

AFRICAN DEVELOPMENT BANK



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PROJECT APPRAISAL REPORT

GLOBAL TRADE LIQUIDITY PROGRAM (GTLP)

REGIONAL

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ABBREVIATIONS

ACP	African, Caribbean and Pacific Group of States
AfDB	African Development Bank (“the Bank”)
AGOA	African Growth and Opportunity Act
AsDB	Asian Development Bank
BAFT	Bankers’ Association for Finance and Trade
BMCE	Banque Marocaine du Commerce Extérieur
CAF	Andean Development Corporation
CIAA	Co-Investment and Administration Agreement
DFI	Development Finance Institution
EBRD	European Bank for Reconstruction and Development
FFMA	Financial Management Department
FTII	Funded Trade Investment Instruments
GECL	Legal Department
GTFP	Global Trade Finance Program
GTLP	Global Trade Liquidity Program
HSBC	Hong Kong and Shanghai Bank
IB	Issuing Bank
IADB	Inter-American Development Bank
IFC	International Finance Corporation
IMF	International Monetary Fund
IsDB	Islamic Development Bank
LC	Letter of Credit
LOC	Line of Credit
OPSM	Private Sector and Microfinance Department
PCS	Preferred Creditor Status
RMC	Regional Member Country
RSAL	Risk Sharing Agency Line of Credit
SCB	Standard Chartered Bank
SMEs	Small and Medium Scale Enterprises
SWIFT	Society for Worldwide Interbank Financial Telecommunication
TCX	The Currency Exchange
TFI	Trade Finance Initiative
TF LOC	Trade Finance Line of Credit
UB	Utilization Bank
USD	US Dollar

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SUMMARY TABLE	
Project Description:	The Global Trade Liquidity Program (GTLP) is a temporary crisis-response initiative among DFIs and donors (the Participants) to support trade finance in the developing world. The GTLP will pool resources from Participants and will use 2 primary investment structures: (i) a risk-sharing structure whereby funding will be channeled to local trade finance banks through international banks and (ii) direct dedicated lines of credit to local banks with regional coverage.
Sponsor:	The IFC is the sponsor of the GTLP and will act as Agent on behalf of the Participants. The IFC has a strong track record in the trade finance sector with its <u>guarantee program</u> that was started in 2005.
Cost Structure and Financing Plan:	The GTLP aims to mobilize USD 5 billion of resources from the Participants. This will be used to catalyze up to USD 50 billion of trade finance operations over 3 years, of which USD 15 billion will be targeted for Africa. Each Participant will each pay a one-off, upfront fee of USD 250,000, plus an annual administrative fee equal to 0.3% of committed amounts.
Role of the AfDB:	The Bank will make an initial investment of USD 500 million into the GTLP that will be used exclusively to finance trade in Africa.
Implementation Arrangements:	A Co-Investment and Administration Agreement will govern the implementation of the GTLP and all funds will be channeled through a master account that is administered by the IFC as Agent. The IFC will identify and appraise the banks that will qualify for the GTLP on behalf of the Participants.
Market:	The global financial crisis has precipitated a sharp slowdown in trade finance which is negatively affecting the real economies of developing countries. The estimated global funding gap for documentary trade is USD 100-300 billion p.a., of which as much as USD 90 billion is for Africa. The GTLP is a timely response to the crisis that will help to offset some of this slowdown by providing liquidity and sharing risks with banks actively involved in the trade finance sector.
Justifications for the Bank's Involvement:	
Strategic Alignment:	The promotion of trade and commerce underpins the development strategies of RMCs. The Bank's Trade Finance Initiative is a temporary strategy to respond to the request by Africa's finance ministers to address current market constraints. Therefore the GTLP aligns well with both RMC and Bank priorities.
Commercial Viability:	Trade finance is considered one of the lowest-risk asset classes with historical loss rates less than 0.1%. The IFC, which has a 0% loss rate in trade finance, has the experience and capacity to successfully take on the role of Agent on behalf of the Participants. The risk-adjusted returns of the GTLP are attractive.
Development Outcomes:	By providing liquidity and sharing risk with African financial institutions, the GTLP will facilitate Africa's exports and imports at a time when the global financial crisis is cutting off critical funding. The projected USD 15 billion of GTLP resources for African trade finance will support African economies and reduce job losses. The GTLP is expected to have a strong demonstration effect to catalyze African and international banks back into the trade finance sector.
Additionality and Complementarity:	An initial USD 500 million investment by the Bank will make it the GTLP's single-largest contributor to African trade finance. The Bank's presence in the transaction has also helped to increase the share of GTLP resources targeted for Africa. By using the IFC's trade finance platform to achieve economies of scale, the GTLP demonstrates strong complementarity among the Participants.
Processing Plan:	
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1. INTRODUCTION

1.1 The global financial crisis and the resultant high levels of uncertainty are severely constraining trade in Africa. Demand for exports has fallen, as have commodity prices, while the use of trade instruments, particularly letters of credit, has declined along with global trade volumes. At the same time, the price of credit has risen and banks have shortened the maximum tenors offered in line with their lower appetite for risk. Moreover, availability of import finance facilities is being sharply constrained by a lack of liquidity in international markets. Regional banks seeking to expand their servicing of other African commercial banks are finding that limited access to US Dollar liquidity constrains their ability to do so. Larger exporters have, in the past, been able to access the syndicated export finance markets. However, similar to the funded import finance market, the syndicated export finance market is currently constrained by lack of liquidity, fewer participants, and credit concerns. Furthermore, as commodity prices are falling, warehouse and asset-backed deals are less financeable due to increased collateral requirements and higher risk perceptions. Finally, as in the import markets, regulatory change and the impact of write-downs of other assets are increasing the cost of funding and constraining its overall availability.

1.2 In response to rapidly deteriorating conditions in the international trade finance markets, which triggered an urgent request for help from African Ministers of Finance,¹ the AfDB's Board of Directors approved on March 4, 2009 a proposal to extend up to USD 500 million in the form of lines of credit to African financial institutions to support their trade finance operations (TF LOC). This program for TF LOCs was presented as the first phase in the Bank's multi-part Trade Finance Initiative (TFI) of up to USD 1 billion. Since launching the new trade finance product, demand has risen quickly and the Bank is currently processing several facilities that will be presented for Board consideration in the second half of 2009.

1.3 In parallel with the deployment of the Bank's TF LOC program, several other programs under the umbrella of the TFI are being developed. In February 2009 the Bank launched a field study to better understand the constraints in the trade finance sector in all of the major Continental markets. It also began technical discussions with the International Finance Corporation (IFC) to participate in a joint initiative called the Global Trade Liquidity Program ("GTLP" or the "Program").² On April 14, the Bank hosted a roundtable meeting of Development Finance Institutions (DFIs) and commercial banks to discuss the state of Africa's trade finance markets and to assess the adequacy of the Bank's TF LOC and the proposed GTLP to address the constraints. In view of the positive reactions of participants to the TF LOC and the proposed GTLP, this appraisal report proposes the Bank's participation in the GTLP as the second phase of the TFI.

1.4 The report is organized in four parts. After the introduction, the second section provides a brief description of the key features of the GTLP and the market gap that it seeks to address. The third section analyzes the GTLP in terms of the Bank's four key selection criteria for private sector projects: (i) strategic alignment, (ii) commercial

¹ The Finance Ministers met in Tunis in November 2008 to discuss the effects of the crisis.

² On March 18, 2009 the Bank participated in meetings hosted by the WTO in Geneva to discuss the global trade finance market and crisis responses. On March 19, a technical team from the IFC came to Tunis to present the GTLP and discuss modalities with Bank staff.

viability, (iii) expected development outcomes, and (iv) the Bank's additionality and complementarity. The final section summarizes the primary conclusions and presents Management's recommendations. The results-based logframe matrix is presented as Annex 1. A summary of the key conclusions of the Bank's trade finance study is presented in Annex 2.

