

Overview of Trade Finance

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Outline

- Definition
- Trade Finance and Trade Facilitation
- Key Issues In Trade Finance
- Trade finance tools and instruments

Definition

The institutions, laws, regulations and other systems related to the following three activities:

1. Provision of **capital to firms** that are engaging in international trade transactions,
2. Provision of support services to **manage the risk** involved in these transactions, and
3. Provision of international **payment mechanisms**.

Main Players

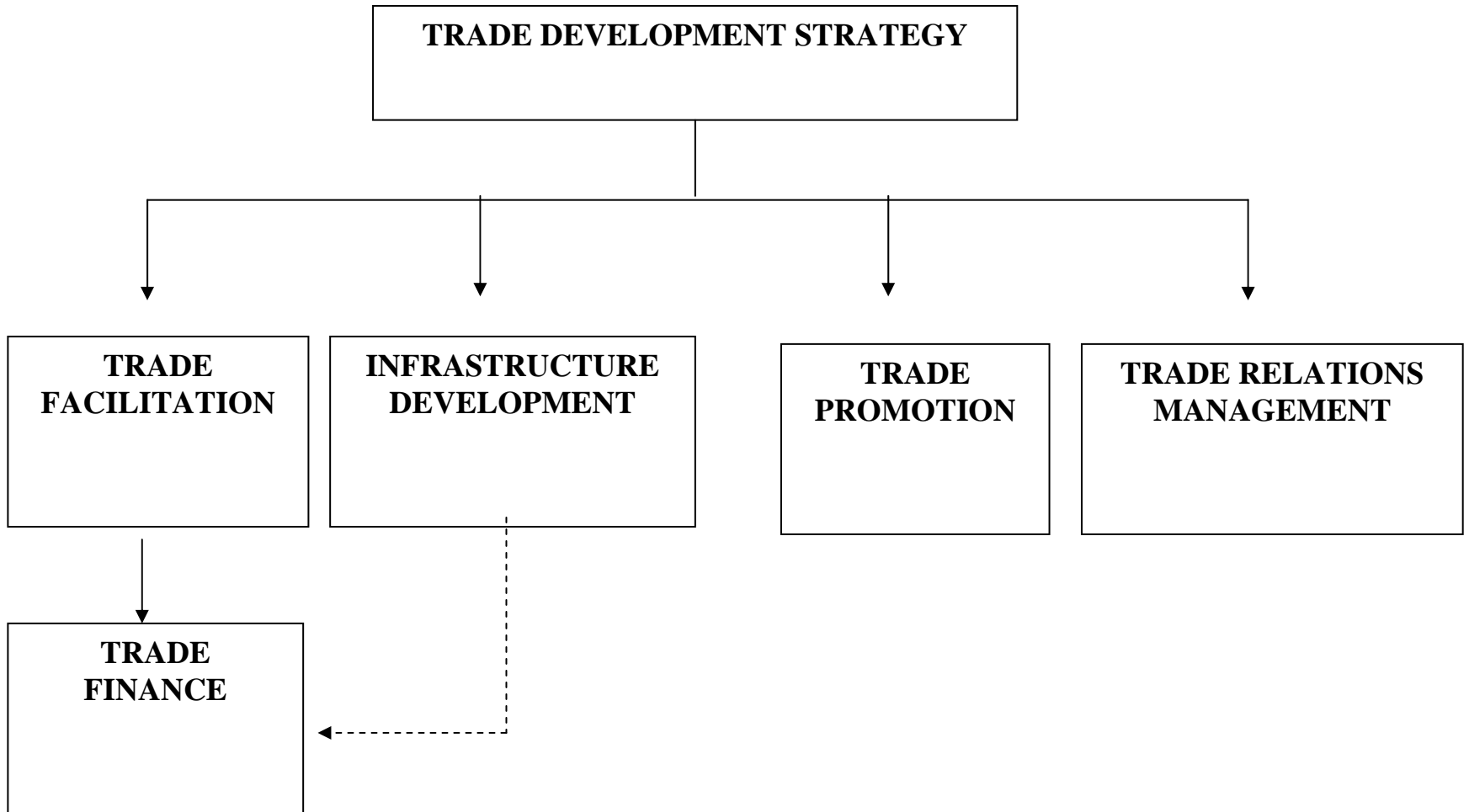
- Government agencies
- Banks & other Financial Institutions
- International Agencies

