

# DCInsight

THE TRADE FINANCE QUARTERLY OF THE INTERNATIONAL CHAMBER OF COMMERCE

## Can Obama's team revitalize trade finance?

By **Mark Ford**

**Over recent weeks it has become abundantly clear that the credit crunch that started in the US sub-prime mortgage market has bitten hard into the letter of credit market, and consequently into international trade and shipping.**

In November, Barack Obama won the US presidential race. Of course, no one expects a new US president to instantly solve a global credit shortage that can lead to an immediate revival of L/C business, but Obama – assisted by the US Secretary of Commerce, the US Trade Representative and one of his erstwhile political rivals, Hillary Clinton as Secretary of State – will play a critical role in the future of international trade.

### Assessing the crunch

The last few weeks have seen L/Cs featured in mainstream media articles, probably to an unprecedented extent, as it became apparent that the financial instrument now much more widely recognized as a facilitator of international trade has become too scarce a commodity.

Goods are reportedly piling up in the world's dockyards. Exporters and shippers



Geithner, Obama and Clinton: tough choices ahead

EMMANUEL DUNAND/AFP/GETTY IMAGES - INSET: KAREN BLEIER/AFP/GETTY IMAGES

are said to be unable to obtain L/Cs. Wary sellers are asking for L/Cs from importers used to dealing on open account terms, while buyers are simply finding banks less willing to write L/C business.

Banks with credit available are becoming far choosier about which other banks they do L/C business with. Beleaguered banks, such as Wells Fargo and Wachovia, have forced traders and shippers to look elsewhere for L/Cs. Chinese banks have tightened standards for L/C issuance.

Moreover, major trading firms have had to issue reassuring statements on L/Cs – Glencore International had to announce it has had no problems in obtaining L/Cs to finance transactions.

### Beyond banking

The impact of the L/C has been felt beyond the banking system. Merchant fleets are becalmed. The Baltic Dry Index, which tracks shipping costs for commodities, thereby providing an indicator of demand for shipping, seems to be disappearing. By early December it had plummeted by more than 90 per cent in a few months, and a component of the

index indicated that Panamax vessels could be chartered for just 5 per cent of the charter rate quoted on the index in October 2007.

The depth of the L/C shortage has yet to be revealed. The failure of international buyers to obtain L/Cs to pay for lucrative Christmas orders from Chinese manufacturers was expected to contribute to the collapse of thousands of Chinese small- and medium-sized enterprises. A report by JPMorgan confirmed that pre-Christmas orders from China suddenly ground to a halt, as sufficient credit simply could not be found.

Some countries have tried to make L/Cs more attractive. The State Bank of Pakistan has removed a 35 per cent cash margin requirement on import L/Cs for certain items. The US Export-Import Bank has widened availability of L/Cs for US firms.

A few non-bank entities – including specialist commercial export finance houses and quasi-public sector entities – such as a UK chamber of commerce that is offering its own L/Cs – are reporting increased L/C demand.

> *continued on page 23*

### Inside DCInsight

Fraud watch	2
Queries and responses	3
Expert commentary (Mohammad Burjaq)	6
The Insight interview (Sir Roy Goode)	8
SWIFT	10
Transport documents	11
Incoterms	13
Point of view (A.T.M. Nesarul Hoque)	14
Right of response (Haluk Erdemol)	15
Documentary dialogue (non-bank L/Cs)	16
Special report: reactions to the trade downturn	18
DOCDEX	21
In brief	24



**International Chamber of Commerce**  
The world business organization

## From the editor

In a time of financial turmoil, with banks and major corporations failing and with some shippers having difficulty obtaining L/Cs, it's natural that in this issue of *DCInsight* we run several articles dealing with the state of trade finance and how some actors in the market are responding to it. In our lead article, Mark Ford assesses the state of the market and whether Obama's new

team is likely to revitalize it. In a special section, we look at how the IFC's Global Trade Finance Program is keeping trade finance flowing to developing countries at a time of drastic changes in market conditions. And in the same section, Michael Quinn examines supply chain financing and how

it can, given proper international standards, help to alleviate some of the uncertainties associated with documentary trade.

This is an ongoing story and, in keeping with *DCInsight's* tradition of staying on top of breaking news, readers can expect more in-depth reporting on it.

