02

EVALUATION OF
IDB GROUP'S WORK THROUGH FINANCIAL INTERMEDIARIES

TRADE FINANCE

See all background papers

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ABBREVIATIONS AND ACRONYMS

AML	Anti-money laundering
CB	Confirming bank
EBRD	European Bank for Reconstruction and Development
FI	Financial intermediary
IB	Issuing bank
IDB	Inter-American Development Bank
IDBG	Inter-American Development Bank Group
IIC	Inter-American Investment Corporation
IMF	International Monetary Fund
KYC	“Know your customer”
LAC	Latin America and the Caribbean
L/C	Letter of credit
MDB	Multilateral development bank
MPA	Master Participation Agreement
NSG	Non-sovereign-guaranteed
OMJ	Opportunities for the Majority
OVE	Office of Evaluation and Oversight
SCF	Structured and Corporate Finance Department
SME	Small and medium-sized enterprise
TFFP	Trade Finance Facilitation Program
TFRP	Trade Finance Reactivation Program
WTO	World Trade Organization

I. TRADE FINANCE AS A DEVELOPMENT TOOL

A. Context

1.1 **Trade finance plays an important role in facilitating international trade, which has been shown to have strong positive development effects.**[1] International transactions are generally characterized by longer time-lags between the production of goods, shipment, and payments; financial institutions facilitate these transactions by intermediating between buyers and sellers to reduce risks to the parties and provide liquidity. Exporters with limited access to working capital often require financing to process or manufacture products before receiving payments, and importers often need credit to buy raw materials, goods, and equipment from overseas. The need for trade finance is underlined by the fact that competition for export contracts is often based on the attractiveness of the payment terms offered: stronger importers prefer to buy on an open-account basis with extended terms, and stronger exporters prefer to sell on a cash or secured basis if extended terms are needed. It is estimated that 80% to 90% of trade transactions require some kind of credit, insurance, or guarantee.

1.2 **In volume, trade finance through banks is estimated at around 20% of annual global trade.** Trade financing instruments to exporters and importers can take several forms: documentary credit, short-term loans, working capital loans or overdrafts, discount letters of credit, advance payment bonds, pre- and post-shipping financing, or buyers' credit. Annual global trade volumes are around $15 trillion a year, and it is estimated that the amount covered by these financial instruments through banks is around $3 trillion per year; the rest is done through cash in advance and open-account operations (which includes inter-firm and intra-firm financing options).

1.3 **Financial crises can disproportionately affect access to affordable trade finance (especially short-term), reducing trade flows.** During extreme financial events in the 1990s and the 2008-2009 global financial crisis, the credit crunch generated fears that lack of trade finance could have negative effects on the real economy. For that reason, national and international organizations—the World Trade Organization (WTO), International Monetary Fund (IMF), World Bank, Inter-American Development Bank (IDB), Asian Development Bank (ADB), and Export Credit Agencies—launched several initiatives to reduce the possible negative impacts on trade. This included a pledge by the G20 leaders, at their April 2009 London Summit, to ensure $250 billion of support for trade finance.

1.4 **Regulatory factors—such as Basel III regulations, and changes in anti-money laundering (AML) and "know your customer" (KYC) requirements—have also affected the flow of credit for trade.** For example, under Basel III, global banking rules intended to make the financial system safer also affect

[1] See, for example, Commission on Growth and Development (2008), *The Growth Report*. Openness to trade was one of the key common factors for countries that enjoyed high, long-term sustainable growth.

cross-border businesses and make trade finance more expensive.[2] This could drive smaller banks out of the market and prompt large banks to cut back their lending to emerging market banks. Regarding AML and KYC rules, the increased screening requirements for international banks that work in multiple jurisdictions are augmenting both operational costs and the risk of fines for breaches of regulations. This all reduces the profitability of trade finance, and when local banks cannot meet financial hurdle rates, the relationships with them are cut.[3]

1.5 **Poor countries, in particular, continue to feel that trade expansion in their countries is hampered by a structural lack of affordable trade credit.** Large emerging markets also feel vulnerable to shifts in market sentiments, which can reduce their ability to access commercial credit; this was expressed most recently in the WTO context, in the Working Group on Trade, Debt and Finance, and under the Aid-for-Trade Initiative. The availability of trade finance was identified by the Task Force on Aid-for-Trade as a key supply-side constraint to be addressed in low-income countries.[4] In the poorest countries, there is a risk of a structural gap in the trade finance market (financing and a technology gap): the financial sector remains risk-averse, and much of the deposits are invested in low-risk instruments. The largest banks, in which the knowledge and customers to handle trade finance operations are concentrated, provide finance only on the basis of strong collateral requirements and the "reputation" (credit record) of companies, while emerging companies face much higher interest rates, fees, and capital requirements – or cannot access trade finance at all.

B. Trade finance in Latin America and the Caribbean (LAC)

1.6 **There are no readily available statistics covering the global bank-intermediated trade finance market.** In general, the reporting systems that feed into the BIS International Banking Statistics do not allow for separating bank-intermediated trade finance from other forms of short-term bank credit.[5] Even though there are some efforts to enhance the coverage of trade finance activities,

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[2] The Basel Committee on Banking Supervision, which sets rules that national banking regulators implement, announced a comprehensive reform package that raises capital requirements and sets global standards for overall borrowing. The new rules sharply increase the risk-weighting of lending between financial firms – an essential element of trade finance because it involves the importer's bank lending money to the exporter's bank, often through a letter of credit. The new rules also tighten the definition of what counts as a government guarantee; some export credit agencies may not qualify. Moreover, new leverage ratios require banks to hold top-quality core tier-one capital equal to 3% of their total assets, including those traditionally held off balance sheet. Trade finance commitments count in full toward that ratio, which is a fivefold increase over the current capital requirements. The part of the liquidity proposals that would require banks to match long-term obligations with long-term funding, and vice versa, could also penalize trade finance. In sum, these rules raise the costs to banks of trade finance more than those of other types of short-term credit, such as working capital and liquidity guarantees.

[3] At the February 2015 meeting of the Bankers' Association for Foreign Trade, several major international banks stated that their internal hurdle rate of annual fees generated by each correspondent bank (emerging market bank) was above $50,000 per year, and if the hurdle rate was not met, they would disengage from those relationships. Very few local banks headquartered in IDB's C&D countries will meet the international banks' hurdle rates in terms of client profitability.

[4] This view was supported during a dedicated Aid-for-Trade meeting on trade finance in April 2007, and during the regional and global reviews on Aid-for-Trade.

[5] Committee on the Global Financial System/BIS (2014), "*Trade Finance: Developments and Issues*," CGFS Papers No. 50.

at the moment the information is limited, covering only on-balance-sheet lending activities (which excludes letters of credit) by resident domestic banks, with a focus on domestic borrowers. Global activities are thus also excluded.

1.7 **In Latin America, only Brazil has detailed data capturing large parts of overall trade finance activities.** All other countries have statistics covering only specific components of their trade finance markets, such as export-related trade finance or letters of credit (L/Cs), and several countries have no specific information on bank-intermediated trade finance. For most countries, the available data cover only on-balance-sheet items.

1.8 **In interviews, several international banks that are active in trade finance in Latin America estimated the bankable trade finance market to be in the range of $40 billion.**[6] However, they also noted that the spreads available for the top-tier banks in the middle-income countries—particularly Brazil, Mexico, Chile, and Colombia—are too thin to meet their internal hurdle rates, so they are not focused on those markets.

1.9 **In general, there is limited transparency in the pricing of trade finance.** There are no live screens or post-transaction pricing services for tracking trends. Leading international banks adjust pricing subject to perceived demand, counterpart and country risk, and movements in hurdle rates, taking into account the cost of funds, liquidity premiums, and capital. Only Brazil has some information to track price trends.

1.10 **According to the top international bank officials interviewed, the pricing of trade products in the region has trended downward in recent years, reaching very low levels in 2014.** Abundant liquidity in the Latin American trade finance sector, as the North American economy continues its recovery after the 2008-2009 global financial crisis, could be partially responsible for that trend. After the retreat of international banks during the crisis (and the increase in pricing of trade finance instruments), the return of lenders and intense competition have also driven down pricing.[7] As a result, spreads have fallen by half or more.

1.11 **However, this trend has been reversing in 2015, as top international banks retrenched from the region.** Main market participants have suggested that an uneven playing field in terms of regulatory implementation across jurisdictions may lead trade finance providers to withdraw from some countries or markets. In addition, pricing may eventually need to rise to be more consistent with the hurdle rates needed to cover the internal capital and liquidity charges that the international banks are phasing in as they prepare for the full implementation of Basel III. Additionally, some international financial institutions will be restricting

[6] Citibank New York, Standard Chartered Bank New York, J.P. Morgan Chase (New York).

[7] Market participants such as Citibank, Bank of America, and J.P. Morgan Chase report that the intense competition within the sector has been particularly influenced by top-tier banks that are not directly active in Latin American trade finance and that are seeking syndications participation in all flagship deals in certain areas' industries, in particular lending to financial institutions for trade finance purposes. Major trade finance banks also report that with the excess liquidity in the Latin American banking systems, spreads for trade loans for top-tier banks located in middle-income countries are no longer attractive investment alternatives for them.

business relationships to avoid risk ("de-risking" trends). This is consistent with the past public announcements of banks that are reducing their presence in the region (such as Deutsche Bank, HSBC, Citigroup, and Société Générale SA.).

C. Market failures

1.12 **A critical question regarding the rationale for public intervention in these scenarios is whether a reduction in the supply of trade finance is the result of market and/or government failures.** Even when a reduction in trade is observable, it is not always clear whether it results from a failure in the financial markets (supply side), which can be lessened by intervention, or from other causes—such as demand-side effects through lower business and consumer wealth, or confidence—which would not necessarily be resolved by injecting liquidity and promoting trade finance. Regulatory aspects (e.g., excessive risk-weighting for trade finance) could also contribute to lack of trade finance, for which of course the "first-best" solution would be to improve regulations (which, however, is difficult in a global market).

1.13 **In principle, a trade finance "gap" could be the result of "missing markets" (insufficient supply) or "overshooting markets" (prices temporarily too high to meet demand).** Reasons for a greater reduction in trade finance than in other forms of credit during a crisis, and for missing markets, include (i) a temporary inability of the market to properly calculate risk during a crisis; (ii) information asymmetries in international markets; (iii) the need for banks to quickly recapitalize during liquidity crises, with short-term trade finance usually the first to be cut; and (iv) unbalanced support from central banks and governments that provide liquidity and insurance to domestic banks to support domestic lending. Reasons for overshooting markets that temporarily affect trade finance (more than other types of credit) include (i) changes in regulatory regimes (such as Basel III) and their impact on prices out of line with true risk profiles; and (ii) risk recalibrations in the markets that may affect prices temporarily, with important adjustment costs.[8]

1.14 **In terms of empirical evidence regarding the impacts on international trade flows, the field is still in development, but the literature suggests a link between credit restrictions and trade patterns.** Firms engaged in trade usually face more stringent capital constraints than other domestic firms because the activity requires additional up-front expenses, delivery of goods takes longer, and there are additional risks compared to domestic transactions (like currency fluctuations, or different regulatory frameworks between countries).[9] There is evidence that financial frictions have impacts at the firm[10] and country levels[11]

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8 Jean-Pierre Chauffour and Thomas Farole (2009), *Trade Finance in Crisis: Market Adjustment or Market Failure?* World Bank Policy Research Working Paper 5003.

