January 16, 2024

BAFT response to the Agencies Request for Public Comment on the Implementation of the Basel III Endgame Notice of Proposed Rule (NPR).

Office of the Comptroller of the Currency, Treasury
https://regulations.gov
Docket ID OCC-2023-0008

The Board of Governors of the Federal Reserve System
http://regulations.gov
Docket No. R-1813, RIN 7100-AG64

FDIC
https://fdic.gov/resources/regulations/federal-register-publications
Docket RIN 3064-AF29

ELECTRONICALLY DELIVERED

January 16, 2024

Office of the Comptroller of the Currency, Treasury (Docket No. R-1813, RIN 7100-AG64)
The Board of Governors of the Federal Reserve System ((**Docket** ID OCC-2023-0008)
The Federal Deposit Insurance Corporation (Docket RIN 3064-AF29))

Dear Sirs,

Re: BAFT response to the Agencies Request for Public Comment on the Implementation of the Basel III Endgame Notice of Proposed Rule (NPR).

BAFT (Bankers Association for Finance and Trade) welcomes the opportunity to respond to the request for comment made by the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency in respect of the Proposed Rule 88-FR-64-028, the "Basel Endgame."

BAFT is an international financial services industry association whose membership includes U.S. banks which range in asset size from G-SIBs to Regional Banks with less than $200 billion in assets, as well as a broad range of other financial institutions throughout the global community, many of which also operate within the United States. As a worldwide forum for analysis, discussion, and advocacy in international financial services, BAFT member banks provide leadership to build consensus in preserving the safe and efficient conduct of the financial system worldwide. BAFT closely monitors the impact that new regulatory initiatives could have on the provision of trade financing and payment services that support real economic commerce. To that end, our comments and recommendations are focused on the impact of the Final Basel III Reforms on trade finance.

BAFT supports the intent of the Basel III reforms to reduce variations in reported risk-weighted assets across banks. However, we are concerned that the proposed framework will likely have unintended consequences that negatively affect the availability of credit and liquidity supporting international commerce conducted by US companies as a result of inappropriate calibrations. Specifically, trade finance, which consists primarily of short-term, self-liquidating instruments, does not serve as a source of leverage and is vital to the settlement of international commerce involving hundreds of thousands of US companies.

We therefore ask that proper consideration be given to the treatment of trade finance, specifically with regards to:

1) **Defaulted Exposures**: Trade settlements greater than 90 days should be carved out of the defaulted exposures where the delay is for operational, not credit reasons. The defaulted exposure regarding 90 days past due exposures should be limited to cases where it is material. This is particularly significant for supply chain finance. Commercial disputes, not related to credit issues, also cause defaults. However, industry data globally confirms that trade products defaults are very low risk and banks' historical data shows that corporations try to work through their trade business even where they are having financial difficulties. The proposed use of "any" credit exposure, even to obligors outside of the individual financial institution, is not practical.
2) **Risk Weights for Bank Exposures**: BAFT is proposing a 20% risk weight for the more than well capitalized banks for international comparability to jurisdictions that allow the use of external ratings.
3) **Tenor for Trade Instruments**: In contrast to the recommendations of the BCBS and the UK regulators which proposed that exposures to institutions receive a lower risk weight of 20% where the maturity is six months or less for trade related exposures, the NPR has proposed a 3-month ceiling. BAFT is requesting US Regulators to expand the short-term risk weight to extend the tenor to 6 months, and to include unfunded and funded trade finance exposures and cover both goods and services.
4) **Credit Conversion Factor**: The NPR proposes to apply a 50% CCF in line with Basel for performance guarantees/stand-by letters of credit (bid bonds, performance, associated advance payment guarantees and retention bonds) and guarantees not having the characteristics of direct credit substitutes. BAFT is requesting adjusting the CCF to 20%, which is also in line with what the EU has already approved.[1]
5) **Operational Risk**: Trade finance features a number of fee-based activities that can best be described as high volume, low margin revenues such as letter of credit advising fees, amendment fees, negotiation fees, amendment fees etc. On a combined basis, these trade related fees comprise no more than 4% of the total bank wide fees that our largest bank members earn. Actual losses from these trade-based fees are next to zero. BAFT recommends that the agencies revise the operational risk framework particularly as it applies to fee heavy business and is supportive of the recommendations of the ABA/BPI trade letter.
6) **Commitments**: Adopt the National Discretion provided in Basel CRE 20.94, footnote 43 exempting certain arrangements from the definition of commitments if certain conditions are met and where these apply to corporates and SMEs only where counterparties are closely monitored on ab ongoing basis. BAFT recommends revising the CCF based on the fact that other jurisdictions are not eliminating advanced approaches for credit risk and in order to ensure a level playing field as CCFs are generally lower than 10%.

