

# End of an era?

The world is changing fast. *TFR* talks to a range of top professionals in trade finance to find out how.

## THE PANEL



**Bruce Proctor**  
Head of Global Trade and Supply Chain Finance  
Bank of America  
Merrill Lynch



**David Sullivan**  
Group Chairman  
TFC Financial Group



**Klaus Michalak**  
Global Head,  
Structured Trade & Export Finance  
Deutsche Bank



**Ashutosh Kumar**  
Global Head of Local Corporate Products and Receivables Management  
Standard Chartered Bank



**Mike McDonough**  
Managing Director and Head of Trade Product Management  
BNY Mellon

**TFR: So, how was 2010 for you?**

**Bruce Proctor, BofAML:** Very good. Our trade business is expanding and there has been a strong sense of progress. Both in the US and a number of other markets there is both an increase in activity and a renewed client interest in international trade.

**David Sullivan, TFC:** Marginally better than awful. That means instead of no income (2009) we have done a little bit better. The media kept talking about stimulus packages and hot money, but it seems that all the money missed the TFC deals.

**Klaus Michalak, Deutsche Bank:** It has been a challenging year across the trade finance discipline. There has been a significant chance to generate growth, helping the global economic upswing gain traction. But significant risks remain. Unstructured and unsecured lending remain scarce, which has been good for both the volume and the pricing of structured finance. Risk mitigation is certainly crucial in this climate, which means the full range of trade finance products are being utilised. So the opportunities are also significant.

**Ashutosh Kumar, Standard Chartered:** It has been a very good year in terms of volume and scope of business. Although trade volumes at the beginning of 2009 fell dramatically, they came back strongly in 2010 and we enjoyed double-digit growth.

**Mike McDonough, BNY Mellon:** 2010 was a good year for BNY Mellon's trade business. We were able to regain ground lost in 2008 and 2009 following the crisis, while also maintaining our strategic growth focus on products and clients segments that for us have the greatest potential to add to the value of our business.

**TFR: Sovereign debt crises... robust commodity prices... growth across Asia and Africa... Europe and the US moribund. What, exactly, is happening?**

**Bruce Proctor, BofAML:** I would take issue with Europe and the US being moribund. We have seen growth in both regions, and both represent significant opportunities.

In the past two or three years, there has been a tremendous dislocation in trade, yet we have also seen strong resilience among our clients. And many have been looking to strengthen their dealings with vendors and customers along the supply chain – looking at new ways of achieving efficiencies, and growth, in both developed and growth economies.

We have had many enquires from customers asking us to look at their business and see what supply chain

changes can be made to give them an advantage. They are looking for partnerships – a deeper relationship with their banking provider that includes competitive prices, good service and a quick turnaround, but also shows a willingness to be engaged for the long term.

**David Sullivan, TFC:** I don't see huge sums of money going into Asian deals at all. Where is the money? The trend of the past two years continues: big companies investing in big things, banks only lending to big companies, no funding for small- and mid-cap projects. There's also too much hype about china spending its money everywhere. They are actually very conservative when choosing an investment and may sign a lot of letters of intent in which nothing eventually gets done – a bit like G20 meetings.

**Klaus Michalak, Deutsche Bank:** Different crises are reflected in different needs by product and by region yet the thread that unites the current situation is the fact that the emerging markets are doing well and making big strides towards matching the OECD in terms of demand. Asia, in particular, has become a strong export-credit-agency-market, as well as private credit insurance. Yet risk is increasing in the OECD markets, producing risk mitigation opportunities in markets where we would have once assumed that no security was required. Certainly, these are interesting times.

**Ashutosh Kumar, Standard Chartered:** We have just been through one of the most difficult periods in living memory, so things are likely to take time to settle. While the recovery has been strong – especially in Asia – we are not completely out of the woods. In the US and Europe in particular, there is major uncertainty. Some parts of the global economy are out of crisis, and some parts are not, which means that there are two realities. The robust growth in Asia has had an impact on commodities, hence the contradictory signals from a European point of view.

**Mike McDonough, BNY Mellon:** The world economy – and, by extension, many of the businesses that are most directly affected by it – continues to adjust to the reality check we experienced in 2008, as well as new challenges we continue to encounter.

We are truly getting to grips with the fact that the 21<sup>st</sup> century version of trade finance will be dramatically different from the 20<sup>th</sup> century version with which we had become accustomed. Crises and upheavals aside, trade bankers are now confronting many structural and risk-management issues around trade finance (such as the Basel regulations, open account, Kazakhstan and so on) that will require approaching this age-old business in a dramatically new way.

