



# BAFT-IFSA

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## **Basel Impact on Trade**

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# Agenda

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1. Welcome and Introduction
2. Overview of Basel III / Impact on Trade Finance
3. Ongoing Advocacy
4. Citi View of Current Environment
5. Evolution: Basel I to Basel III
6. Expected Impact on Trade Finance
7. Q & A



# BAFT-IFSA Overview

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- BAFT-IFSA is the trade association for organizations actively engaged in international transaction banking.
- It serves as the leading forum for bringing the financial community and its suppliers together to collaborate on shaping market practice, influencing regulation and legislation through global advocacy, developing and adapting new and existing instruments that facilitate the settlement of products and service offerings for clients, providing education and training, and contributing to the safety and soundness of the global financial system.
- Roughly 200 members worldwide (global, regional, and local banks, firms, suppliers)
  - Africa
  - Europe
  - Middle East/North Africa
  - Asia
  - Latin America
  - North America



# Basel III – Summary Perspective

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- December 2009 – Basel Committee Publishes texts of Basel III Capital and Liquidity Framework; Final Text Agreed at November 2010 G-20 Meeting in Seoul. <sup>1</sup>
- During the 2008-09 financial crisis, global trade fell 23% (\$3.5 trillion in value) <sup>1</sup>. Banks reduced the availability of trade finance to shore up capital positions, accounting for an estimated 10-15% of the reduction. <sup>2</sup>
- In 2010, the G20 reiterated the importance of trade to the global recovery, in terms of low-income countries (LICs) in particular, and emphasized their commitment to trade programs promoting and facilitating growth. The G20 agreed to “assess the impact of regulatory regimes on trade finance”. <sup>3</sup>
- The Basel Committee agreed to evaluate the impact on trade finance in the context of low income countries. <sup>4</sup>
- Trade Finance products have significantly different risk profiles, default rates and capital uses from other corporate products. Basel III will negatively impact the availability and cost of trade financing - most commonly used by small and medium enterprises (SME), particularly in LICs.

1. Basel Committee – December 2009/December 2010

2. World Trade Organization (WTO)

2. Robert Zoellick, *Financial Times*, February 19, 2009

3. G20 Seoul Summit 2010 Communiqué

4. BIS press release Results of Basel Committee meeting on Banking Supervision – Dec. 2010



## Basel III: Objectives

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- The fundamental goal is to ensure resiliency in the financial sector through global standards on capital and liquidity
- At a macro level, capital requirements increased and new leverage and liquidity requirements were introduced
- Key measurements will be focused on:
  - Capital – Capital Requirements
  - Leverage – Leverage Ratio (L/R)
  - Liquidity – Liquidity Coverage Ratio (LCR)
  - Funding – Net Stable Funding Ratio (NSFR)



## Basel III: Measurements

- OECD study (Feb. 2011) estimates that Basel III will decrease GDP 0.05-0.15% per annum
- Allowance for national regulatory discretion (hold up to 2.5% additional capital during high credit periods)
- Observation periods to allow for calibration

Measurement	Basel II	Basel III (2015 – 2019)
Capital (% RWA)	2% common equity 4% Tier 1	4.5% common equity 6% Tier 1 10.5% Total capital (incl. buffer)
Leverage Ratio	Does Not Exist	3% minimum
LCR	Does Not Exist	[HQLA / 30 day NCO] $\geq$ 100%
NSFR	Does Not Exist	[ASF / RSF] $\geq$ 100%



## Basel III: Impact on Trade Finance

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- Informal survey - Basel III may raise Trade Finance costs 18-40%, which is likely to be passed on to corporate clients
- Potential reduction of Trade Finance offered in favor of using the balance sheet for other, more profitable corporate products
- Key concerns for Trade Finance:
  - 1-year Maturity Floor – does not reflect short-term reality of Trade Finance assets
  - Credit Conversion Factor (CCF) – converts off-balance sheet assets at 100% (2-5x increase for commercial, performance SBLC) – not consistent with low risk nature of Trade Finance
  - Asset Value Correlation (AVC) – lumps Trade Finance in with other, higher-risk corporate products



# Assessing the Current Trade Finance Environment

## December 2010 Survey – BAFT-IFSA / International Monetary Fund

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- **Survey conducted Oct. – Dec. 2010; continuation of research 2008--2010**
  
- **Senior executives representing 118 banks in 34 countries**
  - 57% - Industrialized countries
  - 17% - Latin America
  - 8% - Developing Asia
  - 6% - Emerging Asia (incl. China / India)
  - 5% - Middle East
  - 4% - Emerging Europe
  - 4% - SE Europe / Central Asia
  - 1% - Sub-Saharan Africa
  
- **Wide distribution in size**
  - 43% - Large bank (\$100 billion +)
  - 21% - Medium banks (\$5 - \$99.9 billion)
  - 36% - Small banks (Under \$5 billion)



