrevocable undertaking has been lost. At best this results in a delay in settlement whilst the discrepancies are referred to the buyer/applicant; at worst the documents as presented will be rejected and payment will not be made. Yet the proportion of documents rejected on first presentation remains stubbornly high at 60%. An L/C is only the exporter's friend if the terms and conditions are followed precisely.

What are the underlying causes of this rejection rate? There are many; some are minor and may be quickly corrected but some are more fundamental.

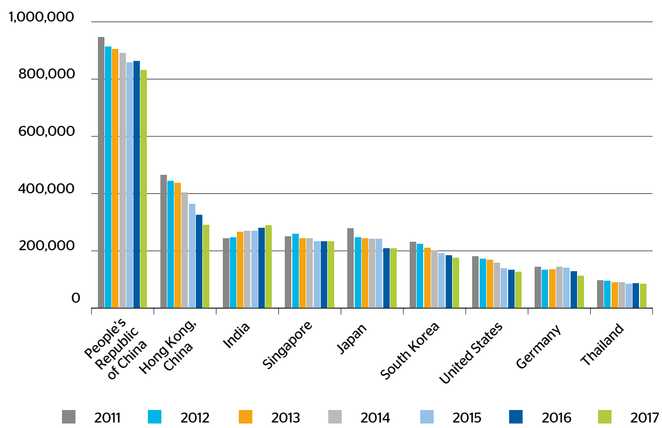
First of all it is critical that exporters (or beneficiaries) check each letter of credit, line by line, to establish that they understand the various terms and conditions and that they are able to comply precisely. If in doubt they should ask the buyer (or applicant) to have the L/C amended. Then exporters need to ensure that that the relative documents are presented and comply precisely with the terms of the L/C. They will need, as a minimum, a good understanding of UCP 600 without which they will almost certainly be unsuccessful. Similarly bank operational specialists responsible for checking documents need a high level of expertise to ensure that they only pay complying presentations and only reject documents that have true discrepancies. Mistakes at this level can be expensive for banks.

While it is true that there is no substitute for experience, relying on experience alone can be a long process. Most banks and many major exporters support internal 'on the job' learning with training and also with qualifications from recognised external providers. The most widely regarded qualification dedicated to L/C practitioners is the Certificate for Documentary Specialists (CDCS®). This was developed jointly by BAFT in the USA and The London Institute of Banking & Finance in the UK and first examined 20 years ago. It was subsequently endorsed by the ICC. There are currently well over 10,000 CDCS holders worldwide.

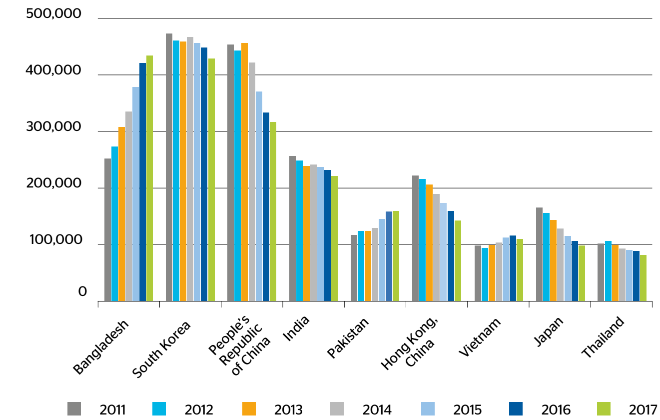
CDCS is unashamedly aimed at those whose day to day role is issuing, amending and checking presentations of documents. The challenging exam includes questions testing candidates' ability to apply their knowledge and understanding to realistic scenarios. Having successfully completed the course, CDCS holders are then required to recertify every three years to maintain the currency of their knowledge.

The following two tables show the major importing and exporting countries and regions using L/Cs as measured by SWIFT MT 700 messages (source 2018 ICC Global Survey on Trade Finance).

Top exporting countries and regions

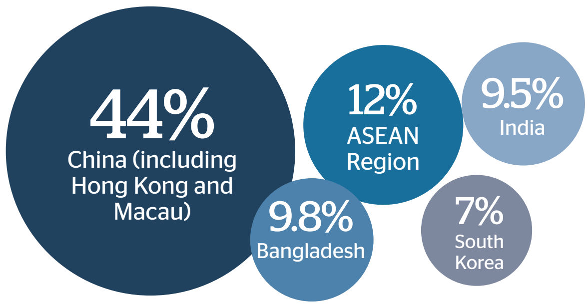


Top importing countries and regions



Not surprisingly there is a direct correlation between the big users of L/Cs and the countries with the most current CDCS holders.

