Posting a solution

Executive summary

■ The European Bank for Reconstruction and Development has put forward proposals to ensure trade finance is still available to companies despite the freeze on bank lending and the current stormy economic trading conditions. But while treasurers will welcome any measures that help them to fund trade deals, letters of credit may not be the perfect answer every time.

At a conference held at the end of January the European Bank for Reconstruction and Development (EBRD) announced measures to mitigate the consequences of the liquidity crisis and its impact on trade finance. One of its key decisions was to increase the limits on its trade facilitation programme from €800m to €1.5bn. The EBRD also plans to increase the availability of facilities for foreign subsidiary banks in the EBRD region, and provide liquidity in the form of cash facilities to issuing banks, a move aimed at supporting intra-regional trade between EBRD countries.

The trade facilitation programme aims to promote foreign trade to, from and within the EBRD countries of operation. Through the programme, the EBRD provides guarantees to international confirming banks, taking the political and commercial payment risk of international trade transactions undertaken by banks in the countries of operation. This is seen as a clear shift back to traditional trade finance products with an increased demand for risk mitigation tools such as letters of credit (LoCs).

In theory this would see a step back from the quest in trade finance of the last few years for increasing efficiency and better processing techniques. How corporates and banks will go about trading and sharing risk in practice remains to be seen. At the recent ***talkingtreasury*** event in London part of the discussion on trading and counterparty risk focused on how to ensure commercial activity continues even when there is little confidence and companies view each other with a great deal of suspicion, fearful that any credit extended could soon turn into a bad debt. One suggestion was that treasurers could help their companies overcome the confidence crisis by managing risk through the use of instruments such as LoCs, bank guarantees and advance payment guarantees.

The banks certainly seem to be making some effort to support trade. At the International Trade Awards held in March at the House of Lords, Stuart Nivison, head of trade and supply chain for Europe at HSBC (the sponsor of the awards), said: "HSBC is committed to helping businesses currently trading or planning to trade internationally. That's why we have made available a £1bn fund for UK SMEs – in addition to what we normally lend – to support working capital, trade finance, LoCs and guarantees. We have also formed a partnership with UKTI to provide a series of training events and trade assistance for businesses looking to trade overseas for the first time or expand their international capability."

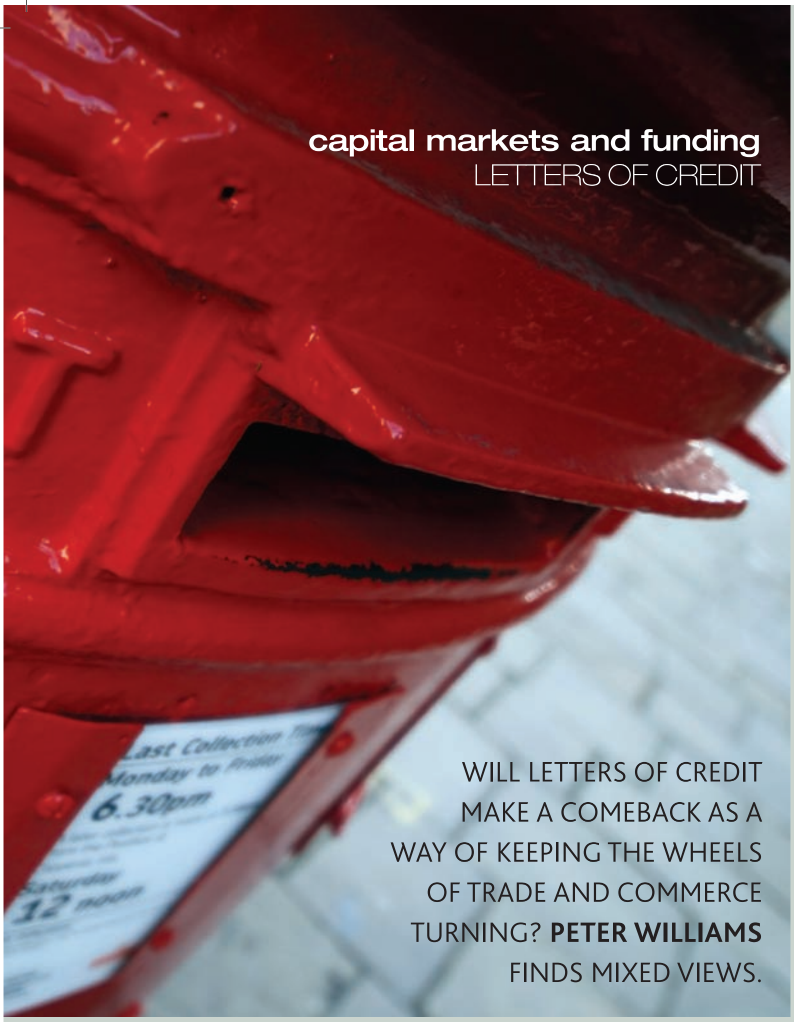
And it seems some treasurers are seeing more interest in ways to keep trade on the move. As well as LoCs, the slightly more complex standby letters of credit have emerged blinking into the daylight. John Jackson of Weir Group says his company has seen a rise in the use of various facets of trade finance. The type of instrument his company is becoming involved with includes bid bonds, performance bonds and advance payment guarantees.