**TFR: What, in particular, is behind the bounce-back in commodity prices and do you think that they will endure?**

**Bruce Proctor, BofAML:** There is a lot of demand in a number of markets for basic commodities and, in some areas, demand has been well ahead of supply. For instance, there has been a dramatic rise in Latin American-Asian trade flows in both dollar terms and with respect to the breadth of purchases. Ten years ago, Asia was only purchasing commodities from Latin America. Now there is a wide range of manufactured goods being produced in that region for the Asian market.

## “The media kept talking about stimulus packages and hot money, but it seems that all the money missed the TFC deals.”

DAVID SULLIVAN, TFC

**Klaus Michalak, Deutsche Bank:** Commodity prices reflect global demand and, significantly, expected global demand. So, while the commodity market is – overall – expecting growth, the real story with commodity prices is one of volatility. The market remains unsure about future demand because general expectations of strong growth are being challenged by periodic events that undermine this confidence.

**Ashutosh Kumar, Standard Chartered:** In short: demand from Asia, although there are other factors at play. During the crisis, there were drastic cutbacks in inventory, which had a major negative impact on world trade (down by 23% in 2009). In some cases, three months of inventory dropped back to three-to-four weeks, which is too short to be efficient.

But then the economy in Asia bounced back and companies cautiously sought to stretch their inventories, which created a jump in demand. Even a move from three to four weeks inventory would create a 20% increase, so it is easy to see how demand quickly outstripped supply.

There is also a lot of liquidity because interest rates are low, forcing money out of cash into others assets, including commodities (especially gold) and quantitative easing in the US has increased the money supply. Finally, there are longer-term factors such as population growth and the fact that people are living longer – it all adds to the pressure on prices.

**TFR: Structured trade finance would appear to be back in vogue, but do the prices really reflect all the potential risks?**

**Bruce Proctor, BofAML:** The market determines the price. At Bank of America Merrill Lynch we focus on structuring transactions that can be distributed, even if we then decide it is one for our own book. Portfolios need to have that level of liquidity built into them, so there is an automatic market check on pricing.

Certainly, the risk issues on a specific exposure should be addressed through price and tenor, although there are other factors that may have a bearing on price in the future – probably the most important of which is regulation. We need to bear in mind that trade generally has a lower risk profile than other forms of finance, as long as the deals are well structured. We want to make sure we are creating good deals for our clients that are priced well.

**David Sullivan, TFC:** Who is doing structured trade finance in Asia? It's difficult enough to get a letter of credit line. Is the insurance market supporting pre-export financing? No, I guess, so I presume it is only pre-export finance to big-name producers, so little risk. Apart from pre-export what other kind of structured trade is there?

**Klaus Michalak, Deutsche Bank:** This depends on who you ask. Obligor will say that pricing is too high, while banks will claim that it is still too low. My view is that spreads are okay. Prior to the crisis, spreads did not reflect the underlying risk. Post-crisis, the risk has perhaps been a little exaggerated. This has settled back to make a rare moment of correct pricing, although the trend is towards a narrowing in the future.

The interesting additional element to this is Basel III, which will require the banks to provide more equity against trade financings – putting up the price. This is a shame because trade finance provides stable and low-risk revenue for banks that the regulators should encourage. Nonetheless, trade finance will remain an attractive business for banks.

**Ashutosh Kumar, Standard Chartered:** Structured transactions are back because it provides better risk control than unsecured transactions. Many of these transactions are structured to reduce the capital requirements from a Basel perspective.



As for the price/risk relationship – that is market dependent. Before the crisis, pricing didn't reflect risk levels. Then, during the crisis, pricing went to the other extreme. It has now come down again, but not back to the unsustainable pre-crisis levels. Lessons have been learnt. But in a very dynamic trade and finance environment, it could go either way. Certainly, the crisis proved the reactivity of the modern market, causing a sharp drop in activity followed by an unusually quick pick-up.

**Mike McDonough, BNY Mellon:** Pricing is a proprietary topic from our perspective as a service provider. It's enough for us to say that our financial strength was a significant competitive advantage for us during the darkest hours of the 2008-2009 crisis, and our approach to risk management reflects our commitment to maintaining the financial strength that's served us so well in recent years.

**TFR: How significant are the moves to internationalise the renminbi?**

**Bruce Proctor, BofAML:** Very significant. The world has had a single reserve currency for well over a century. Yet the size of the Chinese domestic economy means that it is natural that cross-border transactions – at least within the region – should be in the Chinese currency. It is a very interesting move for the Chinese government to therefore open its economy to the idea of the renminbi as an international currency – starting with settlement and then broadening out.

At Bank of America Merrill Lynch, we have been very involved in this and will remain so going forward. Certainly, when transacting it is good to have another currency available so the demand is there – it is for the Chinese government to decide how far this process should go. Can I see Latin American-European trade settlement in renminbi? My guess is that, for now, it can involve all Chinese trade and, potentially, non-Chinese intra-Asian trade.