9 Fritz Foley and Kalina Manova (2015), *International Trade, Multinational Activity, and Corporate Finance* Annual Review of Economics Vol. 7: 119-146.

10 Raoul Minetti, Susan Chun Zhu (2011), *Credit constraints and firm export: microeconomic evidence from Italy*. J. Int. Econ. 83:109–25. And Robert C. Feenstra, Zhiyuan Li, Miaojie Yu, *Exports and credit constraints under incomplete information: theory and evidence from China*, NBER Working Paper 16940.

11 Kalina Manova (2013), *Credit constraints, heterogeneous firms and international trade* Rev. Econ. Stud. 80:711–744.

that can prevent profitable firms from exporting, and that the health of financial institutions affects firm-level exports, specifically during crises.[12] However, this literature is recent, and the policy question is still open; there is some regional evidence of significant positive impacts of credit programs on the export outlooks of firms in Brazil[13] and Colombia.[14]

D. Multilateral development banks and trade finance programs

1.15 **Concerns about the scarcity of trade finance for developing countries increased at the end of the 1990s, in the aftermath of the Asian crisis.** The WTO Group on Trade, Debt and Finance identified the need to examine this issue,[15] in cooperation with experts from partner institutions—the IMF, World Bank, regional development banks, export credit and insurance agencies, and international banks—in the aftermath of what appeared to be a brutal interruption of credit flows in a period of crisis.

1.16 **At that time, multilateral development banks (MDBs) developed crisis response trade finance schemes that subsequently became more standardized.** These schemes were initially inspired by the "trade finance facilitation program" launched in 1999 by the European Bank for Reconstruction and Development (EBRD). While the trade finance market recovered with the exceptional expansion of trade and the world economy from 2002 onwards, trade finance programs have found their "market" in the niche left by shrinking national export credit agencies. In this context, private banks (with smaller transactions, particularly in small countries), while safe and sound, had little access to international financial markets. After the global financial crisis in 2008-2009, the G20 organized additional support through export credit and investment agencies as well as MDBs.

1.17 **The objectives of MDB programs are always related to the reduction of certain perceived gaps in the trade finance markets.** These programs are intended to close three types of gaps: (i) those that suddenly emerge during crises; (ii) structural gaps related to the size of the trade transactions; and (iii) structural gaps related to country or bank size and creditworthiness. The trade finance programs' main instruments are short-term guarantees to international and regional banks (confirming banks) to cover the political and commercial risks of international trade credit transactions emanating from local banks (issuing banks). Some programs also provide revolving credit facilities or cash advances to specified companies and banks for financing trade transactions.

1.18 **The most commonly used instrument in these programs is guarantees (for covering trade transactions), but loans to banks have also been used to support their trade finance activities.** For example, the EBRD not only

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12 Mary Amiti and David Weinstein (2011), *Exports and financial shocks* Q. J. Econ. 126:1841–1877

13 BNDES card preapproved credit lines, and public credit.

14 Danielken Molina and Monica Roa (2014) *The Effect of Credit on the Export Performance of Colombian Exporters,* MPRA paper 56137.

15 Jean-Pierre Chauffour and Mariem Malouche (2011), "*Trade Finance During the Great Trade Collapse*," Washington, DC: World Bank.

provides guarantees but also extends short-term loans to selected banks and factoring companies. ADB has a special program (Funded Product Revolving Credit Facility) to provide loans directly to banks to support pre- and post-shipment transactions. However, loans and guarantees provide a better fit for different perceived market gaps, with guarantees addressing excessive risk (perceived by financial systems or regulators in the form of high capital requirements), and loans addressing lack of liquidity/funding. Table 1 summarizes the main features of these MDB programs.

Table 1. MDB trade facilitation programs

Category	EBRD	IFC	IDB	ADB
Number of countries of operation	26	90	20	17
Program commencement	1999	2005	2005	2004
Number of trade transactions since commencement	17,300	40,000	5,277	11,308
Value of transactions since commencement	EUR11.8 billion	US$38.6 billion	US$5.03 billion	US$21.7 billion
Number of confirming banks	800+	1,100	300+	139
Claims to date	2 (no write-offs)	Zero	Zero	Zero

Source: International Chamber of Commerce: Rethinking Trade and Finance 2015; Figures for AfDB not submitted.

II. IDB'S TRADE FINANCE FACILITATION PROGRAM

A. The program and its objectives

2.1 **In 2003, the IDB Board of Governors approved the Trade Finance Reactivation Program (TFRP).**[16] During the 2002 crisis that affected several countries in Latin America, international trade in the region suffered a remarkable drop that was attributed in part to the reduction in traditional sources of trade finance. Following the example of other multilateral institutions during the Asian and Russian crisis, the Bank created this reactivation program to extend support for trade finance. With the TFRP, "international trade finance" (which included trade-related working capital) began to be eligible for private (non-sovereign-guaranteed, or NSG) loans and guarantees at IDB.

2.2 **The TFRP was approved with a ceiling of $1 billion.** At that time, the Governors resolved that (i) individual project limits would be determined by the Board of Executive Directors; (ii) the financing would be included in the 10% ceiling of the outstanding NSG portfolio; (iii) the financing would not exceed $1 billion during the two-year term of the program; and (iv) the Board was authorized to approve such financing (delegated authority to the Board). Further delegation of authority to the Executive Directors to extend the program beyond two years and increase the $1 billion ceiling was proposed, but not approved.[17] Increasing the program over this limit would require a decision by the Board of Governors.

2.3 **The TFRP also explicitly delegated to Management the authority to approve operations under a trade facilitation program similar to those of other MDBs (EBRD, World Bank, and ADB).** The proposal stated: "In the exceptional case of the *Trade Facilitation Program* (guarantees of letters of credit), that does not have an established procedure, and requires approval of small guarantees for individual letters of credit (usually less than US$1 million), the overall framework will be approved by the Board, delegating to Management the approval of individual guarantees."[18] This delegation was not unusual, as the programs of both the EBRD and IFC operate under similar arrangements.

2.4 **Around a year later, in 2004, the Board approved IDB's Trade Finance Facilitation Program (TFFP) with a maximum possible exposure of $400 million.** At approval, TFFP was a revolving partial credit guarantee facility that supported short-term trade credit transactions.[19] Its objective was to "support

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16 *International Trade Finance Reactivation Program for the Private Sector*, Resolution (AG-1/03), February 5, 2003.

17 "Some Directors supported Management's proposal that the Resolution request that Governors delegate authority to the Board of Directors on the possibility to extend the instrument for more than the 2 years originally intended. Other Directors preferred that all reference to such an extension be eliminated from the Resolution." Policy and Evaluation Committee meeting minutes, December 12, 2002 (PEA/02/25).

18 *International Trade Finance Reactivation Program* (December 2002), GN2239-1, Paragraph 3.24.

19 Eligible transactions for TFFP include, for example, export and import financing, documentary letters of credit, standby letters of credit, and international guarantees (such as bid bonds, performance bonds, and advance payment bonds).

economic reactivation and growth through the expansion of international trade financing to [LAC] companies," acting as a countercyclical tool in times of liquidity shortages. It was expected that TFFP would (i) contribute to facilitate imports of critical goods into the region; and (ii) allow issuing banks (IBs) to extend more financing to local exporters and importers through additional liquidity provided by confirming banks (CBs), especially in periods of economic difficulty.[20] As expected, the approval of individual operations was delegated to Bank's Management (the Structured and Corporate Finance Department, or SCF) with some limitations, including a maximum exposure of $400 million for the whole program (see Box 1).

Box 1. Main characteristics of the TFFP in 2004
• Maximum exposure: $400 million (40% of the total limit for TFRP) • Exposure limit per issuing bank: $40 million at any time • Exposure limit per country: $120 million at any time • Coverage levels: Up to 90% per eligible transaction • Tenors for individual eligible transactions: less than 1 year • Program term: 5 years

2.5 **In the proposal for the TFFP, a logical framework with goals and some performance indicators was established** (see Annex). The main goals stated in the logical framework were to promote IBs' activities, economic reactivation, and the expansion of intraregional trade. Several performance indicators were established at that time, most of which were output indicators: increase of the exposure to L/Cs, the number of IBs enrolled, the countries where IBs are based, the average coverage of the guarantees, and the volume of trade-related transactions. The logical framework did not provide a clear vertical logic, and only two indicators were established to measure outcomes (size of trade finance portfolios and intraregional trade financing). However, milestones, targets, or means for verifying these outcomes were not provided. Over time, and with further changes in the program (explained in the next section), the logical framework was not renewed or improved. By 2009, this framework was clearly outdated, and new Bank documents were not clear about possible changes in objectives of the program and further means for verifying the expected achievements.

B. Main operational characteristics and changes in the program

2.6 **In September 2006, a review of the TFFP was presented to the Board, describing the progress of the program and recommending its expansion,**

20 "By addressing cross-border trade and country risk concerns of Confirming Banks the guaranties would provide comfort to Confirming Banks to continuously provide short-term trade finance credits that are critical for international trade, in particular to provide liquidity to Issuing Banks during periods of economic difficulty and high international flows volatility" (PR-2871).

which was granted.[21] Some of the main achievements reported were as follows: (i) a streamlined process for approving and establishing credit lines (by the end of that year 17 lines had been approved); (ii) an efficient and timely operational response to banks for transactions; (iii) establishment of a dedicated trade finance team and use of market-based standardized documentation; and (iv) establishment of a bank network of issuing and confirming banks.[22] At that time the Board resolved to permanently extend the TFFP program (from the original five-year term) and increase guarantee coverage limits up to 100% of individual eligible transaction amounts (from 90% at the beginning of the program).[23]

2.7 **In 2008, in the context of the global financial crisis, a review of the program led to increasing the exposure limit to $1 billion and removing some of the limits.** The review eliminated the $40 million exposure limit per IB, and the total exposure limit of $400 million. Additionally, non-bank financial institutions were allowed as eligible participants in the program, and the application of the Bank's procurement policies regarding procurement of works and goods and contracting of consultants financed by IDB was waived to allow financing imports originating from any country (not only from IDB members).

2.8 **Regarding country limits, the total exposure by country at any time was increased from $120 million to $300 million.** All Management recommendations were accepted, except for the proposal to completely waive the individual country limits.[24] The Board also emphasized that client banks in C&D countries would be the major beneficiaries of the direct lending, and asked that the TFFP trade team report twice yearly on the direct lending utilization. No documentation that would fulfill the Board's reporting request has been found.[25]

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21 Previously, in April 2005, the Board of Governors had resolved to extend the TFRP, providing (i) permanent authorization, (ii) inclusion of delegated authority to the Board of Directors to terminate the program if it is not satisfied with the results of an independent evaluation, (iii) extension of the maximum term of subloans to be covered by guarantees (from 1 year to 3 years), and (iv) maintenance of exposure limits and delegated authority to the Board of EDs for individual project limits (Resolution AG –9/05).

22 *Trade Finance Facilitation Program - Mid-term review and proposal for expansion (2006)*, PR-2871-1.

23 *Trade Finance Facilitation Program - Mid-term review and proposal for expansion* (2006), Resolution DE-142/06.

24 "A group of Directors felt that access-to-financing considerations should prevail over alternative ones, and these considerations would suggest the maintenance of per-country limits"… "The need to continue supporting the C & D Countries, as an important priority, was also stressed [by EDs]." "Suggesting that the limit had not been a binding constraint they asked Management for an additional document providing the figures, simulations, background information and technical and financial considerations behind the proposal, including the limit's adverse effect on the instrument's intended countercyclical function. The need to continue supporting the C & D Countries, as an important priority, was also stressed in this connection" (PR-2871-4). Some EDs "expressed a preference for removal of the per-country limits or, at least, for setting them temporarily in line with shifting world economic conditions" (PEA/09/08).

