

BAFT-IFSA

ONE VOICE FOR THE INTERNATIONAL BANKING COMMUNITY

April 16, 2010

Secretariat
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002
Basel, Switzerland

Re: Consultative Document: *Strengthening the resilience of the banking sector*

Ladies and Gentlemen:

BAFT-IFSA is an international financial services trade association whose membership includes a broad range of financial institutions throughout the global financial community. As a worldwide forum for analysis, discussion, and advocacy in international financial services, BAFT-IFSA member banks have a high interest in preserving the safety and soundness of the global financial system.

BAFT-IFSA welcomes the opportunity to comment on the consultative document on capital published by the Basel Committee on Banking Supervision (Committee), entitled *Strengthening the resilience of the banking sector* (consultative document). BAFT-IFSA supports the Committee's goals of promoting a more resilient banking sector and agrees that a strong and resilient banking system is the foundation for sustainable economic growth. BAFT-IFSA believes, however, that certain recommendations in the consultative document could add to the existing uncertainty with Basel II implementation regarding the treatment of trade finance instruments. Certain proposals presented by the Committee could result in reduced trade flows for trade focused banks at a time when they are essential to support a global economic recovery.

Introduction:

Trade finance has historically maintained a low risk profile in comparison with other financial instruments. Trade finance transactions are generally fixed, short-term instruments that are not automatically renewed or extended upon maturity and are self-liquidating by nature (*i.e.*, exposures are liquidated by payment at maturity). In stress situations, countries and banks have traditionally continued to prioritize the repayment of short-term trade finance obligations as they fall due. Furthermore, banks active in trade finance are generally able to react swiftly on deteriorations in bank and country risk, as a result of the short-term, self-liquidating nature of the transaction. According to a survey conducted by the International Chamber of Commerce (ICC) in March 2009, banks have experienced relatively minimal losses on trade lending over the past

few decades¹. Internal studies conducted by financial institutions have, in some cases found, a loss of less than 0.1 percent in trade finance volume on an analysis of commercial trade transactions conducted during a period of time greater than ten years.

However, the implementation of Basel II, concomitant with the global recession, has put additional pressure on banks, as global risk deterioration has had a dynamic effect on bank capital requirements. This dynamic propelled deleveraging even further during the economic crisis. Given the global economic contraction, banks have had a heightened sensitivity in their exposures to trade clients and have experienced decreased access to private-sector risk mitigation providers, as a result of retrenchment due to the economic impact on their non-trade related business. Trade underpins the prospects of global economic recovery and any measures that potentially restrict the willingness or ability of banks to support trade has the potential to disrupt or slow global economic growth.

Trade finance instruments are pivotal in supporting international commerce and contributing to the growth of the world economy. In the economic crisis, world trade fell by more than 12% in 2009, in part due to some global banks stopping the flow of credit to cut losses.² While some banks in fact raised their lines of available trade credit during the crisis, the fall in overall demand for trade in goods and services mitigated that rise and largely caused the fall in trade volume. During the G-20 meeting in London in April, 2009, it was recognized widely by world leaders that trade finance is the lifeblood of \$14 trillion USD in annual global commerce and one of the fundamental engines of growth and development, especially in the emerging markets. Restricting the flow of credit to this area, by increasing the risk weight of trade finance instruments disproportionate with their nature, means essential goods cannot be traded, posing a threat to importers in emerging countries, with smaller banks and small- and medium-sized enterprises disproportionately affected.

Besides the issues raised herein regarding the consultative document, BAFT-IFSA is also concerned with the continuing impact that Basel II implementation has on trade finance. These concerns are outlined in Appendix I and link directly with the overarching need to ensure a rational and balanced treatment of trade finance by global regulators.

