BAFT-IFSA

Basel III Update
Global Trade Industry Council

CLACE 2012 – Miami, FL

June 4, 2012

Tod Burwell
Sr. Vice President, Trade
BAFT-IFSA

Agenda

1. Introduction to BAFT-IFSA
2. Basel III – Summary View
3. Basel III - Impact on Trade Finance
4. Basel III - Implementation Status
5. GTIC – Global Trade Industry Council
6. Trade Definitions
7. Trade Investors – New Liquidity?
8. Q & A

BAFT-IFSA Overview

- 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 185 members worldwide (global, regional, and local banks, firms, suppliers)
  - Africa
  - Europe
  - Middle East/North Africa
  - Asia
  - Latin America
  - North America

Basel III – Summary Perspective

- Basel III unintended consequences have an effect on the real economy.
- Basel III is a framework, not a regulation. Several countries have drafted rulemaking and are in consultation periods. Capital implementation has advanced, Liquidity is being considered.
- Externalities such as the Euro Zone crisis, bank trading losses, political elections and economic conditions in Europe and North America have an impact on the perception of tighter regulation vs. over-regulation; austerity vs. growth. This impacts the pace of implementation.
- Trade Finance is part of a broad basket of corporate products and as such, receives disproportionate capital treatment. Disincentives for Trade Finance lending has an unintended, but direct consequence on real economic growth.
- Discussions on Basel have leveraged industry collaboration - corporates/banks, BAFT-IFSA Trade Finance definitions, ICC Trade Register. Continued dialogue with local/national regulators and policy makers is essential.

Basel III: Objectives

- 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)

Multi-Year Timing But, Banks are Racing to Basel III Compliance

	2011	2012	2013	2014	2015	2016	2017	2018	2019
Capital Framework									
Minimum Common Equity (CET1)	2.0%	2.0%	3.5%	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Deductions from CET1[1]	NA	NA	NA	20%	40%	60%	80%	100%	100%
Minimum Tier 1 Capital			4.5%	5.5%	6.0%	6.0%	6.0%	6.0%	6.0%
Minimum Total Capital	**8.0%**	**8.0%**	**8.0%**	**8.0%**	**8.0%**	**8.0%**	**8.0%**	**8.0%**	**8.0%**
Capital Conservation Buffer (CCB)	NA	NA	NA	NA	NA	0.625%	1.25%	1.875%	2.5%
Total Capital including CCB	**8.0%**	**8.0%**	**8.0%**	**8.0%**	**8.0%**	**8.625%**	**9.25%**	**9.875%**	**10.5%**
Counter Cyclical Buffer (if triggered)						Up to 0.625%	Up to 1.25%	Up to 1.875%	Up to 2.5%
					Phase In				
Additional Loss Absorbency for G- SIBs[2]									1% to 2.5%
Potential Max Total Capital with G-SIB and Countercyclical Buffer [2]				Parallel Run with Disclosures 2015+					**15.5%**
Leverage Ratio [3]								3%	3%
Liquidity Ratios									
Liquidity Coverage Ratio (LCR) [4]	Observation Period				≥ 100%	≥ 100%	≥ 100%	≥ 100%	≥ 100%
Net Stable Funding Ratio (NSFR) [4]	Observation Period							> 100%	> 100%

1. Deferred Tax Assets (DTA), Mortgage Servicing Rights (MSRs) and equity ownership of other financial institutions is capped each at 10% of CET1 and combined at 15% of CET1; phased out completely by 2018
2. Additional requirement for Global – Systemically Important Banks (G-SIBs) proposed June 25, 2011, ranges from 1-2.5% (with an additional 1% for banks in the top category who increase their systematic importance). Significant uncertainty remains in this.
3. Test run at 3% during observation period before figure set for 2018+.
4. Proposed but not final ratio

Basel III: Impact on Trade Finance

- 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 – several jurisdictions provided a waiver; Basel Committee provided a partial global waiver (Oct. 2011)
  - 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) – Trade Finance is grouped with other, higher-risk corporate products
  - Liquidity – counts only 50% of inflows instead of 100%

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

			Basel 1			Basel II			Proposed	Basel III
S&P/ Moody's Rating	Type of obligor	Tenor of loan	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%
AA+/AA1	OECD Bank	Sight L/C	20%	20%	**4%**	6.1%	20%	**1.2%**	100%	**6.1%**
BBB-/Baa3	Corporate	1 year	100%	100%	100%	46..5%	100%	46.5%	100%	46.5%
BBB-/Baa3	Corporate	Sight L/C	100%	20%	**20%**	46.5%	20%	**9.3%**	100%	**46.5%**
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%
BB-/BB3	EM Bank	Sight L/C	20%	20%	**4%**	127.3%	20%	**25.5%**	100%	**127.3%**
BBB+/Baa	Sovereign	1 year	0%	100%	0%	22.2%	100%	22%	100%	22%

Basel II – Implementation Status (as of Sept. 2011)

Final Rule is in Force, but at different stages of implementation

Implementation Completed	Implementation In Process	Exceptions
Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong, India, Italy, Japan, Korea, Mexico, Netherlands, Saudi Arabia, Singapore, S. Africa, Spain, Sweden, Switzerland, UK, EU	• Indonesia – Pillar 1 done, Pillar 2 (Dec. 2012) • Russia – Pillar 2 (2014) • Turkey - parallel run on-going (July 2012) • US – Regulatory Ratios reported under B1 but banks are implementing B2 advanced approaches	Argentina*

