Latin American Foreign Trade Challenges and solutions for building sustainable financial architecture

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1. World Trade Outlook

World trade is expected, according to the latest report of the World Trade Organization (WTO), to close the year 2017 with 3.6% recovery, after having dropped to 1.3% last year. For the first time since 2010, world trade in goods will reach growth in excess of the gross domestic production forecast of 2.8%. This can be attributed to the resurgence of Asian trade currents brought about by growing intra-regional trade and recovery of the U.S. demand for imports, after having stagnated in 2016. Recovery of the greater part of the member countries of the Organization for Economic Development (OECD) was instrumental in this showing, as well. Rising raw materials prices are also working as a stimulus to the emerging economies. Even so, it should be stressed that trade has not yet returned to pre-crisis growth levels.

As (Maqueda, 2017) mentions, China’s accelerating trade and inter-annual increases of up to two digits in the exports of countries like Taiwan or South Korea did much to improve world trade. The OECD, for its part, indicated that the partial recovery of oil prices also appears to have given a boost to investment in the United States, which slowed abruptly in 2016, particularly in the energy sector, which has since then shown growth in the first half of 2017. And it is precisely this that is fueling imports and, consequently, trade.

A comparison of the ratio between trade and global production (Figure N°1) reveals that trade had not outpaced GDP since 2010, in a course similar to the normal situation starting in 1984, save for 2001 and 2009. This weakening of world trade can be explained, according to the Economic Commission for Latin America and the Caribbean (ECLAC), by the poor growth in global demand, the slowing spread of world value chains and reduced trade liberalization, or even rising protectionism. The IMF, for its part, attributes this loss of vigor to the poor performance of demand and investment in recent years (Figure N°2). Low growth in investment on the part of the developed countries is detrimental to growth and world trade.

The WTO claims that it is unlikely that the world trade growth rate reached in 2017 will hold steady and expects it to moderate in 2018 to close to 3.2%. The organization adduces the following reasons for this: Trade growth in 2018 will not be measured against a weak reference year, as was the case this year. The developed countries are expected to tighten their monetary policy, inasmuch as the U.S. Federal Reserve System (FED) is gradually pushing up its interest rates and the European Central Bank (ECB) is working to progressively do away with measures for quantitative easing in the Eurozone. At the same time, trade agreement negotiations are flagging, as can be seen in the U.S. withdrawal from the Trans-Pacific Partnership (TPP) and the paralysis of the agreement between the U.S. and the European Union (E.U.). The renegotiation of the North American Free Trade Agreement (NAFTA), which is to be replaced by a NAFTA 2.0, has created uncertainty, as do matters relating to Brexit. To conclude, it is quite likely that China will moderate its fiscal spending and credit facilities in order to avoid economic overheating. And here, the fact that it is moving from an industry- to a service-oriented economy must not be overlooked, for this means that its import needs will be reduced.
1.1 International Trade in Latin America and the Caribbean

ECLAC, in its recent annual International Trade Outlook for Latin America and the Caribbean, pointed out that in 2017 the region would emerge from half a decade of dropping export prices and weak increases in export volume, to reach growth of 10% in the value of its foreign sales. At the same time, imports would also show recovery after four straight years of declining values, with projected growth of 6.1% in 2017.

Although considerable uncertainty is seen to be reigning in the international macroeconomic, technological and geopolitical spheres, stronger aggregate demand on the part of some of its main trading partners, recovery of growth in the region itself—which is expected to reach 1.2% in 2017 and 2.2% in 2018, after two years of recession—, higher prices of some of its basic export products, and the removal of tariff and non-tariff restrictions in some of its countries have contributed to the resurgence of LAC trade, according to the report.

Continuing with that document, shipments to China and the rest of Asia (for rises in value of 23% and 27%, respectively) will spearhead regional export recovery in 2017, while exports to the U.S. and the region itself will achieve expansion close to the average (9% and 10%, respectively). At the same time, sales to the EU will evolve less dynamically (up 6%). Insofar as intra-regional trade is concerned, an upsurge is expected in all of its regions, particularly South America. Intra-regional exports are projected to rise some 10% over the year as a whole. Their weight among the region’s total sales to the rest of the world will amount to 16.8%, below the maximum level of almost 22% reached in 1994 (Figure N°5).

The report goes on to add that intra-regional trade holds great potential for the export of manufactured goods and of products with a greater value added in general. “This highlights the pressing need to deepen regional integration, even more so considering the recent new turn in U.S. trade policy and uncertainty over the NAFTA,” it points out.

