

TRADE FINANCE

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ECAs help shipping
shake off the ice

Bold initiatives to meet big challenges

As Sibos 2010 in Amsterdam drew to a close, Oliver O'Connell spoke with John Ahearn, global head of trade at Citi, about the bank's new multi-bank industry initiative, its work with ECAs, and challenges ahead for the industry.

Trade Finance Magazine (TFM): Citi has used Sibos this year to announce its Multi-Bank Global Trade Programme allowing banks to originate and fund trade finance through a securitisation conduit. Can you take us through the thinking behind this?

John Ahearn (JA): The whole world of trade has changed dramatically since the credit crisis and banks in the trade finance space have traditionally had a book

and hold mentality. You do a transaction, you put it on your books and you hold it there. What has happened since the advent of the credit crisis is that trade has had to fill in the gap left by traditional lending. The needs of the clients have got much larger – \$100 million trade transactions are no longer uncommon.

Looking at the chunky transactions we do, it is relatively simple to sell those because from an economic point of view, if you are selling a bank a \$100 million take, it makes sense for them to dedicate staff to understand the credit and underwrite the deal etc. However, as an industry, we also do thousands and thousands of \$50,000 transactions and \$5,000 transactions, and there is really no efficient way in the industry to get those off the balance sheet. So we saw it as an opportunity for Citi to create a utility for the industry in which we could move these smaller assets off our balance sheets. By sourcing assets from a group of banks, the idea is that we get a much larger granular pool of transactions, and the assets don't consolidate back onto any of our balance sheets.

The banks we are talking to are coming into it for different reasons. Some because they have a lot of assets on their balance sheets and they are under pressure to reduce them; others because trade is still financed in US dollars, and while we are well positioned to access dollars as a US bank, a lot of our competitors and correspondents find it expensive – by coming into this programme with us and doing a securitisation, they gain the ability to take assets off their balance sheets and obtain relatively cheap US dollars.

We anticipate six banks on this including Citi, some of the largest trade banks in the world that have enough flow to do a transaction of this nature. We are now going through reviews with them to build the



John Ahearn of Citi delivering a presentation

portfolios. We have already talked to the rating agencies and they have given us indicative criteria for constructing the portfolio and we are putting the final touches to that. We are targeting a launch of mid-2011.

What we anticipate is that each bank will contribute an approximate \$500 million portfolio to begin with and then we will scale it from there. One of the reasons this works as a collaborative effort is that with a programme like this you have to continue to feed it and if you don't the costs really start to mount up. \$500 million is really not a problem for any of the institutions involved but the capacity levels are fungible so that if an institution only has \$400 million one month, the extra \$100 million can be contributed by one of the other banks. Once the core bank group is up and running then a second tranche might be launched at perhaps the \$100 million level for local and regional banks.

The nice thing about this securitisation is that a lot of investors want to buy trade paper, and it is not structured as in you are not buying slivers of mortgages, but you are buying into true commercial flows between buyers and sellers. The ICC-ADB data loss registry shows that trade losses are nominal which makes it good quality paper and investors are very keen to get this in the market.

We are keen to increase the velocity of our book and this is the next step in doing that.

TFM: *You have just signed an agreement with Canada's TD Bank concerning Asian trade – how does this fit in with Citi's strategy?*

JA: TD is a great partner of Citi's in that we work together in a variety of ways. The bank has been on an acquisition path recently in the US, acquiring Commerce Bank and Bank North, among others. On the other hand, they do not have a very large Asian franchise and so we have signed a Letter of Credit Relay programme with them in which their commercial LCs will go into our Asia footprint.

It's a win-win for us in that we get to develop our Asian business further, and for TD in that they get

access to fee income that they otherwise would not have. TD also gains a physical presence wherever our presentment windows are located, the ability to track items and view document images via the Web, and consistent service and quality standards for their transactions.

This is a space in which we want to become more active, trying to leverage our infrastructure around the world for our partners. We do this for a variety of banks already and it allows regional players to access our global network.

TFM: *Citi has a solid reputation working with the export credit agencies and multilaterals, how will this side of the business continue to develop?*

JA: We have recently signed the first deal under US Ex-Im's new supplier finance programme, for an agricultural and construction equipment manufacturer. It really is an innovative structure and a win-win for all three parties.

Citi structured the deal working closely with US Ex-Im which had approached us about a year ago with their new mandate from Congress to lend more money to SMEs. In the US SMEs and middle market companies do not tend to be big exporters, which is something that the Obama administration is trying to change, but what these companies do a lot of is they supply the components that go into making large pieces of equipment that are exported – Boeing's suppliers would be a case in point.