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[1] ICC United Kingdom/GCD 2023 "Performance Guarantees Paper
Iccwbo.uk/products/update-to-icc-gcd-performance-guarantees-paper

Trade as an Engine for Global Growth

Trade finance plays a crucial role in the U.S. economy, providing the necessary funding and risk mitigation tools for U.S. businesses engaged in selling U.S. goods and services overseas and sourcing inputs, finished goods and services on behalf of U.S. consumers. Trade finance supports roughly 40% of the $25.3 trillion in global merchandise trade and $6.8 trillion in services.[2] There is an estimated $2.5 trillion in unmet demand for trade finance, with small and medium sized businesses (SMEs), which are critical to global supply chains, being the most significantly impacted.[3]

For a variety of reasons, trade finance should be preserved for its role in the U.S. economy:

1. **Facilitating International Trade**: Trade finance provides the necessary funding and tools for U.S. businesses to engage in international trade. It allows them to buy and sell goods and services across borders, expanding their market reach and revenue potential.
2. **Boosting Exports:** Exporting is a significant driver of economic growth in the United States. Trade finance helps American exporters secure orders and get paid promptly, making it easier for them to compete in global markets. This, in turn, supports job creation and economic prosperity.
3. **Supporting Small and Medium-Sized Enterprises (SMEs)**: SMEs make up a substantial portion of the U.S. economy. Trade finance can be particularly vital for small businesses, as it enables them to participate in international trade by mitigating risks and providing access to working capital.
4. **Risk Mitigation**: International trade carries inherent risks such as currency fluctuations, political instability, and non-payment by foreign buyers. Trade finance instruments, like letters of credit, standby letters of credit, guarantees and export credit insurance help mitigate these risks, giving U.S. businesses more confidence in international transactions.
5. **Supply Chain Efficiency**: Trade finance optimizes supply chain management by ensuring the timely movement of goods/services from suppliers to buyers. This efficiency can lead to cost savings and better inventory management for U.S. companies.
6. **Economic Growth**: A robust trade finance system contributes to economic growth by increasing the volume of trade and attracting foreign investment. It also supports the development of related industries such as logistics, shipping, and financial services.
7. **Access to Capital**: Trade finance provides businesses with access to working capital and liquidity. This capital can be essential for financing the production, purchase and transportation of goods, especially for companies involved in international trade.
8. **Maintaining Competitiveness**: In a globalized economy, U.S. businesses must remain competitive with similar companies from other countries vying for the same business. Trade finance enables them to offer competitive terms to international buyers and maintain or grow their market share.

[2] World Trade Organization, *Global trade Outlook and Statistics*, April 2023

[3] Asian Development Bank, *2023 Trade Finance Gaps, Growth and Jobs Survey*, September 2023

9. **Job Creation**: The availability of trade finance can lead to job creation in various sectors including manufacturing, agriculture, and services. As businesses expand their international operations, they often hire additional workers to meet increased demand.
10. **Economic Stability**: A vibrant trade finance sector contributes to economic stability by reducing the risks associated with international trade and ensuring that transactions are conducted smoothly. This stability is essential for the overall health of the U.S. economy.

Regulated financial institutions — primarily banks, still provide the majority of traditional trade finance today, including Documentary Letters of Credit, Documentary Collections, Standby and Guarantee products, and loans or risk mitigation solutions derived from these various instruments. Hence, Basel Endgame proposed requirements on US financial institutions will disadvantage U.S. businesses that are engaged in international trade by imposing measures that are more extreme than what was established under the original Basel Agreement and what some jurisdictions have implemented. Further, data shows that trade finance continues to be extremely low risk, so it is unclear why there would be any need to increase capital provisions on these assets.

Detrimental Implications of Basel Endgame for Trade Finance

It is our contention that the application of the capital weightings, as put forward under the NPR, will result in a number of negative, unintended consequences. Within the Basel Endgame proposal, trade finance falls into the broader asset class of Corporates and Banks within the regulatory capital framework. However, trade finance is distinguished from other corporate and bank lending as it is low risk and generally characterized by short tenors, self-liquidating with underlying collateral. The proposed Basel Endgame implementation makes no specific mention of trade finance as a specific asset class, nor does it recognize its unique low risk qualities. While we recognize that it is difficult for authorities to bestow differentiated regulatory treatments to many financial products, we believe that the unique characteristics of trade finance have been well and objectively demonstrated and should be appropriately reflected in the proposal.