Role In Facilitating And Promoting Trade

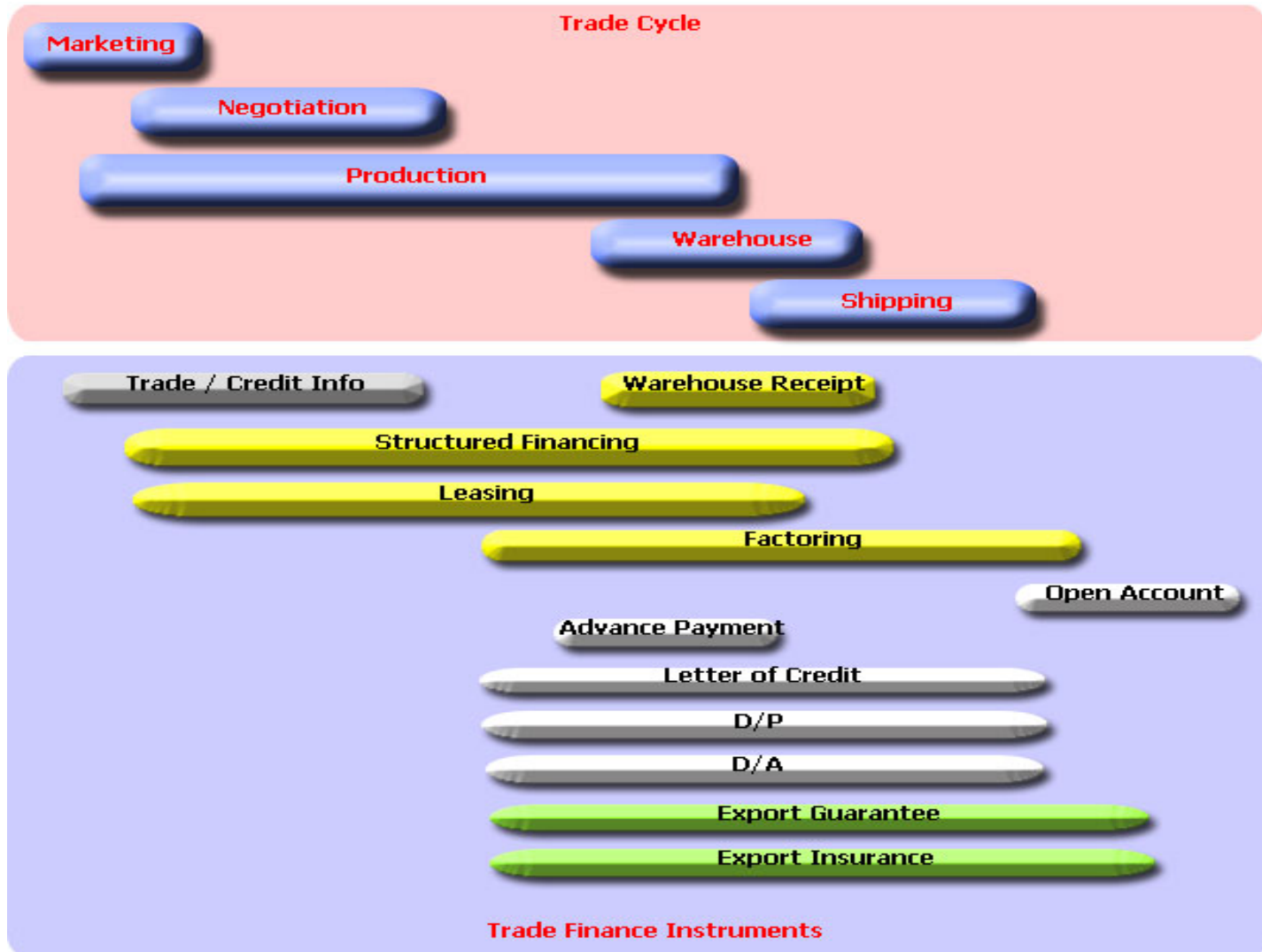
Traders need to secure financing so that the transaction may actually take place.

- Manage cash flow, risks and costs.
- Raise fund and capitals
- Access Credit Information

The faster and easier the process of financing an international transaction



Trade Finance and Trade



Key Issues In Trade Finance

- The mechanics & systems for arranging for and receiving payment
- The Legislation and custom requirements of the export and import countries
- Foreign exchange policy and other risks associated with international trade
- The institutions - the operations of the banking system in operating the trade finance instruments, and payments and settlements.
- Infrastructure and a host of ICT services

