New Markets Lab

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White Paper

The Role of Law and Regulation in International Trade Finance: the Case of Correspondent Banking

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Executive summary

Improving access to trade finance is becoming increasingly important for developing countries, many of which are experiencing increases in production opportunities as a result of the evolving patterns of trade. While many factors impact international trade financing, legal and regulatory frameworks are a critical yet often-overlooked element affecting the ability of the international trading system to deliver broad-based economic development benefits.

This white paper will present a view of legal and regulatory structures in the context of trade financing, using the recent example of correspondent banking as a case study that highlights the connection between legal frameworks and broader trade-financing opportunities.

The trade finance gap has become particularly acute for developing countries, especially since the global financial crisis of 2008-2009. Exacerbating this challenge, as this white paper will highlight, is the system of strengthened international regulations that has led to a decline in correspondent banking relationships (CBRs) as globally active banks have rationalized business away from developing markets perceived to be of higher risk. Although local and regional banks in developing country markets have tried to seize opportunities for increasing their participation in the trade finance market in the wake of this shift, these efforts have encountered a major bottleneck due to increasingly complex international rules.

A range of legal and regulatory instruments impact trade financing (and financial services more broadly). These measures fall into three general categories[1]: systemic regulations (or macro-prudential regulations) that include a range of measures designed to identify and mitigate risks to the stability of the financial system as a whole; prudential regulations (or micro-prudential regulations) that include measures concerned with the stability of individual financial institutions; and non-prudential regulations that cover other aspects of financial services regulation. For context, the Basel III Accord developed by the Basel Committee on Banking Supervision is an example of systemic, or macro-prudential regulations designed with the stability of the system in mind. While largely "soft law", Basel III has had a significant impact on international financial regulation and has played a pivotal role in the international finance landscape.

While not the only vehicle, correspondent banking networks with local and regional banks are an important channel for international trade finance. At present, inter-company finance and bank-intermediated trade finance, supported by a global web of CBRs, are the main sources of trade finance. **Recent changes in the legal and regulatory environment, however, have triggered a process of withdrawing developing market banks from CBRs across the globe**. Surveys of the International Monetary Fund (IMF, 2016), World Bank (2015), and the Association of Supervisors of Banks of the Americas (2015) indicate that countries in Africa, the Caribbean, Central Asia and Europe have been hit hardest. These are also the markets in which financial services options tend to be the most limited, particularly for small and medium-sized enterprises (SMEs). CBRs are essential for local and regional banks to gain access to international financial networks and provide services to their local customers on a cross-border basis, making them a central factor in addressing the need for trade finance in a post 2008-2009 financial environment in which the financing of trade is less concentrated within global banks.

The legal and regulatory environment, bank due diligence requirements and assessment of risk are among the main factors impacting the decline of CBRs. Tighter anti-money laundering and counter terrorist financing controls, increased prudential baking and tax transparency regulations, and an enhanced enforcement environment for financial services, including through economic and trade sanctions, have changed the landscape of government-led intervention in the provision of financial services. Changes in correspondent banking networks impact not only trade financing flows but also affect the "operational services for trade", or the entire services structure around remittances, payments and collections.

Solutions to date seem to be primarily high-level and top-down, and developing country stakeholders have not been included to a great enough degree. Efforts have also focused on the correspondent banking problem, which has been a pressing concern, while overlooking the wider trade finance challenge. **A holistic approach is needed which is more inclusive of local and regional stakeholders and accompanied by technological and non-bank financing solutions and regulatory capacity building**. Overall, an approach that targets not only the decline of correspondent banking but also the wider trade finance problem would also improve the capacity of stakeholders to identify and respond to future challenges.

This white paper proposes a shift in focus and solutions through both regulatory and financing channels that are directed both at the deterioration of CBRs and at ways in which to help local and regional stakeholders more effectively meet the demands of finance for local customers, thereby addressing the broader trade finance gap. This white paper puts forward a **four-pronged approach**, which includes non-bank financing solutions and approaches arising from the wave of digitalization, as well as local, regional and international regulatory components that can more comprehensively draw in a wide array of stakeholders.

First, **innovative new approaches are needed, including through the use of technology, to help change the trade finance game**. Non-bank financing solutions, along with models that create incentives for paperless transactions, promote online trade document management, and advance other technologies (such as distributed ledger technology) could transform the way the trade finance business is conducted, while minimizing the effects of CBR withdrawal. There is already an ongoing shift in the use of traditional bank-intermediated trade finance instruments towards inter-company and supply chain finance. Further, as companies become increasingly familiar with their trading partners, their need for risk hedging may decrease and their use of trade finance instruments may become more selective. The advent of digitalization is also likely to lead to new alternatives in the market and encourage bank-intermediated finance to operate in a more cost-effective and transparent way. Non-bank financial services could also provide alternatives to traditional bank financing, making it easier for SMEs and other stakeholders to access much-needed financial services and contribute to the Fourth Industrial Revolution.