Trade finance products arise from trade-related obligations underpinned by the movement of goods or the provision of services and evidenced by commercial contracts which document the arrangement between the buyer and the seller. Hence, trade related contingencies are hardly speculative in nature. In providing such facilities, the banks are simply intermediaries between the parties, i.e., the buyer and the seller, and are offering a service providing risk mitigation and transaction structuring for the counterparties. Traditionally, trade finance received differentiated capital treatment on the part of national and international regulators, as well as by international financial agencies on the grounds that trade finance is safe, short term, self-liquidating, and not used to create leverage.

The ICC Trade Register[4] draws on data from 26 trade finance and export finance banks – including more than 47 million global trade finance and export finance transactions with exposures in excess of $23 trillion. The ICC Trade Register presents a global view of the credit risk profiles of trade

[4] 2022 ICC Trade Register Report "Global Risks in Trade Finance" Summary Report: ICC_Trade_Register_Report_2022_Summary_vFii.pdf

finance, supply chain finance and export finance transactions. Exhibit A shows the extremely low default rate trends for 2015 to 2021, while Exhibit B demonstrates that given the already low default rates, trade finance instruments have tremendously low loss given default rates.

Exhibit A

Summary of default rate trends for trade finance, 2015–2021

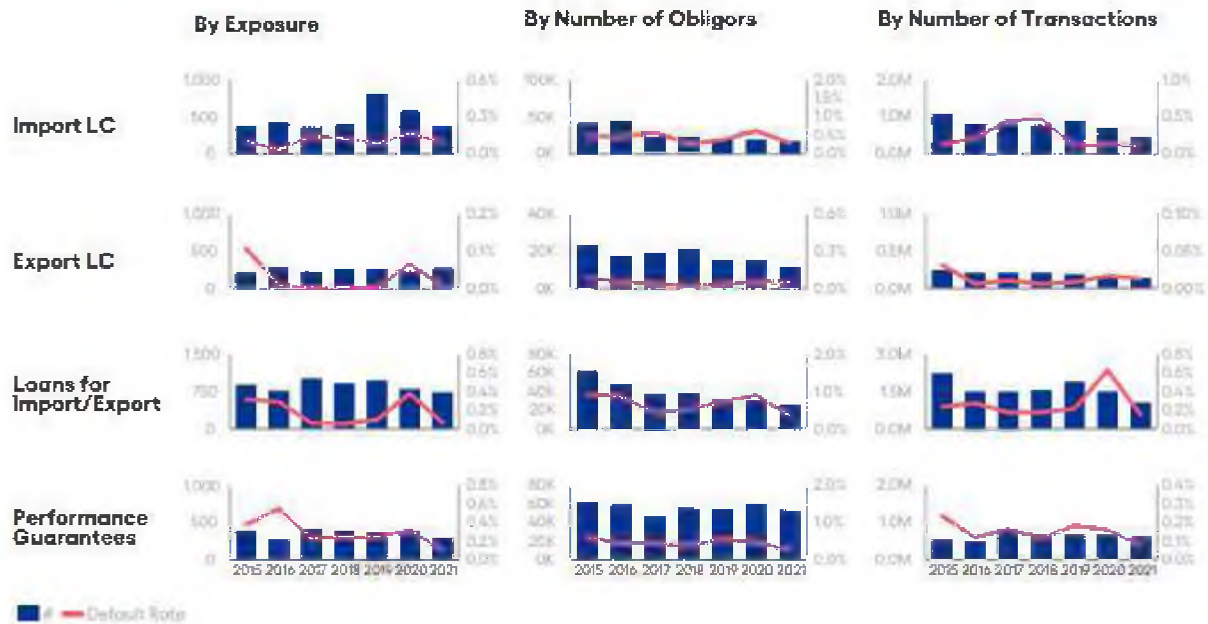
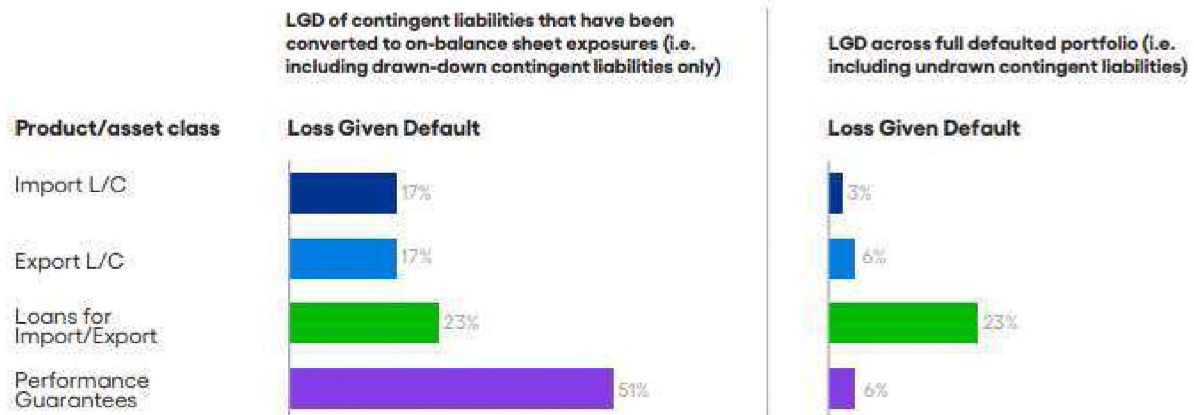


