

ICC concerned trade finance may suffer due to proposed bank leverage rules

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ICC has expressed concern that proposals to introduce a new framework to limit excessive leverage in the world's banking system may have unintended, negative consequences on trade finance, and it urged the creation of a special trade finance working group to examine the problem.

The concern was raised in an ICC paper responding to the Basel Committee on Banking Supervision's consultative document on "Strengthening the Resilience of the Banking System." Last week ICC also released the results of a trade finance survey among 161 banks in 75 countries showing that while demand is high, access to affordable trade finance remains constrained.

The trade finance survey revealed mounting evidence that the implementation of the existing capital adequacy regime under Basel II was contributing to the current drought in trade finance. It said the proposed changes to limit leverage could significantly reduce the flow of trade at a time when increasing trade is crucial to ensure a global recovery from the recession. Furthermore, the changes as they are envisioned classify trade-and transaction-related exposures as risky, when they actually provide risk mitigation and structure to the trade of goods and services.

"Without commenting on the appropriateness of a new mechanism to limit bank leverage, ICC has been concerned to note that the proposals group trade products with a number of other instruments which exhibit significantly different characteristics," the ICC Banking Commission said in its response to the Basel Committee. "It is our contention that this approach is unjustified; and, moreover, is liable to lead to an overall reduction in the supply of trade finance."

Citing broad concerns about the impact of Basel II on trade financing, ICC urged the creation of a specialist trade finance working group to examine the issues that arise when the existing regulatory framework is applied to trade facilities. "ICC would be delighted to participate in the work of such a group," the paper said.

The proposals being considered to reform the Basel II framework would increase the Credit Conversion Factor (CCF) for all off-balance sheet exposures, including trade products, to 100% when calculating a leverage ratio constraint. This compares with just 20% for trade-related contingencies and 50% for transaction related contingencies under the current Basel II framework.

"ICC considers that this blanket approach to 'off-balance sheet' items under the proposed leverage ratio is based on a fundamental misunderstanding of both the operational context and the mechanics of trade financing," the ICC paper said.

It added that increasing the CCF to 100% for trade-and-transaction-related contingencies when calculating the leverage ratio could adversely affect the provision of trade finance instruments since banks could achieve higher yields with non-trade products.

ICC said the proposed changes should be amended to exclude trade related contingencies as well as transaction related contingencies since these are not used to lever a bank's balance sheet. "As such, ICC recommends that if a leverage ratio is to be adopted, off-balance sheet trade products should be allowed to retain the CCF values used by banks under the current 'risk weighed assets' calculation," the paper said.

"It is our fundamental concern that this cycle will adversely impact on the supply of cost-effective trade credit, thus compounding existing, well-known market constraints," the paper added. "Such a situation would likely risk a significant dislocation of trade – contrary to the London G20 Summit agenda to promote trade as an engine of renewed growth."

To view *ICC response to the Basel Committee Consultative Document on “Strengthening the Resilience of the Banking System”*, please visit the following link:

http://www.iccwbo.org/uploadedFiles/ICC/policy/banking_technique/Statements/1139%20ICC%20Position%20Paper_Basel%20Committee%20Consultation.pdf

To view *Rethinking Trade Finance in 2010* report, please visit the following link:

http://www.iccwbo.org/rethinking_trade_finance_2010/

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