Trade finance tools and instruments



To raise Capital

- Loan / Line of Credit
- Structured Financing
- Leasing
- Inventory Financing



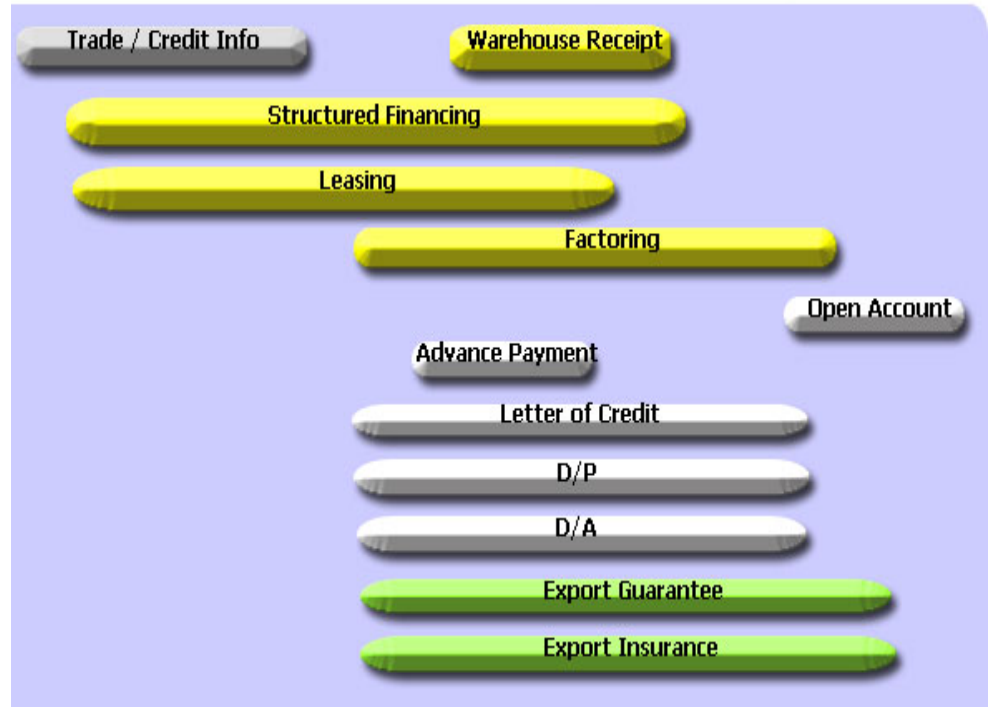
To Mitigate risks

- Factoring
- Export Credit Insurance
- Export Credit Guarantee



Terms of Payment

- Advance Payment
- Open Account
- Collections (Document on Payment or Document on Acceptance)
- Letters of Credit



To Raise Capital

Pre & Post-Shipping Financing

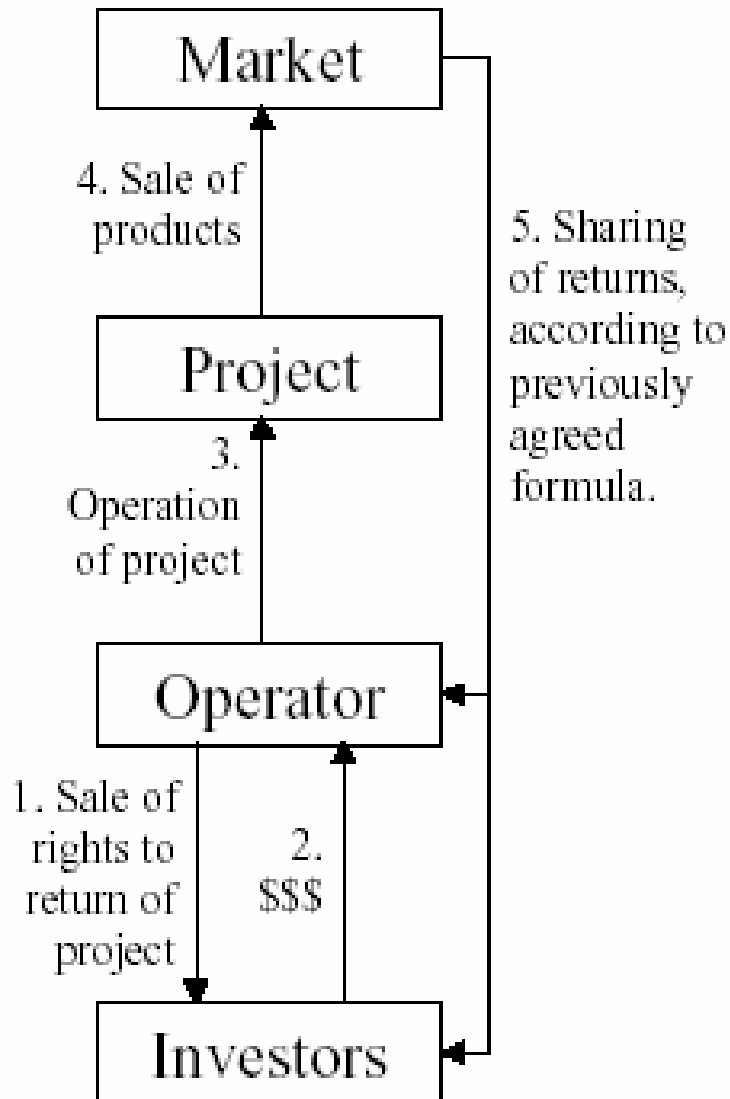
- Pre-Shipping
 - Prior to the shipment of goods.
 - To support pre-export activities like wages and overhead costs.
- Post-Shipping
 - The period following shipment.
 - Ensures adequate liquidity until the purchaser receives the products and the exporter receives payment.