25 "The Executive Director for Argentina requested that Management report periodically (every six months) with breakdowns of transactions under the TFFP for the Group C and D countries. This information would be useful for monitoring and review. The Executive Directors for Bolivia, Nicaragua, and the Netherlands seconded the request. Management proposed to include more detailed information on such transactions than was normally part of the quarterly reports to the Board of Executive Directors on non-sovereign guaranteed operations" (PEA/09/08).

2.9 **One important change to the TFFP made at that time was the addition of direct lending (including B-loans) of up to three-year tenors for financing trade transactions as an instrument of the program.** At the time of this decision, and because of the financial crisis, there was considerable demand from client financial intermediaries (FIs) in the region for a measure to bridge their liquidity shortages when operating in trade finance. The justification presented to the Board provided two main reasons for direct lending under the TFFP.[26] Direct lending was justified (i) in cases of a financial crisis in "which Issuing Banks present acceptable credit risks, but Confirming Banks face systemic liquidity problems" (countercyclical argument); and (ii) "to support the growth of the trade finance operations of smaller FIs in the Region, especially those in C&D countries that lack ample access to trade finance correspondent lines even when the financial markets are stable" (smaller FIs in difficult countries argument).[27]

2.10 **Part of the justification for allowing direct funding by IDB, in addition to the non-funded guarantees, was that IDB would not incur an additional credit risk, if such loans were offered under the same credit criteria and tenors as apply to guarantees under each approved line.** This is technically true, if considered under IDB's risk management matrix, which does not differentiate risk weightings between various assets. However, under the same conditions a direct loan issued against a pool of revolving trade receivables technically does represent additional risks relative to a guarantee (Box 2).

Box 2. Risk treatment of loans and guarantees
Under a standard bank risk approach, a guarantee issued in support of a specific underlying trade transaction is a non-fungible, off-balance-sheet contingent liability; it differs from a direct loan, which is a fungible on-balance-sheet item. Additionally, each guarantee issued under a trade finance program covers a specific trade transaction (or grouping of trade transactions) such that the guarantee expires when the trade transaction is completed. Therefore, unlike a loan, the guarantee is specifically tied to a pre-identified, self-liquidating trade transaction. Whereas initially, disbursement of the loan requires a list of trade transactions (which would result in having priority over other lenders if the client FI goes bankrupt), these transactions would be liquidated over time and then it would be not so clear if the lender would still be treated as a trade creditor (as opposed to a general creditor). Not using a risk differentiation within IDB between loans and trade finance guarantees may affect internal incentives favoring the use of loans over guarantees. IIC's management is currently working to tackle this issue.

2.11 **The TFFP program differs from other IDB instruments because approvals of both the lines to IBs and individual guarantee or loan operations are delegated.** The approval of a non-committed line (or the IB approval) is a process that takes on average about 3 months from the time the IB expresses an interest. It includes a pre-screening, a due diligence, and a review by a Quality and Risk Review committee of SCF. An agreement signed with the IB states the conditions under which loans or guarantees will later be provided.

[26] *Trade Finance Facilitation Program - Mid-term review and proposal for expansion* (2006), PR-2871-3.

[27] "For such FIs, the TFFP could play a bridging role, providing direct financing by which smaller FIs can expand their trade finance portfolios to a scale that is interesting for correspondent banks when assessing the establishment of a line. Such FIs would also benefit from having a track record with the Bank and from the demonstration effect from having worked within the TFFP when approaching correspondent banks for financing."

2.12 **In 2012, SCF approved new operating internal procedures with new guidelines and the introduction of new simplified agreement documents for IBs and CBs.** After the review by appropriate parties within IDB,[28] the Master Participation Agreement (MPA) replaced the cumbersome legal documentation requirements that had been presented to TFFP participants in the past (Confirming Bank and Issuing Bank Agreements). The new MPA considerably simplified the granting of direct loans under TFFP: it no longer required Internal Legal Opinions and New York Process Agent Appointment Letters; references to the Trade Facilitation Agreement have been eliminated to allow financing not only trade-related eligible transactions but also other eligible purposes that may be available in the future; the eligibility period for eligible transactions was extended; and the need to report for the disbursement request was ended. Additionally, eligible transactions no longer need to be assignable to IDB to comply with market practice for unsecured transactions. However, all eligible transactions must continue to be screened for adherence to the Environment and Social "Exclusion List." (Box 3 summarizes the present characteristics of the TFFP.)

2.13 **Under this new documentation procedures, a more expedited process starts when an IB, which has already signed a MPA and has an approved line under the program, requests either a loan or a guarantee to support one or more underlying trade transactions.**

a. For a *guarantee request,* the IB sends a spreadsheet that includes the transactions to be guaranteed. SCF checks whether the transactions are eligible and the conditions and covenants are met. IDB usually takes less than 48 hours to review and issue a guarantee from the moment it receives the application.[29]

b. For a *loan,* the IB requests disbursement with an initial list of transactions deemed eligible. SCF reviews that request and assesses it for compliance with terms and conditions. After informing several IDB units (LEG, PMU, and FIN), IDB disburses within 8 days (5 days if it only involves an A-loan). The IB has to send a final report of eligible transactions within 95 days after disbursement. Transactions must be originated by the IB within 180 days before and 90 days after disbursement.

c. For *loans over a year,* a new report of eligible transactions must be presented annually, within 95 days of each anniversary of the disbursement. For loans in general, the underlying transactions are not as tightly linked to IDB's support as a guarantee, which by nature requires specific reporting for each transaction. This is more evident with longer-tenor loans, given that trade transactions usually need short-term finance (around 180 days). The bank is not required to produce a

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28 Structured and Corporate Finance (SCF), Legal Department (LEG), Non-Sovereign-Guaranteed Operations (NSG), Risk Management Group (RMG), Finance Department (FIN), Office of Executive Auditor (AUG).

29 The operation of a guarantee program is also different from one with other types of instruments, since it requires short-term answer capabilities from the team (using the interbank system SWIFT), processing and monitoring of individual transactions, a specific billing system that takes into consideration high-frequency transactions and collections, a reporting system, and planning in case of a claim.

follow-up list until a year after the first disbursement (unless there is a specific request by IDB).

Box 3. Main characteristics of the TFFP in 2014
• Maximum exposure: $1 billion (or total limit for TFRP) • Exposure limit per issuing bank: none • Exposure limit per country: $ 300 million at any time • Coverage levels: up to 100% per eligible transaction • Tenors for individual eligible transactions: up to 3 years • Program term: permanent authorization (subject to Board termination) • Instruments: guarantees and loans (including A/B) • Simplified documentation (IBs and CBs): Master Participation Agreement

C. Implementation of the program

2.14 **From the launch of the TFFP until the end of 2014, SCF approved 100 trade lines in 20 countries, for a total of $2.2 billion; however, not all these lines were active.**[30] Among the 100 banks with approved lines, 12 never completed the legal documentation to activate their lines[31], and 19 signed but did not use the line. In total about a third of the lines in the portfolio were never used. There are no specific fees or other costs to clients for keeping the lines, so there are no incentives to cancel the lines once they are approved. After two years of inactivity, if the client is again interested in obtaining a guarantee or loan, a review is done and the line is reactivated, without costs or significant delays for the client[32]. Until 2012, the average number of new lines approved annually (that is, new IBs starting to be part of the program) was 11. Approvals slowed to 9 in 2013 and 3 in 2014 (see Annex).

Table 2. Trade finance lines main figures [a]	
Approved lines	**Amount:** $2.1 bn. **Number:** 100 lines for loans/guarantees **Used lines:** 69 **Active lines (2014):** 32%
Disbursed – loans	**Amount:** $1.2 bn **Number**: 64 ops
Used – guarantees	**Amount:** $3.0 bn Number: 1326 ops
Countries	**Number of countries:** 20 **Main: Brazil** (24%), **Chile** (12%), **Argentina** (8%)

[a.] To focus on the TFFP, this excludes one IIC trade finance line for $45 million.

2.15 **The total cumulative use of trade finance lines reached $4.2 billion by the end of 2014, with the majority of commitments in the form of guarantees (about $3 billion).** A large part of these guarantee commitments was approved before the changes in the program that allowed direct lending. Guarantees were mainly promissory notes; only 9% were for L/Cs. In total more than 1,300 guarantee operations (for promissory notes or L/Cs) have been approved under the program. Before the global crisis, the exposure of the program was far from reaching the TFFP limit of $400 million at any time. In fact, the total exposure never went over $200 million until March 2011.

30 After taking into consideration changes in existing lines (usually expansion of lines), the approved amount of the lines was $2.8 billion at the end of 2014.

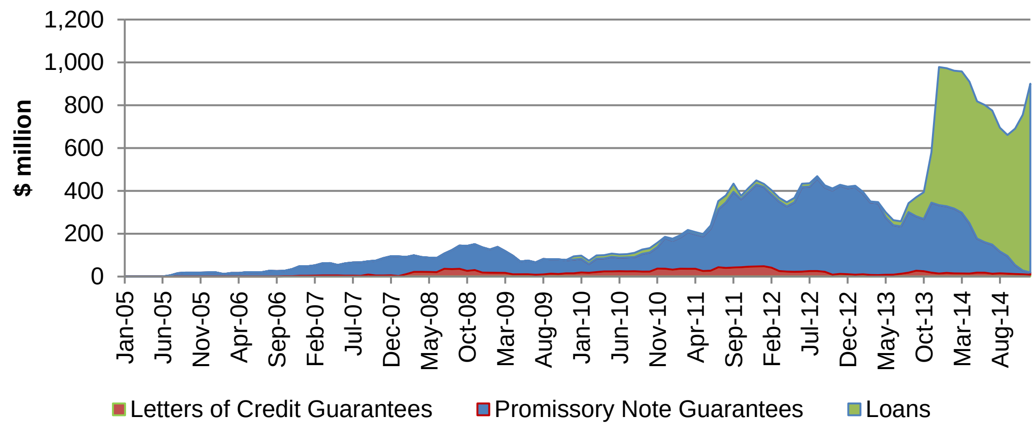
31 Of the 12, 3 were signed in 2015, outside the evaluation period.

32 IIC's Management is currently working on an action plan that may include closing lines for banks that have never used the Program on a selective basis.

2.16 **The program exposure had two important expansions during the lifetime of the TFFP, the one after the 2008-2009 crisis and the second at the end of 2013.** In the context of the crisis and after the increase of the TFFP exposure limit to $1 billion with a possibility of doing direct lending, banks that were not yet part of the program demonstrated increased interest in the uncommitted trade lines. In 2009 and 2010 the program showed the fastest growth in new lines since the beginning of the TFFP (approving 14 new lines each year). Requests for guarantee operations increased slowly until reaching an exposure of around $400 million on average during 2011 to 2013. The percentage of active lines in the program[33] also grew to a maximum of 57% in 2011. However, few loans were approved in that period, partly because of the heavy legal documentation needed (already mentioned) and also probably because the expected liquidity shortages in the region did not materialize in full. By the end of 2012, the approval of new guarantees started to drop because of the program's strategic shift to loans, simplified legal documentation, and such market factors as a drop in trade finance pricing.