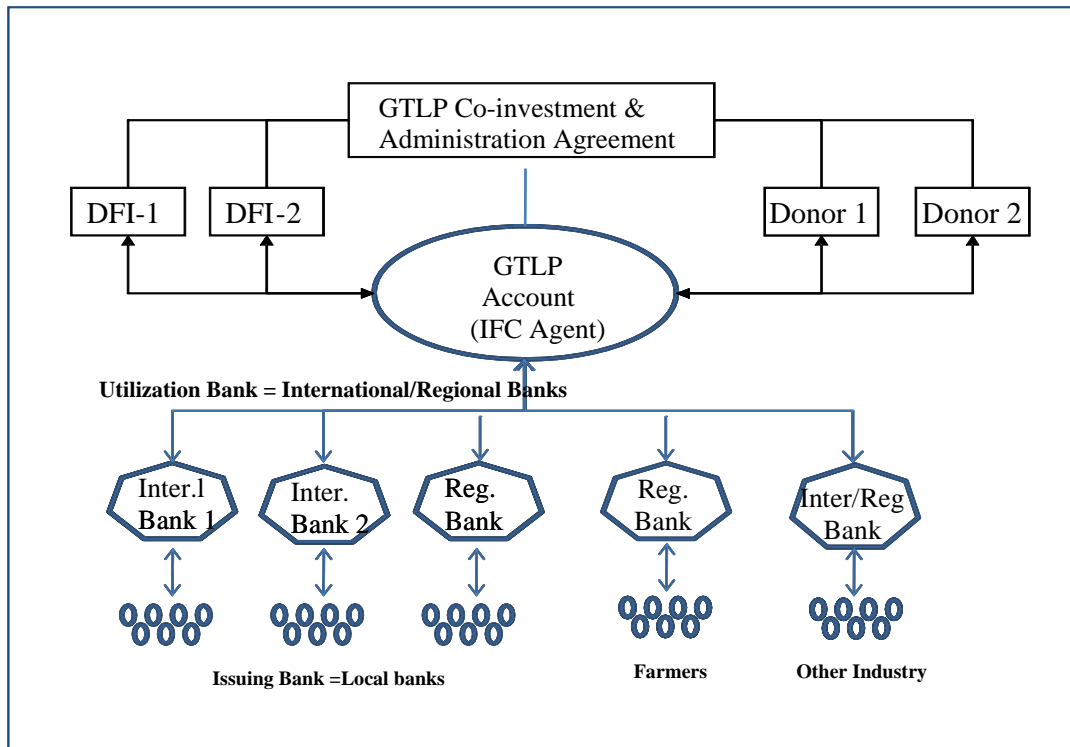
2. THE PROJECT

Description

2.1 The GTLP is a unique collaborative crisis response effort by DFIs and donor governments (collectively the "Participants") to quickly mobilize funding to support trade finance for the developing world in general and Africa in particular. Over the next few months, the GTLP aims to create a pool of USD 5 billion that will catalyze a total of USD 50 billion, of which up to USD 15 billion is expected to go to Africa. These resources will be used to address the funding constraints currently gripping the global trade finance markets. The GTLP is a temporary instrument and will be wound up when the crisis abates and trade finance markets sufficiently return to normal (possibly 3 years' time).

2.2 The general structure of the GTLP is illustrated in Figure 1 below. The Co-investment and Administration Agreement (CIAA) is the core agreement signed by all the Participants and jointly they contribute resources to the GTLP account, with the IFC acting as the Program Agent. GTLP resources are channeled through a number of qualifying international banks or regional banks in developing countries, which are active in the trade finance sector in the target markets ("Utilization Banks" or "UBs"). These resources are then on-lent to: (i) Issuing Banks (IBs) in developing countries that are originating trade finance transactions, or (ii) directly to the real sector in developing countries. Although the GTLP has a global mandate, through the CIAA each Participant will be able to specify the regional distribution of its own resources. In the event that the Allocation Requirements are not satisfied, the Utilization Bank will be required under the related Transaction Agreement to cease funding additional participated Funding Trade Investment Instruments (FTIIs) and thereafter remit all proceeds to the IFC.

Figure 1: Schematic Overview of the GTLP



2.3 In order to ensure maximum reach and leveraging of resources two complementary investment structures are envisioned under GTLP: (i) risk-sharing structure, (ii) direct line of credit (LOC) structure. In the risk-sharing structure, the GTLP will channel funding to the local IBs through 8-10 large international UBs, where funding and risk will be shared on a 40:60 basis (40% Participants; 60% UBs). This risk-sharing instrument will be GTLP's primary investment structure because it will leverage the capacity of the UBs to generate a large volume of high-quality trade receivables from IBs for the GTLP. The risk of default by the IBs and their underlying trade finance transactions will be borne pro-rata between the UBs and the Participants in the GTLP. The UBs and Participants will also share pro-rata the portfolio returns.

2.4 In the risk-sharing structure, the UBs will be required to invest AfDB funds in Africa-only transactions. This means that the Bank's return will only be affected by the performance of assets inside of Africa. Each UB will be required to monitor the amounts disbursed to ensure that the allocation requirements of the Participants are satisfied, otherwise the UB will be required to cease funding new FTIIs and thereafter remit all proceeds (including principal and interest) to the IFC for allocation to the Participants.

2.5 In the second structure, the GTLP will provide dedicated short-term lines of credit (LOCs) for trade directly to smaller regional UBs without a risk-sharing scheme. This second instrument complements the risk-sharing structure by extending the Program's reach, using Africa's larger regional banks to enhance access to smaller local banks and other players involved in trade finance. The tenor of these LOCs will typically be 2 years, with the possibility of multiple 1-year extensions based on performance and the duration of the crisis. For each qualifying UB under the direct

short-term LOC scheme, the Participants will share pro-rata the risk of default of the UB but will not be directly exposed to the underlying trade transactions originated by the UB.

2.6 The GTLP structure is designed to benefit stakeholders in low-income as well as middle-income countries at all levels of the trade finance value chain. For the SMEs, traders, and IBs in developing markets, the compelling benefit is increased access to liquidity at a reasonable cost to support trade finance operations during the crisis. For the UBs, the major advantages are enhanced access to stable funding and origination fees, coupled with the lower operational cost of directly dealing with one single agent institution. For the Participants, the numerous benefits of the GTLP include: (i) increased deal flow through expanded origination capacity, (ii) access to IFC's due diligence, structuring skills, and global presence, (iii) efficiency in terms of time and costs; and (iv) diversification through risk-sharing among the Participants.³

Sponsor

2.7 The IFC, the private sector arm of the World Bank Group, is the sponsor of the GTLP. The book value of IFC's total shareholders' funds is approximately USD 18 billion and its total portfolio of assets in emerging markets is USD 21 billion, of which approximately 12% is in Africa. In FY2008, the IFC originated USD 12 billion of new operations.

2.8 Although the IFC has traditionally been a long-term financier, since 2005 it has gained good experience in the trade finance sector with its flagship program called the Global Trade Finance Program (GTFP). The GTFP is a USD 3 billion guarantee program that extends and complements the capacity of banks to deliver trade financing in emerging markets. The GTFP offers international confirming banks partial or full guarantees covering payment risk on issuing banks in the emerging markets. Currently, the IFC covers the risk of 143 banks with approved trade lines located across 68 emerging market countries. Since the inception of the GTFP in September 2005, cumulative guarantee volume has reached USD 3.9 billion, of which the Africa region represents USD 1.6 billion (41% of global operations). Reflecting the strong demand for trade finance products, the GTFP commitments represent the single largest contributor to IFC's overall Sub-Saharan African commitments. Furthermore, IFC has found that its trade finance products are strongly aligned to its development objectives. Since inception, 75% of GTFP's transaction volume has been in support of SMEs; 53% in low-income countries; 34% supporting south-south trade, and 28% in support of agriculture.