Trade between Latin America and the Caribbean and India

LAC trade in goods with India took off over a fifteen year-period to reach US$30 billion in 2016. Over that same period, Indian imports from individual Latin American countries rose at an annual rate of 22%, while exports expanded at an annualized rate of 16%, according to data taken from the TradeMap trade analysis platform. Recent years, however, have witnessed a slowdown, which can be attributed to lower fuel prices and the economic difficulties plaguing some Latin American countries (Granados, 2017). While LAC accounted for barely 0.3% of India’s total imports in 2001, by 2016, this figure had risen to 5.1%.

Despite the early stage of their relations, thanks to the trade between the two, India has been able to take a leading position as a trading partner with some of the region’s countries. It has become Argentina’s fifth-ranking export market, Chile’s sixth, Brazil and Paraguay’s eighth, and Bolivia’s tenth. LAC, for its part, allocates 2.1% of its exports to India and receive 1.5% of its imports from that country.

1 It should be noted that raw materials are of basic importance to Latin America, accounting as they do for over 54% of its exports (over 60% in Mercosur’s case and 80% in the Andean region).
Latin American and Caribbean Intra-regional Trade

LAC trade volumes, despite the passage of time, still account for roughly 6% of world trade. While in 1975, the region accounted for 5.1% of total global exports, 42 years later that figure was only 6%. This is in complete opposition to the situation of East Asia, whose share rose from 5 to 22% over the same period, due to its strong industrialization and the bloc’s consequent export of manufactured goods.

Similar results can be seen on comparing trade within the Region with other regions of the world. LAC trade is less intra-regionally integrated than that of the rest of the world. Its intra-regional trade flows are still far smaller than those of other regions, representing only 15% in 2015, while trade within other regional blocs is up to four times greater. Intra-regional trade within the EU stands at about 70%; in Asia, 54%; and in North America, 30%. According to ECLAC, this phenomenon is not of recent standing, but dates back over two decades; although intra-regional exports multiplied tenfold over that period, they never climbed above a 20% share of the region’s total exports. This can be attributed largely to weak connectivity among its countries because of geographic factors and low investment in infrastructure, as can be seen in the lack of adequate highways and railways, together with inefficient ports and airports, although the situation varies considerably from one country to the next (Cerra, 2016).

Moving on with the analysis, at the subregional level, intra-subregional trade within the Central American Common Market (CACM) alone has accounted for almost 25% of its total exports over the past 10 years. At the other extreme, no more than 10% of the Andean Community’s (CAN) total exports have targeted the intra-subregional market.

2. International Trade Finance

In this section, we are going to set aside the operations that involve capital flows—in other words, investments, whether productive (foreign direct investments, FDI) or stock market investments—to concentrate, instead, on foreign market sales operations.

The Bank of Spain (2010) indicates that trade finance can be provided through a series of different instruments, such as by any of the companies involved in the transaction (the importer or exporter of the product or service), or may be intermediated by a third party. In the light of this definition and according to the WTO, 80% to 90% of world trade depends upon trade finance (commercial loans and insurance/collateral), most of which is short-term. Even so, this estimate has been questioned, for although less than 20% of world trade is known to receive some type of intermediated finance [International Chamber of Commerce (2009)], non-intermediated finance is hard to estimate.

As a result, it is difficult to describe how trade finance has evolved, due, in the first place, to the fact that—as pointed out—a sizeable portion of it is not intermediated and, in the second, that consistent data are lacking on the intermediated portion (Bank of Spain, 2010).

Although a smaller proportion of trade is financed by finance institutions than by means of loan arrangements between companies, the former contributes heavily to the growth of international trade. This reflects the fact that countries are able to enhance their trade potential and their international role in the degree to which their exporters and importers are able to accede to foreign trade finance and risk coverage mechanisms that are tailored to their needs (ECLAC, 2014). It is for that reason that the International Monetary Fund – IMF (2003) pointed out that the dwindling of such finance can seriously impair the real economy. Inasmuch as international supply chains have globalized trade finance on a par with production, their complex finance operations, which also cover SMEs, are now of decisive importance for trade, inasmuch as any risk aversion can be created at any stage of the production process.

It is for that reason that the WTO has been concerning itself since the onset of the Asian financial crisis with the shortage of trade finance for developing countries and low-income countries, for those are the countries most strongly affected by the general revaluing of risks and lack of liquidity characteristic of financial crises (Auboin and Meier-Ewert, 2008).
Trade finance mechanisms offered by banks

- Direct Financings: Finance for export (pre- and post-shipment), international factoring, forfaiting, finance for import, working capital, and letter of credit discounting.

“Advance account” credits are a facility that foreign banks grant to local banks for given purposes (they can only be used to finance exports and imports). The local bank acts as intermediary and assumes the risk of granting the loan. It can take the form of a pre-shipment or post-shipment credit or be granted through the purchase of documents (forfaiting).