2.17 **The biggest expansion occurred after 2012, when the simplification of agreement documents made it much easier for clients to apply for loans.** The program's exposure increased very fast, almost reaching the limit of the program by the end of 2014, mostly after the approval of four very large loans to three of the largest banks in Brazil, Mexico, and Chile, which together accounted for half the total program – $500 million. Because of the switch to loans from other banks in the program and further reductions in requests for guarantees, by the end of 2014 almost all the exposure of the program was in loans (Figure 1)[34]. Active lines in the program also fell, reaching 32% (of the 100 lines in the portfolio).

Figure 1. Monthly exposure increased substantially after end-2013, largely because of the approval of four large loans



[33] Those that at least requested a loan or a guarantee that was approved during the year

[34] The TFFP team intended to strengthen its outreach capacity by partnering with large strategic financial institutions. The goal and objectives of this strategy was not stated in any of the program's documents, however the team mentioned that these kinds of partners reinforce IDB's onlending ability through TFFP, assuming FIs are vehicles to reach beneficiaries.

2.18 **In total, by the end of 2014, 64 loans were approved for $1.2 billion, mobilizing an additional $390 million from B-lenders.** IDB was able to arrange A/B loans for the international market, generally when working with better-quality institutions in the region and offering operations of longer tenors (two to three years).[35] Banks participating in these syndications usually work also as CBs, and they use this mechanism to reduce their exposure to some markets.[36] One A/B loan to a Brazilian bank was issued through a subsidiary in the Caribbean and was not counted against the Brazil country limit. Even though the loan has a regional objective that can only be evaluated at the end of the maturity period, most transactions financed with this loan in the first year were in Brazil.[37] Furthermore, IDB's risk management counted this exposure as Brazilian, and with that classification, the Board-mandated country exposure limit for Brazil would have been breached (see Annex, Figure A5).

[35] See Annex, Figure A4.

[36] Some of the banks that participated in these syndications are Commerzbank, Citibank, Barclays, Standard Chartered, Wachovia, and Wells Fargo.

[37] Some 72% of the trade transactions were not intraregional.

III. Results of the Program

A. Relevance

3.1 **IDB's trade finance program has been relatively small compared to the size of the trade finance market in the region, other MDB programs, and the funding needs of some of IDB's FI clients.** TFFP's average annual commitments have been around 1% of the estimated annual trade finance market in LAC, while in recent years the size of the annual commitments of IFC's trade finance program in LAC (only through guarantees) has been 2 to 4 times larger. In addition, the financing provided by TFFP is usually a small portion of the funding needs of top-tier investment-rated banks. In this sense, the program's ability to affect trade finance in the region is limited. Additionally, between 2012 and 2014, with the lower prices of trade finance products and ample liquidity in the market, there were more alternatives for financing trade activities. Thus IDB's relevance as a source of funding has been limited, despite the recent strong expansion in volumes.

3.2 **However, the program has also supported many small banks that were exposed to sudden changes in the market.** During the 2008-2009 crisis and now, with the new trend among international banks to reduce their presence (de-risking, retrenching trends) in the region, conditions for funding short-term trade operations deteriorated relatively quickly. The first correspondent lines to be cut in response to the need to fulfill internal profitability hurdle rates are those to smaller banks or banks with smaller trade finance portfolios. For these smaller banks, even with a reduced scale, IDB's program can provide an alternative and help them to continue in the trade finance market. Mobilization of funds also has this potential, leveraging IDB resources during liquidity shortages.

3.3 **IDB also supported FIs through nonfinancial means.** IDB has provided around 20 technical cooperation operations to support FI clients, including for some trade finance activities. The objectives of these operations were to create or strengthen the borrower's technical capacity and expertise. Under TFFP, IDB has offered, for example, online trade finance courses to 10 banks and capacity-building programs to 3 institutions to enable them to improve their international trade finance units. In addition, IDB supported senior representatives of the trade finance and international commerce departments of FI clients in visiting China (China Insights Program) and Korea (IDB Annual Meeting), to generate a better understanding of these markets and to strengthen commercial relationships. In interviews, participants considered these activities relevant in supporting their trade finance activities.

3.4 **The trade finance program was also envisioned by IDB as a way to establish first business relationships with LAC FIs, and potentially gain valuable knowledge about them.** This information can help in deciding which institutions are the best fit for a development partnership, and in interviews several of the investment officers mentioned this aspect. In fact, 70% of TFFP lines approved since 2007 were the first instrument with a specific FI to be approved by IDB in more than three years. Trade finance operations (especially guarantees) have lower risk than other types of products. Approaching client FIs with this short-term and low-risk product may reduce the cost of learning about these institutions—especially when, because of the size, the market, or other circumstances (such as a financial institution having recently become a bank), information is not readily available through other sources.

However, this objective was not explicit in the program's documents, nor in the application documents of new lines.

B. Effectiveness

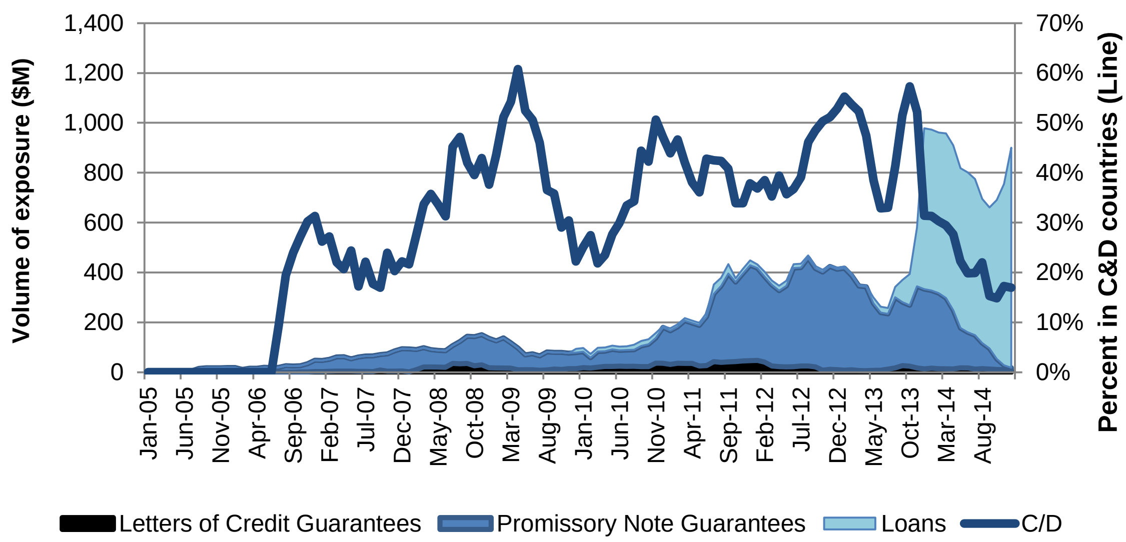
3.5 **Because of the unique features of the program, and particularly the need for a speedy response to clients, TFFP was excluded since its inception from the requirement to comply with IDB's Development Framework.** For example, there is no Development Effectiveness Matrix (in the future, Development Effectiveness, Learning, Tracking and Analysis, or DELTA), nor are there clear development results indicators at the project level for TFFP operations. Even basic information—whether the IB's trade finance portfolio is growing, and to what extent it is contributing to increased intraregional trade—is not being systematically tracked or reported.

3.6 **At the program level, a logical framework was presented at approval, but it did not include an adequate matrix for monitoring outputs and outcomes**. Only two indicators were established to measure outcomes (size of trade finance portfolios and intraregional trade), but milestones, targets, or means for verifying progress were not included (the logical framework is included in the Annex). For output indicators, some milestones and targets were provided until 2009. These outputs[38] were accomplished by 2008. However, in 2009, when the program was enhanced at the Board level to include trade loans directly to IDB client banks, neither the logical framework nor the reporting requirements were explicitly reviewed, which created a gap regarding the objectives of the program and how actual results would be verified and reported.

3.7 **At the time of the expansion of the program in 2008, one of the objectives stated in documents and Board discussions was to maintain a focus on C&D countries.** However, over time, and with the expansion of the program in 2012, the exposure in C&D countries was drastically reduced. Reporting to the Board on the TFFP program did not address this issue. The typical quarterly reporting on TFFP to the Board included only total volume and the distribution of exports and imports by country and by product type. There was no information on country exposures, largest individual exposures by FI, intraregional trade, or distribution by C&D countries. In fact, in 2013-2014, with the approval of four big loans, IDB's exposure was concentrated in a few A countries, and the relative exposure in C&D countries diminished as the program moved from guarantees to loans (Figure 2).

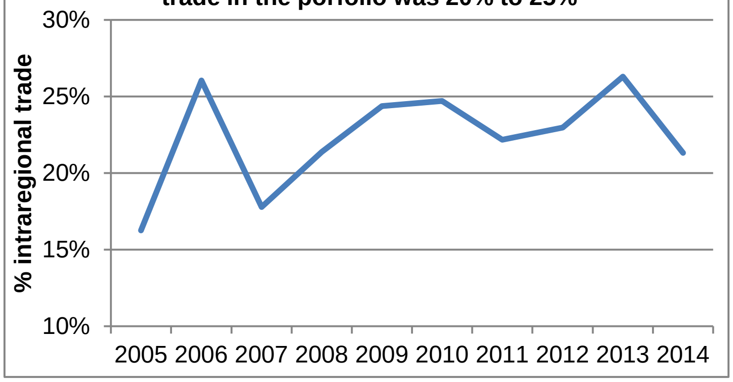
[38] Such as percentage of L/Cs, number of IBs enrolled, number of countries where IBs are based, or coverage levels during a financial crisis.

Figure 2. The relative program exposure in C&D countries fell in recent years



3.8 **Since 2008, the value of the underlying intraregional transactions of the TFFP grew at 23% per year, similar to the total TFFP portfolio** (Figure 3). The expansion of the program in recent years has been significant in terms of the volume of underlying transactions. The portfolio of transactions linked to the TFFP program went from $24 million in 2005 to almost $1 billion in 2014, for a total support of $5.2 billion in underlying transactions. This takes into consideration mobilization of resources through B-loans and cofinancing and the full face amount of transactions guaranteed. However, FIs' relevant trade finance portfolios were not tracked, and given limitations in public data (already mentioned), it is difficult to know their evolution.

Figure 3. Since 2008, the share of intraregional trade in the porfolio was 20% to 25%



3.9 **Analysis by OVE suggests that most FI clients' relevant trade finance portfolios had increased.** OVE drew a statistically representative sample as part of a comprehensive evaluation of IDBG's work through financial intermediaries. This sample included trade finance operations within the TFFP. Although trade finance portfolio information is not readily available, for 12 FIs with TFFP lines, OVE was able to gather relevant portfolio data over the period of analysis. In 8 FIs the portfolio grew, and in 4 it shrank. However, the share of the trade finance portfolio fell in more than half (7) of the cases, which could indicate, among other causes, that trade finance was not a strategic priority for these FIs.

3.10 **However, for loans the attribution of individual trade transactions to IDB funding is weak.** Trade portfolio documentation is being collected from the trade loan participants, but the legal documentation signed by the client bank under the Master Facility Agreement, combined with the fact that – at least for loans – eligible transactions are only submitted much later than they are provided, gives tenuous evidence of a direct linkage between IDB's funding and the individual trade transactions. For loans, as for many other FI operations, the fungibility of money makes it very difficult to attribute the financing of individual trade transactions to the IDB Group (IDBG). Especially when FIs have enough large portfolios, they are easily able to provide a list of eligible transactions that fulfill eligibility criteria at any time. The short-term nature of the funding gives incentives to client FIs to apply the funds to short-term needs (such as trade finance), but this is no guarantee that trade financing increases because of IDB's funds. By contrast, a guarantee is provided against a specific, pre-identified, and self-liquidating trade transaction, and thus by definition it supports only that specific transaction.