Second, **a more inclusive regulatory dialogue and clearer standards should be fostered at the international level**. While efforts are under way, increasing dialogue among stakeholders at the international and developing country levels, including dialogue between globally active banks and their respondent bank counterparts, could be instrumental in clarifying ambiguities in existing international standards and stabilizing regulatory expectations, particularly in areas such as financial crime compliance. Maintaining an open dialogue, especially among regulators, could also help ensure that trade and development considerations are fully reflected in the implementation of international standards.

Third, **regional regulatory frameworks could be a particularly constructive way to foster harmonization of rules**, streamline efforts and reduce compliance. Affected stakeholders could also align their interests, strengthening regional financial services networks and enhancing the capacity to participate in global standard-setting processes.

Fourth, **work could be done at the national level to strengthen the regulatory and due diligence capacities** of local (respondent) banks, including their ability to detect, monitor, mitigate and prevent financial crime, as well as comply with new prudential regulations in a cost-effective way. This could include government and industry-led initiatives, as well as public-private partnerships, to strengthen domestic legal and regulatory frameworks on financial crime, prudential regulation and tax transparency. To varying degrees, this is under way in many jurisdictions, but these efforts could be strengthened and better linked to build synergies among countries.

For the time being, bank-intermediated finance is likely to continue to play a significant role in the financing of international trade. Even under a scenario in which CBRs have a more limited impact, however, trade finance has not been growing at the pace of international trade. Exploring innovative solutions, engaging national and regional stakeholders through the creation of new platforms and bridging existing trade financing gaps will all be needed to unlock the trading potential of many developing countries around the world. These efforts would also help ensure that regional and local interests are better reflected in financial laws and regulations.

Introduction

Trade finance, which has been described as the “fuel” of international trade, contributes significantly to wealth creation and economic development. Without the underlying support of finance, many of the trade opportunities that create jobs and steer economic growth would be overlooked. The dynamics surrounding trade finance are the backdrop against which financial regulation and the correspondent banking challenge are assessed in this white paper.

Regrettably, the global demand for trade finance is far from being met. The gap in international trade finance has been calculated to be as high as $1.6 trillion[2], and financing gaps have been found to be greatest in least-developed countries (LDCs) and low-income countries (LICs). Lack of trade financing is regularly reported as a major bottleneck to exporting in Africa, especially sub-Saharan Africa, as well as in Asia, Latin America, and the Caribbean[3]. In Africa, the value of unmet demand for trade finance has been estimated to be at least in the range of $120 billion for 2012[4].

The demand for trade finance is predominantly a function of time lags in the market which, not surprisingly, are more difficult for developing nations and SMEs to weather. Simply put, there is a lag, or disconnect, between the time at which importers are willing or able to pay for a given international trade transaction and the time at which exporters expect to receive payment. For instance, in many cases exporters expect to receive payment upon shipment of a product, while importers are generally willing to pay, at the earliest, upon its receipt and inspection. In other cases, the time lags may result, *inter alia*, from logistical constraints that affect the time of transport itself. Trade finance bridges these gaps between importers and exporters by providing credit and guarantees of payment in terms that are satisfactory to both the importer and exporter.

Because of these dynamics, adequate trade financing is essential to greater economic development. Only about 20% of international trade is done through cash-in-advance transactions. The remaining 80% requires some form of financing[5]. At present, there are two main forms of international trade finance: inter-company finance and bank-intermediated finance[6]. Each has habitually accounted for similar shares of the trade finance market[7], although, according to a recent survey, inter-company finance (including supply-chain finance) represents only around 17% of both import and export trade finance. Inter-company finance involves credit that is either directly extended by an importer to an exporter or vice versa. This method of finance often takes the form of “open account” transactions, especially for long-standing business relationships. The direction of the trade credit is dependent, among other factors, on the financial standing of each of the parties and on the agreed timeframe for final payment. Frequently, the larger party becomes a creditor of the smaller trader.

Due to a number of dynamics, bank-intermediated trade finance, which is the focus of this white paper, has historically been the preferred form of trade finance. Inter-company finance can be more complicated and often requires further risk mitigation through credit insurance, factoring, or other risk-hedging options that often entail additional complications and costs, many of which are unavailable in certain developing country markets. In contrast, bank-to-bank relations allow traders to disengage themselves from these risk-management components and have, therefore, made this form of trade finance popular, especially in developing countries[8].