Background:

The consultative document states that off-balance sheet (“OBS”) items including “unconditionally cancellable commitments, standby letters of credit, trade letters of credit” are “a source of potentially significant leverage” and “the failure to include OBS items in the measure of exposure creates an incentive to shift items off the balance sheet to avoid the leverage ratio

¹ ICC Banking Commission Recommendations: Impact of Basel II on Trade Finance
http://www.iccwbo.org/uploadedFiles/ICC/policy/banking_technique/Statements/ICC_Recommendations_on_Basel%20II.pdf

² World Trade Organization; http://www.wto.org/english/news_e/sppl_e/sppl148_e.htm

constraint”.³ The Committee therefore proposes to include these OBS items using a 100% credit conversion factor (CCF) for the purposes of imposing a leverage ratio constraint. The proposed change in the consultative document to increase the CCF would affect exposures primarily used in trade finance. The trade exposures affected include trade related contingencies (TRC), transaction related contingencies (TRCP), and unconditionally cancellable commitments.

Increasing the CCF to 100% for trade related and transaction related contingencies for the purposes of calculating a leverage ratio could disadvantage trade finance-focused banks. As noted, trade and transaction related contingencies are viewed as less risky forms of lending relative to other lending products. The most frequently used values of 20% for trade related contingencies and 50% for transaction related guarantees adjust the risk weighted asset calculation to reflect that not all of the OBS exposure will necessarily convert to on-balance sheet exposure. Where the leverage ratio becomes the binding constraint on a bank, it may encourage banks to divert capital to other financial instruments, cease to provide OBS trade/transaction lending or increase the cost of providing these products to customers. These scenarios will most likely result in a reduction of trade activity.

The inclusion of trade in the generic description of OBS items is misleading given the way the products are used to support genuine underlying commercial trade transactions. As a general policy, banks do not enter into “synthetic” trade transactions where off-balance sheet trade structures could potentially be used to disguise on-balance sheet loans.

The consultative document states the objective of leverage ratio metrics is to “constrain the build-up of leverage in the banking sector, helping avoid destabilizing deleveraging processes”⁴ with “amplified downward pressure on asset prices”⁵ As trade finance products require an underlying commercial client transaction (e.g., shipped goods or infrastructure projects) they cannot contribute to an excessive “build-up of leverage”. They also don’t contribute to “downward pressure of asset prices” as they are short-term in nature and liquidated by fulfillment of the underlying transaction and payment at maturity. Therefore, trade finance products should be excluded from the increased CCF calculation without any harm to the objective of the Committee recommendations.

In addition to concerns raised regarding the treatment of OBS exposures, BAFT-IFSA members are also concerned with recommendations regarding the application of the Asset Value Correlation (AVC) in the consultative document. BAFT-IFSA believes that trade assets should not be included in a financial institution’s assets size calculation when determining whether the AVC should be applied. The implementation of this rule may incentivize banks to lend more to financial institutions which are small and rated lower on the rating scale, which may incur undue risk taking.

³ Basel Committee, Consultative Document, Strengthening the Resilience of the Banking Sector, p. 64, para. 232 and 233

⁴ Basel Committee, Consultative Document, Strengthening the Resilience of the Banking Sector, p.60, para. 204

⁵ Basel Committee, Consultative Document, Strengthening the Resilience of the Banking Sector, p.60, para 202

Issues:

1. Off-Balance Sheet Exposure Issues

Certain OBS exposures are used in trade flows. These include trade related contingencies, transaction related contingencies and unconditionally cancellable commitments. Maintaining a CCF of less than 100% when calculating a leverage ratio for these types of trade exposures will help avoid a possible reduction in the volume of trade flows and an increase in the cost of goods and services. A CCF of less than 100% is also consistent with the nature of the OBS exposures used in trade, as outlined below.

a. Trade Related Contingencies

Trade Related Contingencies (TRC) are contingent liabilities that arise from trade-related obligations underpinned by the movement of goods or services and evidenced by commercial contracts that document the arrangements between buyer and seller. These include documentary letters of credit, confirmations of letters of credit, and shipping guarantees. From historical experience, it has been observed that companies prefer to prioritize payment for their trade obligations over other obligations, as they have a tendency to avoid defaults on trade obligations as far as practically possible to ensure their businesses remain an ongoing concern. Moreover, TRCs do not necessarily materialize into an exposure, even if the obligor is in financial difficulty. Historical evidence has shown that the default of the obligor does not necessarily induce drawing of the guarantee by the beneficiary, as the underlying trade contract might still be fulfilled as contracted between the two parties. On the rare occasions that the bank is obliged to make payment following default of the obligor, there will often be constructive possession of the underlying goods validating a prior pledge, allowing the bank to make a recovery from that channel.