**David Sullivan, TFC:** Since I woke up from my two-year slumber, I suddenly realised that this is what foreign banks had been doing when I thought they were not doing anything. While I have been ignoring China, the foreign banks have started doing all sorts of renminbi business, with more transparency on domestic securities, but also cross-border settlement in renminbi and even renminbi-denominated letters of credit being opened

by bankers in Hong Kong. Gone are the days of US dollar loans being disguised as pre-payments going into China. Now, American potential husbands are setting up websites looking for Chinese wives, rather than the other way round...

**Klaus Michalak, Deutsche Bank:** This is more a question for an economist than a trade financier. But, from a trade finance perspective, I think there is still some way to go before the renminbi is seen as a currency alongside the dollar or euro. But the early signs are encouraging. It will come, although this partly depends upon it becoming a freely tradable currency.

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ASHUTOSH KUMAR, STANDARD CHARTERED

**Ashutosh Kumar, Standard Chartered:** We are seeing a lot of enthusiasm and a lot of transactions in renminbi, which are better than expected. It is certainly an area that will continue to grow, and we are pleased to be leaders in this respect. In my view, the renminbi will become a strong currency for international trade – with a decent percentage of global trade redenominated in it. Certainly, this is the feedback we are getting from clients in multiple locations that deal with China, especially in ASEAN countries. There is a lot of interest in the workshops that we conduct to explain to our clients the potential applications of the renminbi. And I think this is going to be a major growth area for 2011.

**Mike McDonough, BNY Mellon:** We believe that the renminbi, and the role it plays as an international currency, will directly reflect the growing influence of China and the Chinese economy in global affairs. This growing influence will certainly include banking and trade finance. With the influence of China unquestionably growing so too in our view will the importance of the renminbi continue to grow.

**TFR: What does increasing intra-Asian trade and the booming trade between Latin America, Africa and**

### Asia potentially mean for the predominantly US and European trade banking aristocracy?

**Bruce Proctor, BofAML:** Increasing trade between different regions of the world is good news – and far better than the alternative of protectionism. In the US, we are noticing middle-market companies, which had relied on America's large domestic market, becoming keen cross-border players. They are importing from manufacturers elsewhere and selling internationally.

Will this trend continue? Yes, and it will include mid-market companies in many regions, including China. Yet this leads to questions such as the financial management of this process and cross-border legal agreements, which will create enormous opportunities for financial institutions, such as Bank of America Merrill Lynch, of course.

For instance, there is increasing trade between India and China. However, this generates complexities that may be a challenge for local banks that have been domestically focused. The good news is that such institutions are increasingly willing to work with more internationally-focused counterparties in order to support the activities of their corporate clients. And this has become a major focus for Bank of America Merrill Lynch.

**“Ten years ago, Asia was only purchasing commodities from Latin America. Now there is a wide range of manufactured goods being produced in that region for the Asian market.”**

BRUCE PROCTOR, BOFAML

**David Sullivan, TFC:** They must rush to get internal approval for handling renminbi products. While some banks are already actively involved in handling renminbi products I heard that others in Hong Kong are still seeking product approval. Booming trade means more Sibos junkies, and more trade finance bankers spending their budgets at a Sibos gatherings. Big trade services banks confirming more letters of credit from safe countries. I really don't know what US and European trade aristocracy does. Like most aristocracy, they probably spend all day in the pub.

**Klaus Michalak, Deutsche Bank:** This is what people used to call south-south trade and it is certain to become a more significant share of global trade in the future. Having said this, my aim is to support our clients around the world. We want to win our clients' trade finance business no matter what the trade flows and no matter

what the geography. Global means global, and any bank that cannot be global is just a regional player, no matter how good they are within that region. Pricing is an important part of this: and for that we need to be as lean as possible, as well as being global.

**Ashutosh Kumar, Standard Chartered:** From Standard Chartered's perspective we are in the right markets as Asia, Africa and the Middle East are all key growth areas.

Our role will be to continue to support trade flows between emerging markets – between China and ASEAN, or China into Africa or Latin America. Of course, we will increasingly see other banks focus on this area, although many of the big western banks have a lot of ground to catch up and will want to enter into these markets in a big way. Intra-Asian trade is now more than 50% of Asian trade, making south-south trade a far more concrete concept than five years ago.


Yet there is a big role for international banks. Local banks play in two different local environments – those in the biggest cities and those in the smaller towns. People tend to gravitate towards the big-city banks, giving them the intellectual capital to catch-up fast in terms of product offerings.

Those local banks in the second- and third-tier cities will lag behind with respect to product knowledge, although they remain very strong on local knowledge, which is equally important. So those with the important local knowledge lack the products and *vice versa*. The answer is to try and marry the two. IT is another differentiator – the bigger banks have deeper pockets so they have more robust IT infrastructures.