Jackson says: "We've been encouraging our customers to pay more upfront and they in return have been asking for advance payment guarantees, which we are happy to give."

He says there has been a notable rise in popularity of traditional trade finance instruments over the last year or so and predicts they will become even more popular as worries persist over the credit quality of counterparties.

Those who are not used to working with LoCs or related documents should be warned they are not straightforward. Surveys by trade facilitation body SITPRO show that over 50% of documents presented by exporters to banks for payment under LoCs are rejected on first presentation. This can cause expensive delays for both exporter and importer and may result in a lesser payment or even none at all. A great many of these rejections could be avoided if more care was taken to ensure the documents called for in the credit are properly completed.

Even allowing for technical problems the banks have not been slow to recognise a renewed interest in these instruments.



WILL LETTERS OF CREDIT MAKE A COMEBACK AS A WAY OF KEEPING THE WHEELS OF TRADE AND COMMERCE TURNING? **PETER WILLIAMS** FINDS MIXED VIEWS.

Jackson says: "We've gone back to the 1970s and 1980s. The challenge for treasurers is that they may be on a learning curve as they are having to work with instruments they may only have met in their AMCT textbooks."

He also cautions treasurers that these trade finance solutions may have an impact on the corporate credit facility headroom that banks provide, which could have repercussions for other areas of financing.

But not everyone is switching over to using LoCs. Some treasurers are perfectly happy with the processes they already have. For example, Greg Croydon, group treasurer at IMI, says his company continues to use bank guarantees to maintain acceptable cashflows. Croydon says that bank guarantees are more flexible than LoCs and simpler to operate.

He points out that LoCs are often used to confirm a particular payment or to certify a particular trade, while bank guarantees can be used to provide a customer with the confidence to trade openly with a supplier. The use of a guarantee to support advance payments and release retention payments will improve cashflow and the customer is in a position to claw back the money if the transaction goes wrong for any reason. And assuming the transaction does go ahead without any problem, then the guarantee can just be terminated in due course. Croydon says IMI tends to offer bank guarantees to customers and is still doing so on the same basis as before the current downturn.

Lynda Heywood, assistant treasurer at Kingfisher, says her organisation does use LoCs for the purchase of inventory from southeast Asia. However, she claims that in terms of the instrument of choice the sentiment has started to shift from LoCs towards open account. But she adds that is too early to judge whether the long-term trend of moving away from LoCs will be disrupted or even halted altogether by the current economic downturn and the increased awareness of counterparty risk.

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