2.9 Despite the past success of the GTFP, the IFC has observed that somewhat counter-intuitively, the global financial crisis has actually weakened demand for this unfunded trade finance product. Closer examination has revealed that liquidity constraints caused by the global crisis have squeezed out many financiers from the trade finance market. These financiers may have the appetite for the low-credit risks that are typical of the trade finance sector but they cannot access adequate liquidity at a reasonable cost. It is in this context that the IFC and other DFIs determined that a funded product such as the GTLP would be required to complement the GTFP as a temporary crisis response facility.

³ Note, however, that IFC's privileges and immunities will not be extended to the Program Participants.

Cost Structure and Financing Plan

2.10 *Sources of Funding* Over the next few months, the GTLP aims to mobilize a total of USD 5 billion of funding from the Participants. In recognition of the different approval procedures of each Participant, these resources will be mobilized in 3 phases: (i) USD 2.5 billion by June 2009, (ii) USD 1.6 billion by July 2009, and (iii) the remaining USD 900 million from other Participants by August 2009.

2.11 In its role as sponsor for the GTLP, the IFC has spearheaded resource mobilization efforts. As shown in Table 1 below, a combination of firm and tentative commitments from prospective Participants provides a strong indication of support for the Program; discussions with other regional Participants such as the Inter-American Development Bank (IADB), the Islamic Development Bank (IsDB) and the Asian Development Bank (AsDB) are underway.⁴ Although USD 5 billion is the funding objective, failure to reach this target would not jeopardize the viability of the overall Program but would lessen its potential impact.

Table 1: Prospective Participants and their Funding Commitments

(USD Millions)

Participant	Amount	Share
International Finance Corporation	1,000	20%
Commonwealth Development Corporation	450	9%
Canada	200	4%
Andean Development Corporation (CAF)	100	2%
Netherlands MOFA	50	1%
African Development Bank	500	10%
European Investment Bank (outside Europe)	250	5%
Proparco	200	4%
OPEC Fund for International Development	100	2%
Others	1,950	39%
Korea	200	4%
Total	5,000	100%
Japan Bank for International Cooperation*	1,500	

* Through parallel co-financing

2.12 The GTLP seeks to leverage the Participants' resources through the 40:60 risk-sharing arrangement with UBs. Through this mechanism, the USD 5 billion from the GTLP can catalyze combined direct financing of USD 12.5 billion. This can be further leveraged by redeploying these resources as soon as the original trade finance transactions mature. Assuming that the USD 12.5 billion of combined GTLP resources can be redeployed 4 times over the 3-year projected life of the Program, the total funding generated by the Program could reach USD 50 billion.

2.13 *Uses of Funding* The IFC has estimated an indicative geographical distribution of GTLP resources based on demand and the expressed regional interests of

⁴ The IADB, IsDB and AsDB already have trade facilitation programs. IsDB and AsDB are considering the possibility of participating in the GTLP as Utilization Banks under the risk sharing scheme. In this structure they would originate trade receivables with local Issuing Banks and share 40% of the risk with the GTLP, retaining 60% for their own accounts.

Participants. As shown in Table 2 below, Africa (including North Africa) is expected to receive the largest share of Program resources, representing approximately one-third of the total USD 50 billion catalyzed through the GTLP.

Table 2: Indicative Distribution of GTLP Resources
(USD Millions)

Region	GTLP	With Leverage	With Redeployment	Share
Africa (including North Africa)	1,611	4,028	16,111	32%
Latin America	1,556	3,889	15,556	31%
Asia	744	1,861	7,444	15%
Eastern Europe	767	1,917	7,667	15%
Middle East (excluding North Africa)	322	805	3,222	6%
Total	5,000	12,500	50,000	100%

The Bank's Role

2.14 There are two primary aspects to Bank's role in the GTLP: financial and operational.

2.15 **Financial** As the key African regional Participant, the Bank proposes to initially invest up to USD 500 million under the GTLP to promote trade in Africa. Although the GTLP is a global platform for trade finance, the Bank's contribution will be used exclusively to finance eligible pools of African trade operations (trade operations originating, terminating, or both in an African country). The Bank's contribution would make it the single largest contributor to GTLP operations in Africa (IFC has earmarked at least 25% of its USD 1 billion contribution for Africa). Even though the direct line of credit structure under the GTLP is similar to the Bank's own TF LOC product under the phase 1 of the Trade Finance Initiative, both programs will be managed separately. Lines of credit issued under the GTLP will not count against the USD 500 million initial program ceiling established for phase 1 of the TFI. The combined ceiling for phase 1 and 2 of the TFI would be USD 1 billion.

2.16 **Operational** The GTLP's operational modalities are similar to a risk-sharing agency line of credit (RSAL).⁵ Under the GTLP, the Bank and other Participants will delegate specified operational decision-making powers to the Agent – in this case the IFC. However, even though the IFC will be responsible for most of the operational aspects of the GTLP on behalf of the Participants, the Bank will still play an operational role by endorsing the UBs that will access the Program at entry. The Bank will also monitor the activities of the IFC as Agent to ensure compliance with the terms and conditions specified in the GTLP agreements. If after the one-year interim review period, the IFC fails to propose qualifying UB Trade Facilities to the Bank (in

⁵ **Lesson Learned** – In 2005 the Board approved the Bank's first risk-sharing agency line of credit (RSAL) with Nedbank of South Africa. This prototype facility took an extended period to structure, missed the market opportunity, and was subsequently canceled. Although the Bank has gained useful internal experience from the Nedbank operation, it does highlight the importance of rapid implementation to ensure relevance, particularly for an operation that aims to address temporary constraints.

accordance with the CIAA) and as a result there are undisbursed amounts outstanding, then the Bank reserves the right to cancel such undisbursed amounts, without affecting amounts that have been committed.

Implementation Arrangements

2.17 ***Funded Trade Investment Instruments (FTIIs)*** To be eligible for funding under GTLP, the underlying trade instruments must meet the following criteria:

- ***Type*** (i) Negotiation/purchase or discount of documentary presentations by the UB under deferred payment letters of credit issued by IBs; (ii) Extensions of credit to IBs to refinance obligations in respect of sight letters of credits issued by such IBs; (iii) Reimbursements under letters of credit issued by the IBs that create a deferred payment obligation of the IB to the UB; (iv) Purchase/discount of drafts/ bills of exchange or promissory notes issued by or accepted by IBs; and (v) Bankers' Acceptances funded or guaranteed by the bank.
- ***Features*** (i) Stated to be payable or reimbursable by the relevant IB on a date not less than 90 days but not more than 360 days following the date of booking; (ii) documented in accordance with International Chamber of Commerce guidelines known as the Uniform Customs and Practices 600 or the International Standby Practices 98 or revisions thereof; (iii) expressed in U.S. Dollars and to be in respect of a face amount not more than USD 5 million; (iv) not issued in relation to an excluded transaction identified in the syndicated participation agreement and agreed with the UB and the Participants, in each case as amended from time to time by written notice from the Agent; (v) originated in accordance with the UB's policies and procedures as if such FTII were being held 100% for the UB's own account; and (vi) the UB will represent to the Participants that all FTIIs in the portfolio meet the eligibility criteria. The Participants reserve the right to require the UB to remove/replace FTIIs that do not meet the eligibility criteria.

2.18 ***Legal Framework*** The principal legal document that will underpin the GTLP is the Co-investment and Administration Agreement (CIAA). The CIAA, which is in respect of participations and loans relating to Trade and Investment Instruments, will be signed by all Participants (including IFC both as Participant and Agent).⁶ Its main provisions comprise the following:

- Conditions and procedures for funding by each Participant of its pro-rata portion; payment of each Participant's portion of principal, interest and fees; rights of each Participant
- Regional allocation requirements of Participants
- Criteria and guidelines to select the UBs
- Role and duties of IFC as Agent for the Participants

⁶ UBs will not be party to the CIAA.

