European Banking Federation

Barcelona 8th September 2014,
14th Annual Global Export Finance Conference

"The regulatory environment for investing in export finance:

Are the right regulations in place to create an attractive investment environment?"

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(30 minutes, shared with Marc Auboin, Counsellor, WTO)

Introduction - Slides 1 & 2

Thank you for inviting me today.

Regulation is a central concern for the European Banking Federation.

We represent the Banking Associations of the EU and EFTA countries; indirectly, some 4,500 banks, of all kinds. This means that we speak for the main banks in export and trade financing in Europe.

We aim to ensure that regulation is realistic, and does not unnecessarily hamper economic activity.

Our Export Credit Working Group has 24 members from 19 countries. We are fortunate to have as Chair of the group, Ralph Lerch of Commerzbank.

The export credit market is constantly on the move. We see that market change is strongly influenced by regulatory change.

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THE IMPACT OF BASEL & CRD - Slide 3

Regulation is clearly a threat – albeit unintended – to the ECA business

The broad form of the EU's Capital Requirements Directive (CRD) was completed mid-2013.

Capital

The tightening of **capital rules** has affected banks' ability to provide business finance. We must make strategic choices between activities. Although the ECA guarantees are accepted as reducing Risk-Weighted Assets, activities that are low-risk - and therefore low-return - may make less economic sense.

Leverage

The Basel **Leverage ratio**, a non-risk-based exposure measure, is also likely to be a constraint on regulatory capital. Under the proposal, export credits will be recorded gross, without netting off the ECA guarantee. This would bite particularly hard on our business. More discussion is needed. Basel foresees migration to Pillar 1 in January 2018.

Liquidity

The short term Liquidity ratio is close to phased introduction – completion in 2018. Perceived liquidity will affect banks' and investors' choice of assets. But export credit assets have not been much traded.

One measure which could help is a change in ECB policy to recognise ECA-covered assets as eligible collateral (as with the US Fed). This would help investors understand the quality of the asset. Regulators might then grant them the label of **High Quality Liquid Asset**. This would give them greater value as collateral for bank treasurers.

NSFR

Basel's proposed longer term liquidity measure, the **Net Stable Funding Ratio,** is still under review. It could directly hurt banks' ability to transform shorter term liabilities into longer term assets. We are lobbying on these concerns. BCBS aims for introduction January 2018.

It is helpful that the Basel Regulation allows for **gradual introduction**, and **evaluation** along the way. The CRD provides for monitoring of the impact on finance for trade. The EU has also agreed to monitor effects on long-term financing for the economy. We take some comfort from the fact that the door is open to change.

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REGULATION SUPPORTING THE ASSET CLASS – Slide 4

Regulation has given investors confidence in the quality of the ECA-covered loan.
And it has provided a properly-supervised infrastructure for trading ECA-covered assets.

Quality of ECA asset

The quality of the asset is founded on the various national regulations governing Export Credit Agencies (ECAs). Supporting this layer of legislation lies the framework of "soft law" in the OECD, and the over-arching WTO rules. Cover from an ECA converts country and corporate risk to sovereign risk. Decades of experience have shown the worth of this cover, particularly at times of crisis. After 2008, it operated as a safety net, ensuring continuity of financing for global trade flows.

ICC Trade Register and ECA asset risk

Last year our member banks, working on the ICC Trade Register, provided an unprecedented amount of data on the outcomes of their ECA-covered loans. The ICC report, issued in June, gives **for the first time empirical evidence that ECA-covered loans are low risk**.

This was the second year of reporting on medium and long-term (MLT) assets, as well as shorter-term trade finance instruments. This year, contributing banks for MLT loans increased to 16 (the main banks in the market), covering 26,000 transactions.

For a loss to occur, not only the borrower but also the state-backed ECA would have to default. The overall result of the ICC study shows an **Expected Loss of approximately 2 basis points** for MLT Trade Finance products - much lower than for 'vanilla' corporate lending.

Regulatory framework supporting market developments

Until recently, there was hardly a secondary market in export credits. Banks tended to "book and hold" the loans on their balance sheets. The crisis, and new regulation, led banks to explore wholesale markets more. A trade finance asset class is now being forged.

National regimes for securitisation and covered bond issuance, supported by EU single market legislation, have provided the platform. The legal bases already existed: for example the SCF in France and the Pfandbriefe in Germany.