3.11 **Finally, supporting SMEs was an implied objective of the program, but IDB's default definition for categorizing small and medium-sized enterprises (SMEs) – those presenting eligible trade transaction under $1 million – does not ensure that beneficiaries are actually SMEs.** OVE identified several instances of multiple transactions under $1 million for the same final beneficiary with a very large combined total value (e.g., over $25 million), and to large enterprises. An IFC evaluation also found the cutoff of $1 million (which IFC also used to apply) to be inappropriate to identify SMEs for trade finance operations, and IFC no longer uses it.[39] This contrasts with the use of loan size as an appropriate proxy for firm size in investments other than for trade.

C. Efficiency and sustainability

3.12 **There is currently no profitability report on the TFFP program, and systems do not collect the information necessary to determine operating results.** Thus it is a challenge to determine the bottom-line financial contributions of the program and to calculate whether it delivers an efficient return on economic capital. Additionally, since about one-third of TFFP lines were never used (and thus did not provide any income), it is unclear whether the program costs – which include assessment and supervision costs – are being profitably amortized.

3.13 **Since no financial performance targets have been set, except for program volume targets, it is difficult to determine whether TFFP's financial performance is in line with expectations.** The programs of other MDBs have objectives regarding financial performance and use different ways to generate income and offset costs—for example, (i) full recovery of appraisal fees from the IB, (ii) assessment of portfolio supervision costs, (iii) cost recovery from the client for legal documentation, (iv) minimum charges per year for line continuation, and (v) full allocation of costs to the client for technical advisory services.

39 World Bank Group – Independent Evaluation Group (IEG 2013): Evaluation of the International Finance Corporation's Global Trade Finance Program, 2006–12; and, in particular, The Big Business of Small Enterprises – Evaluation of the World Bank Group Experience with Targeted Support to Small and Medium-Size Enterprises, 2006 –12 (Box 2.7).

3.14 **However, recent operations with larger FIs could have contributed to increased profitability.** On the income side, average interest gross margins are slightly lower than for IDBG's other operations (2.3%).[40] However, on the cost side, TFFP has also lower origination and administration costs[41] and smaller loan loss allowance costs because of lower credit risk. As of 2014, very few trade operations[42] were classified as high-risk (see Annex, Figure A2). Since the origination and administration costs were to some extent fixed, larger operations – also usually involving larger FIs – were the most profitable. For TFFP this profitability is boosted by the change from guarantees, which usually require higher operational costs per dollar committed, to loans (Figure A7 in the Annex shows the reduction in number of total operations managed by the program in recent years).

3.15 **The business model has been oriented to the fast-turnaround and volume-oriented nature of TFFP transactions.** Dedicated TFFP staff are well-versed in trade finance and have built efficient stand-alone systems to process the TFFP guarantees. Some shortcomings in internal controls that were identified by IDB's Audit Department have been corrected. The processing of trade loans is done within IDB's current loan accounting system, and staff respond to and execute loan requests within client-centric time parameters. Recently IDB has been exploring further expanding the mobilization capacity of the program through reinsurance of trade portfolio, as other multilaterals have done.[43]

D. Supervision and reporting

3.16 **It is widely held within IDB that TFFP products are low-risk, but that does not mean no-risk.** Operational risk is constantly present in any trade finance activity, and for a development institution and its shareholders, a significant form of risk is also reputational risk. Compliance—with a focus on sanctions, AML, KYC, environmental concerns, and fraudulent activities—has become a fast-growing area in commercial banking. Some of TFFP's own global FIs have been fined billions of dollars for compliance breaches. Most of the cursory reviews of TFFP clients' trade finance portfolios are done under the assumption that the client always performs all of the necessary steps; and ultimately, as the newly introduced MPA guidelines show, IDB is really only looking at the counterpart risk of the TFFP loan recipient.

3.17 **With the switch to direct loans, TFFP relies now more on the client banks to provide adequate safeguards.** With guarantees, IDB can rely to some extent on

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40 For SCF, the gross interest margin calculated for the FI operations analyzed by OVE has been around 3.5%, in line with the SCF average (3.8%). For OMJ, the gross interest margin for FIs is 3.6%, similar to SCF's but below the OMJ average (5.1%). Calculations made by IIC, although they are not completely comparable with the ones done by OVE for SCF and OMJ, show similar results.

41 For SCF, origination and administration cost as a proportion of the outstanding balance for FI (0.3% average 2012-2014) and trade (0.2% average 2012-2014), was below the ratio obtained for the overall SCF operation (0.5% average 2012-2014). This is also the case for IIC, where this same ratio for FI operations (0.7% for 2013), is well below the one calculated for IIC overall (1.7% for 2013).

42 Under 6% of SCF's trade operations are classified as high risk, and that is based solely on country risk, not on operational risk.

43 For example, in 2011 and 2013 IFC has expanded its GTFP program through a trade-credit insurance policy brokered by Marsh.

the stricter regulatory frameworks of international CBs. For loans, IDB now relies exclusively on the client FIs in the region to provide adequate safeguards checks on their local clients for AML, KYC, sanctions, politically exposed persons, and environmental standards (see Box 4). This reliance on FIs without IDB's own verification exposes the Bank to potentially significant reputational risks. OVE acknowledges that the issue of where to draw the line of compliance liability is a challenge for IDB and also an open question at the industry level.

Box 4. Environmental and social risks in trade transactions
Even though trade finance is automatically classified as "low risk," OVE found trade transactions bearing high environmental and social risks, particularly in high-risk sectors and with large companies. One example is a trade finance operation with a Brazilian bank through its Caribbean subsidiary, which financed a pig iron producer in Brazil, with 47 transactions in 2013 and 2014 for a total amount of $26.7 million. Before this trade finance operation, the pig iron producer had already been convicted in 2011 of illegally purchasing charcoal and thus contributing to deforestation of over 9 million acres of Amazonian rainforest. The company was obliged to recover the deforested area or pay a fine of $31.6 million. The membership of this pig iron company in the National Pact against Slavery had also been suspended in 2012, after the Ministry of Labor found 150 workers held in slavery-like conditions in a charcoal production site linked to its supply chain. The company was required to agree to a change in conduct. In 2015, the Brazilian Ministry of Environment announced an embargo against the company for violation of that agreement.

3.18 **Finally, reporting on TFFP was limited, partly because the program is by nature different from other IDB products, and also because there is no standard regarding the information needed for measuring progress.** For example, for some operations under delegated authority detailed information was provided in the main quarterly report on NSG operations to IDB's Board (amounts as small as $1-$2 million by individual operation), and in some cases even the pipeline of projects was being reported before approval. In contrast, for the TFFP, individual approvals as large as $100-$200 million were not individually reported in that quarterly report, and some of the reports were potentially confusing.[44] Information systems have been improving in recent years through an internal activity reporting system[45]; and partial information on operations can be found in Bank´s loan management systems (PRYS, OPUS, LMS), the President´s Report to the Board of Directors and IDB´s Annual Reports. However, some of the information relevant for describing the program, such as credit line utilization or information on individual transactions, is not integrated between systems.

44 An example of this is the Quarterly Report on NSG Operations – First Quarter 2015 [GN-2815], affirming that "TFFP Issuing Banks stand at 101, covering 21 borrowing member countries," when about one-third of these 101 banks had not issued any loans or guarantees (and 12 of them had not even signed an agreement). Another example is a reported regional operation that had the objective of supporting intraregional trade, but more than 70% of individual transactions were done outside the region.

45 During 2010 a new system was designed and implemented to enhance and automate the processing and monitoring of the TFFP. In the beginning of 2011 IDB's Audit Department audited operations and systems of the TFFP; it found that they needed some improvements, and it recommended some changes to the TFFP's control process design and its system application, security, and controls. The recommendations were implemented.

IV. Going Forward

4.1 **The nature of the TFFP program has changed in recent years in terms of documentation, instruments, and volumes.** Outstanding TFFP amounts have increased significantly, from about $300 million before the MPA was introduced to about $900 million recently. Loans (trade advances) now predominate, and use of the guarantee product has dropped to below $130 million. The geographic volume distribution of TFFP products to C&D countries reached a low point in 2014, while concentration in few big banks increased.

4.2 **However, the flexibility embedded in the program's framework, with no established strategy or explicit objectives to follow, makes it very difficult to establish the progress of the program.** By the few standards established in 2005, and looking at the statistics of TFFP in 2014, the program seems to be diverging from the original intentions, which did not foresee extending large, short-term loans to the biggest banks in the region. Thus it would be useful to develop a new well-articulated strategy, and a set of clear goals against which the success of the TFFP can be measured, taking into consideration IDB's comparative advantages. This strategy could be built on the analysis of IDB's new role in trade finance, and ways it can maximize its development impact and additionality. The following are some possible steps to develop and improve such a framework.

1. **A formal entry into the IDB's Development Matrix.** A program with TFFP's development profile could create the tools to effectively measure the development impact of this short-/medium-term product. For example, IFC already uses a Development Outcome Tracking System that has been customized for its Trade and Supply Chain Solutions products. Such a system could be developed in conjunction with IDB's general Development Effectiveness Framework. Trade finance can be highly developmental, but because TFFP is outside IDB's development matrix, the development impact results claimed and reported are largely anecdotal. Under such a system, attribution could be better assessed, as each FI would provide, in a standardized format, data on the characteristics of its trade loan portfolio before and after IDB's operation. Such information could include the year-on-year growth of the trade portfolio, the number of SME clients, and direct feedback on how TFFP loans helped the FI to grow its portfolio.

2. **Improve consistency and transparency in the way that TFFP results are reported.** Standard periodic reports could include terminology that is consistent with other lending products of the IDB (for example, in terms of approvals, which are sometimes reported as new lines and sometimes as new operations from lines that already exist). Reporting could include the status (for example, activity) of the lines and other indicators of use. Additionally, the information reported on transactions can be improved; refining what constitutes SMEs for the purpose of trade and moving away from the definition of under $1 million per transaction – as other MDBs have already done. Currently, the information on exporters and importers is only limited to their names (not necessarily full names) and country, which makes

it very difficult to produce a systematic analysis of their characteristics. If a better enterprise identifier could be added, additional more meaningful reporting—based on the country's enterprise surveys, for example—might be possible.

3. **Improve scrutiny of the program in terms of environmental, social and reputational risk.** IDB relies on the client bank to provide sufficient due diligence to meet IDB's KYC, AML, sanctions, and environmental and social standards. The lack of information from client banks regarding importers and exporters (such as full names and addresses) makes it difficult to proactively run their names through a checking system[46] so as to reduce the risk that IDB is indirectly financing illicit or illegal activities. Environmental and social concerns could also go beyond just looking at the Exclusion List. Given the significant reputational risk, oversight could include verification, particularly where trade in high-risk sectors is being financed (e.g., mining, agribusiness with known deforestation risks).

4. **IDB could also improve (i) the framework for assessing expected additionality and client selection for program approvals, and (ii) reporting on the achievement of intended objectives.** One example that needs clarification is whether and under what circumstances IDB should support top-tier banks in the least risky countries with a low-risk product like trade finance. Once TFFP's strategy and objectives are reevaluated, then TFFP could define how it will measure and evaluate the stated objectives. For example, one of the stated objectives of the original TFFP included the promotion of regional trade. Intraregional trade supported by the program increased in volumes but never surpassed 26% of the total value of all transactions. The absence of a clear framework makes the achievement of this goal subject to the interpretation of the officers running the program. The same is true for other initial objectives of the program, such as the focus on C&D countries or small FIs. One objective could also be to strategically use trade finance as an "entry product" for new FIs that until now had not received IDB financing, but with clear goals to subsequently expand the product range in a minimum percentage of selected client FIs.