Structured Financing

Structured Financing is a technique whereby certain assets with more or less predictable cash flows can be isolated from the originator and used to mitigate risks (eg. transfer of foreign exchange, contract performance and sovereign risk), and thus secure a credit.

Structured trade finance is the art of transferring risks in trade financing from parties less able to bear those risks to those more equipped to bear them in a manner that ensures automatic reimbursement of advances from the underlying assets.

www.unctad.org/commodities



Direct sale of rights to future commodity production to investors

Source: Mr Lamon Rutten, Chief, commodity finance and energy, United Nations Conference on Trade and Development, Geneva.

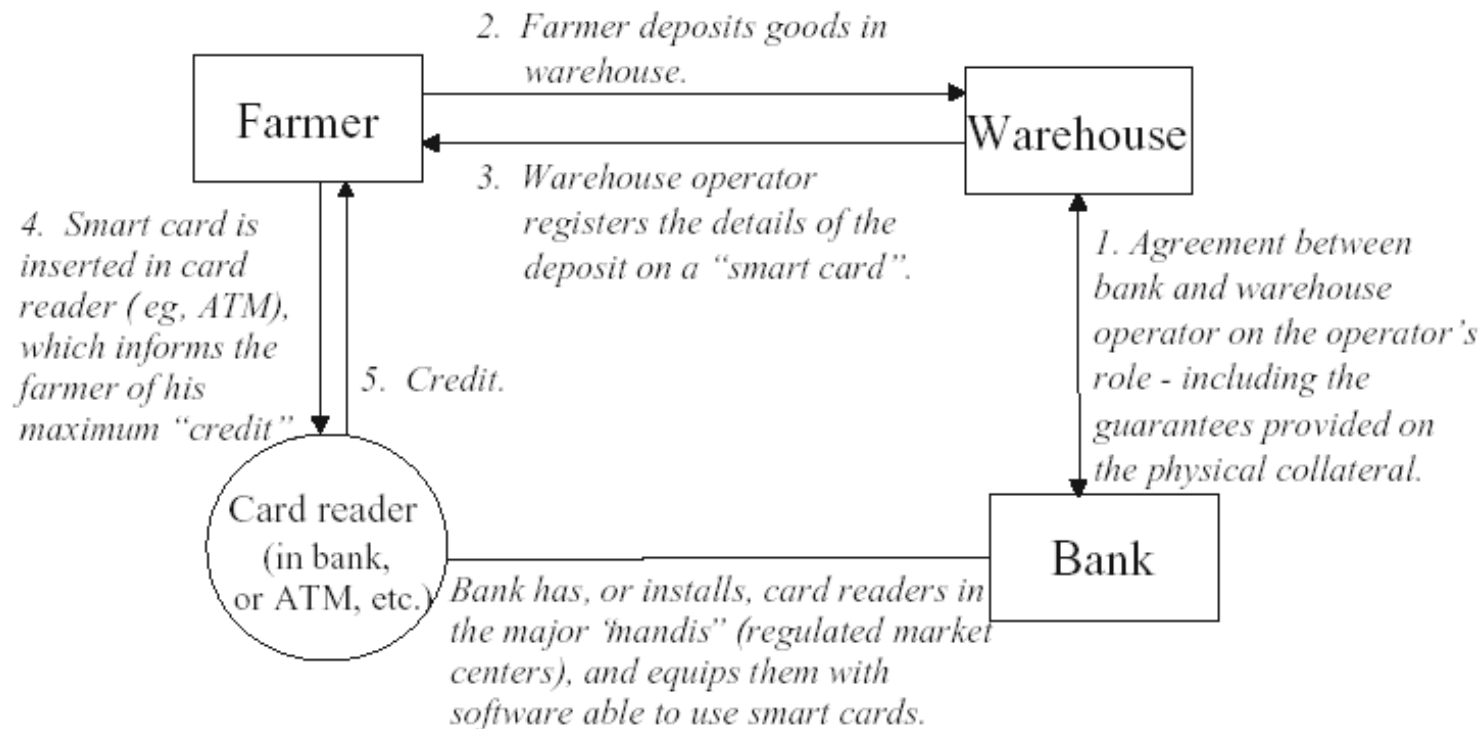
Leasing

- A mid to long-term financing
- Importer lease the product intended from the banks.
- The banks would sign a leasing agreement directly with the importer (lessee).
- The agreement is tailored to the specific needs of the supply contract between the exporter and importer.

Inventory Financing

- Inventories held up space and is a cost to the exporter until its is shipped to the importer.
- Warehouse receipts - These inventories can be a source if fund through both secured and unsecured loan against the inventories a company has.