We also continue our assessment of UCP 600 one year on. In Expert commentary, Mohammad Burjaq recounts some of the redundant terms still being employed by some bankers and practitioners in their credits despite clear language in the new UCP rendering these terms superfluous. This is the other side of the coin from the thoughtless exclusion of UCP articles by some practitioners.

The Insight interview continues our coverage of the revision of ICC's Uniform Rules of Demand Guarantees (URDG). Our interviewee, Professor Sir Roy Goode, one of the fathers of the original URDG, explains why the revision may be ready for a vote in May 2009.

As we head into the 15th year of *DCInsight*, we intend to expand on these and other hot issues practitioners have to deal with in their daily jobs.



**Ron Katz**  
Editor

## Fraud watch

# Scams during the last quarter

**L/C fraudsters remained imaginative and active since the last issue of *DCInsight* appeared. While there's no evidence that the financial crisis prompted the latest surge, it's clear that the temptations to defraud will be enhanced in hard times.**

Consider the cases of Bernard Madoff, a prominent US trader and former Chairman of NASDAQ, who operated a multi-billion dollar Ponzi scheme until he was arrested in December, and Marc Dreier, a hard-charging US lawyer who forged promissory notes and backed up his claims with phony financial statements and bogus audit opinions from a reputable accounting firm. Following are a few of the latest scams from the US, Bangladesh and Hong Kong.

In the US, a man from Utah who stole money from four people – including a 73-year-old widow – as part of an investment scheme avoided prison through plea bargaining with the state prosecutor. Even though the judge hearing the case wanted to jail Michael Ostler, she had to order, on the state prosecutors' recommendation, a sentence of 36 months probation, 500 hours community service and restitution of USD 130,000.

Ostler's fraud involved promising investors L/Cs valued at USD 2.5 million from a European bank. In a classic advance fee fraud move, each investor paid USD 15,000 for his L/C. Ostler told the investors they could withdraw money from their L/Cs to make loans, invest, buy real estate or pay off debts. But none of them received the L/Cs or their money back. Instead, the court heard that Ostler used the money for personal expenses such as domestic bills and travel.

In Bangladesh, L/Cs may be being used in scams in the volatile urea market. The alleged scams took place against a backdrop of soaring world urea prices, government subsidies and accusations of corruption in the state-owned Bangladesh Chemical Industries Corporation (BCIC). The global price of urea has soared to more than USD 800 per tonne compared with prices of USD 150-200 in 2007. Local media in Bangladesh, however, reported that organized racketeering outfits were making alluring offers of between USD 200-250 per tonne to buyers on L/C terms such that the racketeers are able to cash in L/Cs without delivering the ordered goods. Market

sources said that buyers should not take seriously any offers of urea for sale at a price of less than USD 500 per tonne.

Another report suggests that L/Cs may feature in suspect dealings between one of the country's largest private sector urea dealers and BCIC. It appeared that shipments from the private sector supplier to the state-owned buyer were not being completed, even though the L/Cs covering these shipments may have been cashed.

In Hong Kong, a merchant charged by Hong Kong's Independent Commission Against Corruption was convicted for his role in a HKD 260 million L/C fraud. The fraud involved dozens of L/Cs and was based on non-existent commercial transactions. During his trial, the court heard that between 1994 and 1996 the defendant, Chen Xun, conspired with others to defraud three banks in Hong Kong – Kincheng

Banking Corporation, Kwangtung Provincial Bank and Bank of China. Chen used three companies to apply to those banks to issue 50 L/Cs payable to Max Rise Industrial Limited.

Chen Xun submitted false documents to the banks showing ostensibly genuine underlying commercial transactions of goods between the three companies and Max Rise to support the L/C applications. There were no such genuine transactions, and the banks were duped into releasing a total of over HKD 260 million to Max Rise under the L/Cs. A Hong Kong court found Chen Xun guilty on five counts of conspiracy to defraud and jailed him for 55 months. A fellow conspirator was jailed for 32 months.

The scale of these frauds, most involving phony documents and non-existent transactions, is breathtaking and throws more light on how easily investors can be fooled by dubious promises of wealth. ●

**“Investors can easily be fooled by dubious promises of wealth”**

## Obama and L/Cs *continued from page 1*

The L/C market is certainly not dead in the water. First-tier traders and shippers say there is still availability in the market, but overall the outlook looks grim.