Yet this advantage is being eroded as costs come down and local banks increase their IT investments. The key will be in how focused the big banks are in developing new systems based on client requirements. So while products are the key, banks also require intellectual capital.

**Mike McDonough, BNY Mellon:** It's important to not confuse the notion of 'aristocracy' with experience. For our part, we believe that our experience and the strength and duration of our standing as a trade finance service provider enables us to add value to our client relationships. But in an increasingly global economic environment, trade bankers wherever they're located need to view the world as an interconnected place, and need to be prepared to support an even wider variety of trade needs than they may have done in the past.

We see this as the continuation of an economic dynamic that's been in place for some time: what's new is that globalisation's effects are becoming more apparent at the same time that we are seeing other issues, such as credit and technology, continuing to drive dramatic changes in trade. In short, we're seeing the continuation



and intensification of a process that's been underway for the past 10 years, and its effects are universal.

**TFR: What do you believe will be the biggest opportunities – and risks – in 2011 and beyond?**

**Bruce Proctor, BofAML:** Cross-border trade will increase, generating an upward momentum of economic activity globally. That creates opportunities for providers such as Bank of America Merrill Lynch. Yet we need to be aware that customer demands are changing. Clients now require partnerships rather than just providers of services and products. We need to be well versed in their business – focused on what makes a real difference in their particular industry whether it is food, chemicals, automotives, or whatever. Each has unique drivers and we need to do our homework.

Technology is another facet of this partnership. Clients expect speed and accuracy and global delivery. However, technology also creates challenges for banks. The cost of entry has fallen dramatically. Large technology platforms are no longer a requirement of entry into this market, which has led to a rise in non-bank providers, helped by moves towards standardisation. That said, this is still a business of transactions, making the ability to respond quickly and offer finance at key moments, and to deal with customers right across the spectrum, a vital need.

**David Sullivan, TFC:** For an intermediary such as TFC, the opportunities are outside trade finance since banks prefer simple products with big companies – there is no role for us. We were becoming more of an investment bank over the past year, arranging loans, equity, restructuring, and doing very little trade finance. The major risk, as always, is that we go bankrupt or we cannot afford the resources to do what we want to do. 'Beyond' is something West Brom supporters don't predict...

**Klaus Michalak, Deutsche Bank:** Clearly, the ongoing crisis in the developed markets cannot be ignored. As opportunities appear in one place so the risks grow elsewhere. This requires a mature response from all players – financial institutions, governments, regulators – because the danger is that the world reverts to protectionism, where we will all be the loser. This is not an immediate danger, although any talk on the subject raises the stakes and is therefore unfortunate.

**Ashutosh Kumar, Standard Chartered:** Of course, the bank's geographic footprint means we continue to see opportunities in Asia, Africa and the Middle East. Africa is emerging fast, with many industrial sectors looking for banking services. Infrastructure spending will be a big

area in Africa, as it will be in Asia – including telecoms. Commodities are another big opportunity area, although – equally – there are risks that need to be carefully managed.

Of greater risk, however, are the unintended consequences of the latest round of the Basel Accords. This requires an industry-wide solution as there is a genuine risk of harming banks' capacity to aid a trade-led recovery. Also, on the opportunities side is the increase in open-account trade, especially in Asia. The crisis took this off the media's radar screens and, indeed, we did see some retrenchment back towards letters of credit (LCs). However, open account is on the march again and this will shake up the trade finance world.

Yet there are also risks. Importantly, open-account trading relies heavily on the availability of credit insurance, which in some Asian countries is a regulated or restricted product. As an illustration, about 90% of the LC market is covered by around 2000 banks. Yet there are only five major credit insurers covering around 90% of the credit insurance market.

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MIKE MCDONOUGH, BNY MELLON

Such a concentration is a challenge globally, but in Asia – due to the restrictions – the problem is likely to become acute. On the whole, however, emerging market trade will remain a key growth area for the world economy, and I see Standard Chartered in exactly the right place.

**Mike McDonough, BNY Mellon:** In 2011 and beyond, the greatest opportunities for trade bankers will derive from the successes we've already achieved changing this tried-and-true business in ways we never would have thought possible way back in the 20th century. Bankers and service providers who are adept, flexible, cost conscious and creative will find the 'new' trade market to be a lucrative and rewarding area of opportunity.

The principal pitfalls for bankers making their first foray into the trade space have to do with forging ahead without properly focusing on the costs and structural issues they will confront as they adapt to the changing trade finance landscape.

Other risks, such as credit and legal risks, are endemic to trade banking; trade bankers have dealt with these challenges forever, and will continue doing so. □