- Pre-shipment: finances production of the good for export and is prior to the shipment of the merchandise.

- Post-shipment: demanded by customers to cover capital expenditures or needs after shipment of the goods or for installment sales.

- International Factoring is a tool that enables export companies to resolve their liquidity problems stemming from unpaid foreign debts; it gives SMEs the opportunity to gain access to financing to help them cash their receivables.

- Forfaiting consists of selling letters of exchange or promissory notes with bank guarantees or all export documents or letters of credit to a financial institution. The seller cedes its rights to collection in exchange for advance payment. The “forfaiter” purchases the documents at a discount and charges a fee for the operation, thereby freeing the exporter from the risk of non-collection.

- Indirect Financings: Letters of credit and stand-by letters of credit (L/C). Letters of credit are the most common form of bank-intermediated commercial financing and are normally short-term (less than 90 days). Banks also offer security or stand-by letters of credit that underwrite the exporter or importer’s contractual obligations. Generally speaking, these are off-balance sheet liabilities that are not financed until the exporter or importer complies with its contractual obligations. A letter of credit or stand-by letter of credit is particularly useful when reliable credit information about an importer is lacking, but the exporter or its bank trust in the financial standing of the importer’s bank.

- Medium- and long-term financings: International financial leasing and finance of fixed assets. International financial leasing or cross-border leasing is a rental contract for goods covering a given period of time and through which the lessee agrees to the irrevocable payment of a series of installments and their maintenance fees and taxes, together with other expenses for the conservation of the contractual good, when the lessor and lessee live in different countries.

- International trade guarantees: Export credit insurance is a coverage mechanism that protects exporters against ordinary and extraordinary international trade risks by allowing them to recover the damages produced by given events that could impede the
collection or recovery of credits agreed with their overseas buyers. The customary risks involved in the commercial activity are ordinary risks and those connected with disasters are extraordinary risks. Guarantee funds, for their part, as their name indicates, supplement the availability of the real guarantees required by merchandise exporters in applying to a banking institution for an export finance credit.

2.2. The role of development banks

As a result of the shortage of export finance in many developing countries and its worsening during financial crises because of the lack of liquidity they produce, the WTO, at the request of a series of members, has brought its efforts to bear on boosting and maintaining trade flows in order to mitigate at least one of the causes of their diminishment.

In this connection, the need has been perceived since as early as 2003 for inter-governmental institutions to find global solutions to the challenges posed by trade finance. This led the Managing Director of the IMF, the President of the World Bank and the Director-General of the WTO, under the WTO mandate on coherence, to gather together the principal interested parties for the purpose of seeking a way to improve trade finance for developing and less developed countries. Particular insistence was placed on the need to encourage regional development banks and the World Bank to expand innovative means for financing trade activities, while respecting WTO regulations.

The response of the regional development and national banks since then has been positive and continuous. They have deployed their greatest efforts to provide trade finance, either directly or by intermediating resources through credit lines intended for foreign trade financing institutions and agencies. Insofar as the development banks’ credit portfolio is concerned, at December 2016, they had mobilized US$807.427 million, up 14.9% on the previous year’s figure, with the agricultural and rural; housing, construction and infrastructure; and trade and manufacturing sectors as the foremost recipients of the financing. International trade lines and programs accounted for 2.1% of those resources.

Development banks draw upon a wide range of instruments for supporting foreign trade and insuring its related operations. The finance lines and programs include export pre-financing and post-financing, credit lines for the procurement of capital goods, financing of SME leasing contracts, coverage of loans to exporters, credit lines for financing working capital, quality and management program administration, development credits for free trade zones, financing of sales and the acquisition of imported equipment, etc. Foremost in the area of export credit guarantees and insurance are insurance against commercial risk, political risk and extraordinary contingencies for short-, medium- and long-term operations; guarantee funds for small businessmen; and export credit insurance for cases of bankruptcy or inability to pay, etc.

Among the export finance methods, pre- and post-shipment stand out as being used by 67.7% of the multi-sector development banks, followed in importance by letters of credit at 64.5% and guarantees at 41.9%. The other, less frequent, mechanisms are used by banks specializing in foreign trade. By way of example, Banco de Inversión y Comercio Exterior S.A. (Bice), of Argentina, Banco Nacional de las Exportaciones (Bandex), Banco de Comercio Exterior (Bancoex) and Banco Nacional de Comercio Exterior S.N.C. (Bancomext) provide medium- and long-term financing. The latter bank offers financings to meet both short-term requirements for consumer goods and medium- and long-term requirements of foreign trade institutions, dependent offices and companies for 2- to 10-year-old intermediate goods.