### Bail-outs

Governments across the world have launched bail-outs. The US introduced a USD 700 billion bail-out plan, while the UK launched a £500 billion rescue package. China will invest nearly USD 3 trillion to stimulate domestic demand.

So far, none of the bail-outs have made banks less wary of taking each other's L/Cs which, if they are offered, are priced far higher than they were. The problem is particularly acute for businesses in emerging markets, according to the director-general of the World Trade Organisation, Pascal Lamy, who says trade finance is being offered at 300 basis points above LIBOR and, even at this high price, it has been very difficult for some developing countries to get trade finance.

Lamy also highlighted the difficulties any government or body would have fitting a "safety harness" to the global financial system that, in his view, "suffers from a lack of regulation, a lack of transparency, a lack of accountability". Moreover, he argues that no international agreement on finance or climate change is possible today without China, India, Brazil or Indonesia on board.

### International trade and the US

Other nations need to be on board too, not least the US, where the global financial crisis ranks along with terrorism at the top of the new administration's chief national security, let alone economic, problems.

International trade will be one of the most important catalysts for improving – or not improving – relations among nations, so that the US president's policy on trade and his choice of who he has appointed to shape relations between the US and the rest of the world are critically important.

During the presidential campaign, those looking for a fresh approach from Obama to improve global credit conditions required for L/Cs to start flowing again could have been disappointed by Obama's campaign talk. A fight for fair trade was one of his key campaign themes, but he made clear that this meant opening up foreign markets to US goods. The new president also said he would use trade agreements to spread good labour and environmental standards around the world.

These policies sounded inward-looking to those hoping for a new world leader to take a lead in solving a problem that might have started in the US but is now a global one. Obama the campaigner sounded even more anti-trade, talking negatively about the Central American Free Trade Agreement and the North American Free Trade Agreement (NAFTA).

Obama's choice to run the Treasury Department, former head of the Federal Reserve Bank of New York, Timothy Geithner, may also have disappointed those looking for a fresh approach to today's financial sector mayhem. Geithner was former Treasury Secretary Henry Paulson's de facto right-hand man, and some complain that he and Paulson failed to see the crisis coming and allowed Lehman Brothers to go bankrupt, deepening the global financial crisis.

“...negotiations between Washington and Beijing will have to be on the top burner”

But three years ago Geithner accurately flagged the risks that would combine in 2007 to create today's financial crisis, and he has experience in international trade through his involvement in the bail-outs of Mexico, Indonesia, Korea, Brazil and Thailand. His appointment was received well by Wall Street. According to one senior New York banker, he is "a fantastic choice to help lead the financial markets out of the wilderness".

### Commerce and the US trade representative

Free trade advocates suffered a blow when New Mexico Governor Bill Richardson was compelled to withdraw his name as President Obama's secretary of commerce because of an ongoing investigation in his home state. Richardson's nomination seemed to reflect the reality that the economic downturn faced by the US is part of a global crisis, which directly affects Washington's relations with the world. By first nominating Richardson, a former US ambassador to the UN, the new president clearly signalled that he wanted international relations managed by an experienced person on day one.

Richardson's appointment had been particularly encouraging to those who thought Obama's campaign talk sounded too protectionist. Richardson was a staunch pro-free-trade Democrat, and his

initial selection indicated that the new administration was less likely to follow a protectionist course. Richardson had cut his political teeth on his support for NAFTA and the Clinton administration when most of his Democratic colleagues fiercely opposed both the idea and the president.

A more problematic Obama choice was that of Ron Kirk to be the US trade representative. The trade representative is responsible for the nation's international trade policy. It is a cabinet-level position with the rank of ambassador. The representative sits as a member of the board of the Export-Import Bank and the Overseas Private Investment Corporation. The officer also represents the country for all activities related to the World Trade Organisation and negotiates on behalf of the United States with the Organization for Economic Cooperation and Development (OECD).

Kirk, a former mayor of Dallas, has little background on trade issues or organized labour in the US. Also, some Republican senators, seemed less than enthusiastic about him. In accepting his nomination, Kirk said that he would balance the interests of robust trade as well as the interests of America's workers – code words, some believe, for a tougher US stance on trade.