# Assessing the Current Trade Finance Environment

## December 2010 Survey – Anticipation of Basel III

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- **92% believe Trade Finance costs will increase due to changes in Credit Conversion Factor (CCF)**
- **32% believe availability of Trade Finance will decrease**
  - 50% of Large banks will reconsider their Trade Finance portfolio
- **Disparity in education between large and small banks as it relates to the impact of Basel III, in particular, the changes to CCF and their impact on Leverage Ratio**
  - 69% of Large bank believe Trade Finance will be more negatively impacted than other products in the bank's portfolio
  - 65% of Small and Medium banks are “Not Sure”

# Basel I,II,III: Impact on Trade (Global Bank sample)

A Global Trade portfolio with a concentration of SME obligors and Emerging Market bank risk will most likely demand higher capital reserves. Banks will have margin pressures and potentially could be non-competitive in this space

S&P/ Moody's Rating	Type of obligor	Tenor of loan	Basel 1			Basel II			Proposed	Basel III
			Obligor Risk Weight	Facility Risk Weight (CCF)	Total Risk Weight	Obligor Risk Weight (LGD based)	Facility Risk Weight (CCF)	Total Risk Weight	Facility Risk Weight (CCF)	Total Risk Weight
AA+/AA1	Corporate	1 year	100%	100%	100%	6.1%	100%	6.1%	100%	6.1%
AA+/AA1	Corporate	Sight L/C	100%	20%	20%	6.1%	20%	1.2%	100%	6.1%
AA+/AA1	OECD Bank	1 year	20%	100%	20%	6.1%	100%	6.1%	100%	6.1%
<b>AA+/AA1</b>	<b>OECD Bank</b>	<b>Sight L/C</b>	<b>20%</b>	<b>20%</b>	<b>4%</b>	<b>6.1%</b>	<b>20%</b>	<b>1.2%</b>	<b>100%</b>	<b>6.1%</b>
BBB-/Baa3	Corporate	1 year	100%	100%	100%	46.5%	100%	46.5%	100%	46.5%
<b>BBB-/Baa3</b>	<b>Corporate</b>	<b>Sight L/C</b>	<b>100%</b>	<b>20%</b>	<b>20%</b>	<b>46.5%</b>	<b>20%</b>	<b>9.3%</b>	<b>100%</b>	<b>46.5%</b>
BBB-/Baa3	Bank	1 year	100%	100%	100%	46.5%	100%	46.5%	100%	46.5%
BBB-/Baa3	Bank	Sight L/C	20%	20%	4%	46.5%	20%	9.3%	100%	46.5%
BB-/BB3	EM Bank	1 year	20%	100%	20%	127.3%	100%	127.3%	100%	127.3%
<b>BB-/BB3</b>	<b>EM Bank</b>	<b>Sight L/C</b>	<b>20%</b>	<b>20%</b>	<b>4%</b>	<b>127.3%</b>	<b>20%</b>	<b>25.5%</b>	<b>100%</b>	<b>127.3%</b>
BBB+/Baa	Sovereign	1 year	0%	100%	0%	22.2%	100%	22%	100%	22%



# BAFT-IFSA Global Regulatory Discussions

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- Coordinated global visibility and education campaign; Europe, US, Asia, Africa, MENA and Latin America
- Regular communication with governments, multilateral bodies and local/regional industry associations
- Communications:
  - Position papers to the G-20 and multilateral institutions
  - BAFT-IFSA/IMF Global Trade Finance Survey
  - Joint industry letter signed by 22 industry associations worldwide
  - Meetings with regulators, legislators and industry associations around the globe



# Global Implementation Status

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- **US** – Capital rulemaking possible by year end 2011/Liquidity TBD
- **EU** – CRD4 presented to Parliament/Council July 2011
- **China** – CBRC Guiding Opinion and draft rulemaking published
- **Australia** – APRA Discussion Paper released; Second Consultation 2012
- **India** – Rulemaking pending; Implementation beginning 2013
- **Basel Committee/G-20** – Review of unintended consequences for trade finance



# General Recommendations on Basel II / III

Based on broad consensus on directional changes needed

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## ➤ Capital

1. Remove one-year maturity floor under Basel II and III. We recommend achieving global adoption.
2. Create separate AVC for trade finance.
3. Adjust default data assumptions - due to previous lack of data, banks should continue to be allowed to enhance their current default data calculations using available industry data as it becomes available (e.g., ICC Trade Register study once it has been expanded)

## ➤ Leverage

1. Adjust CCF since very few trade instruments actually get converted from off-balance sheet to on-balance sheet
2. Create separate CCF for trade contingents like commercial LCs, standby LCs and guarantees

## ➤ Liquidity

1. Recognize liquidity of Financial Institution (FI) balances (similar to corporate clients) by defining operational activities more broadly to include all inter-bank operational transactions
2. Recognition given to FI deposits should be extended to the Net Stable Funding Ratio, enabling them to qualify as an available source of stable funding
3. Prescribe Required Stable Funding Ratio for off-balance sheet trade exposures
4. Re-calibrate net-outflow assumptions in LCR calculation for Trade



# Contact for Further Information

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