A CCF of 100% would be inappropriate for these liabilities due to the fact that TRC exposures are rarely speculative in nature and in providing TRC facilities, the bank acts as an intermediary between the buyer and seller to provide risk mitigation and structure for the counterparties. The risk mitigation provided by TRCs was proven during the global financial crisis where banks witnessed a reduction in open account trading and a shift towards financing international trade through TRCs (predominantly import documentary letters of credit) as the level of risk perceived by the market increased.

TRC's (documentary letters of credit, confirmations of letters of credit (LCs) and shipping guarantees) have unique aspects which emphasize their reliability and security as financial instruments. The LC is the primary TRC used to facilitate trade and provide assurance to the exporter that if they deliver the goods/services requested by the importer and present compliant documents, the bank that issued the LC irrevocably undertakes to pay the exporter. The LC also provides confidence to the importer that they will receive the goods they have requested,

evidenced by documentation, and that the exporter has complied with any additional specified terms/conditions that may have been part of the purchase agreement. To this extent, the obligation of the issuing bank to pay the beneficiary of the LC (typically the exporter) is highly contingent on the exporter not only delivering the correct goods/service as detailed in the LC, but also that all requirements of the LC have been complied with. As such, an LC will remain an off-balance sheet exposure until the documents are presented and accepted in accordance with the terms of the LC. Until this event occurs, there is a high probability that the LC might never convert to an on-balance sheet exposure, even in the event that the importer defaults.

Additionally, the LC may not convert to an on-balance sheet exposure due to the fact that the documents presented to the issuing bank may be discrepant, and thus the issuing bank is not obligated to make payment. When this occurs, there is no liability to the issuing bank and the obligation of the issuing bank to pay under the LC will be cancelled. Whilst re-presentation remains a possibility, in only a small number of cases are the documents subsequently compliant, as payments under LCs are made at the discretion of the banks involved following a request by the applicant. In the event of a buyer default, in many cases, the supplier will make the decision not to ship under the LC, as there is the risk that the documents may be discrepant and rejected by the bank. In this instance, no documents would be presented and the LC would expire with no liability to the issuing bank, even if the importer defaulted.

In some cases an exporter may wish to ensure the credit worthiness of the bank that issues the LC. In this case, the exporter may request its bank to “confirm” the LC. When a bank adds its confirmation, it provides a commitment to pay the exporter once compliant documents are presented and all terms and conditions of the LC are met, thus substituting the credit risk of the issuing bank with that of the confirming bank. From the perspective of the confirming bank, the risk of loss becomes contingent on compliant documents being presented, any additional terms and conditions of the LC being met, and the issuing bank failing to honor its commitment to pay. Where an issuing bank fails to honor its commitments, it is important to note that historically sovereigns and multilateral development banks have intervened to ensure that trade commitments in the issuing bank’s country are honored.

In a scenario where the issuing bank fails to honor its commitments and there is no other support from a sovereign or multilateral development bank, even where compliant documents have been presented and additional terms and conditions of the L/C have been met, all of the OBS exposure may not convert to on-balance sheet debt. This may occur where the importer purchases the goods and the funds from the sale would be used to reimburse the funds paid the exporter.