Exhibit B

LGD for trade finance products, 2000-2020



Bank-intermediated trade finance, particularly where contingent liabilities are heavily documentation driven, provides an additional layer of operational risk mitigation relative to other corporate and bank lending products. This helps to mitigate both the credit and operational risk for banks and their customers. This also allows banks and regulators to monitor financial crime more transparently, better identify attempts at sanctions evasion and export control violations and report suspicious activity. To the extent that the low-risk nature of trade is not properly recognized, financial institutions are disincentivized to continue to provide this type of lending, which typically is more labor-intensive with lower returns than other uses of the bank's balance sheet. The end result of the higher capital cost to financial institutions is that corporations that depend on this type of finance will either pay more, or perhaps find less availability from banks as banks choose to use their balance sheet for products with higher return.

We encourage regulators to consider capital treatment for trade that is aligned with its low risk and avoid the unintended consequences that will harm the sustainability of international trade and supply chains, with a particularly negative impact on SMEs.

We would be happy, if given the opportunity, to meet with those members of the technical teams from the Fed/OCC/FDIC that form the first line of analysis of our response so that we can further discuss the technical aspects that support our industry position. Our goal is to achieve appropriate treatment and an internationally level playing field, where U.S. banks and their corporate and SME clients are not placed at a comparative disadvantage and regulatory arbitrage is not a consideration.

Comments on Basel Endgame Proposal Questions

III. Proposed Changes to Capital Rule
III.C. Credit Risk
III.C.2. Proposed Risk Weights for Credit Risk
III.C.2.A. Defaulted Exposures

Question 13*: How does the defaulted exposure definition compare with banking organizations' existing policies relating to the determination of the credit risk of a defaulted exposure and the creditworthiness of a defaulted obligor? What additional clarifications are necessary to determine the point at which retail and non-retail exposures should no longer be treated as defaulted exposures?*

- Parties must adhere to the legal framework and specific individual agreement provisions. Banks are not privy to individual agreements between its clients and their counterparties.
- Defaulting on a bank's borrowing facility triggers actions based on the agreement (e.g. obtaining collateral, etc.) and a bank's procedures.
- A client's defaults relative to commercial disputes: e.g. a structure is not built to code or contracted specification, or the quality of merchandised ordered is not to the contracted specifications is outside or banking expertise and will only increase operational costs applied to client monitoring.

- The same reasoning applied to the Fed limiting USA banks from entering into Surety Guarantees with its clients should be applied here as banks are in no position to determine who is correct in commercial disputes?
- Trade products do not generally represent borrowed money from a bank so each situation must be governed by its agreements and procedures.

Question 14: *What operational challenges, if any, would a banking organization face in identifying which exposures meet the proposed definition of defaulted exposure? In particular, the agencies seek comment on the ability of a banking organization to obtain the necessary information to assess whether the credit obligations of a borrower to creditors other than the banking organization would meet the proposed criteria? What operational challenges, if any, would a banking organization face in identifying whether obligors on non-retail credit obligations are subject to a pending or active bankruptcy proceeding?*

- Refer to the response in Question 13 above. Commercial disputes cause defaults between companies.
- Banks review their clients periodically. Review periods are based on a variety of client risk factors in accordance with KYC and CDD mandates/policies.
- Industry data globally confirms that trade product defaults are very low risk and history has shown that corporations try to work through their trade business even in instances where they are having financial difficulty.
- Banks do monitor cross defaults in accordance with a client's agreement.