CDCS holders as % of world total



Strong levels of competency will always be valued. CDCS is clear evidence of that maxim. Of course not everyone involved in trade needs the depth of knowledge that CDCS delivers. It is, after all, aimed at documentary credit specialists. For sales staff negotiating contracts on behalf of major manufacturers or client facing staff in international banks the demands are different. The emphasis will be more on the features of L/Cs and the benefits they offer rather than the core detail essential for practitioners. For such personnel, an on-line training module may be the answer. The ICC Academy offers two such courses; the *Introduction to Documentary Credits* and *Advanced Documentary Credits*; both are worth exploring.

Documentary letters of credit can truly be an exporter's friend, frankly importers too, but to take full advantage they need to be understood. For financial institutions, exporters and importers, whatever the method chosen, investment in training will pay dividends.

The growth of supply chain and open account finance

So, if the use of documentary letters of credit as a means of settlement is on the decline, what is taking up the slack? The obvious answer is simply to trade on open account. It is faster, cheaper and far easier to make a simple clean payment than to prepare a complying presentation of documents under the terms of an L/C. The protection offered by an L/C will be lost, of course, but even this risk may be mitigated (not eliminated) by prudent use of credit insurance or perhaps standby L/Cs.

Whilst being aware of credit risk and taking action as appropriate is important, credit is not the only consideration. What if financing has been provided on the strength of an underlying L/C? Discounting of bills of exchange/deferred payment obligations, back to back/transferrable credits etc. all offer opportunities for finance but if companies switch to open account what are the alternatives? The rapid growth of supply chain finance alongside the use of open account is no coincidence.

So what exactly is supply chain finance? In 2016, following a significant amount of work directed by the Global Supply Chain Finance Forum and supported by the ICC, BAFT, ITFA, FCI and EBA, the *Standard Definitions for Techniques for Supply Chain Finance* was published. (This is an excellent document in its own right and, if you are not familiar with it, is strongly recommended.)

The rationale in bringing together and defining the techniques is an attempt to ensure that everyone in the industry is 'speaking the same language'. This is still work in progress... But, essentially, supply chain finance is all about looking at the underlying transactions and the strength of the end buyer whereas traditional trade finance was based on company cash flow, or balance sheets, supported, if necessary, by security. Supply chain finance might sound risky, but, as the ICC Trade Register has established, the credit default risk associated with trade transactions is a fraction of that in mainstream finance.

The techniques may be split into two main categories:

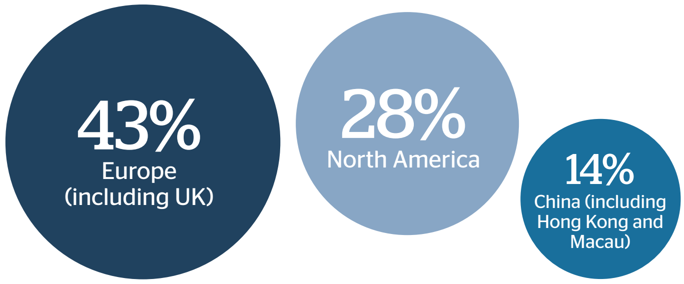
Receivables Purchase	Loan or Advance
▪ Receivables Discounting	▪ Loan or Advance against Receivables
▪ Forfaiting	▪ Distributor Finance
▪ Factoring	▪ Loan or Advance against Inventory
▪ Payables Finance	▪ Pre-shipment Finance

It is important to mention at this point that supply chain finance techniques apply equally to domestic and cross-border transactions and, indeed, many are predominantly domestic in application. The starting point is understanding the customer's physical supply chain and the related financial and information supply chains. These concepts are just as relevant to domestic transactions as they are to cross-border transactions. Undoubtedly the development and availability of software that facilitates supply chain finance within traditional lenders and new entrants has enabled its growth worldwide. Without it, many of the techniques on offer would be highly labour intensive or even unworkable.