Finally, shipping guarantees are issued by banks in favor of the shipping company where the goods have arrived before the documentation. The primary purpose of the guarantee is to ensure that the person receiving the goods from the shipping company is the legal title holder of the goods, as the bills of lading and other documentation that evidence this have not yet arrived. In the event that it is proven that the person claiming the goods was not the legal title holder of the goods, the shipping company can call the guarantee to pay damages to the actual title holder of the goods. Again, the calling of the guarantee is not triggered by an event of default; instead it is initiated by a dispute in legal ownership. It is very rare for shipping guarantees to be called, even

where the importer may default. The bank's obligation to the shipping company under the guarantee is eliminated by presentation of the original title documents once they arrive.

The impact of the proposals in the consultative document on TRC will reflect each bank's leverage ratio constraint. Most banks currently apply a 20% CCF to TRC products, which is consistent with the TRC instruments outlined above. By increasing the CCF by a factor of five, banks with leverage ratio constraints will be incentivized to divert capital to other products, increase the cost of offering these products, or cease to offer key trade products (Appendix II).

b. Transaction Related Contingencies

Transaction Related Contingencies (TRCP) are performance standby letters of credit or performance guarantees. Examples of these types of exposures include performance bonds, bid bonds, tender bonds, advance payment guarantees. These guarantees support certain performance obligations of a borrower, with the drawing on these guarantees being contingent on the specific performance of the borrower rather than the financial soundness of the borrower. Prior to providing a TRCP, the bank will ensure that there is an underlying transaction and that any drawing on the TRCP is triggered by a performance event and not the customer failing to pay. As such, even in the event of default, a contingent standby letter of credit or bank guarantee will not necessarily result in an on-balance sheet exposure and internal bank data suggests that it is more likely that these types of exposures never become a liability for banks. Thus CCF calculations should reflect such an outcome. Bonding is used predominantly in support of the performance obligation of borrowers and the likelihood of performance-related bonding resulting in an on-balance sheet exposure is remote, with bank evidence putting the default rate generally below 2%.

Guarantees issued by a bank in connection with trade-related transactions usually facilitate commercial transactions by providing the beneficiary with coverage during a bid process, related to advance payments as well as payment, delivery, performance and warranty obligations. Drawing of such a guarantee is widely dependent on the performance of the applicant related to the underlying commercial contract, so that in case of a credit event related to the applicant, actual drawings under guarantees are still dependent on the commercial performance of the counterparty which, to a large extent, is not directly correlated with the financial standing of the counterparty. Default of the obligor does not necessarily induce drawing of the guarantee by the beneficiary as the underlying trade contract will likely be fulfilled as agreed. Moreover, in most cases, guarantees do not allow for drawing by the beneficiary in case of insolvency of the applicant, but are triggered by the non-performance of the underlying contract.

Contingent bank guarantees and contingent standby letters of credit are generally applied a 50% CCF. Under the proposal outlined in the consultative document that increases the CCF to 100% for these types of exposures, banks constrained by the leverage ratio will likely either increase the cost of these products or cease offering these products to customers.

c. Unconditionally Cancellable Commitments

Most trade products are offered on an unconditionally cancellable basis, as the customer must provide documentation evidencing the existence of an underlying transaction, before allowing a drawing on a facility. Therefore a customer will be less likely to increase leverage compared to other types of financial instruments. Most banks closely monitor deteriorating credit exposures, with the usual practice being to place such credit on “watch lists” where additional drawings are granted on a restricted basis. Banks have empirically demonstrated that in the months preceding default a customer may not increase its exposure, even if there is available head room, mainly due to this available head room being withdrawn or the exposure being “managed down” prior to default.

Proposals in the consultative document, where banks would be measured for undrawn amounts for the leverage ratio, could lead to a reduction in the rate at which businesses have access to increased bank lines and could increase transaction costs to businesses to cover increased capital costs. Both outcomes could lead to a decrease in trade business and slower recovery in economic downturns.