These financial instruments (programs) are provided for the most part by retail banks, above all for cases of pre- and post-shipment, letters of credit and other banking services offered to the sector, like: foreign currency transfers, export/import collections, and financings of sales and the acquisition of imported equipment, etc. In the case of the remaining programs, it is the wholesale banks that provide the finance. This is in line with the functional characteristics of the development banks, consisting today mainly of retail banks (64%) and wholesale banks (27%).
Import substitution companies, according to Bancomext.

For example, if there is a very long term financing need for a project, a company might seek to syndicate the operation amounting to US$50 million that needs a 7-year term, we will seek to enter together with other banks by syndicating the operation and could assume the longest segment."

Foreign trade support instruments: At September 2017, 39.2% of the loan portfolio corresponded to documentary credits, amounting to 9% less than the previous year on the same date (48.4%), and which consist basically of financing granted under the program for exports and the finance of investment advances to public energy and technological companies. Secondly, 36% of the financing consists of loans to the financial sector (13.8% in September 2016) granted in the context of the investment and financial leasing project regimes. Mortgage guarantee-backed loans account for 20.8% of the total finance.

Among the instruments offered by the Bank are credit lines to support company internationalization and short- and long-term lines with multinational agencies for financing machinery procurement (ECA’s). Forfaiting, another of the new instruments, is a non-recourse finance operation that will permit the exporter to place its products in the world market and offer its buyers a 10-year term in which to pay off their debt. Under this mechanism, the company will collect the cash value of the export from BICE through the discounting of letters of credit, promissory notes and/or guaranteed bills of exchange. The Bank, for its part, assumes the risk of default in payment of the receivables by requiring an additional bank guarantee needed to make the collection in the event that the importer fails to pay. The launching of this line proved possible thanks to a joint effort between BICE, the Central bank and the Trade Secretariat that resulted in the amendment of a regulation requiring exporters to convert their foreign currency earnings within a 365-day period. The amendment first extended the period to five years and then its current ten year-term, thereby producing a basic instrument that places Argentinean export companies on the same level as the rest of their competitors throughout the world. The line is intended for use in the export of industrial manufactures, agricultural manufactures, capital goods and services in amounts ranging from US$200

* BICE’s experience in the areas of long-term financing and the financing of export SMEs

BICE operates as a wholesale bank by offering credit directly and through lines maintained with financial institutions and reciprocal guarantee companies. It aims to promote foreign investments and trade through medium- and long-term credits. Along this line, it is currently boosting the financing of export SMEs, whose entire business cycle it finances from the moment of their creation, through their bankarization, to the start of their export activities. The bank also maintains credit lines to support the internationalization of companies that have grown, exported and wish to expand their activities abroad and does this by providing long-term financings.

According to its President, “banks today provide short-term financing of two or three months with fixed-term sight deposits. What BICE seeks is to encourage them to lend on a long-term basis and to that end it covers the mismatch, but it is the banks that assume the long-term risk. BICE also participates in direct long-term financings by taking on the long segments. For example, if there is a very long

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2 Import substitution companies, according to Bancomext.
thousand to US$6 million.

Lastly, in order to improve access, it launched the “Impulsa COMEX” credit line to enable Argentinean SMEs to export their goods. This is a pre- and post-export finance line with a fixed rate of 1.5%, through which the Bank seeks to promote productive development by providing financial assistance to SMEs that are not yet able to secure access to international markets and support to large companies requiring more financing for further growth.

- Foreign Trade Finance in Brazil

Brazilian exports are financed through public and private instruments differentiated according to the origin of the funds used. In the case of public funds, the main instruments for supporting foreign trade are the Programa Federal de Estímulo a las Exportaciones (Proex), Banco Nacional de Desenvolvimento Econômico e Social (BNDES), and Banco do Brasil financing lines, while the finance provided from private resources, established under the control of Brazil’s Central Bank, favor exchange contract advances (ACCs) and export pre-payments.

Banco do Brasil: The Proex, created in 1991 by the Brazilian government, seeks to provide the necessary conditions to enable Brazilian export companies to compete in the international market. The program operates using National Treasury funds allocated every year in the public budget and disbursed by the Bank of Brazil. A limitation is based on the gross billings of the companies applying for the available resources, which is expanded annually by the Chamber of Foreign Trade.

Financing can be granted in the following forms: Proex financing provided for the post-shipment of goods and services and Proex equalization, which requires a financing contract signed beforehand with another institution. As designed, the Program is not of interest to large companies, which are able to negotiate better terms directly with the financial market. It does favor small companies, however.