Question 16*: What alternatives to the proposed treatment should the agencies consider while maintaining a risk-sensitive treatment for credit risk of a defaulted borrower? For example, what would be the advantages and disadvantages of limiting the defaulted borrower's scope to obligations of the borrower with the banking organization?*

- The broadening of the scope for defaulted exposures to those where an obligor is in default on an unrelated obligation (whether to the same banking organization or a third-party creditor) will be exceedingly difficult in the context of trade finance products. This is due to a combination of a banking organization's potential lack of awareness of cross defaults (particularly in respect of third-party creditors). Trade volumes are very high, particularly in Supply Chain Finance, so there are many cases where settlement may not have been matched after 90 days which are not due to credit reasons.
- On the awareness issue, the legal documentation that supports supply chain finance programs customarily does not contain cross-default or acceleration clauses. This means that the buyer/obligor has no obligation to tell the banking organization providing the financing of those programs that it has defaulted on other payment obligations. Therefore, such organizations may not be aware.
- The documentation is light on any of these "debt-like" features because a large number of obligors in these programs account for their payment obligations as short-term accounts payables and not as debt. As such the obligors are not "borrowers" under these programs.
- On the long exposures and batching point in respect to these programs, banks discount thousands of small invoices and receive payment at maturity. Given the volumes of invoices,

whilst we have no concern over the obligor's ability to pay, tracing invoices, credit notes etc. can mean exposures can sometimes take longer than 90 days to match and clear.

- The broadened scope means that, for the same creditor, other exposures to that obligor would be caught. Tracking 90-day overdue payments to other creditors isn't operationally practicable and we support the banking industry's suggestion to remove this requirement.

Recommendations: Trade settlements greater than 90 days should not be included in the defaulted exposures where the delay is for operational, not credit reasons. Where the defaulted exposure is for credit reasons, the size of the defaulted exposure must be material to trigger default treatment. This is particularly significant for supply chain finance.

III.C.2.C Exposure to Depository Institutions and Foreign Banks

Table 1 — Proposed Risk Weights for Bank Exposures

	Grade A Bank Exposure	Grade B Bank Exposure	Grade C Bank Exposure
Base risk weight	40%	75%	150%
Risk weight for a foreign bank exposure that is a self-liquidating, trade-related contingent item that arises from the movement of goods and that has a maturity of three months or less	20%	50%	150%

Question 17*: What are the advantages and disadvantages of assigning a range of risk weights based on the bank's creditworthiness? What alternatives, if any, should the agencies consider, including to address potential concerns around procyclicality?*

- In general, it makes sense for risk weights to be differentiated based on creditworthiness. However, for trade finance, the proposed Grade A base risk weight at 40% means capital for a substantial proportion of trade finance exposures would double, which is not justified based on the low-risk nature of the asset class.
- Whilst there is the lower (20%) risk weight for contingent exposures with a maturity less than 3 months which is further discussed under Q19 below, this excludes, for example, non-contingent unfunded and funded trade finance exposures to the most creditworthy counterparties. Meanwhile, industry data supports that Trade Finance solutions carry significantly lower levels of credit risk, both on- & off-balance sheet exposures, even in times of economic instability when compared to traditional credit products, further conveying the potential capital constraints imposed by the proposed rules may have outsized, unintended

consequences relative to the risk and limit the ability of the banking system to support the economic benefits generated from international trade.
- BAFT recommends that well capitalized banks get a risk weight of 20% consistent with the EU/UK who use the ratings-based approach.

Recommendation: BAFT is proposing a 20% risk weight for the more than well capitalized banks for international comparability to jurisdictions that allow the use of external ratings.