Using smart cards as a “shortcut” for warehouse receipt finance



Note: This scheme only applies to selected commodities, which have a ready market (that is, can be easily sold) and a reliable price reporting system. The smart card contains details on the quality and quantity of the products deposited. The card reader is connected to a system with up-to-date price information, and programmed to calculate the current value of the products; the farmer can take up to, say, 60 to 70 per cent of this value as a short-term (say, up to 180 days) credit. The credit is registered on the smart card, and delivery from the warehouse is only possible after its reimbursement. The scheme has the added value of providing an up-to-date central registry of charges over products, and allowing to create “track records” for individual farmers. With general use of the smart cards, warehouses could also use them to provide inputs on credit.

Source: Mr Lamon Rutten, Chief, commodity finance and energy,
United Nations Conference on Trade and Development, Geneva.

Experience with warehouse receipts for farmers in Ghana

Since 1989, the NGO TechnoServe has worked closely with the Department of Co-operatives and the **Agricultural Development Bank (ADB)** in Ghana in encouraging small-scale farmers to form cooperatives and **use warehouse receipts to store their crops for sale in the lean season.**

ADB provides loans against the members' grain, at **75-80% of current market price**, and the grain is stored in **cooperatively owned warehouses**. The scheme is concentrated in the Brong-Ahafo “maize triangle” of Ghana – the major area of agricultural surplus, where annual price fluctuations are high.

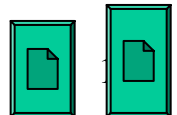
From 1992 to 1996, farmers participating in the scheme in this region were able to increase their profits on grain sales by an average of 94% per year. By 1997/98, more than 130 farmers groups were being assisted and for over 8 years, the loan repayments have been an impressive 100%.

Some of the benefits resulting from the scheme include: increased food production; better food security for farming families previously forced to accept low prices when selling at the same time (harvest); reduced post-harvest losses and higher rural investment.

Source: TechnoServe '98 and Coulter and Shepard '95.

Factoring

- This involves the sale at a discount of accounts receivable or other debt assets on a daily, weekly or monthly basis in exchange for immediate cash.
- The debt assets are sold by the exporter at a discount to a factoring house, which will assume all commercial and political risks of the account receivable.





[Trade Financing](#) | [Asset Based Financing](#) | [Others](#) | [Government Assistance Schemes](#) | [Enquiry Form](#)

Trade Financing

- **Factoring**

Factoring is a well-established means of providing companies with working capital. Very simply, our clients assign their accounts receivables to us in return for a cash advance of up to 90%. We undertake the task of collecting the receivables as and when they fall due and keep our clients informed of their account status. Not only does this service help our clients to increase their turnover, it also relieves them of the time-consuming tasks of sales ledgering and credit management.

Types of Factoring

IFS offers a full range of factoring services, including:

- **Domestic Factoring** : cash advances of up to 90% against your domestic receivables.
- **Export Factoring** : cash advances of up to 90% against your overseas invoices.
- **IntFactor** : factoring facilities via the Internet.
- **Non-Recourse Factoring** : factoring with credit insurance against bad debts; IFS will bear the risk should your debtors default on payment.
- **With Recourse Factoring** : factoring without credit insurance.

For more information on factoring, [please click here](#)

- **Accounts Receivable Financing**

This facility helps our clients convert trade credits into cash immediately. With cash in hand, clients can then secure the best possible terms from suppliers or grant more competitive credit terms to their customers.

- **Working Capital Loans**

Short-term loans are extended to meet the client's working capital requirements and these may either be revolving or repaid progressively over a period of time.