The instrument is applicable to almost 80% of the country’s exportable supply and particularly benefits sectors like textile machinery, woodworking and leather-footwear. Proex equalization is provided to the transportation, machinery and equipment sectors having received prior loans and financings from BNDES-Exim. To give an idea of the importance of this instrument, in the first half of 2017 alone, of the US$98.5 billion produced in export foreign currency earnings, the Bank of Brazil was the source of US$19.2 billion and was responsible for almost 20% of those operations recorded in the Brazilian Central Bank.

In 2016, the bank accounted for 21% of the US$176 billion in foreign currency trading. It should be stressed that the Bank of Brazil has over 100 Managers specializing in International Business, together with teams of consultants who promote courses for company training in foreign trade-related issues, consultancy and foreign currency trading, who help their customers prepare their business solutions. Currency exchange operations can even be carried out 100% digitally, including commissioning, document remittance, signing and management of the operations.

PROGER Exportación was created to deal with the exports of micro and small Brazilian companies. It targets companies with gross annual billings of up to US$1.5 million and its purpose is to finance the pre-shipment export of goods and export-related promotional expenses. Its budget up until 2016 was US$44 million.

BNDES- BNDES has a series of products and programs to support company exports and internationalization lines. These products are: BNDES Exim (Pre- and Post-Shipment), BNDES Finem (with lines supporting company internationalization and the procurement of capital goods) and BNDES Automático. Each of these has specific mechanisms and objectives, but the financing lines may be combined should the Bank choose to do so. From 1998 to 2016, 12% of the Bank’s financing went to the export sector; in this sense, it operates similarly to an export credit agency, in being empowered to provide official assistance by means of finance, insurance and guarantees.

In order to support the internationalization of Brazilian companies, Decree N°4,418 was amended in 2002 to allow the Bank to take the following actions: a) finance the acquisition of assets and investments made by Brazilian companies abroad, provided that they contribute to the country’s economic and social development; b) finance and promote the export of goods and services, including installation services and expenditures abroad in connection with export operations; c) commission technical studies and provide technical and financial assistance for structuring projects that will promote Brazilian economic and social development or the country’s integration within Latin America; d) use funds raised in the foreign market to finance the procurement of assets and implementation of projects and investments abroad by Brazilian companies, subsidiaries of Brazilian companies and foreign companies in which the majority shareholder with a voting right is, directly or indirectly, an individual or a legal entity domiciled in the country, and to acquire in the market securities issued by those companies or for which they are responsible (Bruno, 2014). As of that moment, it became possible to open representative offices outside Brazil; as a result, an office was opened in Montevideo.

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3 The payment period is up to twelve months and the financing limit is US$ 80 thousand.
Uruguay in August 2009; in London (now known as BNDES Limited), and in Johannesburg, South Africa, in December 2013.

BNDES-Exim operates on a pre-shipment and post-shipment basis. In the case of post-shipment, the financing is intended for the marketing of export products and the payments are made by BNDES. With pre-shipment, the finance is used for the production and draws on funds transferred by financial institutions. BNDES Automático finances the post-shipment marketing of Brazilian goods through a network of overseas banks accredited by BNDES.

Instituto Brasileño de Análisis Sociales y Económicos (Ibase), (Brazilian Institute of Social and Economic Analyses) states that approximately 87% of the investments made under the Exim post-shipment program over the past 10 years went into LAC infrastructure and capital goods purchases. By 2012, the Bank had already disbursed US$2.17 billion in that category (Post-Shipment). More recently, export finance more than doubled in 2016, compared with the previous year, to reach US$4.1 billion. The main category, accounting for 80% of the disbursements, was the financing of capital goods exports. This support represented 11% of Brazil’s total exports of capital goods.

In 2016, US$2.6 billion were spent on pre-shipment operations and US$1.5 billion on post-shipment. Repayments and interest on post-shipment financings each year are a stable source of foreign currency for Brazil. In 2016 alone, the country received US$2.1 billion in payments for these operations.

The BNDES Exim Automático line, for its part, raised the number of Brazilian exporters, expanded its network of partner banks abroad (11 new institutions were incorporated) and simplified operational processing. The average financing granted during the period was US$600 thousand, half its historical average, which is indicative of the instrument’s growing use. The sectors most favored were farming machinery and tools, buses, trucks, industrial machines and construction machinery that exported goods for projects abroad.

- **The experience of Colombia’s Bancóldex**

Banco de Comercio Exterior de Colombia (Bancóldex) (Colombian Foreign Trade Bank) is one of Colombia’s foremost wholesale banks and through its rediscount credit lines and administration of special programs, it promotes corporate development, financial inclusion and entrepreneurship in Colombia. In its role of promoting foreign trade and economic internationalization, at November 2016, the institution disbursed some US$ 510 million to 784 export companies whose total exports added up to US$2.724 million. On this point, the company expressed its assurance that the Bank would have over US$ 1.7 billion available for export finance starting in 2018.

