THE DIRECTOR GENERAL

Ms Sharon Bowles
Member
Chair - Economic and Monetary Affairs Committee
European Parliament
Rue Wiertz
Altiero Spinelli 10G201
B-1047 Brussels

26 March 2012

Dear Madam, dear Chair,

We would like to express our strong concerns regarding the proposed regulation on capital requirements for banks due to the unintended negative impact it will have on trade and export finance. We support efforts by the European Union and its partners in the framework of the G20 to reform banking regulations to improve the stability of the financial system in a manner that will facilitate trade, which has been the main driver of the global economic recovery.

However, we would like to draw your attention on some provisions of the proposals made by the Basel Committee on banking supervision that relate to trade finance and to the implementing measures proposed by the European Commission in the Draft Regulation included in the Capital Requirement Directive 4 (CRD IV). In our view, Basel III's capital requirements and the CRD IV proposals do not take sufficiently into account of the low risk profile of trade finance related assets.

We welcome the amendments tabled by your colleague Rapporteur for this important piece of legislation, MEP Othmar Karas, who recommends amending the Commission's proposal in a way that favorably impacts the treatment of trade finance. We would like to encourage you to support these amendments that would allow the real economy to continue to benefit from affordable trade finance tools that are of utmost importance for our companies to be able to export in the emerging countries where the growth is, and allow them to maintain the millions of jobs in the European Union, in particular in the SMEs, that directly depend on the capacity to export.

If adopted and implemented as currently defined, new capital and liquidity requirements will seriously reduce the availability of short term trade and export finance and will increase significantly the cost of trade finance. Furthermore, implementing a risk-insensitive leverage ratio will have a disproportionately large impact on off balance sheet positions, particularly trade finance positions.

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The restriction of trade finance products for European business will also ultimately threaten the recovery of the global economy, since European banks are providing a very large share of the world's needs to finance international trade.

Trade finance, which is essentially a means of payment and a guarantee mechanism for the movement of goods and services, has historically maintained a low risk profile in comparison with other financial instruments. A survey conducted by the ICC (International Chamber of Commerce) found that out of 5.2 million trade finance transactions, the default rate was only 0.022% and the average tenor of a transaction was 115 days. Trade finance transactions are indeed generally fixed, short-term instruments that are not automatically renewed or extended upon maturity and are self-liquidating by nature. In stress situations, countries and banks have traditionally continued to prioritise 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.

We have clear empirical indications that banks are already anticipating the implementation of the measures related to both liquidity and leverage ratios, and indeed to the medium and long term export business and we are making an alarm signal that non-binding observation period are not sufficient as a tool to persuade banks to continue to provide the trade and export finance instruments to exporters under the same conditions as today. Should these proposed measures not be amended soon, the unintended impact on trade and export finance will be extremely detrimental to the European and the global economy.

Furthermore, the Basel III requirements need to be implemented and applied in the same way globally to maintain a level playing field. It is unclear how major exporting economies like the US and China will implement the new rules. Differentiated implementation of Basel III rules could severely harm European exporters by putting them at an economic disadvantage with their main competitors.

We urge you to take up these concerns into consideration and call upon you to support the amendments tabled by Rapporteur Karas on this related issue.

Sincerely yours,

Philippe de Buck

POSITION PAPER

26 March 2012

Unintended consequences of Basel III and CRD IV on Trade Finance

On 20 July 2011, the European Commission put forward proposals to implement Basel III capital requirements in Europe, known as Capital Requirements Directive 4 (CRD IV) package. It contains a Proposal for a Regulation governing how activities of credit institutions and investment firms are carried out. The trade finance provisions in the proposal are governed under the regulation.

Industry estimates indicate that pricing for trade finance products could increase by 18-40% under the European Commission's CRD IV proposals. The draft European Parliamentary report on CRD IV, published in December 2011[1] by your colleague Rapporteur Othmar Karas, recommends amending the Commission's proposal in a way that favorably impacts the treatment of trade finance. The draft parliamentary amendments will help to ensure that regulatory treatment of trade finance corresponds to the nature of the instrument as a driver of economic growth. The following parliamentary amendments should be supported and included in the final implementing legislation for CRD IV:

a. **Amendment 4: Proposal for a New Regulation, Recital 53**: **Trade Finance Description:** The draft parliamentary report includes an important recital paragraph recognizing the nature of trade finance. It emphasizes that trade finance exposures are diverse in nature but share characteristics such as being small in value and short in duration and having an identifiable source of repayment. It distinguishes that they are underpinned by movements of goods and services that support the real economy and help small companies in their day-to-day needs, thereby creating economic growth and job opportunities. (Amendment 4: Proposal for a New Regulation, Recital 53)

b. **Amendment 56: Article 158 Para 3 (2) (b) - Maturity**: The Commission proposal harmonizes the treatment of certain trade finance instruments so that always actual maturity will be used for these exposures. The draft parliamentary report creates greater market certainty by specifying the types of self-liquidating short-term trade financing transactions that will use actual maturity calculations.

c. **Amendment 92 – Article 416 Para 8 (b) and Amendment 93 – Article 416 Para 8 (ba) - Leverage**: Under the leverage ratio, the Commission

[1] European Parliament: http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-%2f%2fEP%2f%2fNONSGML%2bCOMPARL%2bPE-478.506%2b01%2bDOC%2bPDF%2bV0%2f%2fEN

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proposes a credit conversion factor (CCF) for off-balance sheet instruments, including trade finance, of 100%, which would increase the cost of providing trade finance. The proposal to increase the CCF would affect exposures primarily used in trade finance because of the low margin involved. The Basel Committee and the Commission propose that the EBA shall report to the Commission by 31 October 2016 on the impact of the proposals on bank lending, with a particular focus on lending to small and medium enterprises and on trade financing, including lending under official export credit insurance schemes. However, we would like to draw attention on the fact that financial institutions are already seeking to meet the ratios even before the adoption of the CRD IV by the European institutions. Therefore our companies already report to us now that they encounter difficulty in finding affordable trade finance in the EU. The draft parliamentary report amends the proposal by recognizing that medium/low risk and medium risk trade finance instruments should carry a 20% and 50% CCF respectively. This will help ensure banks' continued ability to provide this important financing to customers.

d. **Amendment 89, Article 413, Para 2 (a) - Liquidity**: The Commission proposes that liquidity inflows shall be measured over 30 days and shall comprise only certain types of inflows. The draft parliamentary report states that monies due over the next 30 days from self-liquidating short-term trade financing transactions, import and export letters of credit and similar transactions with a residual maturity of up to one year, shall be taken into account in full as inflows. This change further recognizes the nature of trade finance and its importance to global trade.

The draft parliamentary amendments to CRD IV tabled by Rapporteur Karas recognize the criticality of trade finance to European companies and will help to ensure their ability to engage in international trade. The amendments respect the goals of CRD IV to create a stronger banking sector, without damaging lending to the real economy.