5. **Examine TFFP's management information systems and risk management applications.** IDB may want to evaluate the program in terms not only of its development impact but also of its profitability and efficient use of capital. With the focus on private sector operations in the context of the NewCo, optimal allocation of scarce resources will require additional information and analysis. IDB's current risk management matrix could be reviewed, accounting for differences in risks and possibly different capital uses for different products. Additionally, by measuring and incentivizing other goals, such as sustainability, efficiency, and development impacts, the focus could move away from merely approval volumes.

[46] For example, World Check Risk Intelligence, KYC/AML/CFT and PEP Due Diligence: info.risk.thomsonreuters.com

ANNEX I

Table A.1. TFFP Logical framework 2004

Goal / purpose / components		Performance indicator	Means of verification
Goals	Safety net mechanism provided that promotes issuing banks' activities in international trade financing	Size of trade finance portfolios increases	(Not stated in the Logical Framework)
	Economic reactivation and the expansion of intraregional trade financing fostered	Growth of intraregional trade financing	
Purpose	Trade finance exposure of foreign banks (confirming banks) to the region increases	Letters of credit (trade finance) exposure increases by 10% from 2004 to 2009	Country Exposure Lending Survey – Federal Financial Institutions examination council
Components	Partial credit guarantee set up for LAC issuing banks for short-term trade-related transactions	Number of issuing banks enrolled in the program expanded from 0(2004) to 18(2006) and 30 (2008)	Semiannual monitoring report
		Number of countries in which issuing banks are based served by the program increases from 0 (2004) to 6(2006) and to 10(2008).	
		Program's average coverage levels increases during financial crisis (up to 90%)	
		Volume of short-term trade-related transactions increases from 0 (2004) to $27 million (2006) and $67 million (2008)	

Source: Proposal for a loan for a trade finance facilitation program (PR-2871), August 24, 2004.

Figure A1. Number of lines approved reduced in recent years, while average amounts per line approved increased

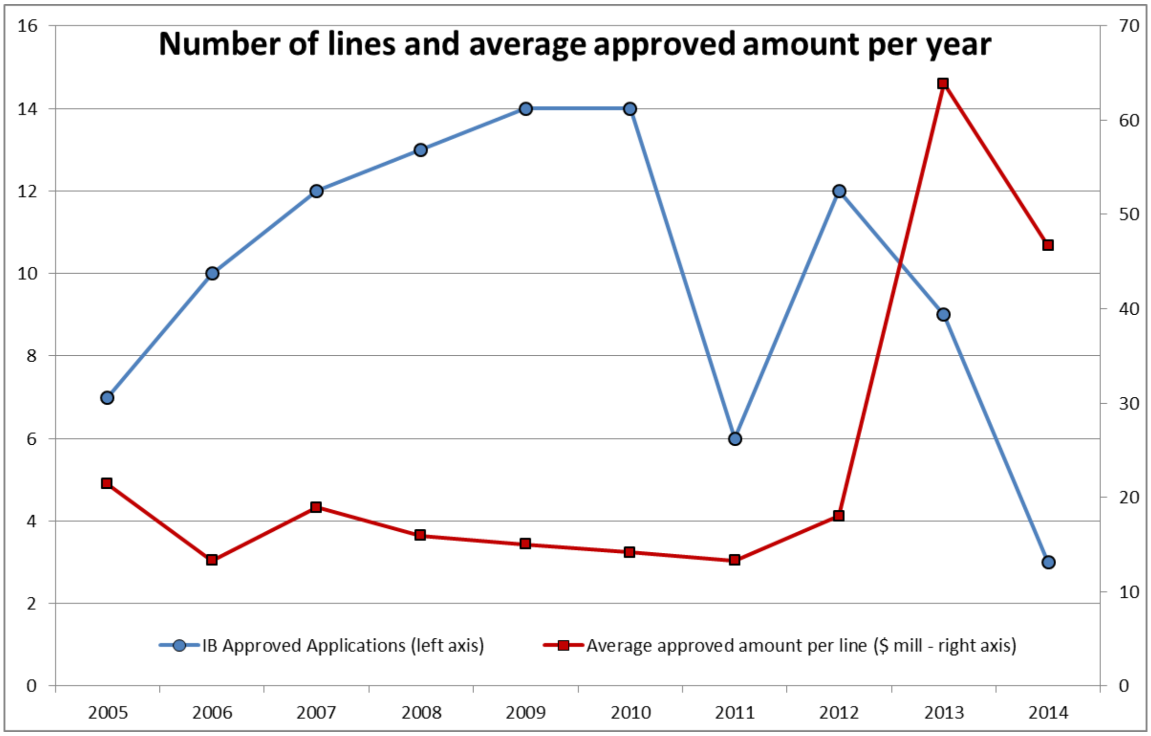


Figure A2. The majority of operations are classified as low risk

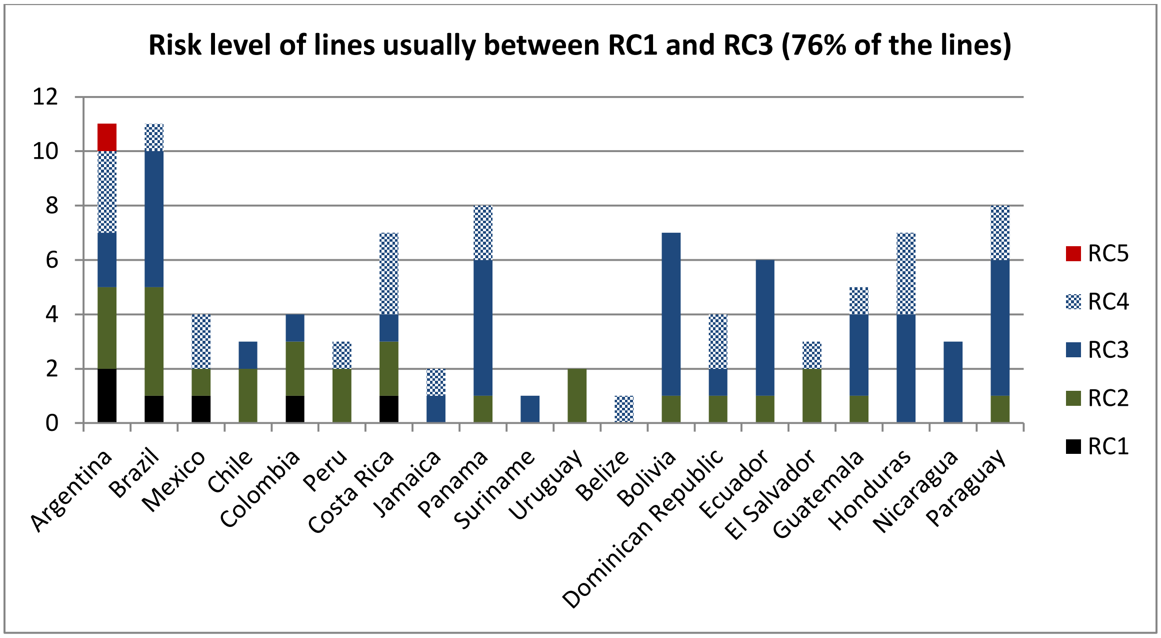


Figure A3. Active lines (as % of total lines in the portfolio) have been decreasing since 2011