The Bank, through its financial intermediaries, has an ample portfolio of products and services that enable it to ensure that companies involved in the foreign trade sector, among others, have access to the peso and dollar-denominated resources to cover the needs of their economic activity.

It is able to accordingly offer Colombian exporters different international banking services like the confirmation or report of sight, acceptance or differed payment export letters of credit (L/C); management and negotiation of documentary collections; confirmation of stand-by letters of credit; and receipt of post-shipment bank transfers deriving from the export of Colombian goods, among others. It is also endowed with exchange coverage mechanisms, buyer credit lines and financing for engineering and construction projects and other services. In some cases, there are special credit allotments that target specific sectors or company sizes, according to the particular economic situation.

Bancóldex also offers supplier and buyer credit as a mechanism whereby importers of Colombian goods and services abroad are able to finance their purchases with a financial intermediary that is one of the Bank’s correspondents. It further provides facilities for negotiation abroad through the purchase of dollar-denominated invoices for all exporters holding credit insurance policies. Businessmen interested in gaining a practical knowledge of the most important points of an international payments flow negotiation can turn to the Bank for a range of non-financial services known as “management advisor in international business,” that will help the company to recognize and identify the risks inherent in an international operation of this kind. It will also enable it to describe and use the Bank’s products and services and to learn about the financing an exporter can provide to its overseas buyer, in keeping with its type of business, product, the approximate costs and, of course, the benefits. The financing strategy for export companies with little access to the commercial banking system has been shored up with the Fondo Nacional de Garantías’ (FNG) (National Guarantee Fund’s) guarantee program that offers backing drawing on the resources of Bancóldex and the traditional banking system.

- **Bancomext and international factoring**

Bancomext is a public financial institution that operates as both a retail and a wholesale bank. Among its primary aims are to promote foreign trade finance and the internationalization of Mexican institutions abroad and to enhance participation in global value chains. Over its entire history of operation, the Bank has given financial assistance to companies involved in Mexico’s foreign trade, including exporters and
their suppliers, importers and import substitution companies. In 2016, it placed almost US$5.6 billion, of which 48% was provided through syndicated financings with commercial or development banks. Furthermore, suppliers were offered US$360 million in factoring lines that benefitted 266 companies.

The purpose of the financial products and programs through which Bancomext’s financing is channeled as a retail bank is to provide direct assistance to companies involved in foreign trade by means of credits and structured operations, export and import factoring, supplier factoring, inventory finance, letter of credit servicing and financing, and the provision of guarantees and avails. The Bank also offers direct credit, corporate financing and letter of credit servicing with the option of providing funds to the public sector. Insofar as its wholesale finance activities are concerned, a multiplier effect is sought in the channelling of support through banking and non-banking financial intermediaries that provide credits (discount), grant speedy selective and automatic guarantees, motor vehicle parts and buyer credit for overseas financial intermediaries and a letter of credit service with banks abroad. In addition, Bancomext has a Financing Program for SME exporters and importers, under which financings of under US$3 million are provided. In the event that a company’s needs are in excess of that sum, the institution must be contacted directly in order to accede to financing.

**International factoring:** launched in 2012, this is a short-term financing mechanism through which a company or an individual engaged in a business activity promotes its growth by selling off its effective receivables to a factoring company. The program was initially developed to channel financings to exporters in the form of: 1) Prime Revenue, 2) Factoring guarantee and 3) Export factoring through financial counterparts. International import factoring was later added and by the close of 2016, a total of US$122 million had been granted for the financing of receivables in 29 countries, of which it should be stressed that 85% of the exporters are SMEs. A total of 15,659 export invoices have been financed for a six-fold growth compared with the 2,200 invoices initially financed in 2012, when the program was launched.

**De-Risking Effects**

A study conducted by the Global Provider of Secure Financial Messaging Services (Swift) warns that the streamlining of correspondent banking over the past two years by several U.S. banking institutions with Latin American and Caribbean banks in a trend known as “de-risking,” is affecting international transactions and the flow of remittances from that country to the region, the Caribbean subregion being the most heavily affected by it.

This policy was adopted by the international banking system in response to the implied risk of being penalized with large fines for being open to money laundering and terrorist financing (ML/TF) as a result of the ineffectiveness of their anti-laundering controls. A further reason was to put obstacles in the way of the appearance of new and dynamic competitors representing a threat to traditional financial institutions.