Managing Risks

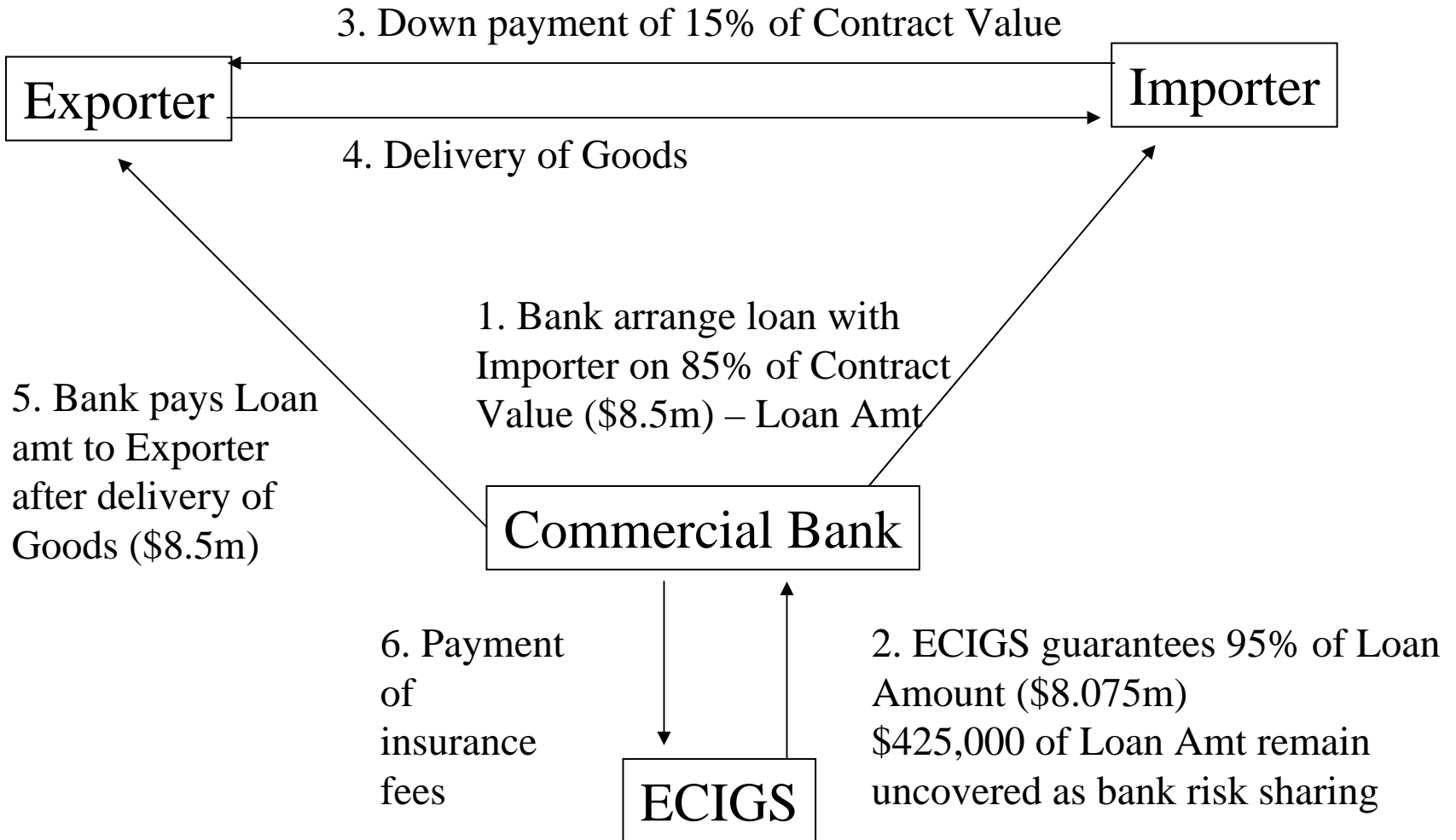
Export Credit Insurance

- Export Credit insurance involves insuring exporters against possible:
 - Commercial risk such as non-acceptance of goods by buyer, the failure of buyer to pay debt, and the failure of foreign banks to honour documentary credits.
 - Political risk arises from factors like war, riots and civil commotion, blockage of foreign exchange transfers and currency devaluation.

Export Credit Guarantees

- Issued by a financial institution, or a government agency
- Assist companies without sufficient track records to obtain credit from banks
- Instruments to safeguard export-financing **banks** from losses that may occur from providing funds to exporters.

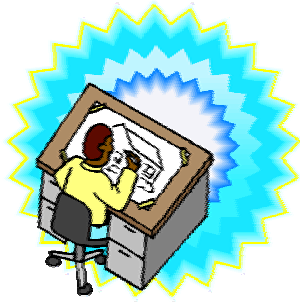
Contract Value \$10m



Payment Terms

Payment Terms And Associated Risks

- Advance Payment
 - Time of payment : Before shipment
 - Goods available to buyers : After payment
 - Risk to exporter : None
 - Risk to importer : Relies completely on exporter to ship goods as ordered



Seller

Buyer sends Purchase Order



Seller acknowledge PO



Payment



Shipping



Buyer

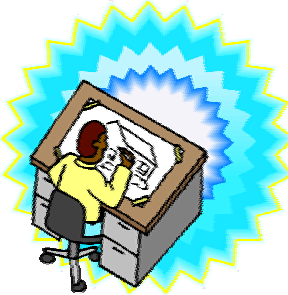
Best Practices

- Seller:
 - Give clear payment instructions to the buyer including the mode of payment. Example by SWIFT or TT.
 - Avoid accepting bank draft (cheque) or a company cheque.
 - If you are asked to issue an advance payment guarantee, tell your bank to make the guarantee ‘inoperative’ until you receive the payment
- Buyer:
 - Avoid this arrangement. Try offering a Letter of Credit instead.
 - Insist on an advance payment guarantee to allow you to recover the payment if the seller fails to fulfill their part of the contract.