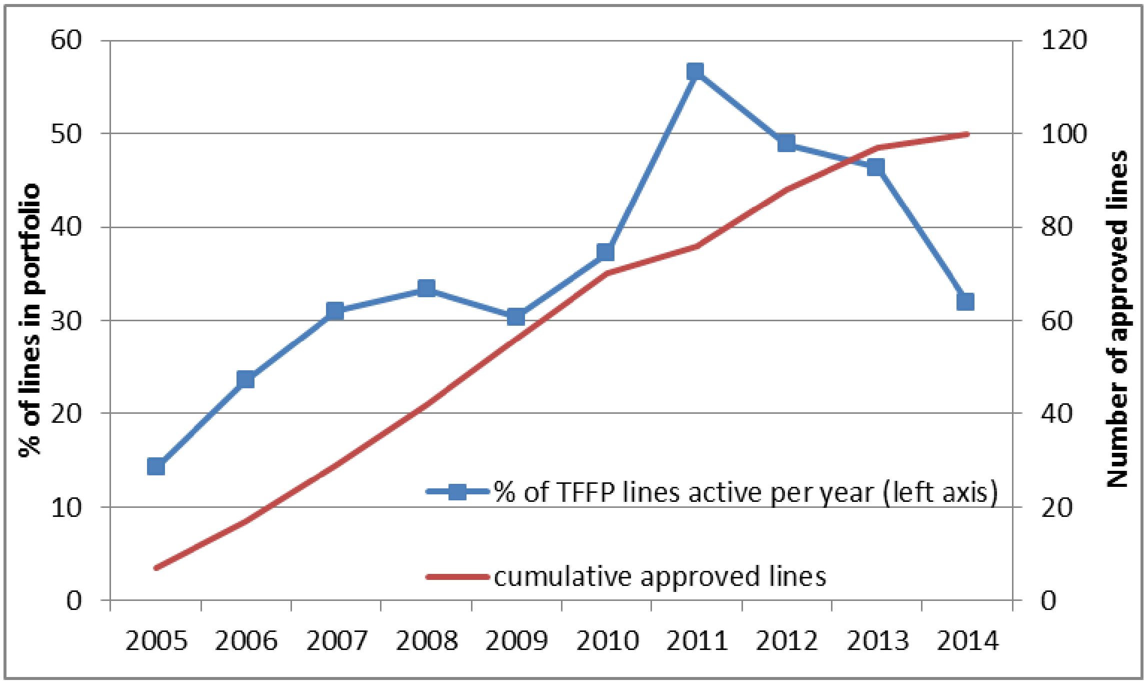


Figure A4. A/B loans and cofinanced operations by country

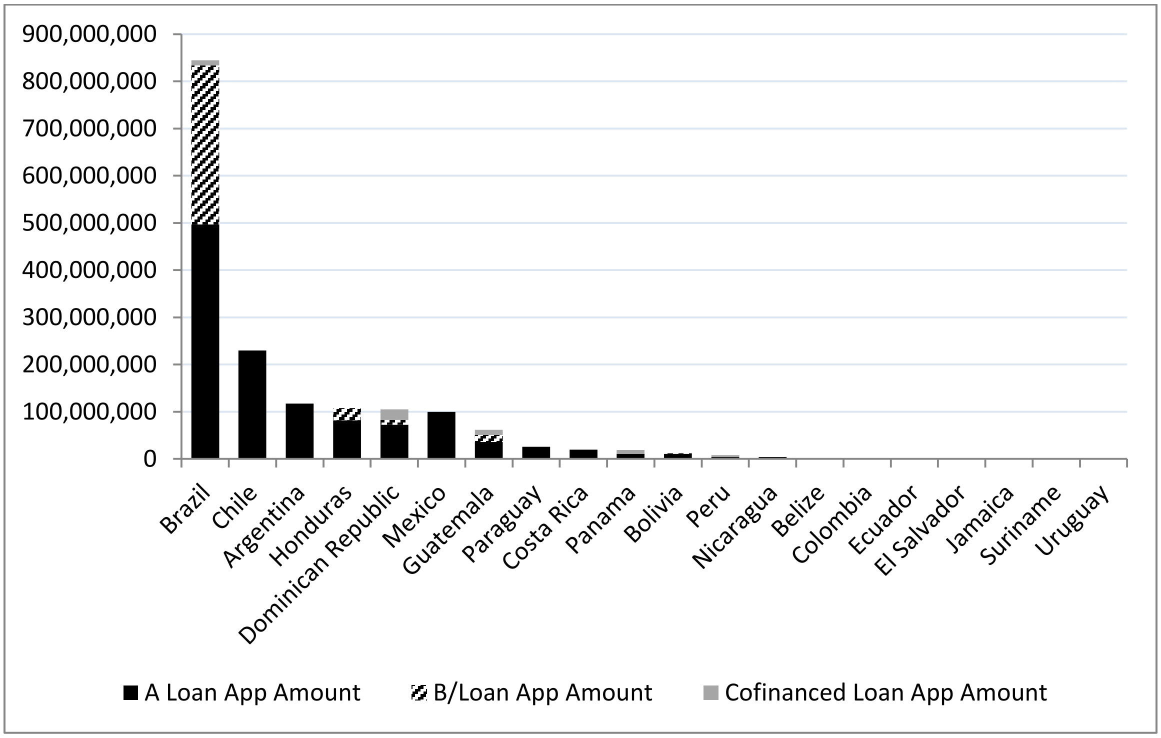


Figure A5. Monthly exposure to Brazilian banks

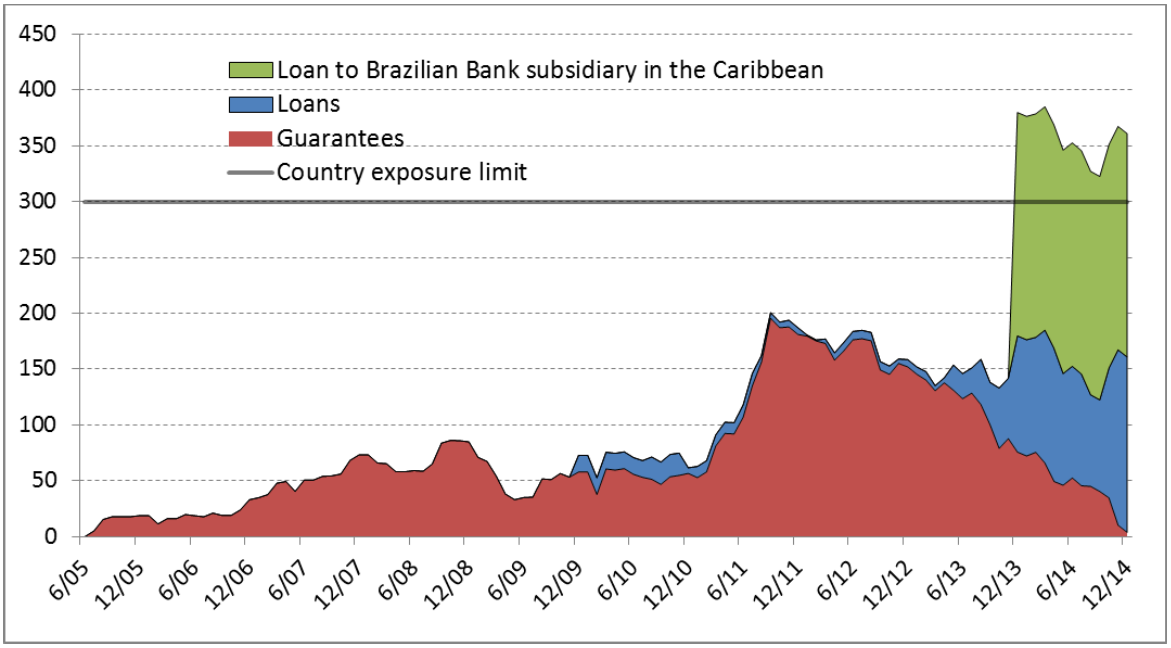


Figure A6. TFFP commitments in 2014 by country (% of total)

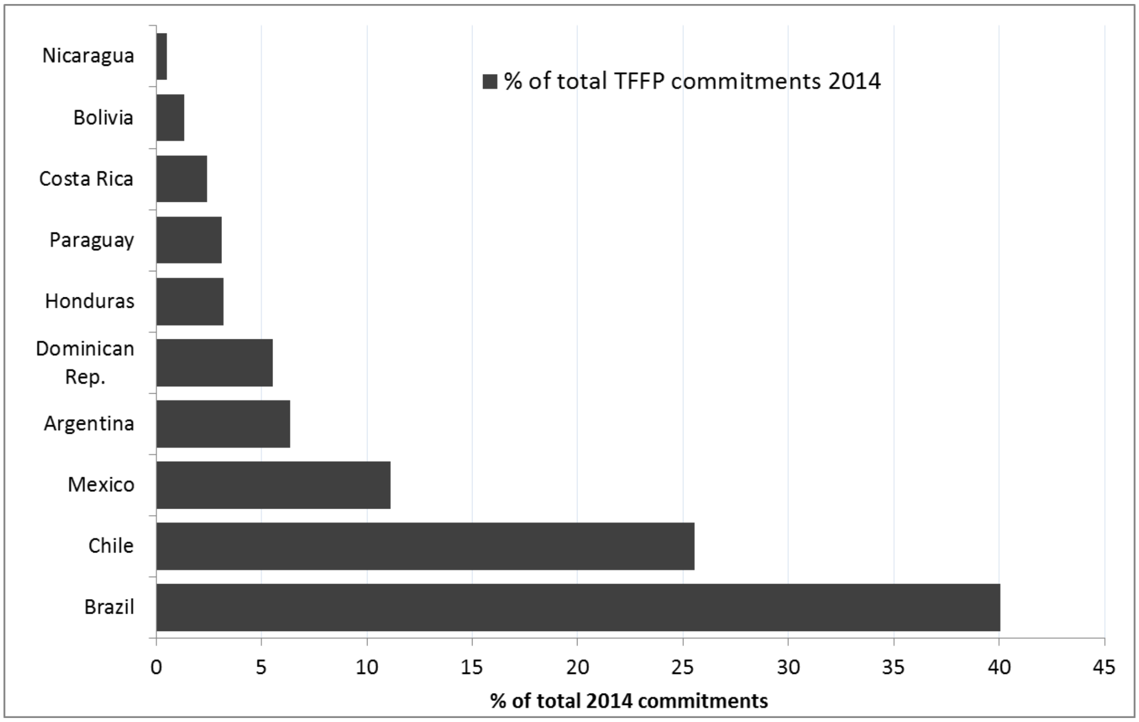


Figure A7. Number of TFFP guarantees or loan operations approved per year

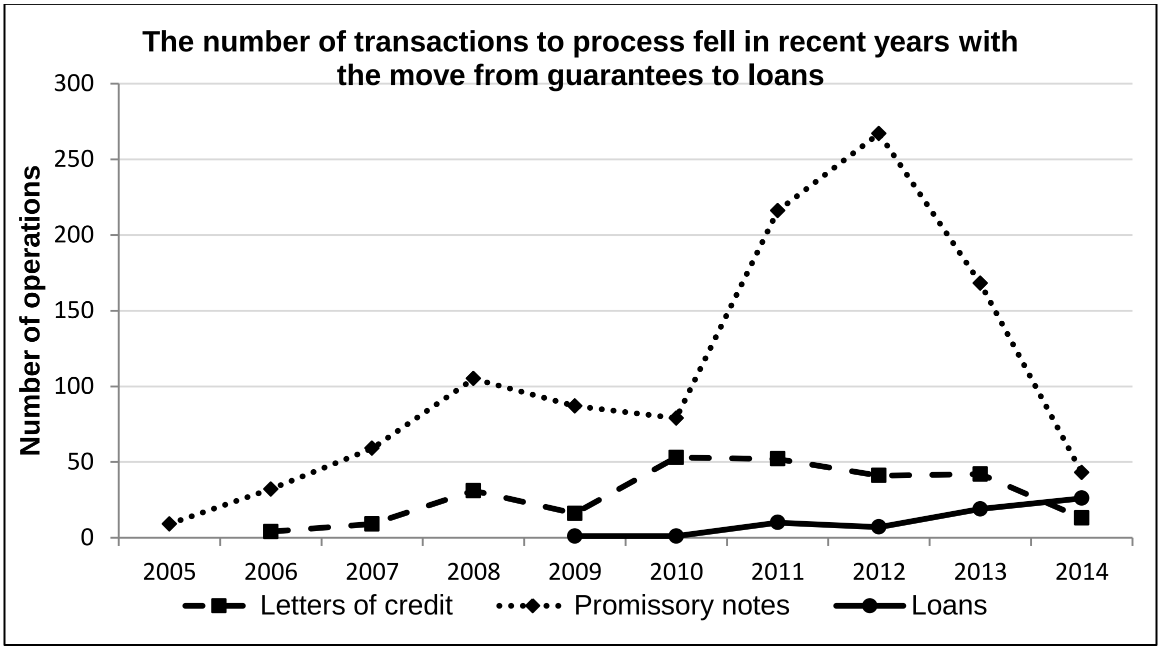


Table A2. Volumes of intraregional transactions by year

	TFFP amount financed (underlying operations, $ million)			% of intra-regional trade in total
Years	Inter-regional	Intra-regional	Total	
2005	20.9	4.1	24.9	16%
2006	71.2	25.1	96.3	26%
2007	140.8	30.5	171.3	18%
2008	219.4	59.6	279.0	21%
2009	195.4	63.0	258.4	24%
2010	243.4	79.8	323.2	25%
2011	740.2	211.0	951.3	22%
2012	657.1	195.9	853.0	23%
2013	939.8	335.2	1,275.0	26%
2014	748.9	202.9	951.8	21%
Total	**3,977.1**	**1,207.1**	**5,184.2**	**23%**

Table A3. Total commitments of TFFP by country and year ($ million)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Grand Total
A											
Argentina						9.6	57.8	86.5	66.5	57.2	277.6
Brazil	18.9	52.5	98.6	109.1	98.2	100.1	293.4	284.3	467.3	211.9	1,734.1
Mexico								3.4	4.7	100.0	108.0
B											
Chile								7.0	230.0	60.0	297.0
Colombia						28.9	40.0	19.9			88.8
Peru			4.4		1.6		6.2	8.0	14.0		34.2
C											
Costa Rica				1.0		1.8	6.2	15.9	10.6	21.7	57.2
Jamaica				1.4							1.4
Panama				3.0	6.6	3.7	18.8	41.8	60.1	2.0	135.9
D											
Belize							1.8	1.5	0.4		3.7
Bolivia						3.4	12.1	13.5	23.4	19.4	71.8
Dominican Republic						29.4	52.2	29.2	50.0	75.1	235.9
Ecuador		10.0	17.9	56.1	41.3	28.8	39.3			3.3	196.6
El Salvador								13.6	5.8		19.4
Guatemala				27.2	15.9	20.8	89.8	155.5	100.8	4.0	414.1
Honduras			10.8		4.9	9.1	11.0	45.5	92.7	48.2	222.3
Nicaragua		5.1	3.0	9.1	12.2	1.4	5.6	19.1	25.8	14.8	96.2
Paraguay				4.1	5.0	7.3	34.5	26.8	60.9	33.3	171.9
Grand Total	**18.9**	**67.6**	**134.7**	**211.1**	**185.6**	**244.2**	**668.7**	**771.6**	**1,212.9**	**650.9**	**4,166.2**