Overall, the environment for trade finance is undergoing a period of transformation. The digital economy has driven the entry of new actors into the market and is altering many of the channels used by traditional financial institutions. It has become routine for banks to digitize many of their internal processes and there is a widespread recognition among relevant stakeholders that financial inclusion is a pressing problem, particularly with respect to SMEs. Further, there is also a shift under way to move from the use of traditional bank-intermediated trade finance instruments towards inter-company and supply-chain finance[9]. As a result, the solution to the trade finance problem is unlikely to come only from within the confines of bank-intermediated finance, even though that remains a dominant source of trade financing. A comprehensive solution to the trade finance gap must, therefore, take into account innovative new approaches, including non-bank financing solutions and approaches arising from the wave of digitalization. Bank-intermediated finance is likely to continue to account for a significant part of the trade finance market in the years to come, but technological innovation and changes in the market are at least bound to transform the existing product mix of trade finance instruments.

Legal and regulatory structures will impact the way in which the market for trade finance develops. These structures are often a central component in assessing and mitigating risk, and the design of regulatory systems within and between countries will have a significant impact on trade financing flows in the future. This white paper focuses on legal and regulatory systems as a critical element of enhancing trade financing opportunities, using the correspondent banking issue as an example of how international regulation and weak systems to defray risk and respond to market gaps can affect trade financing opportunities. As the recommendations in the conclusion of the white paper will highlight, this assessment embraces a strategy that incorporates innovative approaches in both financing models and regulatory implementation as a way to both address current challenges in trade financing and ensure that it becomes more aligned with development goals.

The Legal and Regulatory Landscape of Bank-Intermediated Trade Finance

The legal and regulatory environment affecting bank-intermediated finance is multilayered and sometimes complex. At least three major types of regulatory measures, arranged according to functional lines, regulate banking in most countries around the world today[10]:

- *Systemic regulations (or macro-prudential regulations)*: This category of regulation covers a range of measures designed to identify and mitigate risks to the stability of the financial system as a whole. Some examples are countercyclical capital buffers, dynamic provisioning rules, reserve requirements, and quantitative restrictions on borrowers such as loan-to-value and debt-to-income ratios.
- *Prudential regulations (or micro-prudential regulations)*: This category of regulation covers measures concerned mainly with the stability of individual financial institutions. Examples of micro-prudential regulations include minimum capital requirements, capital adequacy ratios, solvency margin requirements, restrictions on credit concentration or portfolio allocation, and reporting and disclosure requirements.
- *Non-prudential regulations*: This category covers all other financial regulations which can be achieved regardless of the financial health of an institution or the integrity of the system. Some examples include:

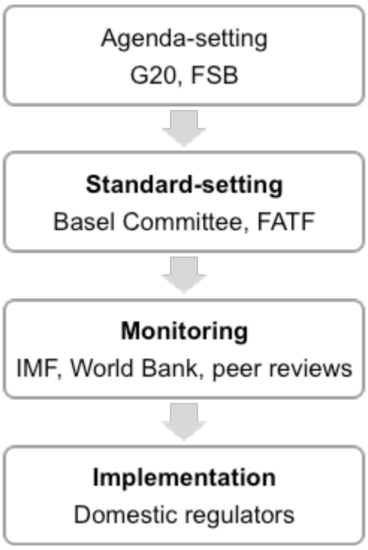
    - Consumer protection regulations, such as transparency and truth-in-lending disclosure rules that allow consumers to make informed decisions; they also cover privacy matters and personal data protection
    - Financial fraud and financial crime regulations, which range from anti-money laundering and counter terrorist financing measures to those prohibiting abusive investment arrangements and other fraudulent action
    - Tax-related regulations, such as codes that govern financial transactions and finance sector profits; they also cover, among others, tax transparency matters and mechanisms for the exchange of tax information
    - Trade and investment-related regulations, which may include economic and trade sanctions, as well as rules on the participation of foreign equity, the establishment of branches, borrowing from foreign sources, and employment of non-citizens in management positions
    - Regulations on secured transactions.

The majority of these measures are informed by an international soft-law framework that exerts significant normative influence over financial rule-making at the domestic level. This framework is determined by a group of international bodies that have one of three distinctive vertically integrated roles. The first of these roles concerns setting the agenda for financial rule-making. The group entrusted with this work has, since the global financial crisis of 2008-2009, consisted of the G20, as the world's leading economic forum, and the Financial Stability Board (FSB), a technocratic body that aids the G20 in coordinating the activities of the different global regulatory standard-setting bodies.