Question 18: *What are the advantages and disadvantages of incorporating specific capital levels in the determination of each of the three categories of bank exposures? What, if any, other risk factors should the banking agencies consider to differentiate the credit risk of bank exposures? What concerns, if any, could limitations on available information about foreign banks raise in the context of determining the appropriate risk weights for exposures to such banks and how should the agencies consider addressing such concerns?*

- Sourcing and ongoing monitoring of capital levels, particularly for emerging markets, could be an issue for some U.S. banks. How often is review of capital levels expected given that banks will publish at various times of the year? Capital rules and therefore ratios will differ between prudential supervisors – whilst there is a statement that, for Grade A and B, the standards need to be consistent with BCBS, the complexities of capital mean this is much harder to assess. Could a register of bank Grades be maintained by an authorized third party in order to achieve the efficiency and transparency afforded under the previous OECD CRC methodology?
- Holistically, the proposed Basel III Endgame risk weight (RW) for FI exposures under the new grading regime with sovereign floors is expected to increase capital consumption. At best, the most beneficial risk weight (Trade Finance, contingent exposures <3 Months for a Grade A Bank) would have no impact relative to current rules for exposure to banks in U.S./OECD countries. Meanwhile, industry data supports that Trade Finance solutions carry significantly lower levels of credit risk, both on- & off-balance sheet exposures, even in times of economic instability when compared to traditional credit products. Further, conveying the potential capital constraints imposed by the proposed rules may have outsized, unintended consequences relative to the risk and limit the ability of the banking system to support the economic benefits generated from international trade.

Question 19: *What is the impact of limiting the lower risk weight for self-liquidating, trade-related contingent items that arise from the movement of goods to those with a maturity of three months or less? What would be the advantages and disadvantages of expanding this risk weight treatment to include such exposures with a maturity of six months or less? What would be the advantages and disadvantages of limiting this reduced risk weight treatment to only foreign banks whose home country has an (OECD) Country Risk Classification (CRC)* [69] *of 0, 1, 2, or 3, or is an OECD member with no CRC, consistent with the current standardized approach?* [70]

- The US should adopt the rule as proposed by Basel, which includes the maturity of up to 6 months for exposures relating to the movement of goods and services. Therefore, shifting the tenor threshold to 6 months would better align to the shorter-term tenor profiles seen in the

market, standards outlined in Basel III Finalized Standards and standards proposed by other national supervisors. Both 3 months and 6 months fall well within the 1-year tenor assessed by the ICC data showing the low-risk nature of trade and therefore expanding to a 6-month maturity would mean a more level playing field for US banks whilst still capturing only negligible risk exposures.
- Additionally, consideration should be given to including non-contingent off-balance sheet exposures (including acceptances) and on-balance sheet exposures, as allowed under Basel III Finalized Standards (BCBS CRE 20.19 Footnote 14). This would alleviate the burden of some of the incremental capital and align the Federal Code with those seen under the latest European Banking Authority (EBA)and UK Prudential Regulatory Authority (PRA) proposed rules.
- Limiting this rule set to the "movement of goods" means that services, which are an important part of trade finance globally-and a particularly critical component of trade from the United States, will be excluded. Services trade forms an increasing share of global trade.

Recommendation: In contrast to the recommendations of the BCBS and the UK regulators who proposed that exposures to institutions receive a lower risk weight of 20% where the maturity is six months or less for trade related exposures, the NPR has proposed a 3-month ceiling. BAFT is recommending that the US should adopt the rule as proposed by Basel which includes the maturity of up to six months for exposures relating to movement of goods and services.

III.C.3.B. Credit Conversion Factors

Question 46: *What additional factors, if any, should the agencies consider for determining the applicable credit conversion factors for commitments?*

- The Basel Endgame proposes to align with Basel 3.1 and apply a 50% CCF for performance guarantees (bid, performance, associated advance payment and retention bonds) and guarantees not having the characteristics of direct credit substitutes. We believe there is an opportunity to update CCF values to better reflect the actual CCF values for the range of performance guarantees that the industry has collected.
- The 50% CCF value was calibrated by Basel in the 1980s and, in the light of the empirical data presented since then, CCF values globally should be lowered to 20%. It is important to note that the EU has advised that they will institute the 20% CCF.
- The continuation of the 50% CCF (instead of the BAFT proposed 20%CCF) means that a U.S. bank will be allocated a capital charge that is 150 % higher than an EU bank, and a US corporate will be at a cost disadvantage to an EU corporate,
- The ICC/GCD (Global Credit Data)5 study covering both performing, and defaulted, performance guarantees are footnoted as a reference point for U.S. Regulators to take into consideration for lowering the CCF to 20%.
- Aligned with the data on performance guarantees, as well as with desirable policy outcomes such as assuring market access to guarantee products and the economic development impacts, they enable it is recommended that the CCF for performance guarantees be changed to 20%.