Payment Terms And Associated Risks

- Letters of credit (L/C)
 - Time of payment : When shipment is made
 - Goods available to buyers : After payment
 - Risk to exporter : Very little or none
 - Risk to importer : Relies on exporter to ship goods as described in documents

Ships Goods to buyer's country



Buyer sends Purchase Order



Seller acknowledge PO



Seller

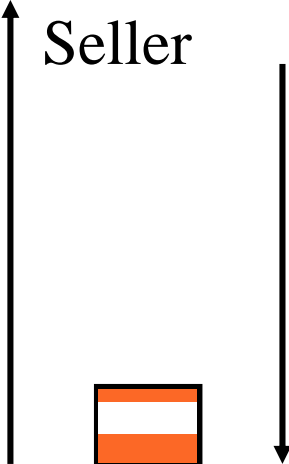
Buyer

Presents Doc

Apply LC

Confirm
LC

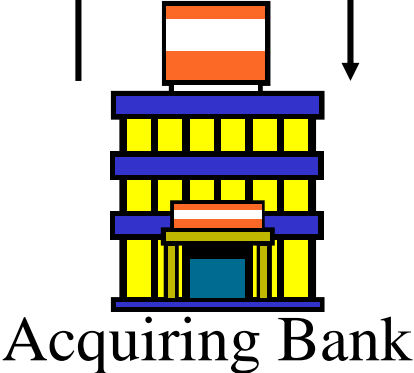
Check
And
settle



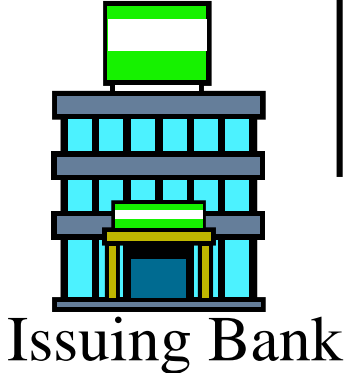
LC issued



Claims for payment



Acquiring Bank



Issuing Bank

Best Practices

- Seller

- Make sure that a local bank has authenticated the letter of credit.
- Examine the letter of credit carefully and make sure it keeps to the terms of the sales contract.
- Make sure that you can present all the documents named.
- Be extremely careful when you prepare your documents.

- Buyer

- Check with your bank in good time and make sure that you have enough credit with your bank.
- Be careful filling in your application and make sure your guarantee is issued according to the contract terms.
- Use the opportunity to negotiate extended credit terms if possible.
- Make sure that you call for all the necessary documents so the goods pass to you smoothly.
- Insist on terms that you think are important to protect your interest such as latest shipment dates or other such terms.

Payment Terms And Associated Risks

- Documents against payments
 - Time of payment : On presentation of draft
 - Goods available to buyers : After payment
 - Risk to exporter : If draft is unpaid, must dispose of goods
 - Risk to importer : Relies on exporter to ship goods as described

Payment Terms And Associated Risks

- Documents against acceptance
 - Time of payment : On maturity of draft
 - Goods available to buyers : Before payment
 - Risk to exporter : Relies on buyer to pay drafts
 - Risk to importer : Relies on exporter to ship goods as described in documents

Ships Goods to buyer's country



Buyer sends Purchase Order



Seller acknowledge PO



Seller

Buyer

Entrust Doc To Bank With D/P or D/A



Pay or Accept

Act According To D/P or D/A

Receive Money or Advice of acceptance

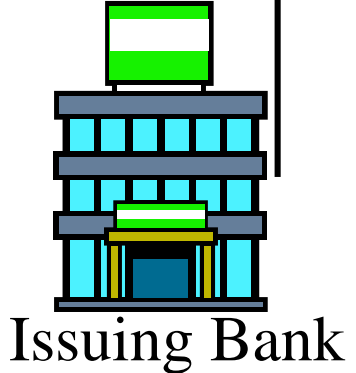
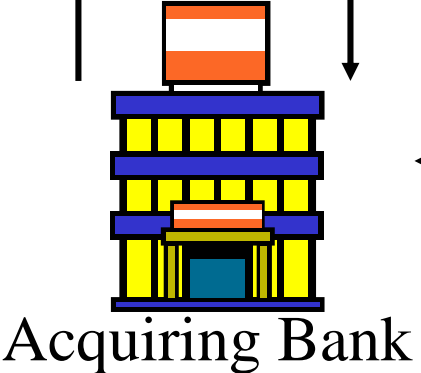


Release Doc

Proceed remitted or acceptance advice sent



Forward Doc

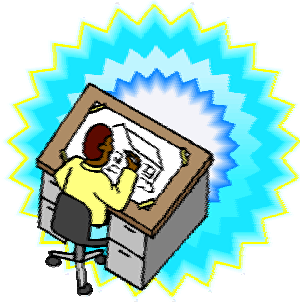


Best Practices

- Seller
 - Make sure you are satisfied with the buyer and country risks before you agree to this method.
 - Make sure you supply your goods and services by keeping to the contract terms so you avoid disputes.
 - Make sure that your collection instructions are clear and match the terms agreed in the contract exactly.
- Buyer
 - When you are asked to pay or accept the bill of exchange, make sure the terms are exactly as you agreed in the contract.
 - If possible, make sure you are satisfied with the goods or services before you tell your bank to pay or before you accept the bill of exchange.
 - Make sure you have received the correct documents to get the goods. Once you are satisfied that everything is in order, respond promptly when you are asked to pay or accept the bill of exchange.