But which are the lines of business most heavily affected by “de-risking?” According to a survey carried out by ASBA (Association of Supervisors of Banks of the Americas) in 2016, these are the products, services and channels most subject to money laundering and the financing of terrorism. Those most prone to this risk are therefore: remittances (60%), followed by correspondent banking (50%), trade finance (28%) and currency exchange (12%). On the other hand, mobile banking, electronic money and electronic payments, each with 8%, are associated with the ML/TF risk and technological regulatory demands.

This leads to an increase in operating costs and/or the loss of market access by the region’s economic agents. The differences in approaches to regulation taken in the various jurisdictions are a key element in raising costs. According to ASBA, this could also bring about an advance in “shadow banking,” which includes fintechs or unregulated investment funds that are potential suppliers of services to agents not served by the regulated system.

It should be stated here that according to the Financial Stability Board (FSB), “Shadow Banking’s” share of the financial system is growing and rose from 14.5% in 2012 to 15% in 2014. That is why it is important to level the playing field by establishing similar conditions for the operations of all participants in the financial market.

EY is of the opinion that digital connectivity, consumers’ lack of interest in traditional products and limited innovation are motivating consumers to move to the fintechs. Technological innovations pose new

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6 78% of compliance professionals reported increases in regulatory charges over the past 3 years to the KPMG Global Anti-Money Laundering Survey.
challenges for ML/TF management and customers' knowledge should evolve with the advance of the new technologies.

De-Risking Effects:

- Migration of high-risk customers to institutions with poor management capacity: Although de-risking aims to reduce financial sector vulnerability, its effects have been precisely the opposite. The most risky customers are migrating to institutions lacking the capacity to manage the risk.

- Use of less regulated channels: The conclusion of relations with given actors has forced them to migrate to less regulated channels. This is an element that may promote the growth of “shadow banking.”

- Reduction of trade finance and retreat of financial inclusion: The global closure of various channels and operations has reduced the access of emerging economies to other currencies. This could impact the development and financial inclusion of emerging countries. According to the Financial Times, the offering of correspondent banking services in the Eurozone declined from 25,000 in 2002 to 15,000 in 2015.9

- Greater risk concentration among fewer institutions: The risk is becoming concentrated in the few institutions that have decided to continue pursuing lines of business that are considered high-risk. There is a growing risk of abuse by institutions that are assuming risks vis-à-vis customers that are excluded by the rest of the formal financial sector.

By way of conclusion, in order to avoid the effects of de-risking, innovative mechanisms need to be adopted to ensure due diligence in the customer’s knowledge, without resorting to the use of traditional mechanisms (interviews and questionnaires). New methods of money laundering are emerging, prompted by technological advances together with the development of new business models. As a result, systems for the prevention and management of ML/TF risk need to advance in parallel and align themselves with the pace of innovation in the market. This cannot be construed to mean the imminent relaxation of the processes for identifying, gauging, controlling and monitoring ML/TF risk. What is being called for is the update of the mechanisms being used without overlooking the risks.

8 Based on the presentation made by Gerardo Hernández Correa, Colombia's Office of the Financial Superintendent, July 2016.

3. **Regional Financial Institutions that Support Foreign Trade**

The case of the Latin American Export Bank (Bladex), founded in May 1975 by twenty-three Latin American and Caribbean central banks as a specialized bank to support the region’s foreign trade. As a result, 66% of its transactions have to do with that sector. Later, in the past decade, a growing series of products and services (trade, leasing, factoring, financed sales, syndicated loans and structured loans) covering all stages of foreign trade was added to its given business.

Bladex’s target market has expanded in recent years to take in medium-size companies and an amendment of its bylaws now allows it to lend to corporations domiciled outside the Region whose line of business is to import/finance the Region’s imports.

A total of US$243 billion in loans have been disbursed since 1979, with South America having received the lion’s share, amounting US$138.5 billion. The geographic distribution of its commercial portfolio at 2016 revealed that 57% went to South America; 21% to Central America and the Caribbean; 18% to North America and 4% to other regions. Segment-wise, these loans favored the corporate sector (61%), followed by the financial institutions (39%).

In 2014, Bladex devoted its efforts to offering financial solutions and structures to Latin American multinational corporations. It also reinforced its supplier credit product to achieve growth of 48% in income deriving from the spread compared to that of 2011, with a volume of transactions in 2012 of over US$2.5 billion, 33% more than in 2011.

The Andean Development Corporation (CAF), for its part, invested a total of US$18,344 million between 2010 and 2016 in foreign trade projects, company internationalization and the creation of business opportunities. With this same aim in mind, the Inter-American Development Bank (IDB), through sovereign guarantee operations, granted a total of US$772.6 million to the Region’s export sector; of this amount US$654 million were allocated to the promotion of exports, with its trade facilitation, trade logistics and customs lines receiving US$118.6 million.