- Establishment of a GTLP master account (for all cash flows) to be administered by an approved processing bank, and
- Required information to be provided, including the Information Memorandum for each UB, to Participants for their review and approval.

2.19 In addition to the CIAA, there will a Risk Participation Agreement that will be entered into between all Participants and each approved UB. It will incorporate provisions relating to the participations and administration by the Bank of each FTII, i.e. waivers, amendments, conditions of disbursement, covenants, events of default and other standard terms and conditions for transactions of this nature.

2.20 ***Role of the Agent*** As Sponsor, the IFC will also act as Agent on behalf of all GTLP Participants. In this role, the IFC will be responsible for a number of functions:

- ***Utilization Banks*** The IFC will appraise and propose the UBs for the Program, including the maximum facility size for each UB. Each UB will need to meet the following criteria: (i) to be financially and operationally sound with a public credit rating or a rating of 4 or better on IFC's internal risk scale; (ii) to be a client in good standing of the IFC for the immediately preceding 3 years; (iii) to be a majority, privately owned entity located in an IFC member country (an AfDB member country for AfDB's resources), (iv) to have an existing wide reach in trade finance in the target geographical markets, and(v) to have a predicted high utilization. IFC will conduct full due diligence on each prospective UB and present a comprehensive report in the form of an Information Memorandum to each Participant for review and approval.
- For each qualifying UB under the risk-sharing structure, the IFC will prepare a separate UB Trade Facility Agreement, whereby the Participants will collectively share the risk of the underlying portfolio of funded trade finance transactions on a pro-rata basis by purchasing up to 40% of eligible pools of newly generated trade receivables from the UBs. Each agreement will stipulate, among other things, the level of Participant funding; eligibility criteria; a list of pre-approved Issuing Banks and their limits; and regional distribution to meet the Participants' requirements. For each UB qualifying under the direct line of credit structure, the IFC will prepare a specific loan agreement between the UB and the Participant. The primary financial terms will mirror the terms of the agreement between the UB and the IFC.
- Each agreement with each of the UBs will specify that the underlying goods to the transactions supported by the GTLP will meet the requirements of the IFC's Exclusion List, and will require the UB to report on implementation. In addition, for projects that follow the risk-sharing model, each trade pool will be supported by underlying documentation and the IFC will have the right to review the details of the underlying trade transactions. As part of IFC's appraisal, there will be verification that each UB has a process and system in place that can screen and check all transactions in connection with IFC's Exclusion List.

- ***Issuing Banks*** The IFC will review and approve IBs for participation in the GTLP based on proposals from each qualifying UB. Each IB will be required to: (i) have a public or internal IFC rating of 4 or better; (ii) be a client in good standing of the UB for the immediately preceding 3 years and for which the IFC does not have knowledge of any adverse information; (iii) not be on the IFC's watch-list for credit risk monitoring; and (iv) be located in an IFC member country (an AfDB member country for AfDB's resources). IFC will inform each Participant of the proposed IBs and Participants will have the option to eliminate the IB from the UB list. The exposure limits for each IB will be determined by the IFC in accordance with its risk and exposure management policy but Participants will have the right to impose additional exposure limits on IBs.
- ***Monitoring and Reporting*** The IFC will oversee the implementation of the Program and take corrective actions as necessary. It will issue comprehensive semi-annual reports on all trade finance operations under the direct lines of credit structure and quarterly reports on all activities under the risk-sharing structure. Each Participant will also receive an annual report summarizing the utilization effectiveness of the Program including sectors, regions, countries, etc.

2.21 *Role of the AfDB's Board of Directors* The Bank's Board of Directors will delegate to Management the authority to approve (i) the UBs and IBs eligible for the Bank's resources under the risk-sharing facility and their exposure limits, and (ii) each of the lines of credit to local banks with regional coverage. Decisions on UBs and IBs will be made by the Operations Committee based on the documentation prepared by the IFC and submitted to the Committee by the project team led by the Private Sector Department (OPSM). Whenever a new UB is approved by the Operations Committee, OPSM will submit an Information Note to the Board indicating the new UB and its exposure limit. OPSM will also submit an annual report on the implementation of the Program to the Board of Directors, for information. The Bank's exposures through the GTLP will be reported independently in the annual portfolio credit risk review by FFMA.

2.22 *Disbursement and Repayment* As Agent, the IFC will make pro-rata disbursement requests on all Participants to match the pace of implementation of GTLP programs. Full deployment is expected within 9-12 months. The IFC has already approved 4 UBs for the Program: (i) Standard Chartered Bank, Rabobank, Citibank and Commerzbank as UBs under the risk-sharing structure,⁷ (ii) Standard Bank of South Africa as a UB under the direct line of credit structure⁸. IFC is currently assessing IsDB as a potential UB under the GTLP risk-sharing structure and Banque Marocaine du Commerce Extérieur (BMCE) under the direct line of credit structure. During the life of the GTLP, UBs are expected to redeploy the proceeds of maturing trade finance transactions into new operations. Therefore capital will normally only be returned to

⁷ Standard Chartered Bank is eligible for up to USD 500 million of funding under the Program, Rabobank is up to USD 500 million, Commerzbank is up to USD 500 million and Citibank is eligible for an amount yet to be determined.

⁸ Standard Bank has been approved for up to USD 400 million of funding under the Program. IFC will contribute USD 100 million from its own resources toward the USD 400 million target funding for Standard Bank.

Participants upon the termination of the Program or if, for whatever reason, the IFC acting as Agent fails to propose qualifying UB Trade Facilities to the Bank, then the consequent undisbursed amounts outstanding can be canceled by the Bank. The Agent will always seek to minimize the level of funds in the GTLP account.

2.23 Pricing For the risk-sharing structure, the pricing of the underlying trade finance transactions will be determined by the originating UB. The IFC will monitor UB pricing with floors and caps to ensure pricing is consistent with market practices and is neither usurious nor unfairly under-cutting other players. All Participants will receive returns based on the weighted average yield of their allocated portion of each UB's portfolio. For the Bank, this return will reflect the weighted average of the African portfolios. For the direct line of credit structure, the IFC will negotiate the pricing (all fees and interest charges) on behalf of the Participants and all Participants will receive the same rate of return.

2.24 Fees All Participants will pay a one-time, upfront fee of USD 250,000 to the IFC to offset the costs of establishing the Program. Participants will also pay an annual administrative fee equal to 0.30% of committed amounts to defray the IFC's cost of structuring, due diligence and administering the Program.⁹

2.25 Taxes The trade transactions originated by UBs will be subject to normal taxation in their respective jurisdictions. Participants may, however, be subject to tax based on their tax status. It should be borne in mind that the Bank, its operations and transactions, are exempt from all taxation.

2.26 Exit Mechanism The GTLP is a temporary, crisis-response initiative and is therefore designed to wind down at the end of the financial crisis. As it was the case in previous international crises such as in Korea or Argentina, rapid intervention is critical for signaling purposes, but the need typically dissipates 1-2 years from the onset of the crisis. The GTLP will therefore rely on flexible infrastructure (and outsource when possible) to be able to cease operations once the markets have normalized and demand for its products is no longer sufficient to justify continuation of the Program. Although the Program is expected to operate for a few years at most, Participants may withdraw from the Program 2 years after the commitment date of the last UB transaction agreement and the Agent will return funds as the Participant's investments are redeemed at maturity. Participants may recover the undisbursed amounts of their funds, as mentioned in para. 2.17.