One of the barriers to a greater take up of supply chain financing solutions is a lack of awareness by both finance providers and their clients (at least some of them) as to how these may be best applied. Clearly it is not the only reason for the identified USD1.5tn trade finance gap, but it will be contributory.

How can that awareness and expertise be increased? Clearly, education has a role to play. The London Institute of Banking & Finance has developed a dedicated qualification, the Certificate in Supply Chain Finance (CSCF), which incorporates the ICC Academy's Advanced Supply Chain Finance module. CSCF has been adopted by many organisations.

CSCF holders as % of world total



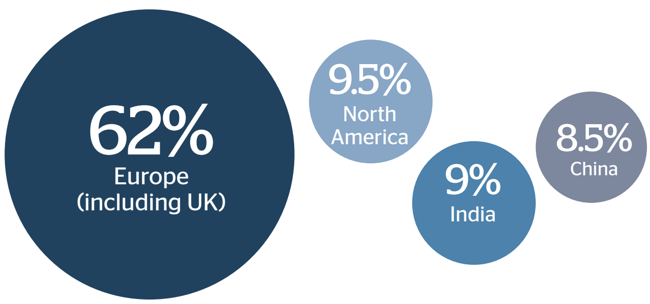
The China Council for the Promotion of International Trade **China Chamber of International Commerce Training Centre** (CCPIT Training Centre) has been at the forefront of educating banks and financial institutions in China about the opportunities. In the context of open account trading, this includes knowledge of both domestic and international clean payments. This may seem straightforward but for buyers there are a number of facets to consider when agreeing contract terms, such as:

- Timing – when must payment be made and what will the impact be on cash flow? This is a major consideration when trading on Advance Payment terms.
- Fees – clean payment terms will be the most effective way of keeping costs down but not if separate payments are made for individual shipments rather than aggregating. Urgent payments tend to demand premium fees so forward planning is important.
- Currency – what will the impact be of adverse movement in the rate of exchange when trading internationally?

Providers of payments systems are mostly, although not exclusively, financial institutions that will have invested in robust and secure payments infrastructure to provide accessible, easy to use payment options for their customers. This sounds clear-cut but there many considerations that need to be addressed and constantly refreshed as the market develops. These include adherence to the technical standards of message transfer and gross settlement systems; reliability and continuity planning; liquidity management; the regulatory framework including international sanctions; and data protection.

To meet these concerns The London Institute of Banking & Finance introduced its Certificate in Principles of Payments (CertPay). Endorsed by the SWIFT Institute this was developed specifically to address the needs of those working in the payments industry. To ensure that every candidate has a solid understanding of the topic the text covers every payment type from cash to straight through processing, and essential facets from liquidity management to regulation and sanctions.

CertPay holders as % of world total



Demand guarantees and standby letters of credit – the need for contingency

Demand guarantees and standby letters of credit are essential components of international trade – particularly for sales of capital equipment and for large infrastructure projects. Bid bonds are frequently required alongside contract tenders as evidence of commitment by potential suppliers. Contract winners have to provide performance and warranty bonds as assurance that contract commitments will be fulfilled. As a contingency, standbys are popular in supporting regular trade.

The risks associated with demand guarantees, however, are not always understood even by trade professionals. In response to research undertaken for the LIBF's *Certificate for Specialists in Demand Guarantees* (CDSG®), one senior banker responded that such a qualification was unnecessary as the bank simply took a client counter-indemnity for each demand guarantee issued. In other words the bank could issue any wording it liked and if a claim was received it could just debit its customer. It isn't that easy of course, it never was; such an approach is best described as reckless! Poor drafting will adversely impact applicants, beneficiaries and banks alike.

Guarantees may be straightforward or complex but, regardless, the underlying risks to both the customer and the bank need to be clearly understood *prior to issue*. Clarity is needed in establishing what constitutes a complying demand and when the guarantee expires or may be cancelled. In the event of a legal challenge what law will apply and in what jurisdiction will the case be held? There are many other considerations. If there is any doubt, legal advice should be sought.