### China

One of Hillary Clinton's first stops if international trade is to be restored will likely be Beijing. The Chinese regime that Secretary Clinton will approach is increasingly the US' de facto banker. The Chinese have accumulated USD 2 trillion in cash reserves and, over recent years, have been buying increasing amounts of US debt, a process that is likely to gain momentum as the US continues to finance its recovery programmes.

Clinton and her colleagues will therefore have to negotiate with the Chinese from a weaker position than her predecessors. Several issues will probably be on the table – including energy and the environment – but the global economic crisis is the most volatile.

Neither Obama's anti-trade rhetoric, nor measures such as China's increased tax rebates for exporters – which make Chinese goods cheaper in the US – seem to bode well for restoring confidence in the credit markets and rejuvenating world trade. But new presidents have a way of surprising the markets. In any event, negotiations between Washington and Beijing will have to be on the top burner. ●

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## In coming issues of DCInsight

- A survey: the financial crisis and L/Cs worldwide
- Liner conferences
- Standards for determination of discrepancies
- The latest UCP 600 Opinions
- And more

## In brief

### L/Cs heavily used by US CFOs

For a second year running, in 2008 L/Cs ranked second in the list of financial products and services most used by US-based chief financial officers (CFOs) in US manufacturing firms, according to a survey. Moreover, it appeared that L/Cs were in greater demand from a larger percentage of CFOs than in 2007. In 2008, cash management topped the list of financial products and services used by CFOs, with 63 per cent of them including it on the lists they submitted for the survey. L/Cs ranked second in the survey for Bank of America and were included in 59 per cent of the lists. Apparently in a reflection of difficult global financial markets, the CFOs surveyed were clearly more concerned about credit availability than they were in 2007. In the 2008 survey, about one-third of CFOs said their lender has restricted credit availability. In 2007, only 10 per cent said they were expecting credit to become harder to obtain.

### Mumbai and India/Pakistan trade

Relations between Indian and Pakistani business people may well deteriorate depending on the level of involvement Pakistan had in the attacks on multiple sites in Mumbai that left at least 188 people dead. During previous fall-outs between India and Pakistan, traders from Pakistan found it more complex and expensive to obtain letters of credits for trades with India, but as of December 2008 there had been no such impact, according to a Pakistani business leader. During conflict between the two states in 1999 in the Kargil district of Kashmir, Indian businessmen asked their Pakistani counterparts to have L/Cs reconfirmed by international banks. A number of Indian partners made the same demand after terrorists attacked the Indian parliament in New Delhi in 2001.

### China's SMEs suffer from a lack of L/Cs

A lack of letters of credit in recent weeks has added to a catalogue of problems already experienced in 2008 by China's small- and medium-sized enterprise (SMEs) sector. Thousands of SMEs went out of business in 2008, and experts suggest that 2009 will see even more SMEs moving towards the brink. More than 67,000 SMEs in China were declared bankrupt in the first half of 2008, some of them pressured by Beijing's discouragement of firms making low-quality goods. One banker said the L/C shortage at the end of 2008 made a significant impact on China's exporting SMEs. International buyers of Chinese products failed to obtain L/Cs in October, which led to significant cancellations of Christmas orders. One economist said that it was common to hear from business people that the flow of L/Cs had "suddenly ceased".

### Standard Chartered tops Asia L/C rankings

For the second year running, SWIFT in 2008 ranked Standard Chartered Bank number one in terms trade transaction volumes in Hong Kong, Singapore and the UAE. The top ranking is based on an analysis of trade transaction volumes handled by the financial messaging provider for the year ending 30 September 2008. Standard Chartered continued to lead in growing its share of total market volumes of L/Cs issued, according to SWIFT's analysis.

### Banking Commission to Dubai

The ICC Banking Commission's Spring meeting will be held on Tuesday 10, Wednesday 11 and Thursday 12 March 2008 at the Dubai Chamber of Commerce in Dubai, UAE. This is the first time the Commission will have been to Dubai. More information can be obtained from Whitney Jacob at e-mail wjb@iccwbo.org.

### Ole Malmqvist

It is with great sadness that we report the October death of Ole Malmqvist of Denmark, an active ICC Banking Commission member for many years. Ole served as Co-Chair of the Drafting Group for ISBP 645 and as a member of the UCP 600 Drafting Group. His understated wit and perceptive comments on ICC rules, as well as his personal warmth, will be missed by all Banking Commission members.