The Market

2.27 The Global Picture One of the first consequences of the global financial crisis has been the apparent drying up of liquidity in international markets. This has restricted the ability of banks to offer, inter alia, trade finance in emerging markets due to reduced appetite for risk and tighter liquidity management.

2.28 According to an IMF survey¹⁰ of major global banks, the cost of trade finance has increased despite less restrictive monetary policies in many countries. The survey indicates also that the fall in trade is faster than expected, confirming widespread

⁹ These fees have been calculated to cover the IFC's incremental costs of managing the GTLP.

¹⁰ IMF with BAFT, *Survey of Private Sector Trade Credit Developments*, February 27, 2009.

anecdotal evidence that the cost of trade finance has risen rapidly while its availability has fallen. Such a gap in trade finance could be as much as USD 300 billion, according to a World Bank estimate in March 2009.

2.29 One of the headline commitments in the G20 communiqué from its meeting in London on April 2, 2009 concerned the urgency of the development community to bolster trade finance. The communiqué identified the withdrawal of trade credit as a key reason for the dramatic drop in world trade and promised "at least USD 250 billion over the next two years to support trade finance." This liquidity infusion is designed to lessen the impact of the financial and economic crisis on world trade and thus reduce the extent to which poor nations in particular are affected.

2.30 However, despite mounting political commitment to address the apparent trade finance shortages, its role in the collapse of world trade is still being debated by economists. While specific and firm data are difficult to locate, empirical evidence such as the drop in commodity exports from Africa due to liquidity constraints among international bank syndicates, indicate the severity of the problem.

2.31 *The African Context* The trade finance situation in Africa is deteriorating rapidly; however, the necessary data that would shed light on the extent and causes of the crisis are generally fragmented and inaccessible. A key problem is that trade volumes are falling so fast. The AfDB has indicated in its forecasts that African exports will fall by USD 250 billion in 2009, or almost 45% from its pre-crisis levels. Consequently, it has proven hard to demonstrate the proportions of the trade finance supply-side and/or demand-side impact for the falling trade volumes. Therefore analyses must rely largely on empirical perceptions. Further, African markets are facing a diverse range of constraints commensurate with their levels of financial sector development and integration in world markets, which renders generalized conclusions difficult.

2.32 It is clear that trade values in Africa are falling due to a variety of factors. For example, recession in advanced economies and slower growth in China have reduced demand for African resource exports. At the same time, the deflating of the commodity price bubble over the past several years has resulted in falling import values for foodstuffs. Volumes are falling as well; financial institutions around the continent report that their clients had imported heavily to protect themselves against further price increases and are now liquidating these inventories. In several markets, political events have slowed government spending, further reducing imports.

2.33 The impact of the global crisis on African exporters is highly differentiated – by region, by sector, and by type of firm. A study carried out by J. Humphrey of the Institute of Development Studies in March 2009 shows that Sub-Saharan Africa appears to have been less affected, so far, by trade finance problems than other regions. The study indicates also that restrictions on credit in the domestic African market are hitting small traders and cooperatives that do not have the business linkages needed to access inter-company credit; furthermore, to the extent that there is some credit rationing, the marginal firms are hit first. Finally the study shows that the African exporters interviewed were clearly affected by other issues arising from the global financial crisis, particularly declining demand for garments and exchange-rate volatility for horticulture exporters targeting the UK market.

2.34 The Bank's recently commissioned study¹¹ on key trade finance constraints in Africa indicates that the use of trade finance instruments is falling. One multinational bank reports that the number of trade instrument transactions processed declined by 50% in east Africa in Q4 2008 compared with a year earlier. This bank felt that "most of the difference" can be attributed to greater use of open account transactions, rather than a fall in demand.

2.35 In some markets, however, Central Banks, seeking to restrain capital flight, are requiring that all transfers be justified by trade instruments. The Central Banks of Nigeria and Egypt, among others, are currently only transferring funds that are backed by a bona fide trade instrument.

2.36 At the same time, market conditions for trade instruments are changing. Financial institutions in Kenya and Ghana report a 50% increase in the cost of LC confirmation, those in Senegal and South Africa report increases of "at least" 25%, while banks in Nigeria say prices have increased "significantly." Further, financial institutions report that available tenors are significantly shorter. They point out that most top-tier financial institutions across the continent had access to up to 360-day confirmation lines throughout 2008, whereas presently tenors are no longer available for more than 180 days. Most banks report that this does not inhibit their operations, as the bulk of their client transactions are less than 180 days. From the foregoing it becomes clear that the reasons for the decline in trade in Africa are many and diverse.

2.37 The market for funded transactions is significantly more difficult. Financial institutions in Nigeria, South Africa, and Egypt all report that funded import lines are quasi-unavailable due to USD liquidity constraints. One large Nigerian bank reported that line availability has shrunk by 70% in the past 6 months, seriously impacting their ability to serve their clients. One medium-sized South African bank reported that their only funded import line from a large regional bank had just been canceled. Global and regional banks that have been major players in this market indicate that they have no interest in funded transactions at this time. One global bank said it would consider 90-day funded transactions on a case by case basis but only for its best clients. One Kenyan bank indicated that the number of funded transactions was 10% of what it had been in the past and that prices for USD facilities had doubled, despite the fact that Kenya was "a better risk now." The African Trade Insurance Organization (ATI), so far mainly operating in Eastern Africa from its base in Kenya, indicated that a general re-assessment of risks – caused as much by the financial crisis as by the slowing down of the world economy – is harming Africa's trade.

2.38 Globally the export finance syndications market has declined rapidly, and the situation in Africa is no different. From 2006 to 2008, 164 non-African financial institutions participated in USD/EUR African deals. Coffee, cocoa, tobacco, palm oil and cotton are the primary commodities that are financed via international export syndications. The case of COCOBOD, Ghana's cocoa export organization, serves as a useful "borrower of reference" as it has a long track record and borrows large amounts. The export of the 2009 harvest is now endangered by the difficulties the long-time syndicate leader is facing to raise the required funding, primarily due to liquidity constraints by traditional syndicate members.

¹¹ *A Diagnostic Study on Trade Finance Constraints in Africa*, M. Grossman, May 2009.

2.39 Manufacturing exporters generally operate on open-account or long-term contractual arrangements. Volumes are likely to fall due to weak demand in Europe. Furthermore, the crisis may also have implications for the viability of manufacturing supply chains and outsourcing that have driven globalization in recent decades (via AGOA and EU-ACP Agreements). Insofar as global production fragmentation was conditional on cheap finance and ample liquidity, a reversion to a period in which trade finance is more expensive may result in a geographic restructuring of production chains and greater vertical integration within large firms.

2.40 In conclusion, Africa is not immune to global trends and as the crisis spreads, the ability to meet the demand for trade finance may become increasingly challenging. At the same time, the cost of failing to anticipate severe shortage of trade finance in general – particularly short-term trade finance – could have drastic implications for exporters and importers in Africa. Consequently, while the impact of the global crisis on African exporters and importers varies among regions and countries as well as in type and form, what emerges as a common denominator, in parallel with the multitude of other contributing factors, is the *lack of liquidity*. Therefore, bolstering liquidity through a wholesale mechanism like GTLP would seem to constitute an effective means of alleviating the impact of the crisis in Africa.

3. JUSTIFICATIONS FOR THE BANK'S INVOLVEMENT

Analysis of Strategic Alignment

3.1 *Country and Regional Priorities* The promotion of commerce and trade is one of the fundamental priorities underpinning the development strategies of Africa's regional member countries. During their November 2008 meeting in Tunis, Africa's Ministers of Finance lamented the sharp slowdown in trade and the rapidly diminishing availability of reasonably priced commercial financing for trade. They exhorted the Bank and other development partners to step up their engagement in the trade finance markets to help to alleviate the constraints resulting from the global financial crisis. This same message was reiterated in the communiqué from the Group of 10 established by the Ministers to address the effects of the global financial crisis. The GTLP is a direct response to this call for help.