[5] 2023 ICC-UK Performance Guarantees Paper
https://iccwbo.uk/products/update-to-icc-gcd-performance-guarantees-paper

It should be noted that the EU originally proposed a 50% weighting, but after assessing industry feedback and supporting data, revised the weighting to 20%.

- As the empirical data collected by the ICC Trade Register (TR) points to a lower CCF irrespective of tenor, the 20% CCF is reflective of the true underlying risk for L/Cs. Consequently 50% is an overstatement of risk as the underlying risk only changes when documents are presented.
- For banks following the IRB approach, applying a 50% CCF to take account of the longer maturity is effectively a double count as maturity is factored in explicitly into the calculation of risk-weighted assets (RWA)

III.F Operational Risk

III.F.1.B The Services Component

Question 74*: What are the advantages and disadvantages of the proposed approach to calculating the services component, including any impacts on specific business models? Which alternatives, if any, should the agencies consider and why? Similarly, should the agencies consider any adjustments or limits related to specific business lines, such as underwriting, wealth management, or custody, or to specific fee types, such as interchange fees, and if so what adjustment or limits should they consider? For example, should the agencies consider adjusting or limiting how the services component contributes to the business indicator and, if so, how? What would be the advantages and disadvantages of any alternative approach and what impact would such an alternative approach have on operational risk capital requirements? For example, under the proposal, fee income and expenses of charge cards are included under the services component. Would it be more appropriate for fee income and expenses of charge cards to be included in net interest income of the interest, lease, and dividend component (and excluded from the services component) and for charge card exposures to be included in interest earning assets of the interest, lease, and dividend component and why? Please provide supporting data with your response.*

- The vast majority of trade finance revenues are credit related rather than services related, however fee-based services are a vital part of trade products. There is a concern about a duplication of capital charges for a product like letters of credit. Under existing guidelines RWAs will already be allocated for the letter of credit, but under the new proposal it appears that the fees associated with a letter of credit, such as advising fees, discrepancy fees, amendment fees, cancellation fees etc., will also be subject to capital charge as operating fees. We ask that this be clarified.
- The trade finance business is a high volume, low margin business, but the fees cover labor intensive operating costs. For one large money center bank who is a global leader in trade finance, fees from trade products make up less than 4% of the bank's total fee-based revenues.
- A summary of the types of fees that trade products generate is shown in Exhibit C.

Recommendation: Trade finance features a number of fee-based activities that can best described as high volume, low margin revenues such as letter of credit advising fees, amendment fees, negotiation fees, amendment fees etc., On a combined basis, these trade related fees comprise no more than 4% of the total bank wide fees, and operational losses are close to zero. BAFT

recommends that the agencies revise the operational risk framework particularly as it applies to fee heavy businesses and is supportive of the recommendations in the ABA/BPI trade letter.

III. G) Commitments

Question 46: What additional factors, if any, should the agencies consider for determining the applicable credit conversion factors for commitments.

- Traditionally, the majority of bilateral, stand-alone trade facilities are uncommitted, and the applicability of the 10% provision is up to each institution's interpretation or analysis.
- For trade finance products (including receivables finance and equipment finance) where the facility is committed, there will be a disproportionate impact given the short-tenor and low margins which characterize this business.
- A 10% CCF (instead of 0%) will lead to differing levels of capital increases for a broad range of customers based on levels of utilization. For example, on a 50% utilized trade loan facility (unconditionally cancellable and meeting other conditions of Basel CRE 20.94 footnote 43) with a probability of default (PD) of 0.2% for a loan with 120-day tenor, the pricing will need to change from 1% to 1.1% p.a. For a $10m trade loan facility, this will equate to client cost going from $100k to $110k pa. It is noted that individual banks price differently, and capital is only one factor influencing pricing.
- Other countries are able to model credit risk, so they don't have to apply the CCF of 10% which becomes arbitrary.
- BAFT recommends adopting Footnote 43 of Basel CRE20.94[6], as banks can only apply it if they meet the four conditions set out in the Footnote. This can be subject to an audit process to ensure the criteria set out in the Footnote is met consistently.
- If the Fed does not adopt the National Discretion provided in Basel CRE 20.94, footnote 43, then it is recommended that the 10% CCF be phased in starting from 1st January 2030. This is in line with the approach adopted by the EU and will allow banks time to make suitable changes to their processing systems and business practices.