The G20 and the FSB direct and coordinate the second set of functions, namely the standard-setting processes that regulates the activity of banks. Within this group, the Bank for International Settlements (BIS), its Basel Committee on Banking Supervision (Basel Committee), and the Financial Action Task Force (FATF) are key institutions. These "standard-setting" bodies design and articulate the rules for banking supervision and financial crime. They set the standards that, although ordinarily not codified in treaties, become informal best practices that are subsequently implemented across (and beyond) these bodies' member states by way of domestic laws and regulations.

Finally, the IMF and World Bank support this vertically integrated framework through monitoring and surveillance. The evaluations, reports, information-sharing exercises and peer reviews conducted within the IMF and World Bank examine the extent to which national regulators are complying with the internationally agreed upon standards, and serve to track and apply pressure on the domestic processes of implementation of these best practices. The FSB and Basel Committee have similarly adopted in-house monitoring systems that further add to the system of surveillance of financial rule-making at the domestic level.

Figure 1: Vertically-Integrated Framework for Bank-Intermediated Finance



Source: New Markets Lab and International Centre for Trade and Sustainable Development "Regulatory Guide for the Financial Services Sector" (adapted from
Brummer, 2014)

The bodies mentioned above have been exceptionally active since the 2008-2009 financial crisis, with the Basel Committee notable among these. They, along with other international organizations, have supported a number of legal and regulatory changes that have impacted bank-intermediated finance. The most significant of these include:

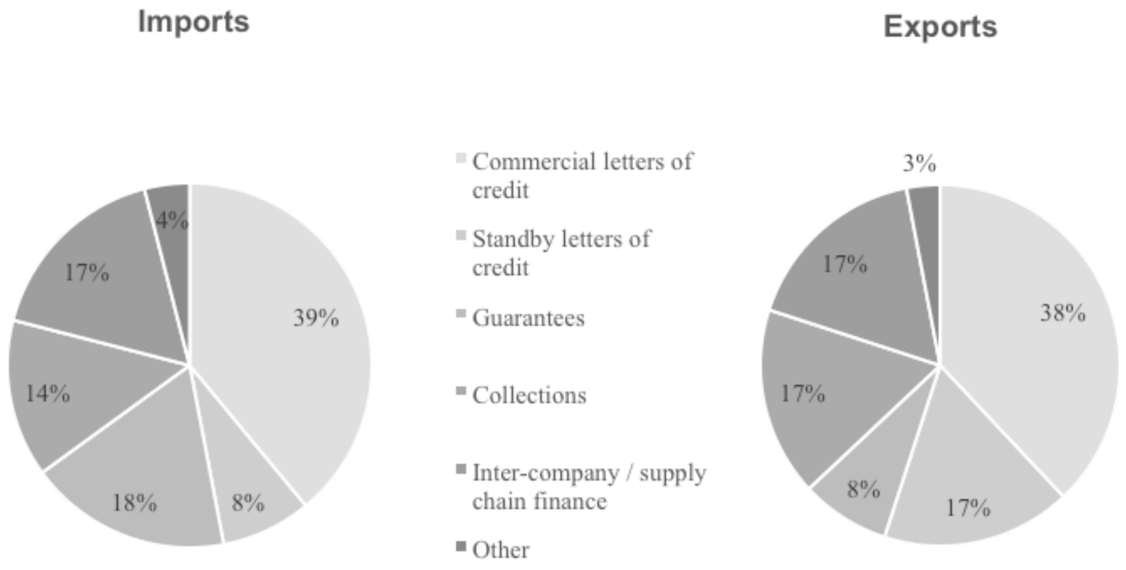
- *Anti-money laundering and counter terrorist financing regulations*: emanating principally from the 2012 revised FATF standards
- *Prudential/systemic regulations*: as a result of the Basel III Accord, a set of reform measures designed to strengthen standards on capital requirements for banks
- *Tax transparency regulations*: particularly arising from the Foreign Account Tax Compliance Act in the United States and recent initiatives being concluded within the Organisation for Economic Co-operation and Development (OECD) on tax reporting
- *Economic and trade sanctions*: largely contained within regulations of the United States and the European Union (KPMG 2014[11]; European Central Bank 2015[12]; World Bank 2015[13]).

These changes in the international legal and regulatory landscape have transformed the market for bank-intermediated finance, with significant implications for developing countries. Tighter anti-money laundering and counter-terrorist financing controls, increased prudential baking and tax transparency regulations, and an enhanced enforcement environment for economic and trade sanctions have had an important unintended consequence: they have contributed to the withdrawal of CBRs worldwide. The post 2008-2009 financial crisis rule-making process triggered a surge in the costs of compliance of globally active banks, to the point at which it has become most cost-effective for these banks to de-risk and reduce their international networks, thereby downsizing the number of CBRs they maintain. This development has presented both a challenge and an opportunity for international trade finance.