3.2 *AfDB Priorities* On January 21, 2009, Executive Directors met to discuss the Bank's crisis response plans. During this meeting the Board endorsed the proposal for the Bank to establish a Trade Finance Initiative (TFI) as part of a broader package of crisis response initiatives. On March 3, 2009 the Board approved a proposal to offer lines of credit to African financial institutions engaged in trade finance as the first phase of the TFI. As the second phase of the TFI, the proposed contribution to the GTLP is perfectly aligned with the Bank's strategic priorities for timely responsiveness to the crisis in general and trade finance in specific.

3.3 *Private Sector Operational Priorities* The GTLP will quickly and temporarily boost the size of the Bank's portfolio and is therefore consistent with the Bank's 3-year business plan for expanding its private sector operations. It will provide financing to African financial institutions and will thus support the Bank's objective to channel 30-40% of its new operations through the financial sector. As a risk-sharing agency facility, the GTLP aligns with the Bank's PSO strategy to leverage the

comparative advantage of partner institutions to expand reach while remaining within the Bank's own risk tolerance.

Analysis of Commercial Viability

3.4 As a risk-sharing agency facility, the commercial viability of the GTLP must be assessed at two levels: (i) the risks of the underlying transactions in the GTLP and (ii) the risk associated with relying on the IFC as the Program Agent.

3.5 ***Risk Profile of Trade Finance*** As a general rule, trade finance is considered to be one of the lowest risk forms of international finance.¹² The transactions eligible for financing under the GTLP comprise a set of instruments that have been extensively tried and tested over many years by trade finance practitioners. These instruments are short-term (up to 270 days), self-liquidating (repaid by the funds received from the buyer in the underlying transaction), and secured by the trade receivables underlying the transaction. The financial institutions engaged in trade finance, including African UBs and IBs, have numerous cross-exposures through multiple instruments and transactions and therefore actively monitor each other. As a result, the reported loss rates in trade finance are generally less than 0.1%,¹³ which is consistent with the expected loss rates of very low-risk assets on the Bank's internal risk rating scale. The robustness of trade finance as an asset class is further reinforced by the fact that there has been no reported increase in trade finance loss rates during the financial crisis.

3.6 ***IFC as GTLP Agent*** Participants in the GTLP will rely on the services of the IFC as the Program Agent. In this role, one of IFC's initial responsibilities will be to appraise the Utilization Banks proposed for the GTLP (and their Issuing Banks for the risk-sharing structure). The IFC will prepare an Information Memorandum on each of the recommended UBs, which will serve as the basis for each Participant to approve the UBs. With 143 banks worldwide in its Global Trade Finance Program, the IFC has already evaluated a significant portion of the institutions that are expected to be eligible under the GTLP (either as UBs or IBs) and is currently assessing a number of other banks for future GTLP eligibility. Normally, only banks that are rated 4 or better on IFC's internal risk scale will be considered for the GTLP and the IFC's risk analysis on UBs and IBs will be made available to all Participants¹⁴.

3.7 Over the years, the Bank has participated in a number of joint appraisals of African financial institutions with the IFC (e.g. Nedbank for a subordinated debt facility in 2007), and the IFC's capacity to evaluate financial institutions is considered fully satisfactory. IFC's due diligence process comprehensively covers all commercial risks as well as in-depth integrity assessments of the institutions and their primary shareholders. IFC's anti-terrorism and anti-money laundering policies are considered to be among the strongest in the industry and its environmental and social management

¹² Given the low risk profile of trade finance, the departure of commercial banks from the sector appears counter-intuitive. Closer examination reveals that many of the banks that appear to have left the sector have done so temporarily because they have been forced to retreat to their domestic markets and are struggling to mobilize liquidity for other core businesses.

¹³ Afreximbank, which provides trade finance exclusively in Africa, reported non-performing loans at less than 1% at the end of 2008.

¹⁴ The IFC's rating of 4 is considered comparable to 4 - 5 on the Bank's internal scale.

policies (which conform to the Equator Principles) are considered by many as the industry standard.

3.8 Although IFC's capacity to select and monitor qualifying UBs and IBs is considered fully satisfactory, Participants will have the right to eliminate a UB or IB from the Program.¹⁵ For the Bank, decisions on adding new UBs or eliminating them will be taken by the Operations Committee, based on the recommendations of the project team led by Private Sector Department. This modality is consistent with the procedures agreed for the Bank's previous RSAL with Nedbank and provides adequate oversight to ensure that the Bank takes responsible decisions. The risk of a UB bankruptcy is further mitigated by structuring the risk-sharing participations under the GTLP as true-sale transactions, so that in the event of insolvency of a UB, Participants can pursue claims on the underlying trade instruments against the IBs. Moreover, the financial interests of the UBs are well aligned with interests of the Participants through the Program's prescribed risk-sharing requirements. The Bank can take comfort in the fact that the IFC will always have exposures to the same UBs and IBs and will therefore have a strong interest to maintain the highest fiduciary standards as Program Agent¹⁶.

3.9 Participants in the GTLP will also depend on the IFC's operational capacity to implement the Program. Over the past 5 years the IFC has built a dedicated team of 35 staff for trade finance that is deployed globally and is expanding rapidly.¹⁷ It has developed procedures and systems to deliver a trade finance program that now exceeds 1,000 operations annually and is being scaled up and reinforced to meet the requirements of the GTLP. *It is notable that with over 2,500 trade finance operations completed, the IFC has never suffered a financial loss from a trade finance transaction.* Overall, the IFC is considered well qualified for its role as Program Agent.

3.10 Furthermore, operational and non-commercial risk is perceived as minimal because of the relatively large number of transactions and small amounts involved. According to the IFC, the reported loss rates in trade finance are generally less than 0.1%, with IFC at 0%; EBRD at 0%; and both Citi and SCB at less than 0.1%.

3.11 ***Exposure Limits*** As the GTLP Agent, IFC will set and monitor exposure limits for each UB and IB in the Program. This will be done in accordance with IFC's internal credit risk and exposure management policy.¹⁸ As a general rule, the Bank's aggregate exposure to any single African IB or UB (exposures through the GTLP plus any other direct exposures by the Bank) will not exceed the limits set under the Bank's nonsovereign exposure limits. The limit for single obligor will be determined upon clearance and approval of the UBs and IBs. For monitoring purposes, each quarter, the IFC will provide a comprehensive report of all transactions under the Program, which will enable the Bank to independently monitor compliance with its internal exposure

¹⁵ Each Participant will determine the UBs eligible for its own resources and eliminate at the onset any IB that fails to meet its eligibility criteria.

¹⁶ To avoid any potential conflict of interest, the IFC will be requested to disclose all existing relationships with any of the proposed UBs.

¹⁷ Seven dedicated trade finance staff are currently deployed in IFC's African offices.

¹⁸ Given the low risk nature of trade finance operations, the IFC's capital adequacy policy prescribes a risk capital requirement of 12% for trade finance, compared to more than double for term finance transactions.

limits.¹⁹ The Bank will have the right to instruct the IFC to drop or reduce the Bank's exposures to any IB at the onset. To facilitate monitoring of the risk profile of its exposure to the GTLP portfolio, the Bank will also have access to IFC's internal risk ratings to supplement its own credit ratings.

3.12 *Cost-Benefit* Under the risk-sharing structure, the Bank's return on investment will reflect the weighted average returns on the portfolio of underlying African trade transactions. These underlying transactions will be priced in line with market conditions by the UBs and are expected to provide a gross average return to Participants of 2-3% over LIBOR for the 2-3-year lifespan of the Program.²⁰ For the direct line of credit structure, the Bank's return on investment will reflect the full fees and margins for each facility. Given current conditions, the direct line of credit structure is expected to provide an overall return of 2-4% over LIBOR for Participants.

