Basel Committee on Banking Supervision

BANK FOR INTERNATIONAL SETTLEMENTS

Treatment of trade finance under Basel III

WTO, Working Group on Trade, Debt and Finance

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Basel Committee on Banking Supervision

- Global standard setter for banks
- Mandate to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability
- 27 member jurisdictions (mainly G20)
- Intensive outreach to other jurisdictions
- Major review of regulation in response to financial crisis

Basel III – Revised Capital Regulation for Banks

- Main elements of Basel III
  - Risk-weighted capital requirements of at least 8%
  - Leverage ratio – for time being, at least 3% of total assets and off-balance sheet positions
  - Liquidity regulation

Considerations about Trade Finance

- To ensure adequate reflection under capital regulation, the Basel Committee benefited from cooperation and discussions with the WTO and other stakeholders
- Basel Committee's Policy Development Group met twice with WTO and industry in 2011
- Significant changes concerning both the risk-weighted measure and the leverage ratio

Trade Finance – Treatment under risk-weighted measure

Minimum ratio: $\frac{\text{Capital}}{\text{Risk-weighted assets}} \geq 8\ \%$

- Different approaches for measuring risk-weighted assets
  - Standardised approach
  - Internal approach
- Committee announced in December 2010 that it will "evaluate the impact of the regulatory regime on trade finance in the context of low income countries."

Trade Finance – Treatment under risk-weighted measure

- Standardised approach
  - Credit conversion factor (CCF) of 20%
    - Text in Basel III: "For short-term self-liquidating letters of credit arising from the movement of goods (e.g. documentary credits collateralised by the underlying shipment), a 20% CCF will be applied to both the issuing and confirming bank."
    - 20% CCF means one fifth of "normal" capital requirements (i.e. based on 8% minimum requirement, capital charge would be 1.6%)

Trade Finance – Treatment under risk-weighted measure

- Internal ratings-based approach approach
  - In general, banks under this approach have to use a minimum maturity of one year (independent of actual maturity)
  - In principle, the longer the maturity, the higher the risk and thus the higher the capital requirement
  - Exception for letters of credit – actual remaining maturity should be used

Trade Finance – Leverage ratio

- In principle, denominator of leverage ratio based on accounting value
- For short-term self-liquidating trade letters of credit, a 20% credit conversion factor will be applied to both the issuing and confirming bank
- Reflects comments received
- Means that banks under the leverage ratio have to hold five times less capital for trade instruments than originally envisaged (as under the risk based measure)