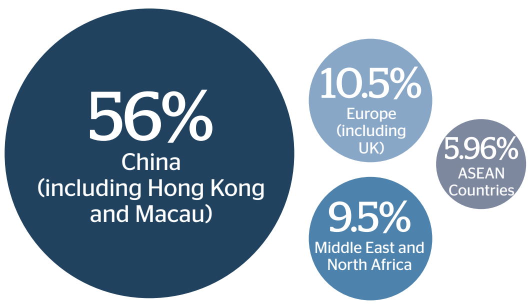
A significant development to help all parties understand the many and varied issues has been the development of the ICC Uniform Rules for Demand Guarantees the latest iteration of which, URDG 758, was published in July 2010. Guarantees issued subject to URDG are binding on all parties – providing great clarity and consistency. Unfortunately, URDG has yet to gain the wide acceptance that UCP enjoys but it is growing as both banks and, in particular, clients see the real and very tangible benefits.

In December 2016, the Supreme People's Court of the People's Republic of China issued new provisions governing all cases involving independent guarantees. These are binding on all Chinese courts and will affect anyone dealing with Chinese banks and with independent guarantees subject to Chinese law or jurisdiction. Interestingly the provisions allow for international practice rules including URDG 758, which in turn may well facilitate its still wider adoption.

Becoming a demand guarantee specialist can be slow. There is much to learn. First-hand experience 'on the job' is essential but the process can be accelerated through targeted learning. LIBF's Certificate for Specialists in Demand Guarantees (CSDG), as its name suggests, was designed specifically for practitioners involved in issuing or checking claims relating to demand guarantees. As such, it can deliver a step change in technical knowledge and the ability to apply that knowledge whilst providing evidence of expertise. It is no wonder that CSDG since its launch in 2013 it has become widely accepted as the definitive qualification in demand guarantees.

Mistakes made when issuing demand guarantees can be expensive in terms of legal costs or claims unnecessarily paid. Bank client relationships can be damaged and fee income lost as a consequence of lack of expertise. Investment in quality training will always be money well spent.

CSDG holders as % of world total



Compliance in world trade and the risks of getting it wrong

In the compliance world generally, bank mistakes can prove expensive. Not so long ago regulator fines could be measured in US Dollar terms in hundreds of millions (OK – still costly). Now, it is billions. In extreme cases, banks have lost their banking license. The same harsh rules apply to trade finance compliance. Failure to comply is going to cost. Repeated or wilful failure to comply is going to cost a lot. And this is not just in terms of potential fines but also reputation. Who wants to bank with an organisation with a cavalier attitude to financial crime?

But when we talk of trade-based compliance what exactly is it that financial institutions need to know and consequently comply with? Using the book '*Trade Based Financial Crime Compliance*', written by the late and much lamented Professor James Byrne and published by the Institute for International Banking Law & Practice (IIBLP) as the core reference, these were the key areas identified:

- Trade finance and associated trade products – banks may have highly knowledgeable compliance personnel but that doesn't mean that they understand trade. Trade knowledge does not have to be at a detailed practitioner level but the basics and the vocabulary need to be understood.
- Principles of financial crime regulation – whilst requirements will vary across jurisdictions the underlying risks and requirements need to be understood.
- Exercising customer due diligence (CDD) and know your customer (KYC) – are really simple concepts but critically important – frankly – for any business. CDD/KYC demand that organisations including financial institutions actually really know who they dealing with and who, ultimately, controls how the business operates.
- Indicators of trade-based financial crime – what should all businesses be looking for? Once identified what are the next steps such as reporting suspicions and record keeping?
- Anti-money laundering (AML) – are the concepts of under and over invoicing, 'phantom' shipments etc. understood? How may these be combatted?
- Countering the financing of terrorism (CFT) – easy to understand but potential breaches may be even harder to detect than money-laundering.
- Sanctions – the cost of implementing controls to ensure adherence to sanctions is significantly less than the cost of failing to do so.
- Weapons of mass destruction – the role of financial institutions in preventing their proliferation is critical to understand.
- Anti-bribery and commercial fraud – the impact of corruption on world trade from every angle

Trade based financial crime compliance is a huge topic in its own right with many pitfalls for the unwary; or for the unprepared...