3.13 Given these projected interest margins, on a total outstanding portfolio of USD 500 million, the GTLP is expected to generate net revenues of about USD 10-15 million per annum for the Bank. The annual cost of running the program (including all fees and internal costs) is estimated around USD 1.5-2 million. Therefore, in view of the low risk profile of the trade finance sector and the UBs in the Program, the GTLP is expected to generate a comfortable risk-adjusted return for the Bank and other Participants.

3.14 *Legal Compliance* The IFC and Bank staff have worked together to adjust the legal and operational structure of the GTLP to ensure compliance in respect to the Bank's regional mandate. Under the Program, the Bank will only approve UBs that commit to financing African trade and the Bank's portfolio will be limited to trade transactions originated by UBs that comply with the Bank's regional mandate.

3.15 In accordance with the Agreement establishing the Bank, the AfDB shall not waive its immunities and privileges²¹. No provision of the CIAA in any way constitutes or implies a waiver, termination or modification by the AfDB of any privilege, immunity or exemption granted in the Articles of Agreement establishing the Bank. The AfDB's operations and transactions are exempt from taxation. This will apply to all transactions under the GTLP where the AfDB shall be exempt from paying, withholding or collection of any tax or duty.

Analysis of Expected Development Outcomes

3.16 *Effects on Economic Performance* Commerce and trade constitute the bedrock of sustainable economic growth and development. By helping to reduce the constraints on Africa's access to trade finance, the GTLP will play an important role in mitigating the negative effects of the global crisis on Africa's growth prospects. With more than 30% of the GTLP financing directed toward Africa, the Program is expected to catalyze about USD 15 billion of trade on the Continent over 3 years. This potentially represents an estimated 10% of African documented trade.

¹⁹ Under the risk-sharing structure, all exposures will be reported by IB. Under the direct line of credit structure, the Bank's exposure is to the UB itself.

²⁰ Assuming loss rates for the GTLP track historical loss rates of < 0.1% that are typical for trade finance.

²¹ The IFC has agreed to waive its immunities and privileges.

3.17 *Effects on Governments* African governments will benefit from the GTLP in two primary ways. First, because of the reduced level of commercial financing, many African governments have been forced to intervene directly to support trade activities. This has put additional pressure on scarce foreign exchange resources. The GTLP will bring new foreign financing, which will reduce the need for government intervention and allow scarce resources to be redirected to other key areas, such as social reform programs. Second, trade activities have traditionally been an important source of tax revenues for governments. By supporting trade, the GTLP will support African government budgets that have suffered because of the crisis.

3.18 *Gender and Social Effects* By limiting the average size of transactions financed under the Program to less than USD 1 million, GTLP support will be largely focused on SME-related trade activities. Because SMEs are the largest generators of employment in economies, the GTLP is expected to provide much-needed support to reduce the loss of jobs as a result of the global financial crisis.

3.19 *Environmental Effects* In accordance with the Bank's Environmental and Social Assessment Procedures, the GTLP is classified as Category 3 since activities related to trade financing do not have direct environmental and social impacts. Each agreement between IFC, as administrator of the funds, and the UBs will specify that the underlying goods to the transactions supported by IFC, will meet the requirements of IFC Exclusion List, and require the Bank to report on implementation. In addition, for projects that follow the risk sharing model, each trade pool will be supported by underlying documentation and IFC will have the right to review the details of the underlying trade transactions. Based on the above, the ESAP requirements are fully met.

3.20 As part of its appraisal, the IFC will ensure that the environmental policies of all GTLP UBs comply with international standards. However, given the nature of trade finance, the operations under the GTLP are not expected to have direct environmental implications.

3.21 *Private Sector Development and Demonstration Effects* One of the primary objectives of the GTLP is to encourage commercial financiers back into the trade finance sector. By catalyzing USD 15 billion of trade finance in Africa (USD 50 billion globally), the GTLP is expected to have a strong demonstration effect that will ultimately lead to its phasing-out when commercial financing returns to the trade finance sector in developing markets.

3.22 *Effects on Infrastructure* Although the GTLP will not have a direct impact on infrastructure projects, its indirect effects should not be underestimated. Many African governments have been forced to intervene in the trade sector because of the sudden shortfall of commercial financing. This has caused some of them to divert resources away from critical infrastructure projects. By helping to restore commercial financing for trade, the GTLP is expected to enable governments to refocus on longer-term development priorities such as infrastructure.

3.23 *Effects on Macroeconomic Resilience* Trade is one of the major ways that African countries can diversify their economies and thus improve resilience to exogenous factors. Trade is also a key enabler of regional integration; it can help build economies of scale in production and boost the competitiveness of RMCs in the global

marketplace. Therefore, by helping to restore trade, the GTLP will help to reduce the negative effects of the financial crisis on the macroeconomic resilience of RMCs.

Analysis of Additionality and Complementarity

3.24 The GTLP is an initiative led by DFIs and donor-governments in response to the global financial crisis. Without their contributions, the GTLP would not exist. Therefore the Participants can legitimately claim strong additionality in terms of ensuring commercial viability and high-impact development outcomes.

3.25 ***Incremental Commercial Viability*** Although additionality is generally assessed among DFIs collectively, the specific participation of the Bank in the GTLP improves the commercial viability of the Program in two primary ways. First, the Bank's initial contribution of USD 500 million represents 10% of the total resources of the Program and approximately one-third of the GTLP resources that will be directed toward Africa. This is a substantial contribution and makes the Bank the single-largest GTLP Participant focused on addressing the African trade problem. Second, the Bank's participation in the Program also provides significant comfort to other Participants that are interested in supporting African trade but are not familiar with domestic financial institutions. The Bank is viewed as a the premier development institution for Africa, with a successful track record of doing business on the continent, an extensive network of contacts in the private finance sector, and established relationships with governments and key development partners. Therefore, the Bank's endorsement of African UBs and IBs will amplify the demonstration effect that the GTLP will make toward normalizing and reinvigorating the trade finance markets.

3.26 ***Incremental Development Outcomes*** The GTLP is a global initiative to support all developing regions at a critical period. However, the Bank's participation in the GTLP has ensured that Africa's interests are given top priority. For example, the Bank has helped to influence the regional distribution of GTLP resources to make Africa the single-largest beneficiary region. The Bank has also insisted that regional targets specifically focusing on Africa are negotiated with the Program's UBs and that these targets are enforced by the Agent.

3.27 ***Complementarity*** Arguably, the most compelling advantage of the GTLP is the way that it leverages the comparative advantage of the IFC's global experience and institutional capacity to bring together a broad range of DFIs and donor governments to address the immediate trade finance crisis. From the cost perspective, the GTLP enables Participants to utilize the IFC's institutional capacity and thereby achieve economies of scale, thereby reducing the overall costs for the development community.²² The GTLP enables institutions such as the Bank, which have no track record or capacity in trade finance, to respond to the crisis much more quickly than would otherwise be possible. It also means that when the crisis is over, Participants can quickly and objectively reassess the need to continue to support trade finance without having made significant investments in dedicated infrastructure and staffing.

²² The total fees that the Bank will potentially pay to the IFC over the 3-year lifetime of the Program could reach almost USD 5 million (USD 250,000 + 3 x 0.3% x USD 500 million). This will be more than offset by the incremental income generated by the GTLP for the Bank, which is estimated at USD 10-15 million per annum. The total fee will also be offset if the IFC is able to recover fees from UBs. In the case of Standard Bank, IFC is collecting a 1% front-end fee over 2 years. If Standard Bank participates with USD 100 million in this facility, IFC will receive USD 1 million as front-end fee.