The Effects of the Legal and Regulatory Environment on Bank-Intermediated Finance: The Case of Correspondent Banking

Typically, bank-intermediated trade financing comprises loans given by banks to importers or exporters in the form of working capital or on a recourse basis against a confirmed export order, as well as credit given in the form of a number of trade-finance instruments. The most common instruments of bank-intermediated finance are letters of credit (commercial and standby), guarantees and documentary collections. Through these instruments, a bank ultimately agrees to vouch for an importer's or exporter's creditworthiness. Between 2008 and 2011, loans accounted for about 48% of bank-intermediated finance of globally active banks, while letters of credit and guarantees accounted for approximately 52%[14]. Currently, commercial letters of credit are the most popular trade finance instrument (see Figure 2 below; products are shown clockwise)[15].

Figure 2: Trade Finance Product Mix



Source: ICC Global Survey on Trade Finance (2016)

Bank-to-bank relations underpin both cross-border loans and credit provided in the form of letters of credit, guarantees and documentary collections because the presence of a bank is generally needed on both sides to facilitate the transfer of funds from importers (and their banks) to exporters (and their banks), and assurances and accompanying documentation need to be able to travel across borders.

Bank-to-bank transactions are managed through CBRs, under which a local or regional bank with limited access to global financial markets (respondent bank) establishes a deposit or other liability account at a larger globally active bank (correspondent bank) which, in turn, provides products and services that the local or regional bank would otherwise not be able to access. These arrangements contribute to international trade finance because they give local and regional banks access to financial services in different jurisdictions and serve as a means for local and regional banks to provide cross-border payment services to their local customers[16]. CBRs allow local and regional banks to gain access to international payment structures (in particular for remittances and other money and value transfer services), clearing and settlement systems, and other networks that allow local and regional banks to extend their services to foreign jurisdictions. However, CBRs enable international trade not only because they provide these operational services to local and regional banks, they also help respondent banks acquire liquidity and satisfy their need for US dollar funding, the currency most often used in international trade.

These bank-to-bank relationships are, however, changing, particularly between developed and developing country financial services providers as a result of changes in international legal and regulatory dynamics. Increased compliance costs driven by anti-money laundering rules, know-your-customer requirements and Basel III prudential regulations have been reported as major reasons for this change in these relationships. Globally active banks have become subject to more stringent capital and liquidity requirements, have seen a weakening in balance sheets due to changed rules and have become structurally more risk-averse as a result. These factors have led to a significant decline in CBRs, especially in Africa, the Caribbean, Russia and countries in Central Asia and Eastern Europe[17], which has contributed to the continued decline in international trade finance and has presented a challenge to the effective participation of local and regional banks in the trade finance market.

The problem can be traced back to the 2008-2009 global financial crisis. The crisis set off stricter rules as discussed above and a wave of de-risking of globally active banks, which in turn led to a trade finance vacuum, especially in developing country markets. This vacuum at first glance represented an opportunity for local and regional banks to increase their participation in the trade finance market[18], but the financial crisis also triggered a process for legal and regulatory change within international standard-setting bodies that would further complicate the trade-financing landscape.

The new environment post-financial crisis led transnational financial institutions, which were uniquely positioned to furnish the goods and services that local and regional banks required to provide financing to their local and regional customers on a cross-border basis, to reduce the number of relationships they maintain. As a result of this "withdrawal" of CBRs, some local and regional banks have been cut off from global finance value chains[19]. Local and regional banks, which have historically been unable to meet the pre-existing demand for trade finance, are now confronted with an additional hurdle in addressing demand. Since local and regional banks are typically confined to local and regional financial markets, their capacity to provide finance on a cross-border basis or with transnational components has traditionally been limited by their ability to access global finance value chains via, among other channels, CBRs with well-established global financial institutions.

The profitability of providing goods and services through CBRs has decreased as well. The post-financial crisis enabling environment is more risk-averse, and there is an upward trend in deterrence and enforcement, flowing mainly from requirements imposed by the US and the EU. Globally active banks are currently less likely to risk being sanctioned internationally for legal and regulatory non-compliance and increasingly fear the resulting reputational damages[20]. Consequently, they have developed a heightened sensitivity to the risks associated with correspondent banking and have cut back relationships that do not generate volumes sufficient to counterbalance the costs and potential risks involved.

There are some factors attenuating the de-risking trend of globally active banks. According to the IMF, the impact of the deterioration in CBRs has been limited, partly because financial institutions in affected countries have been able to find alternative arrangements, such as holding on to and relying on their remaining CBRs, finding replacements and using other means for transferring funds across borders[21]. Further, in 2015 there was a relatively positive overall climate for global finance. According to the Asian Development Bank, the decline in CBRs appears to have peaked in 2014[22].