2. Asset Value Correlation

BAFT-IFSA believes that trade assets should not be included in the financial institutions assets size calculation when determining whether the Asset Value Correlation (AVC) should be applied. Due to the short-term, self-liquidating nature of trade transactions, these transactions are inherently less risky. The proposals could increase the cost of the providing credit to trade transaction, thus potentially inhibiting the flow of trade. The implementation of this rule may incentivize banks to lend more to financial institutions which are small (less than \$25 billion in assets) and rated lower on the rating scale and thereby, taking risks which they would have otherwise not taken. The proposal would also potentially impact the AVC for risk participations, which could limit a bank’s ability to use risk participations, thus increasing a bank’s exposure to underlying risk in a transaction.

The consultative document states that “during the crisis, financial institutions’ credit quality deteriorated in a highly correlated manner and they proved to be relatively more sensitive to systemic risk than nonfinancial firms. As a result, financial institutions were more correlated than reflected in the current Basel II IRB framework. The work conducted by the Committee indicates that asset value correlations (AVCs) for financial firms were, in relative terms, 25% or more higher than for non-financial firms, and the Committee is of the view that this higher degree of correlation with the market needs to be reflected in the IRB capital framework. For this reason, the Committee is proposing that a multiplier of 1.25 be applied to the AVC of financial firms. Under this proposal, the AVCs between financial firms would range from 15% to 30%, as opposed to the 12-to-24% range currently set forth in the Basel II framework.....the Committee is proposing to limit the application of the multiplier to exposures to banks, broker/dealers and insurance companies with assets of \$25 billion or more.”⁶

⁶ Basel Committee, Consultative Document, Strengthening the Resilience of the Banking Sector, p. 36-37, para. 135 and 136

A greater level of coordination between different regulatory bodies in leading the implementation of the multiplier on AVC for financial institutions and increasing the capital ratios requirements for banks is encouraged, so that there is harmonization in additional capital requirements. This will ensure rules do not become overly punitive and block credit flowing to medium-size financial institutions, especially those in developing countries.

Conclusion:

Trade finance fuels international commerce and the availability of trade credit is crucial to continued global growth. Trade exposures are contingent liabilities that arise from trade-related obligations, underpinned by the movement of goods or services and evidenced by commercial contracts that document the arrangements between buyer and seller. As such, trade finance instruments benefit from a low risk profile in relation to other types of financial instruments. The consultative document does not take into account the intrinsically safe structure of trade finance instruments and overlooks the fact that, by design, trade finance products do not contribute to excessive leverage as they are tied to client transactions. Additionally, they do not contribute to a downward pressure of asset prices due to their short-term and self-liquidating nature.

Recommendations in the consultative document in relation to an increase in the CCF could have the effect of amplifying business cycle fluctuations, thus forcing banks to curtail lending in recessionary climates in order to comply with capital requirements. Trade-related OBS instruments, including trade related contingencies, transaction related contingencies and unconditionally cancellable commitments could be reduced or cancelled under the proposed increase in the CCF, leading to substantially reduced trade flows and inhibiting the recovery in international trade. Basel II standardized approach values should, at a maximum, be considered instead of a 100% standard factor. This application would be in line with the “additional option for impact assessment” in the consultative document, which would allow financial institutions to “apply a lower (positive) CCF for unconditionally cancellable commitments or Basel II standardized CCFs”.⁷

Additionally, BAFT-IFSA believes that trade assets should not be included in a financial institution’s assets size calculation in determining whether the Asset Value Correlation (AVC) should be applied. This rule may incentivize banks to lend more to financial institutions which are small (less than \$25 billion in assets) and rated lower on the rating scale and thereby, taking risks which they would have otherwise not taken.

BAFT-IFSA believes that a more rational treatment under the consultative document for trade finance, given its fixed, short-term, self-liquidating nature, will ultimately have a positive effect on the trade finance markets and will spur growth in the global economy.

⁷ Basel Committee, Consultative Document, Strengthening the Resilience of the Banking Sector, p. 66, para 238, Table d.

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We very much appreciate the opportunity to comment on the consultative document and look forward to further dialogue with the Basel Committee on these issues going forward.