4. CONCLUSIONS AND RECOMMENDATIONS

4.1 The negative effects of the global financial crisis on trade are increasingly evident. The crisis has forced many of the international banks that traditionally supported the trade finance sector to refocus on domestic operations and restore their own financial soundness. As a result, the availability of trade finance has contracted and with it both export and import trade volumes have decreased. This in turn is severely weakening the prospects for continued economic growth in developing countries.

4.2 In response to the crisis, a group of DFIs and donor governments have joined forces to provide liquidity and share risks to support trade in developing countries under an initiative called the Global Trade Liquidity Program. The GTLP is viewed as a timely and effective solution to the constraints currently gripping the trade finance sector that: (i) aligns well with the priorities of both African regional member countries and the Bank itself; (ii) is commercially viable and within the Bank's tolerance for risk; (iii) will have strongly positive development outcomes for Africa, and (iv) demonstrates both strong additionality and complementarity among the Participants.

4.3 On March 3, 2009, the Board of Directors approved a program of USD 500 million in lines of credit to African banks to support trade finance as the first phase in the Bank's Trade Finance Initiative. To complement this effort, Management recommends:

- an investment of up to USD 500 million in the Global Trade Liquidity Program as the second phase of the TFI.

Annex 1

PRELIMINARY RESULTS-BASED LOGICAL FRAMEWORK

HIERARCHY OF OBJECTIVES	EXPECTED RESULTS	REACH	PERFORMANCE INDICATORS	INDICATIVE TARGETS & TIMEFRAME	IMPORTANT ASSUMPTIONS
<p>Sector Goal: Trade flows stabilized and increased Economic growth in Africa re-launched and MDGs realized.</p>	<p>Impact: Trade flows increased GDP growth resumes</p>	<p>Beneficiaries: All economic sectors of the beneficiary countries African population Beneficiary Governments</p>	<p>Impact Indicators: Exports and imports Economic performance of African economies <u>Sources:</u> Statistical publications of RMCs WTO Trade Reports</p>	<p>Long-term Targets: Trade flows increased by 5% in year 2011 GDP growth of member countries sustained at 5% or more by 2011</p>	<p>Continued political stability on the continent Stimulus packages to maintain demand for African exports continues. <u>Mitigation:</u> This project shores up trade financing</p>
<p>Project Purpose: Private sector further developed.</p>	<p>Outcomes: Increase in trade transactions</p>	<p>Beneficiaries: African private sector: SMEs, exporters and importers</p>	<p>Outcome Indicators: Number of transactions by SMEs, exporters, and importers <u>Sources:</u> Statistical publications of RMCs</p>	<p>Medium-Term Targets: 6000 transactions (i.e. 30% of total GTLP target) by 2011 Total trade loan turnover of USD15 billion for Africa by Dec. 2011</p>	<p>Sustained political and economic reforms in RMCs <u>Mitigation:</u> UBs will be selectively chosen with care</p>
<p>Inputs and Activities: AfDB: Up to USD 500 million trade finance IFC designated as Project Agent</p>	<p>Outputs Adequate and affordable commercial trade liquidity made available to sustain and increase trade in Africa (USD 500 mn + commercial banks' contribution)</p>	<p>Beneficiaries: UBs and regional banks</p>	<p>Output Indicators: Loan volumes increase <u>Source:</u> IFC reports on UB loans to its commercial clients</p>	<p>Short-Term Targets: USD 500 million committed to loan pool end of second quarter 2009, which mobilizing an additional USD 5 billion</p>	<p>Sufficient other sources of funding from DFIs/IFIs, bilateral and multilateral Due diligence satisfactorily carried out by IFC</p>

Annex 2

SUMMARY OF AfDB'S AFRICAN TRADE FINANCE SURVEY

1 As part of its trade finance initiative, the Bank engaged a consultant to undertake a field survey on the state of Africa's trade finance markets. From January to April 2009, 74 commercial banks and specialized financial institutions were contacted by the AfDB to discuss constraints to trade finance availability in the continent. Financial institutions along the different stages of the import and export financing value chains were interviewed, including global commercial banks, growing regional banks, large, medium and small local commercial banks, as well as specialized trade-focused intermediaries.

2 Several major international players dominate global markets for trade finance: Citibank, HSBC, Standard Chartered Bank, and Deutsche Bank were cited as important correspondents in all the markets surveyed. In addition, banks like the Bank of Beirut, Mashreq Bank, Standard Bank, Unicredito and BNP Paribas have strong regional franchises. Finally, commercial bankers note the emergence of new European-based, African-owned players like Medicapital, Ghana International Bank, First Bank UK, and Trust Bank UK.

3 Across the continent, bankers commented on the global financial crisis: Although the current impact was not yet significant at the time of the survey, the high levels of uncertainty were constraining trade. Many bankers noted that demand for exports was falling as were commodity prices, that government spending was slowing, and remittance flows were expected to fall as unemployment in advanced countries increased.

4 Commercial banks generally reported that the use of trade instruments, particularly letters of credit, was falling along with global trade volumes. In addition, letters of credit are seen as expensive and complicated to use. Commercial banks of all sizes reported that line availability remains strong but terms and conditions were changing. For example, banks in Kenya indicated that prices had increased by 100% over the previous 12 months while banks in Ghana and Senegal reported a 50% increase. Banks in all markets reported tenor shortening, with most indicating that lines were no longer available for more than 180 days, compared to maximum tenors of 270-360 days in 2007.

5 Many commercial banks, particularly large and medium commercial banks, reported working with the IFC on their Global Trade Finance Program. In this program, which is currently available in over 30 countries in Africa, IFC provides credit enhancement to allow greater confirmation line availability to issuing African commercial banks.

6 Commercial banks found IFC useful, although somewhat expensive and slow to respond. Commercial banks indicated that IFC's inability to finance public sector transactions was a constraint to business growth. Smaller and newer banks indicated they had neither the track record nor the balance sheet size to work with IFC. In addition, bankers indicated there is client interest for certain markets in which IFC does not operate, like Zimbabwe and Sudan.

7 Availability of import finance facilities is being sharply constrained by a lack of liquidity in international markets. According to the IMF²³, 90% of banks report that the cost of trade lending has increased primarily due to their own increased cost of funds. Commercial banks reported that a combination of asset arbitrage (funding less liquid assets versus the short term and self liquidating trade assets), fewer participants in the market, and regulatory changes had increased their cost of funding. In addition, these banks also indicated that local market considerations for certain large African markets had resulted in increased risk premiums for these facilities.

8 Increased cost of funds and increased risk perception have resulted in decreased liquidity to fund trade transactions across the continent. Commercial banks reported that funded facilities are less available, and then only at significantly higher prices at shorter tenors. International banks reported a decreased appetite for funded transactions. Some regional banks expressed a desire to expand their servicing of other African commercial banks but indicated that access to US Dollar liquidity constrains their ability to do so.

9 Bankers noted that exporters are typically very small, fragmented, and frequently unstructured. Large, medium and small commercial banks in all the markets indicated they were seeking to expand the SME banking business and were investing heavily in branches and technology to do so. Bankers noted further that the small size of African exporters was leading them to sell to small traders/aggregators, whose creditworthiness is difficult to assess. This constrains their ability to further finance exporters.

10 Larger exporters have, in the past, been able to access the syndicated export finance markets. However, similar to the funded import finance market, the syndicated export finance market is currently constrained by lack of liquidity, fewer participants, and credit concerns. Commercial banks indicated that there are fewer lenders participating in this market. According to Standard Chartered Bank, there has been a significant decline in the number of non-African banks participating in African deals since late 2007. Furthermore, as commodity prices are falling, warehouse and asset-backed deals are less financeable due to increased collateral requirements and higher risk perceptions. Finally, as in the import markets, regulatory change and the impact of write-downs of other assets are increasing the cost of funding and constraining its overall availability.

²³ IMF-BAFT study. *Survey of Private Sector Trade Credit Developments*, February 27, 2009.