Lastly, the Central American Bank for Economic Integration (CABEI) has designed a series of international trade facilitation and promotion programs, policies and strategies. Foremost among these is the Foreign Trade Program (COMEX) that facilitates resources to intermediary financial institutions for promoting the import and export of goods and services within the existing credit lines of the International Trade Facilitation Initiative (I-FACIL). At 2015, CABEI had channeled US$192.1 million in funds intermediated within the scope of COMEX and holds an active portfolio in the neighborhood of US$46.4 million.

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10 The trade portfolio includes the book value of loans, placement of selected deposits, investments in shares, acceptances and contingencies (letters of credit, standby letters of credit, guarantees covering trade risks, and loan commitments).
Even though global trade is expected to recover and reach 3.6% after its slipup of last year, when, for the first time since 2010, it dropped to 1.3%, Latin America must accustom itself to a new, more moderate rate of growth than that of the past decade, given that it is up to the Region to diversify its supply of exportable goods into more elaborated links of the supply chain. The major challenge in this scenario continues to be the need to implement new policies to boost growth and economic reforms that do away with inflexibility, so that exports can be further diversified and competitive capacity can be enhanced in the area of international trade.

In this scenario, governments in the Region are able to make use of their development banks as public policy instruments for promoting the diversification of their export baskets and boosting the internationalization of companies, particularly of SMEs and their tie-in with global production chains. Although the foreign trade loan portfolios of these development banks represent a little over 2% of their total portfolios, this percentage could be far larger, above all in the case of banks specializing in foreign trade. As the International Chamber of Commerce mentioned in 2009, although less than 20% of global trade is known to receive some form of intermediated financing, the amount of non-intermediated financing is very difficult to estimate.

Trade finance in the region is still extremely limited compared to that of other developed and emerging countries of Asia. This shortage and the lack of liquidity produced during periods of crisis have led the governments of several countries and international organizations like the WTO, the IMF and the World Bank to insist upon the need to encourage regional development banks to add innovatively to the methods for financing trade activities, while respecting the rules and regulations of the WTO.

The response of the development banking system and national banks of the Region has been positive and continuous ever since that time. Their greatest efforts have gone into the financing of trade, either directly or by intermediating resources through credit lines extended to financial institutions and foreign trade agencies, with the result that a wide range of instruments for supporting foreign trade and guaranteeing related operations have been deployed.

These financing lines and programs include export pre- and post- financing, credit lines for the acquisition of capital goods, financing of leasing contracts for SMEs, coverage of loans to exporters, credit lines for financing working capital, quality and management administration programs, credits for the development of free trade zones, financing of sales and the procurement of imported equipment, etc. Standing out in the area of export guarantees and credit insurance are insurance policies against trade risk, political risk and extraordinary contingencies for short-, medium- and long-term operations, guarantee funds for small businessmen, export credit insurance for confronting bankruptcy or payment defaults, and others.

Foremost among these export finance methods are pre- and post-shipment financing, which are employed by 67.7% of the multi-sector development banks, followed in importance by letters of credit (64.5%) and guarantees (41.9%). The other, less frequently used, mechanisms are employed by banks specializing in foreign trade. By way of example, medium- and long-term financing is provided by CABEI, Bandex, Bancoex and Bancomext, and Bancoldex.

These financial instruments (programs) are in use mainly by retail banks, above all for the cases of pre- and post-shipment, letters of credit and other banking services offered to this sector, including: foreign currency transfers, export/import collections, financing of sales and procurement of imported equipment, etc. In the case of the remaining programs, it is the wholesale banks that offer the financing, in keeping with the functional characteristics of the development banks, 64% of which are presently retail banks and 27%, wholesale banks.

Export financing is generally not limited to a given company size, although major efforts can be seen on the part of specialized institutions to assist with SME internationalization and to promote the growth of these small export companies. While their business horizon is no longer limited to the local market and they are looking beyond national borders, they run up against serious problems when seeking to break into the regional market, where demands are more numerous and stringent, forcing them to reveal some of their shortcomings. That is why it is so important for development banks to offer not only financing, but also training and advisory assistance.

It should also be considered that development banks, by sustaining good relations with both multinational development organizations and governments, offer great advantages for bringing together interested parties and advancing initiatives to promote foreign trade and investment. In addition, they have access to privileged information, like knowledge of major investment projects, bilateral initiatives between countries occasionally agreed at the political level, or initiatives among national and foreign entrepreneurs proposed for consideration by the governments.

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