Some 60%-70% of suppliers to the programme's first exporter are SMEs and mid-market companies in the US. For big exporters, the program allows them to create new working capital and at the same time allows their supplier access to cash quicker. By putting transactions like this together we found the large exporters new credit capacity within the market, which made them very happy. US Ex-Im is happy because it now has a programme that helps it better fulfill its mandate, and we are happy because we were able to do a transaction for a client that we might not have been able to do by ourselves.

We have some ten to fifteen similar transactions in the pipeline at the moment and see this as a programme that will ramp up quite nicely. It is innovative and fits well into market needs.

TFM: *On the longer term side of the export credit agency business there has been a return to the Libor-plus-lunch pricing of the pre-crisis market. Surely this is going to cause problems further down the line?*

JA: Citi was one of the driving forces behind the 'put option' at US Ex-Im, which was a well-intentioned programme that has kept the flow of aircraft deals moving. However, the reality of how it is being used in my opinion is that some banks are using it as part of an internal conversation with their treasury people as to how liquidity premium shouldn't apply to this deal. If you do that and do not purchase the put option you are not creating as liquid an asset as was intended. What this has done is driven the pricing down to ➤



Citi bankers at the Trade Finance Awards for Excellence ceremony in New York in June 2010

Global head interview – John Ahearn, Citi

► rock bottom again – this was not the intention! We should not be seeing US Ex-Im aircraft deals priced in the 20s [basis points]!

As an industry we really have to start changing our thinking.

Another example – we are seeing five-year transactions today getting done at 50bp to 75bp below the CDS for the country. So if you were to look at optimising this situation, I could go out and instead of doing the ECA deal, buy a government CDS at the higher price, not have to fund it, not have to get a sales team to go out and generate, not have to pay lawyers, not have to service that loan, and still end up with a better priced risk. So I can get 50bp to 75bp more without any infrastructure for the same type of risk. As an industry what we need to do is set the baseline at the CDS level and then start adding on incremental expenses for doing that transaction. Otherwise we are going to kill ourselves as an industry.

Trying to get people to think in that sense is tough. At Citi we have a committee called Global Deal Review. Large deals come before the committee and sometimes are pitched to us at, for example, Libor plus 85bp, when the CDS in the country where the risk is at 240bp! This is not just at Citi but is an industry wide problem we need to fix.

TFM: *What three big messages are you taking away from Sibos this year?*

JA: Firstly, the energy has been injected back into Sibos after two years of flux. From two years ago and the fall out of Lehman to last year where everyone was walking around on eggshells – deals are now being done and things are now being discussed in a proactive collaborative way.

The second message is that for some of the institutions that have spent time studying Basel III, like us at Citi, we have found this a great opportunity for us to get the word out that this is not a good thing for Trade should it be enforced. We have spoken with a lot of banks here who were simply not aware of the draconian impact that these new regulations would have on the industry. For some it is preaching, for others it is learning.

The next step is to make sure that our clients know

what the impact will be – pricing is going to soar and SMEs and mid market corporates are going to get killed because of the penalties of lending into the unrated sector. Bankers are still seen as the bad guys and so the message has to come to the regulators from the corporate world.

We all understand the need for regulation, but now the pendulum is swinging too far. The best example is if you look at leverage conversion factor of letters of credit versus credit default swaps. Before the crisis, a multiple of the world's GDP was outstanding in notional CDS. These were originally designed to be a hedging instrument and they became a speculative instrument. The regulators were uncomfortable with the CDS situation and so decided that 10% of CDS exposure based on the Leverage Ratio Requirement had to come back onto balance sheets and would have to have capital against them. They then looked at LCs and decided to put 100% leverage ratio against them! These are two fundamentally different products and you don't get speculation or leverage in LCs.

If we as an industry don't get that message out to the clients and the regulators and this comes into effect it has the potential to derail the recovery.

The third message I am taking away from Sibos in 2010 is that the Chinese banks are here in force and are here to stay. Not so long ago Chinese participation at this event was low. Now they are in the middle of the hall and RMB clearing deals are happening several times a day. This is the coming out party for the Chinese.

What this tells me is that these are my competitors in the future and I need to start gearing up to face them head to head.

TFM: *What is the outlook for Citi's trade business in 2011?*

JA: What I am proud of is that Citi has really started to punch its weight in trade finance and if you looked at us five or six years ago I'm not sure that was a true statement. Our growth has been solid and we have put a lot of work and effort into turning the franchise around and building it up. This is getting us a lot of recognition both internally and externally and we are positive about our position going into 2011. ■



TD Bank and Citi at the signing of their Asian trade agreement at Sibos in Amsterdam in October