Table A4. Guarantee commitments of TFFP by country and year ($ million)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Grand Total
A											
Argentina						9.6	57.8	86.5	6.5		160.5
Brazil	18.9	52.5	98.6	109.1	83.2	95.1	286.4	275.3	163.3	54.9	1,237.1
Mexico								3.4	4.7		8.0
B											
Chile								7.0	30.0	30.0	67.0
Colombia						28.9	40.0	19.9			88.8
Peru			4.4		1.6		2.2	8.0	14.0		30.2
C											
Costa Rica				1.0		1.8	6.2	15.9	10.6	1.7	37.2
Jamaica				1.4							1.4
Panama				3.0	6.6	3.7	10.6	38.8	60.1	2.0	124.8
D											
Belize							1.8	1.5	0.4		3.7
Bolivia						3.4	12.1	13.5	23.4	8.4	60.8
Dominican Republic						29.4	29.7	29.2	50.0	25.1	163.4
Ecuador		10.0	17.9	56.1	41.3	28.8	39.3			3.3	196.6
El Salvador								13.6	5.8		19.4
Guatemala				27.2	15.9	20.8	84.5	150.5	74.8	4.0	377.9
Honduras			10.8		4.9	9.1	11.0	45.5	37.7	21.2	140.3
Nicaragua		5.1	3.0	9.1	12.2	1.4	5.6	19.1	25.8	10.7	92.2
Paraguay				4.1	5.0	7.3	34.5	26.8	60.9	7.3	145.9
Grand Total	**18.9**	**67.6**	**134.7**	**211.1**	**170.6**	**239.2**	**621.7**	**754.6**	**567.9**	**168.7**	**2,955.0**

Table A5. Loan commitments of TFFP by country and year ($ million)

Row Labels	2009	2010	2011	2012	2013	2014	Grand Total
A							
Argentina					60.0	57.2	117.2
Brazil	15.0	5.0	7.0	9.0	304.0	157.0	497.0
Mexico						100.0	100.0
B							
Chile					200.0	30.0	230.0
Peru			4.0				4.0
C							
Costa Rica						20.0	20.0
Panama			8.2	3.0			11.2
D							
Bolivia						11.0	11.0
Dominican Republic			22.5			50.0	72.5
Guatemala			5.3	5.0	26.0		36.3
Honduras					55.0	27.0	82.0
Nicaragua						4.0	4.0
Paraguay						26.0	26.0
Grand Total	**15.0**	**5.0**	**46.9**	**17.0**	**645.0**	**482.3**	**1,211.2**

Table A6. Mobilization of resources by country ($ million)

Country	Number of lines	Number of loans	Number B/Loans	Number of Loans Cofinanced	Loan Face Amount	A Loan App Amount	B/Loan App Amount	Cofinanced Loan App Amount
Brazil	11	19	11	4	845	497	337	11
Chile	3	5	0	0	230	230	0	0
Argentina	11	9	0	0	117	117	0	0
Honduras	7	7	4	0	108	82	26	0
Dominican Republic	4	3	1	1	105	73	10	23
Mexico	4	1	0	0	100	100	0	0
Guatemala	5	5	2	2	62	36	15	10
Paraguay	8	3	0	0	26	26	0	0
Costa Rica	7	2	0	0	20	20	0	0
Panama	8	6	0	6	19	11	0	8
Bolivia	7	2	1	0	12	11	1	0
Peru	3	1	0	1	8	4	0	4
Nicaragua	3	1	0	0	4	4	0	0
Belize	1	0	0	0	0	0	0	0
Colombia	4	0	0	0	0	0	0	0
Ecuador	6	0	0	0	0	0	0	0
El Salvador	3	0	0	0	0	0	0	0
Jamaica	2	0	0	0	0	0	0	0
Suriname	1	0	0	0	0	0	0	0
Uruguay	2	0	0	0	0	0	0	0
Grand Total	**100**	**64**	**19**	**14**	**1,656**	**1,211**	**389**	**56**

Figure A8. TFFP portfolio of underlying exports from the region

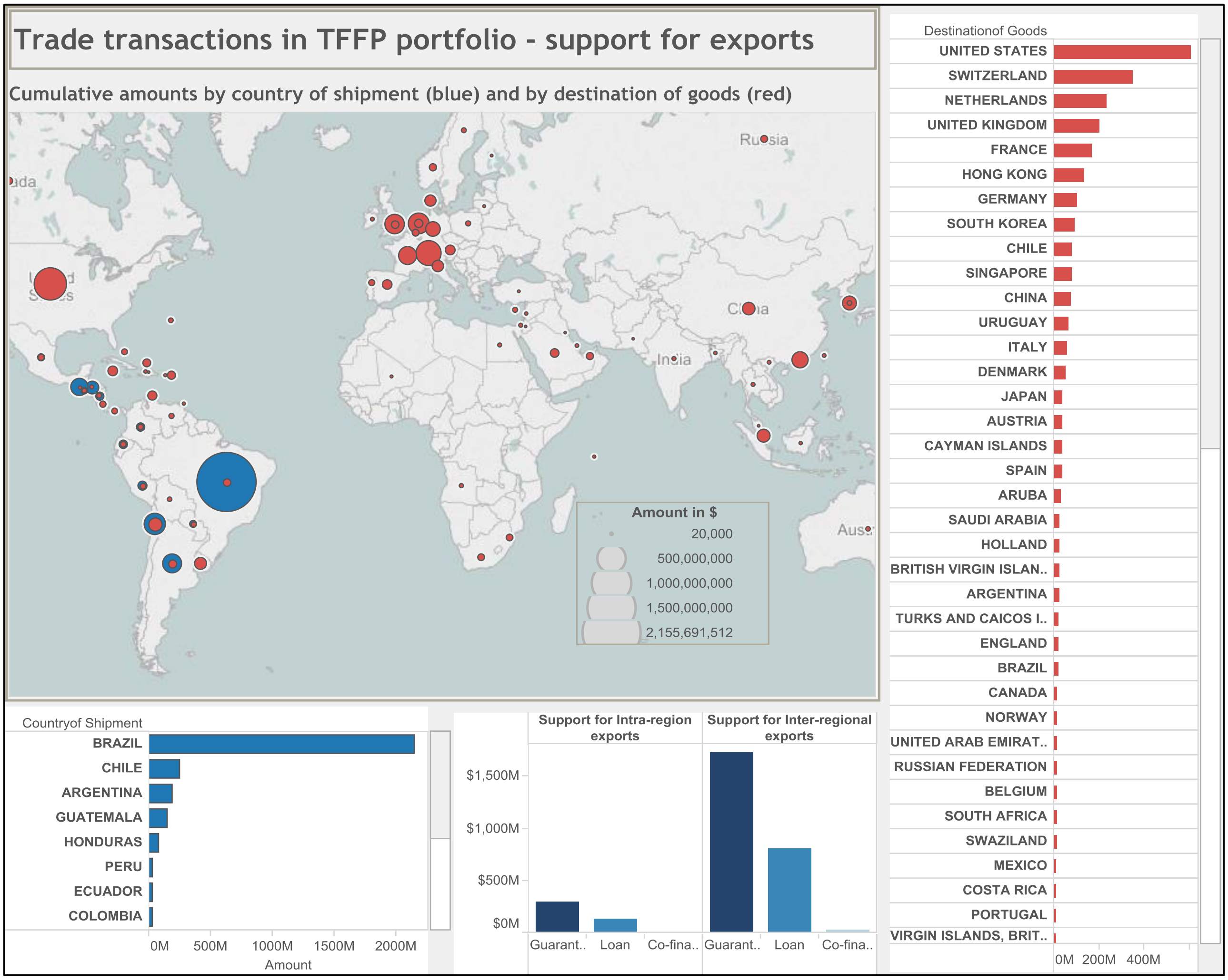
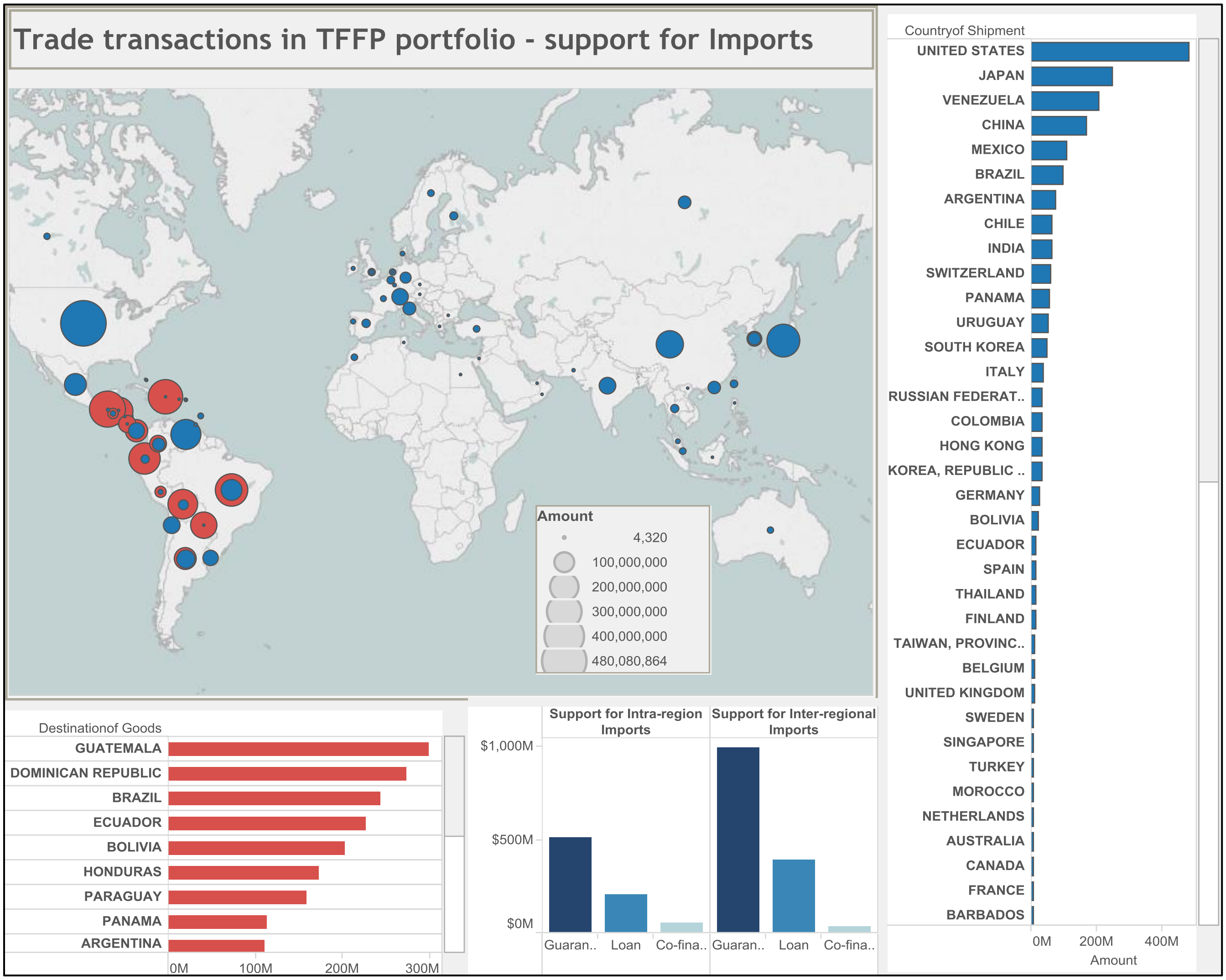


Figure A9. TFFP portfolio of underlying imports to the region



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