Payment Terms And Associated Risks

- Open accounts
 - Time of payment : As agreed upon
 - Goods available to buyers : Before payment
 - Risk to exporter : Relies completely on buyer to pay account as agreed upon
 - Risk to importer : None



Seller

Buyer sends Purchase Order



Seller acknowledge PO



Shipping



Payment



Buyer

Best Practices

- Seller
 - Do not agree with Open Account when buyer is new to you or you are unable to determine the risk and reliability of the buyer.
 - Your goods are delivered first before payment; therefore make sure you supply your goods or services by keeping to the contract terms so you avoid disputes and non-payment.
 - Insist on an electronic transfer (cleared funds) instead of a bank draft or cheque (uncleared funds).
- Buyer
 - Make sure you are satisfied with the goods or services before you make a payment.
 - Make sure that you make your payment within the agreed credit terms as you don't want to damage your trading relationship with your supplier.
 - Make sure you pay according to the settlement instructions.

One primary shift is the move away from letters of credit (L/Cs) to open account structures for short-term sales contracts.

In Asia, for instance, this shift is largely driven by the tightening credit appetite of the local LC issuing banks that no longer extend generous unsecured credit lines to importers.

Deutsche is therefore developing structures for risk mitigation and financing of open account receivables and payables, without the legal protection of an LC.



The screenshot shows the Deutsche Bank website's Global Trade Finance page. The page features a blue header with the Deutsche Bank logo and navigation links for Client Sites, Group Home, and Contact Us. Below the header is a menu bar with categories: Equities, Fixed Income, Foreign Exchange, Commodities, Corporate Finance, Transaction Bank, and Research. The main content area is titled "Global Trade Finance" and contains three paragraphs of text. The first paragraph describes the division's services, the second mentions its global network, and the third highlights awards from Euromoney's Trade Finance Magazine. A "Related Links" sidebar on the right lists various services like Structured Trade & Export Finance and Risk Management Services. Below that, an "Awards" section highlights the bank's status as the No. 1 Mandated Arranger of Global Syndicated Trade Finance Loans in 2003. The footer contains a legal notice and a sitemap link.

Client Sites | Group Home | Contact Us

Deutsche Bank

Equities | Fixed Income | Foreign Exchange | Commodities | Corporate Finance | Transaction Bank | Research

Global Trade Finance

Global Trade Finance brings together all Deutsche Bank's dedicated trade finance and risk advisory product groups- combining all the advantages of specialist expertise with the convenience and efficiency of a one-stop shop.

Global Trade Finance's global network of 65 locations in more than 40 countries combined with state-of-the-art processing technology, innovative structuring capability and superior placement power ensure clients a competitive edge.

In 2003 Euromoney's *Trade Finance* Magazine readers voted Deutsche Bank 'Best Trade Documentation Bank' and 'Best Short-Term Trade Finance Bank' for the second consecutive year in their "Awards for Excellence". We were also runner-up in the 'Best Export Finance Arranger' category and third in the 'Best Forfaiting Institution' category. After the first six months of the year we also topped the league tables as No.1 Mandated Arranger of Global Syndicated Trade Finance Loans by number of deals.

In 2002 Deutsche Bank's Global Trade Finance division consistently topped the league tables for global syndicated trade finance loans by number of deals, market share and volume. We also received a grand total of nine deal awards for 2002 winning five Euromoney *Trade Finance* magazine "Deals of the Year" and four *Global Trade Review* magazine "Best Deals of 2002" accolades. In addition, we were voted in a client poll "Best Trade Documentation Bank" and "Best Short-Term Trade Finance Bank".

Related Links

- Structured Trade & Export Finance
- Trade & Risk Services
- db-markets eTrade
- Risk Management Services
- Tariff for Banks
- DB Asia Application Forms for Customers
- Bankline
- db direct internet
- Global Trade Finance Brochures

Sites marked require registration.

Awards

No.1 Mandated Arranger of Global Syndicated Trade Finance Loans by number of deals for first six months of 2003
- Compiled by Dealogic

In their "Awards for Excellence 2003", Euromoney's *Trade Finance* Magazine readers vote Deutsche Bank for the second year running:
- Best Short-Term Trade Finance Bank
- Best Trade Documentation Bank

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International Standards And Conventions In Trade Financing

- Incoterms 2000
 - Standard trade definitions most commonly used in international sales contracts
- Uniform Customs and Practice for Documentary Credits (UCP500)
 - UCP500 is the Uniform Customs and Practice for documentary credit
- eUCP
 - In November 2002, ICC published a new Guide call eUCP to supplement UCP 500.

International Standards And Conventions In Trade Financing

- ICC Uniform Rules for Collection (URC522)
 - Provides a basic introduction to the operation of collections as part of international trade
- Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits (URR 525)
- Uniform Rules for Demand Guarantees, (RDG 458)