Although fewer relationships are being terminated today, this is most likely because correspondent banks have already experienced a massive withdrawal of CBRs. The fact that so many of these relationships have already been terminated is cause for concern, especially in developing country markets. While the question of whether there has been a net loss of global trade financing capacity as a result of the events that ensued after the 2008-2009 financial crisis is still lingering, the reality is that globally active banks still provide between one quarter and one third of bank-intermediated trade finance[23]. Since the global financial crisis, they have downsized and rationalized existing business away from high-risk markets, leading to a decrease in the volume of trade finance provided globally and a shift away from the markets that need financing the most[24]. Further, trade finance remains sluggish in growth. With the exceptions of China and Hong Kong, the pace of international trade continues to outgrow trade finance[25]. Bank-to-bank relationships underpin the provision of financing for international trade, particularly for countries in which there are hardly any globally active banks or none at all. If unaddressed, therefore, the withdrawal of CBR could have a profound and systemic impact on access to financial services where it is needed most.

To address this problem, this white paper proposes an action plan which is directed at managing and reducing regulatory compliance costs, both individually and across respondent-correspondent relationships, and more effectively drawing in local and regional stakeholders from developing countries. Such a development-focused approach, which also includes a shift towards non-bank financing solutions and approaches, could shift the existing dynamics in a positive direction and help local and regional banks more effectively meet the demands of finance of their local customers and thereby close the trade finance gap.

Recommendations for a Development-Oriented Approach

The trade financing gap and CBR issue are complex, as are the legal and regulatory systems that underpin them. Solutions will have to bridge both trade-related goals and other finance-specific regulatory objectives such as financial stability and market integrity. There will be some risks that financial service providers should not take, regardless of the narrowing effects on international trade, but there is significant room for a more dynamic, development-focused approach to the challenge discussed in this paper.

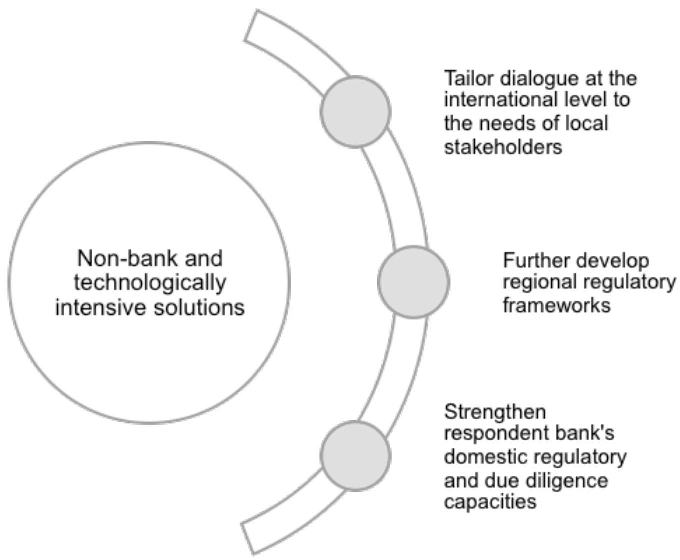
Overall, a shift in focus could have a significant impact. New finance models are needed and certain voices should be given a more active role. For instance, to date, approaches to the correspondent banking problem have been discussed and analysed by the World Bank, the IMF, the BIS and a handful of development banks, among other organizations. While these approaches do rely on consultation with affected stakeholders, they seem to be largely high-level and top-down, with developing countries put in a difficult position because of their reliance on these institutions. Approaches are warranted that are more from the ground up and driven by the needs of countries in which local and regional stakeholders have been most affected by the withdrawal of CBRs, where the trade-finance gap is also steepest.

With respect to CBRs, a recent World Bank survey indicates that the principal reasons for reducing the correspondent banking network are: (1) increased compliance costs brought about as a result of changes in the legal and regulatory landscape; (2) an overall risk-averse appetite of globally active banks; and (3) correspondent bank concerns about existing customer due diligence processes in respondent banks[26]. This highlights the need for solutions that aim to: (1) reduce legal and regulatory compliance costs; (2) stabilize regulatory expectations; (3) improve perceptions of market uncertainty; and (4) facilitate customer due diligence processes affecting local and regional banks and clarify what they entail.

These approaches should, however, also focus on local and regional stakeholders and be tailored to improving the climate for the financing of international trade through the increased participation of local and regional banks so that they can more effectively respond to the unmet demands for trade finance. It is also important to note that while this analysis is tailored to the CBR case, the underlying issues and solutions put forward have broader application for addressing trade-financing challenges.

