Supply Chain Finance

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Outline

1. Two ways of understanding supply chain financing
   a. As structured trade finance
   b. As a specific banking vehicle to finance buyer-seller supply chain

2. Regulatory issues

3. Policy conclusions
1. Supply chain finance as ‘financing the supply chain’

Going beyond the traditional trade financing through L/Cs, starting from production to transport to warehousing to shipping and delivery.

Mitigants: insurance, guarantees. All underpinned by the traded good as security (collateral).
In Trade finance: Collateral is the good being exported/traded and funded.

An example of how trade and supply chain finance supports the real economy.
So, what is the problem?

SMEs find accessing financing difficult...

And increasingly squeezed by the trend towards open account trade from more traditional trade financing e.g. LCs

But FIs are saddled with regulations; And poor regulatory and legal framework for ABL constrain lending
PSU-APFF-ABA Survey of FIs

Financial crime compliance risk is a major reason for rejecting trade financing proposal.

Weak warehousing/collateral management capacity;
Problems of creating and perfecting security interest on goods.
Doing Business Survey corroborates variability of secured transactions environment within APEC; very low index for some

And still far from target growth in EODB index for credit access by 2015
Example: 3M – ‘Mystery of Missing Metals’ in Qingdao

- Bank finance is collateralized by warehouse receipts (i.e., metal deposits in warehouse) – valid financing option in many economies

- News reports of missing metals deposited in Qingdao Port warehouse

- Possible existence of fraud by one company: Decheng Mining
  - multiple use of warehouse receipts (fraudulent issuance) to obtain credit, i.e. same stockpile of metals used to secure multiple loans.
  - Fraudulent warehouse receipts (associated with Decheng Mining subsidiary in port area)

What to do?

- Importance of ‘secured transactions’ environment for the growth of asset based lending where security interests can be easily and cheaply created, perfected, and enforced.

- Components: quality of commercial law, judicial capacity, collateral registry, transparency (of collateral registry), credit bureaus, capable support services e.g. collateral management companies

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- Reforms are on-going
Enforcement issues are also important

Jurisdictional issue problem ...

And potential role of international conventions

Tradigrain company, supplier of vegetable oils and domiciled in country A suffered losses due to the fault of warehouse operator in a country in the Far East

Tradigrain company brought proceedings against: 1 insurer from country A & 28 non-country A insurers in country A’s Court to recover its losses

Lead insurer XYZ domiciled in country B challenged country A’s court’s jurisdiction over the dispute by arguing that the insurance policy was subject to country B’s law and country B’s court’s jurisdiction

Choice of Court Convention

Company in State A

Party brings proceedings in the courts of State A (or any State other than State B)

If proceedings are brought in the courts of State B then:

Company in State B

The courts of State A must decline to hear the case

The courts of State B must hear the case

The judgement of the courts of State B must be recognized and enforced in other Contracting States
2. Supply chain finance as a specific (banking) financing instrument.

Simple example: **Buyer-led supply chain finance**

- FIs can then pay seller within a shorter period using different financing instruments e.g. through purchase of seller’s PO, AR, or invoice, or through other pre-shipment or pre-export as well as post-export financing.

- Buyer usually asks its FI to **structure a supply chain financing** for its suppliers.

- Provides FI with its suppliers’ list (those willing to participate in the SCF scheme).

- FI **onboards suppliers** in the SCF platform after performing KYC check.

- Financing on the back of buyer’s creditworthiness.
2. Policy Issues and APEC Role

- ‘Onboarding’ of tens or hundreds of suppliers in the platform requires multiple KYC/CDD/AML effort by banks;
- Having cross-border suppliers and different regulations in each jurisdiction compound the KYC difficulty => sometimes leads to bank refusing to carry out transactions (onboard)

  - ‘Policing’ expectations plus hefty penalties lead to increased compliance cost and exits from existing correspondent banking relationships
    - Exits of banks can lead to financial exclusion (SMEs and developing economies) and higher trade financing cost and SMEs
    - Also to the rise of less regulated non-bank institutions

- Higher capital requirements for trade finance due to Basel3 implementation is also expected to reduce the available trade financing lines by banks. Ongoing discussions with Basel Committee

- Regulations on cross-border data flows (e.g. localization requirement) is another threat to the development of supply chain financing in developing economies because SCF e-platforms requires free flow of information.
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