7) **Recommendation:** Adopt the National Discretion provided in Basel CRE 20.94, footnote 43 exempting certain arrangements from the definition of commitments if certain conditions are met and where these apply to corporates and SMEs only where counterparties are closely monitored on ab ongoing basis. BAFT recommends revising the CCF based on the fact that other jurisdictions are not eliminating advanced approaches for credit risk and in order to ensure a level playing field as CCFs are generally lower than 10%.

[6] Basel Framework Jan. 1, 2020 "Calculation of RWA for Credit Risk" Standardized Approach

Summary

Trade finance is a vital source of support for hundreds of thousands of U.S. companies that buy and sell goods and services internationally. Small and medium sized enterprises disproportionately rely on trade finance for both the financial benefits as well as risk mitigation that it offers.
It is short-term, self-liquidating and has the additional operational benefits of providing transparency and identifying suspicious activity and reporting potential financial crime. The Basel Endgame proposal, as currently outlined, disincentivizes banks from offering trade finance compared to utilizing its scarce balance sheet for other higher margin products, leading to the unintended consequence of reduced availability for companies that need it.

From a risk perspective, it is the high touch and contingent nature of trade that offers significant operational risk mitigation which will be lost if companies are forced by their banks to shift to clean financing. It needs to be emphasized that trade finance is a vital source of working capital for companies, particularly SMEs who traditionally experience significant barriers to gaining access to clean working capital lines of credit.

The data collected by the industry and aggregated in the ICC Trade Registry demonstrates the low-risk nature of trade finance relative to other corporate lending products. It highlights the need to ensure that capital requirements for trade are properly calibrated based on its differentiated behavior. The Basel Committee provided regulators the ability to use national discretion in implementing the framework, and we ask the U.S. regulatory authorities to consider the unintended consequences and apply discretion. For example, the EU indicated they will implement a CCF of 20% for Performance Guarantees, and it is our recommendation that the US follow suit and reduce the current 50% CCF to 20% CCF.

U.S. companies compete for business against similar companies in other countries. Where those countries apply a more appropriate capital requirement for trade finance, the financing cost is lower, and ultimately it allows those companies to gain a competitive advantage over companies where the regulatory cost of capital is higher as they can offer lower prices to their buyers. When competing for business internationally, this means US companies may lose deals specifically because their financing costs are higher than their competitors in other geographies. On a cost basis, it may be advantageous for a US company to seek their trade financing requirements from a non-bank/grey market alternative. When this happens, US Regulators lose access to the trade data that banks must provide them. We ask you to consider the unintended consequences that will disadvantage U.S. companies competing for business in a global marketplace.

We also ask you to clarify and reconsider the application of capital charges against non-interest fees. Service fees, under Basel III rules, already include capital compared to operational risk components of trade finance products, particularly in respect to letter of credit related fees. It appears the new requirement under the proposed Basel Endgame rules may be a needless duplication that again disadvantages U.S. companies.

As you assess feedback on this proposal, BAFT encourages you to take into consideration the economic impact of trade activities and consider using the allowed national discretion when

implementing the Basel III framework. In our view, implementation in this manner can meet the stated policy goals of prudential regulation, while supporting the availability of essential trade finance for U.S. importers and exporters.

We look forward to further dialogue on these important issues.

For further information, please contact Scott Stevenson, SVP-Trade at sstevenson@baft.org.

Exhibit C: Fee Based Trade Services

Export Commercial L/C/Standby L/C or Demand Guarantee

Advice
Confirmation
Amendment
Document Examination
Acceptance/Deferred Payment
Negotiation
Discrepancy
Transfer Fee
Assignment of Proceeds
Cancellation/non-utilization
Claim Reimbursement
Tracer

Export/ Import Collection

Outgoing or Incoming collection
Wire transfer payments
Amendment/Change
Tracer
Unpaid/Return Item
Protest Rates
Partial Payment
B/L Guarantee/Air Release
Endorsement of a transport document

Commercial L/C or Standby L/C or Demand Guarantee

Issuance or reissuance Commission
Amendment
Transfer
Assignment of Proceeds
Special Handling/Multiple Drafting
Drawing

Supply Chain Finance/Similar Open Account

Receive and save PO information
Advise PO to supplier
Pay a claim
Examination of a claim against PO terms
Finance/purchase a claim

Miscellaneous To All Products:

SWIFT/Telex
Payment/Wire Transfer
Courier - Domestic/International
Check payments