A four-pronged approach would address the current gaps and help strengthen trade-financing systems overall. Its components are: building local regulatory capacity; establishing a regional initiative for trade financing; better tailoring the international regulatory dialogue to the needs of local stakeholders; and fostering new and innovative solutions. This four-pronged approach is tailored around reported bottlenecks for local and regional stakeholders and encompasses a set of solutions that could address the CBR problem in particular as well as the trade-financing challenge more generally. As an overarching recommendation, the areas outlined below should be the focus of further analysis and action-oriented public-private efforts.

Figure 3: Recommended Four-Pronged Development Focused Approach



First and foremost, **new approaches to trade finance should be encouraged, including through the use of technology and non-bank financial services**. This would help minimize the effects of changes in trade financing (exemplified through CBR withdrawal) and change the trade finance game. Trade finance is behind other areas of finance in transitioning to the age of digitization. Innovative models for financial services and products, including online trade-document management, paperless transactions, digitized letters of credit, purchase orders and bills of lading, along with other technologies (such as distributed ledger technology), could transform the way the trade finance business is conducted. By reducing transaction and compliance costs across bank-to-bank relationships, technology could be part of the solution to the problem highlighted by the CBR case.

Change is under way, and end-to-end digitized bank-intermediated transactions have now been successfully completed. Systemic changes are yet to be seen, but the advent of digitization is, at a minimum, likely to lead to bank-intermediated finance operating in a more cost-effective and transparent way.

As the correspondent banking challenge shows, new models and non-bank solutions for financial services delivery are needed to address the trade finance gap. While banks will always play a role in trade finance, non-bank financial services could both help respond to the current challenge and pave the way for engaging more enterprises, especially SMEs, in trade. Many financial products and services have not kept pace with the evolution of inter-company and supply-chain financing. For example, new models that leverage big data have already started to yield benefits. Non-bank intermediated finance providers have started to use information from buyer/supplier networks to extend supply chain financing services to SMEs earlier in the process (such as pre-shipment), delivering trade finance to those who need it the most.

Non-bank financing solutions could be the answer to increased trade in sectors like agriculture, where the risk equations are particularly high regardless of bank-to-bank dynamics. Opening up these new opportunities will involve both market innovation and appropriate policy and regulatory frameworks, which highlights the need for new approaches and public-private collaboration.

Banks might need more encouragement to up their game and pick up on these innovative models. Overall, however, financial institutions are likely to respond to these opportunities both because the potential of new products and services to make bank-intermediate finance operate in a more cost-effective and transparent way is ripe for exploration, and because the trade financing gaps highlight a distinct need in the market that is not being fully met.

While the availability of innovative and tailored products in the market will have a profound impact on the trade financing landscape, as the correspondent banking example highlights, regulatory structures play a direct and instrumental role. The second and perhaps most pressing recommendation is that the **international regulatory dialogue should be tailored to the needs of local stakeholders, with broader participation across countries**. While existing efforts deserve credit, increasing dialogue among stakeholders could be instrumental in clarifying ambiguities in existing international standards and stabilizing regulatory expectations.

Maintaining an open dialogue, especially among local and regional regulators and their counterparts from the OECD, including the United States, European Union and other jurisdictions, would help to link regulators who have been active within international standard-setting bodies with regulators in developing markets to enhance compliance and improve risk perception. This increased engagement among regulators would also help to clarify expectations with regard to global standards on financial crime, achieve a uniform understanding of requirements and common compliance goals, and encourage effective implementation. Active engagement with developing country regulators could help level expectations of regulators of globally active banks, improve overall risk assessment and pave the way for policy that gives comfort to correspondent banks and other relevant actors. Ultimately, this would strengthen an alternative pathway for addressing concerns rather than CBR withdrawal.

A step in the right direction could be the creation of a global registry of countries and their respective local and regional banks which meet the standards of financial crime compliance, tax transparency and prudential regulation. An international dialogue on tax transparency is under way with the collaboration of over 100 countries and jurisdictions, particularly in the context of the base erosion and profit-shifting (BEPS) project spearheaded by the OECD. More could be done, however, to engage a wider base within the international forums in which the financial crime compliance and prudential regulatory standards are set.

These efforts would also help ensure that trade and development considerations are more fully reflected in the implementation of both current and future international standards. Capacity development and technical assistance programmes could also result, which would link jurisdictions hosting globally active banks with the authorities of affected countries, as well as correspondent banks and respondent banks. A first approach could be to try to persuade the BIS, its Basel Committee and the FATF to muster a wider base.