Very truly yours,

A handwritten signature in dark ink, reading "Donna K. Alexander". The signature is fluid and cursive, with the first name "Donna" and last name "Alexander" clearly legible.

Donna K. Alexander
Chief Executive Officer

Appendix I

The Continuing Impact on Trade in Basel II Implementation

Background:

In addition to issues raised regarding the consultative document on capital, BAFT-IFSA continues to be concerned about the overall approach of Basel II implementation and its effect on trade finance. As noted, trade finance has historically maintained a low risk profile in comparison with other financial instruments. Trade finance transactions are generally fixed, short-term instruments that are not automatically renewed or extended upon maturity and are self-liquidating by nature. These exposures are contingent liabilities that arise from trade-related obligations, underpinned by the movement of goods, or the provision of services and evidenced by commercial contracts that document the arrangement between buyer and seller.

Based on initiatives spawned from three successive BAFT Trade Finance Summits in 2009, BAFT-IFSA aggregated feedback from members relating to implementation of Basel II and its impact on trade finance. Some of that feedback is included in the results from the August 2009 (third in series) BAFT/International Monetary Fund (IMF) Trade Finance Survey, a portion of which is provided at Appendix III. This survey highlights banks' concerns--particularly those from industrialized countries--that Basel II has had a negative impact on their ability to provide trade finance. Within the broader context of supporting private- and public-sector partnerships to develop solutions to the ongoing issues in trade finance markets, BAFT-IFSA continues to communicate these concerns to policymakers and regulators, highlighting the pro-cyclical nature of Basel II, and outlining issues resulting in a counter-cyclical climate.

At their April 2009 Summit, the G-20 Leaders acknowledged these key issues raised by Basel II and asked regulators to make use of any flexibility available under capital requirements for trade finance.⁸ BAFT-IFSA issued the fourth in series survey with the IMF in March 2010 and will provide analysis on the survey and follow up accordingly with the G-20 leaders prior to their next Summit in Canada in June 2010.

BAFT-IFSA analysis focuses here on two issues posed by the implementation of Basel II in light of the impact or potential impact on financial institutions engaged significantly in trade finance: (1) the application of the one-year maturity floor, and (2) the application of minimum data requirements for wholesale exposures.

Issues:

Under Basel I, banks calculate risk-weighted assets by assigning assets and off-balance sheet items to broad risk categories according to the obligor or, if relevant, the guarantor or the nature of the collateral. Basel II was designed to be more risk-sensitive than the Basel I approach. Basel

⁸ <http://www.g20.org/Documents/final-communique.pdf>

II encompasses several methodologies for determining a bank's risk-based capital requirements for credit, market, and operational risk.

Two aspects of Basel II implementation of particular concern to banks active in trade finance are (i) the one-year maturity floor and (ii) the minimum data requirements for calculation of Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD). As discussed below, BAFT-IFSA respectfully requests that global regulators address these issues by confirming that the interpretation and implementation of Basel II (i) provides an exemption to the one-year maturity floor for trade finance credits, and (ii) allows estimates based on available data to replace minimum data requirements for calculation of PD, LGD, and EAD. BAFT-IFSA submits that these confirmations of the interpretation of Basel II implementation would assure a rational approach to the capital requirements for trade finance without compromising the safety and soundness of trade finance transactions and the institutions that engage in them. Moreover, these changes would help to stimulate trade finance markets and aid an overall global recovery.

1. One-Year Maturity Floor for Trade Finance Instruments

The one-year maturity floor under the Basel II charter is not appropriate for trade finance credits, which are generally short-term in nature (*i.e.*, a tenor of 180 days or less) and self-liquidating. Trade finance exposures generally are granted with an expiry date for each draw down. In providing the facility to the customer, banks take measures to understand the trade cycle of the customer and, prior to a draw down under the facility, to ensure that the underlying transaction is in line with the stated purpose of the credit and is evidenced with trade documentation. This level of monitoring and analysis allows a bank to structure a facility to match the working capital cycle of the customer and make informed decisions about whether to renew an exposure. If, at expiry, the customer does not repay the facility, the bank is alerted to this and can review the current financial position/health of the customer as well as the underlying transaction. The ability to make a new credit decision at each renewal should mean that the institution does not have a substantial commercial incentive to continue its credit relationship with the obligor in the event of credit deterioration of the obligor.