Financial institutions have a responsibility to get this right. It is not just a question of damage to their business but to wider society as a whole. It is vital to look past the regulations at the activity they are trying to deter:

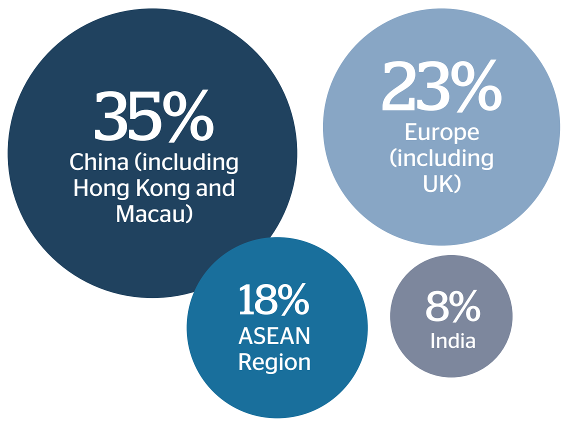
- People trafficking – it is estimated that there are over 20 million slaves in the world; more than the population of London, New York, and Los Angeles combined.
- Illegal drugs – the global illicit drug market is estimated at over US$300bn.
- Sanctions evasion – international sanctions are put in place to both deter and punish activity that destabilises the world order
- Financing of terrorism – from the 'first world' to the 'third world' there are few countries untouched by the consequences of terrorism

Banks have implemented multiple strategies to address compliance issues. These include ensuring that basic operational risk procedures and controls are put in place and regularly reviewed with any concerns fully investigated. Many have additionally sought systems solutions.

But, whatever is implemented to manage the massive volume of activity, banks need qualified staff more than ever to make sense of warnings, red flags, breaches etc. and to act appropriately to escalate, raise suspicious activity reports and ultimately make rational, informed decisions based on the information available. And, then, document those decisions as they may be subject to future scrutiny.

The risks associated with trade finance compliance are quite specific and need special attention. The London Institute of Banking & Finance consulted with various key partners including CCPIT Training Centre to establish the potential scope of a qualification that would meet the demanding needs of world banks. In late 2017, the Institute then launched its Certificate in Trade Finance Compliance (CTFC) using Professor Byrne's book as its core text with Coastline Solutions providing a complementary on-line course. Reflecting the interest in the important area, The London Institute of Banking & Finance reports that candidates have registered for CTFC from over 40 countries. The table below illustrates the main regions to date. Predictably, China is in the vanguard.

CTFC holders as % of world total



Conclusion

Though drums have been beating in some countries for a trade war, global trade is not a zero sum game, nor are its effects easily captured. For example, it helps developing countries grow out of poverty and it allows developed nations to broaden their export markets; it has unleashed harsh competition in some manufacturing sectors and enabled a resurgence in others; and it is both a challenge to, and a chance for, greater sustainability.

As that short list makes clear, trade has many, and many complex, roles to play in the global economy. Further, ongoing digitisation, which allows firms, governments and financial institutions to gather and analyse vast flows of information, could be as transformational in global trade as the invention of the steel shipping container.

What will not change is the need for experts who can help firms safely navigate their way through the many opportunities that changes in global trade will open up. Those experts will, themselves, need to constantly update their knowledge and skills but they are likely to find that the investment is worthwhile – both in terms of career benefits and personal education – as they play a central role in shaping the economy of the future.

The final word:

David Morrish: Director – The London Institute of Banking & Finance

The continued health and wellbeing of international trade is vital to world prosperity. Frictionless trade may not be a reality everywhere but the support mechanisms are there. The International Chamber of Commerce (ICC), created 100 years ago, in promoting international trade facilitated by its global approach to rules and guidelines, regulation and global services plays a major contributing role. In turn ICC National Committees provide local guidance and logistical support to organisations trading internationally. Banks provide essential services including trade finance in all its forms to exporters and importers helping their success. And help is also at hand from a variety of other sources including freight and shipping companies, insurers and so on.

However, like everything, knowledge is key to success and international trade and finance is no exception. Training is available in a variety of forms from traditional classroom format to on-line course modules; there is something for everyone.

Alongside many other ICC National Committees the China Council for the Promotion of International Trade **China Chamber of International Commerce Training Centre** (CCPIT Training Centre) is working together with the London Institute of Banking & Finance in providing specific training in trade and trade finance leading to formal qualifications recognised worldwide.

For more information on these and other services the following are useful first points of reference:

- CCPIT Training Centre Ms. Liu Xiangning 01082217268 liuxiangning@ccpit.org
- CCPIT Training Centre www.ccpit.org/
- ICC National Committees iccwbo.org/about-us/global-network/regional-offices/
- The London Institute of Banking & Finance www.libf.ac.uk/study/professional-qualifications/trade-finance