* Argentina – on-going work to assess migration from B1 to B2 standardized approach; Final rules for operational risk/Pillar 2 published

Basel III – Adoption Status (as of March 2012)

Final Rule Published	Draft Regulation Published	Draft Regulation NOT Published
Japan – implementation of final rules (March 2013) Saudi Arabia – final regulation issued to banks	Australia, Brazil, Canada, China, India, Singapore, Switzerland • EU – Belgium, France, Germany, Italy, Luxembourg, Netherlands, Spain, Sweden, UK	Argentina, Hong Kong, Indonesia, Korea, Mexico, Russia, S. Africa, Turkey, United States

- EU – in Trialogue negotiations on CRD IV amendments
- HK – consultation on draft text planned Q4 2012
- Mexico – final rule expected in Q2 2012
- US – to be coordinated with work on Dodd-Frank – planned Q2 2012

ICC Trade Finance Register

- Initial study (9 banks) 2005-2009 - covering 5.2 million transactions. Expanded study (18 banks) 2008-2010 - covering 11.4 million transactions
- Trade Finance is short-term
  - Avg. tenor of all transactions = 147 days
  - Avg. tenor of Off-Balance Sheet transactions = 80 days
- Trade Finance is low risk (< 3,000 defaults)

Product	Default Rate	Loss Rate
Import LC	0.077%	0.007%
Export LC	0.09%	0.03%
Standby LC	0.013%	0.0007%
Import Loan – Corp.	0.06%	0.07%
Import Loan – Bank	0.09%	0.05%
Export Loan – Corp.	0.29%	0.017%
Export Loan - Bank	0.17%	0.01%

EU – CRD IV Amendments

➢Capital

- Removes one-year maturity floor for ALL Trade Finance products (not just Doc. Trade)

➢Leverage

- Keeps CCF at original levels (not 100%)
  - 20% for Low Risk
  - 50% for Medium Risk

➢Liquidity

- Recognizes 100% of Trade inflows in LCR calculation (not 50%)
- Proposes industry standard definition be developed for operational vs. correspondent banking account to determine liquidity treatment

GTIC - Global Trade Industry Council

- Thought leadership driving industry issues
- Focus on standards development/best practices, regulatory advocacy, education and promotion of a healthy trade finance industry
- Global Heads of Trade Finance

Bank of America	**BNP Paribas**	**Agricultural Bank of China**
BNY Mellon	**Commerzbank**	**Bank of China**
Citi	**Deutsche Bank**	**Bank of Tokyo Mitsubishi**
J.P. Morgan	**HSBC**	**ICICI**
Wells Fargo	**Royal Bank of Scotland**	**Standard Bank**
SWIFT	**Santander**	**Standard Chartered Bank**
	UniCredit	

BAFT-IFSA Trade Definitions

- Common industry definitions facilitate more consistent data collection, which facilitates better understanding of Trade Finance
- BAFT-IFSA definitions facilitated Basel discussions with regulators and policy makers
- BAFT-IFSA definition intended to work in conjunction with ICC Trade Register
- Trade Finance grouped into:
  - Traditional Trade Finance
  - Open Account Trade Finance
  - Structured Trade / Export Finance
- Objective => banks to consistently book data using the same definitions
- Available on BAFT-IFSA website: http://www.baft-ifsa.com/

Traditional Trade Finance Definitions

- Traditional Documentary Products
  - Collections
  - Letters of Credit - Commercial/Documentary
  - Letters of Credit – Standby
  - Letters of Guarantee
- Traditional Financing Products
  - Trade Loans
  - LC Financing (Negotiation, Acceptance, Refinancing/Post-shipment, Prom Notes)
  - Trust Receipts
  - Shipping Guarantees
  - Forfaiting
- Risk Clusters

Open Account Trade Finance Definitions

- Open Account Processing / Servicing
  - P.O. Advice
  - Document presentment and data matching
  - Discrepancy handling / dispute resolution
  - Management of approved invoices
  - Document payment / reconciliation
- Open Account Trade Products
  - P.O. commitment to pay
  - Pre-shipment financing – P.O. financing
  - Post-shipment financing – using receivable as collateral
  - Warehouse financing
  - Approved Payables Finance
  - Receivables purchase
  - Flexible due date

Trade Finance Investors

- Reductions in liquidity making it difficult for SME companies and emerging markets to obtain trade finance and/or driving spreads higher
- Secondary market is informal – driven by large banks
- ECA financing has limitations and sovereign concerns
- Despite Trade Finance being a safer asset than consumer products or other corporate products, it is not widely understood
- Where will additional investors come from?
- What will it take to pull them in?

Summary

1. Basel III may have unintended consequences that negatively impact the availability and cost of Trade Finance, thus, affecting the REAL ECONOMY!

2. De-leveraging, over-regulation and externalities are a troubling combination.

3. The BAFT-IFSA Global Trade Industry Council (GTIC) is attempting to drive consensus across the industry and provide leadership on common issues.

4. Common definitions, common data and common practices are a pre-requisite for common understanding and….progress.

5. Where will the liquidity come from to finance continued growth?

Contact for Further Information

Tod Burwell
Senior V.P., Trade Products
Email: tburwell@baft-ifsa.com

BAFT-IFSA
1120 Connecticut Ave. NW
Washington, DC 20036
Phone: +1-202-663-7575