The Basel Committee is currently composed of 28 member states and two regional and two international organizations, while the FATF currently comprises 35 member jurisdictions and two regional organizations. In addition to efforts to increase dialogue through these channels, correspondent banking and trade finance issues could be linked to initiatives within institutions that have a wider base of representation, such as the World Trade Organization (WTO), to build on other efforts to increase trade finance.

Third, **regional regulatory frameworks could be used to foster the harmonization of rules**, streamline efforts and reduce compliance costs. As in other areas of law and regulation, regional harmonization could lead to streamlined definitions, standards and policies that reduce compliance burdens and improve accountability across related jurisdictions. This could be achieved by setting up regional initiatives focused on financial crime, prudential regulation and tax transparency. In the Caribbean, one of the regions most hard-hit by gaps in trade financing, banks have, for example, created regional banking associations and set up institutional structures around themes such as money laundering and terrorism financing (for example, the Caribbean Financial Action Task Force). The Eastern Caribbean Central Bank has even consolidated national work on money laundering and terrorism financing into a single regional operation. These efforts could provide good practices for other regions, such as the Regional Economic Communities (RECs) in sub-Saharan Africa, and could be integrated and later harmonized across neighbouring regions and shared with the wider international community. This is one area in which IMF and World Bank facilitation could be instrumental.

Further, banks within a region could bundle transactions to create the economies of scale required for globally active banks to maintain correspondent banking services. Affected stakeholders should seek to align their interests by strengthening regional financial services networks and advocating for the increased participation of their governments in global standard-setting processes. This would help ensure that regional and local interests are better reflected in future financial laws and regulations.

Finally, work should continue to be done at the **local level to strengthen the regulatory and due diligence capacities of local (respondent) banks**, including their ability to detect, monitor, mitigate and prevent financial crime and economic and trade sanctions, as well as comply with new prudential and tax transparency regulations in a cost-effective way. This could include government- and industry-led initiatives, as well as public-private partnerships.

For instance, national governments and other stakeholders could play a principal role in minimizing systemic perceptions of risk, especially with regard to jurisdictions that are perceived as having unacceptable levels of risk. Country-level initiatives could be designed to ensure that domestic legal and regulatory frameworks on financial crime, prudential regulation and tax transparency are brought on par with global standards. Such domestic levelling could take place with the advice of, or with support from, the BIS, FATF, OECD and IMF. To varying degrees, this is under way in many jurisdictions and could be further strengthened.

Domestic legislation that eases respondent banks' ability to access local customer information and share that information – in particular as a result of data privacy issues or because of a lack of instruments allowing for the effective local and international exchange of tax information – could continue to be advanced. The peer review process conducted by the Global Forum on Transparency and Exchange of Information for Tax Purposes is an example of a practice that could continue to support the domestic legislative process in jurisdictions that need enhanced mechanisms for sharing and reporting tax information.

Countries housing local and regional banks could also make sure that their regulatory authorities, supervisory agencies and other local entities are held accountable for the effective implementation of and compliance with international standards. These local authorities could help address expectations and reduce negative market and regulatory perceptions by providing guidance on the extent of customer due diligence obligations. They could also work with respondent banks to enhance ways in which they signal their observance of financial crime, prudential and tax transparency regulations. National associations of banks could exert additional pressure on regulatory authorities and other government entities during the adoption and enforcement of international standards, thereby bolstering the accountability and signalling process.

Industry-led initiatives could also pave the way for change and play a direct role in the regulatory process. Some initiatives have already been proposed and include using private sector know-your-customer utilities with the aim of creating a single repository of relevant customer due diligence information and promoting the use of the Legal Entity Identifier[27]. Public-private partnerships could also be explored at the country and regional levels. A key goal could be to induce the local industry to standardize and coordinate information-gathering processes, data content and risk-assessment processes. At the local level, any efforts to improve regulatory capacity and strengthen the local banking sector could have positive repercussions that reach well beyond the correspondent banking challenge and address financial services needs more broadly, acting as a force multiplier for change.

Overall, an approach that is development-oriented, more inclusive of local and regional stakeholders, and accompanied by technological and non-bank financing solutions has the potential to help globally active banks address enhanced legal and regulatory challenges since the 2008-2009 financial crisis, while also improving the market conditions necessary for meeting the demand of international trade finance across the globe. This approach, while tailored to the CBR case, underscores the importance of legal and regulatory systems for the financing of international trade. It also highlights the broader connection between legal and regulatory frameworks and economic development. Laws and regulations regularly impact the institutional and market conditions that have been established in furtherance of economic growth, creating both opportunities and challenges as this paper has highlighted. By helping to bridge the gaps facing developing countries, both in terms of market-based solutions and regulatory capacity, the changing international regulatory landscape can produce positive effects for development rather than negative consequences.

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