Recently ECAs have assisted through product innovation. New funding guarantee schemes give investors a direct claim on their cover, boosting marketability of the assets.

THE FUTURE: FOCUS ON LONG-TERM FINANCING – Slide 5

Investment in the ECA asset class is on the rise. But more can be done.

Commission Communication on Long-term financing

Three areas relevant to trade finance assets – securitisation, covered bonds and ECA services - are particularly under the spotlight now in the EU. The authorities are giving top priority to the need to stimulate the supply of **long-term financing** to the economy.

Last March, a helpful Commission Communication was issued. This:

- Notes the important **role of banks** in Long-Term lending – despite Basel/CRD IV;
- Stresses the importance of **capital markets** to diversify financing sources;
- Says it will report on the appropriateness of **the capital requirements for LT finance**;
- It will review the CRR treatment of **covered bonds**; and study the merits of an EU regime;
- It will work on the differentiation of **high-quality securitisations**;
- It also recognises the important role of ECAs. It plans to publish a report on promoting better coordination and cooperation among **EU ECA schemes**.

We are already advising and working with the authorities on most of these themes.

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REGULATORY HITCH: CRR ARTICLE 194.2 – Slide 6

Last November our members first identified a provision in the detail of the capital rules which could be a trip-wire. This is in Article 194.1 of the Capital Requirements Regulation.

This requires an independent legal opinion in order for a credit mitigation technique (such as a guarantee) to be acceptable.

The provision has raised many questions:

- Does it apply to ECA insurance and guarantees?
- How is “independent” defined?
- Who should issue the opinion, and how often?
- To what product or service should the opinion apply? Can it be generic?

We are taking action, coordinating the national approaches to the issue among members of our Working Group. In this way we aim to ensure that full value is given to ECA cover without confusion or delay.

Impact of the heavy regulatory burden

As the new regulation has multiplied, there is a risk of overload. Our members active in the financing of trade must deal with the cost of changes in systems when new rules are introduced, and the **cost of compliance, such as KYC and anti-money-laundering rules**.

Businesses with fine margins could lose economic viability.

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THE FUTURE: MARKET FORCES WILL PLAY A ROLE – Slide 7

Alongside regulation, commercial forces will also help develop the market

Banks are working for greater **standardisation** - in structure, documentation and procedures - to lower cost and build market depth. ECAs are helping, with the new forms of guarantee, which fit the needs of bond markets.

Financial intermediaries are working to better **reconcile the complexity** of the asset (drawdowns, repayments) and the needs of long term investors.

Banks need to ensure they have sufficient collateral to replenish the cover pool as loans run off.

To feed the assets, banks will need to make loans – but the loan to deposit ratio will remain a constraint.

With greater practice, **experience** will be built up among banks, lawyers, rating agencies and, last but not least, investors.

We expect banks to turn increasingly to the "originate-to-distribute" model, as the product becomes better known.

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ACHIEVEMENTS FOR EXPORT FINANCE – 2013/2014 – Slide 8

I'll close with a short comment on the progress made during the discussions with the EU authorities.

In general we have seen:

- A better assessment of the scope of « Financing of International Trade » and understanding of the distinction between the shorter and longer term business;
- Awareness that Export Finance with ECAs is a net contributor to States' Budgets (and not a Charity).

As regards the CRD:

- Leverage Ratio – CCF (Credit Conversion Factor) of 50% for off-balance sheet exposures;
- LCR – Outflows : 10% of the undrawn portion;
- Agreed revision process with EBA regarding unintended consequences (with consultation of end-users)

Changes underway in EU leadership

The process of choosing new leaders of the European Commission, Council and Parliament is close to completion. The new Commission should be in place by 1st November.

The EBF's advocacy on behalf of export finance will then enter a new phase.

We expect the **Internal Market Directorate** to take forward the work on long-term financing. Other Directorates – **Enterprise, Competition and Economic Affairs** – will be closely involved. We will be encouraging policy coherence.

The **Directorate for Trade** is engaging in outreach to spread the OECD's practices and disciplines in export credits. These welcome efforts are likely to continue.

Last but not least, we will be reminding the new leaders of the risk of **regulatory competition** internationally. This could weaken the carefully-crafted OECD-WTO framework for creating a level-playing field, which would be very damaging for the ECA asset.