BAFT-IFSA notes that under the terms of the Basel II charter, individual jurisdictions have discretion to waive the one-year maturity floor for short-term, self-liquidating trade transactions. This distinction and flexibility for trade finance was encouraged in the April 2009 G-20 Leaders Summit Communiqué⁹. A waiver for certain trade finance exposures has already been granted by the Financial Services Authority (FSA) in the United Kingdom, along with a limited number of other jurisdictions. BAFT-IFSA supports and encourages this explicit waiver of the maturity floor by national regulators implementing Basel II.

⁹ IBID

2. Minimum Data Requirements for Trade Finance Instruments

Implementation of Basel II requires minimum data requirements in the calculation of PD, LGD, and EAD. The March 2009 ICC survey notes that there is a general lack of industry wide historical and performance data to assist in formally validating the risk attributes of trade finance.

Two factors explain the limited amount of data on trade finance facilities. First, default, loss severity, and exposure data on trade finance exposures are sparse, in part due to the limited loss history on these credits. The years prior to the current economic crisis coincided with a period of limited defaults in the market as a whole, with even fewer trade facilities within this data set. Second, there has been a general commingling of facilities in some banks via umbrella limits. When trade facilities have been offered under a single umbrella limit that is also shared by a loan, it can be difficult to determine whether the trade transaction was repaid by a loan or if the contingent liability was never drawn. The inability to meet the data requirements of Basel II could cause great uncertainty for banks active in trade finance as to what capital requirements would apply and could disrupt the crucial trade transactions. BAFT-IFSA requests that, due to the current lack of historical and performance data surrounding trade finance, estimates based on available data be allowed for overall calculation of PD, LGD and EAD.

Conclusion:

Basel II has been implemented in many countries, with implementation pending in others. BAFT-IFSA believes that in the current economic situation, Basel II has created additional pressure on banks subject to Basel II that do business in trade finance. Given the short-term, self-liquidating nature of trade finance, BAFT-IFSA recommends workable solutions to the problem. BAFT-IFSA requests that global regulators clarify the interpretation of trade finance treatment under the maturity floor applied to lending facilities by Basel II, and of data requirements for trade finance instruments, to ensure a rational treatment for trade finance under the charter.

With the G-20 Leaders' acknowledgement of Basel II implications for trade finance banks at their April 2009 Summit, BAFT-IFSA continues to support steps that provide for a more balanced treatment under Basel II for trade finance. Major distortions in trade finance treatment across key jurisdictions, such as the U.S. and Europe, should be minimized to enhance the flow of sustainable trade credit.

Appendix II *

Basel I,II,III: Impact on Trade (est.)

- 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 I			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%
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%

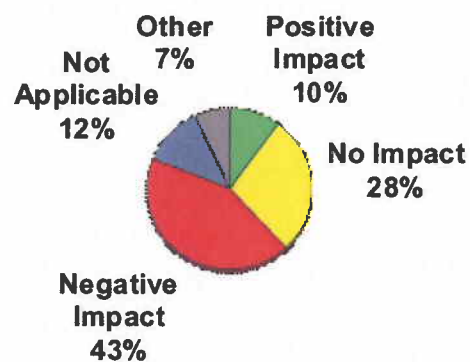
BAFT-IFSA

*Courtesy of Citi

Appendix III

How Has the Implementation of Basel II Impacted Your Ability to Provide Trade Finance?

Qtr2'09 vs. Qtr4'08



Source: BAFT/IMF Trade Finance Services: Current Environment and Recommendations, Wave 2, August 2009.