Regulation: Far from the death of correspondent banking

The death knell for correspondent banking has tolled more times than I care to remember – yet, despite this, it has continued to go from strength to strength. If general consensus is to be believed, however, that bell is now tolling louder than ever, with the cause being regulation. The spotlight of compliance has firmly shifted on to trade finance with the introduction of Know Your Customer regulation and other transparency requirements such as the US Foreign Account Tax Compliance Act. Banks now not only have to know their own clients, but also their clients’ clients upstream and downstream. From an operational perspective this is tricky. From a cost perspective, it is potentially crippling.

But this does not signal the end of the model itself. Correspondent networks remain the best way for corporates and banks alike to access hard-to-reach, but strategically important, emerging markets with the combination of global coverage and local expertise. At the same time, emerging market exporters rely on their local bank being connected to a global trade finance network in order to seize international trading opportunities.

In this issue we focus on Nigeria, which is a case in point. Expanding Nigerian companies increasingly requires the issuance and advising of letters of credit (LCs) to countries all over the world. For their local bank, this often necessitates the advising and confirming capabilities of a global bank. However, in many countries in Africa this is made difficult by volatile political and economic landscapes, resulting in many banks being unwilling to take on significant country risk. In this case, a correspondent banking partner – which understands the local environment, market and bank in question – may be the difference between keeping a client and losing business to a competitor.

Of course, this is not to say that such correspondent relationships are not coming under strain from the aforementioned regulation, and banks must therefore adapt to deal with the shifting landscape.

In this issue of FI News we discuss how Commerzbank is dealing with the looming issue of “unbanked banks” for instance. It would therefore be wrong to deny that a number of banks will scale down, or even exit, their correspondent banking relationships over the next few years as a direct consequence of a tightening regulatory environment. For many, the cost of investment in compliance staff and necessary technology will be too much to bear. But this need not mean completely giving up on what has proved such a successful model. Indeed, the most forward-looking banks will instead look to co-operate with other banks to share the burden of compliance, and collaborate to...
use shared resources (such as LC processing). In this respect, banks may be able to benefit from a global network without having to maintain one of their own – instead relying on a banking partner which can satisfy the necessary criteria, namely: compliance, reach and risk factors.

We like to think we tick all the boxes here. Commerzbank is committed to complying with all transparency regulation and feels that this only enhances our understanding of local markets, banks and their operating environments. Our extensive “on-the-ground” knowledge means that we have a unique risk appetite to confirm LCs where other international banks will not venture. Put simply, our global network remains alive and well.

Many of the issues I have touched upon are discussed in more detail in this issue of FI News, which includes a series of in-depth articles written by our team of specialists and partner banks. I hope you enjoy the content.

Yours
Christof Gabriel Maetze
Global Head of Financial Institutions & Member of the Executive Management Board

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Trade finance securitization back in business

Hans Krohn, Head of Trade Products, discusses why trade finance securitization has only taken off recently – including Commerzbank’s CoTrax Finance II-1 issuance – and what the future holds for the market.

Trade finance securitization is enjoying a comeback. While there was some issuance pre-crisis, only now are banks starting to package up trade finance paper for the capital markets once more. However, while a handful of deals have taken place recently, some barriers still stand in the way of the market’s development.

The main driver behind the increase in securitizations is Basel regulation – forcing banks to hold more capital against trade finance loans and seek new ways to improve their capital positions. At the same time, investors are on the hunt for alternative investment opportunities in the current low interest rate environment and are realising that trade finance assets are not only extremely stable, but can also provide attractive yields when sliced into securitization tranches. Certainly, the asset class’ stability is supported by data collated in the International Chamber of Commerce (ICC) Trade Register, set up in 2005. The data show that across 8.1 million short-term trade finance transactions, fewer than 1,800 (0.02%) defaulted between 2008 and 2011. Furthermore, the likelihood of default is consistently low across all trade finance products with transaction default rates of 0.034% or less.

While securitizations are certainly on the up, the market’s development is still hampered by a lack of standardisation since the contracts and documentation underlying trade finance transactions vary from deal to deal. To address this, Commerzbank has been working towards implementing master agreements for individual deals for a number of years. However, there is some way to go in this regard and progress will rely on not only individual banks, but also the unifying work of industry bodies such as the ICC and BAFT.

Another barrier holding back the market is the fact that very few banks have large enough portfolios to cope with investor demand for granularity. Indeed, most trade finance banks have a relatively small number of trade finance counterparts meaning that concentration risk is a real concern.

While these investor concerns exist, recent deals prove that well-structured securitizations can address them. Commerzbank’s CoTrax Finance II-1 – a securitization of pre-export and import financing transactions with financial institutions – is a good example. In terms of the deal structure, a US$500 million portfolio was sliced into three tranches with a US$27 million...
Calls for standardisation in trade have been growing louder over the past few years – from corporates, banks and regulators – and we are now seeing a response. There are two distinct areas where a lack of standardisation needs to be addressed. Firstly, as regards the definition of trade finance terms and practices and, secondly, in relation to the documentation underlying trade finance transactions.

Certainly, trade finance products and processes can cause headaches; not because of their innate complexity, but rather because no universal definitions of key terms currently exist. This lack of standardisation is also apparent in trade finance documentation. Many different entities from all over the world issue documentation meaning that no two trade finance documents ever look alike. The underlying documentation is also subject to the local laws of the respective countries, which adds to the difficulty of streamlining them. As a result of legal and compliance costs, unstandardised trade finance documents are subsequently expensive for banks.

Therefore, as the trade finance market continues to grow and evolve, several key drivers of standardisation have emerged. The first is the push from globalisation. With trade flows becoming increasingly global, corporates need to be served quicker and at a competitive cost – made difficult when banks have to invest time and money inspecting unique trade documentation. Add to this increasing compliance requirements, forcing banks to make their trade finance processes more transparent, and the need is apparent, especially for smaller banks that are struggling to justify the costs of compliance on their relatively small trade finance portfolios. Lastly, another driver to mention is trade finance securitisations where standardised documentation will be crucial in order to widen the market to potential investors.

Frank Carr-Allinson, Head of Trade & Solutions at Commerzbank, discusses the need for standardisation in the trade finance industry and what progress is being made.
Thankfully, progress is gradually being made. For example, international organisations such as the ICC banking commission, BAFT, EBA and others are aiming to generate a set of market terminology for supply chain finance with a view to harmonising definitions. Moreover, the Master Risk Participation Agreement for Trade Transactions certainly represents a step in the right direction. At the initiative of Commerzbank, the master agreement was drawn up by BAFT and is now used by banks worldwide as the standard documentation for sub-participations in trade transactions. The simplification of the process makes it possible for banks to share trade risks. This will go a long way towards helping those smaller banks who lack a strategy in terms of trade and struggle with costs. Another recent initiative from BAFT is the establishment of a Master Trade Loan Agreement, which should be finalised within the coming weeks. This document will be subject to English/ New York law and should make it easier for banks to meet the growing demand of bank-to-bank trade loans.

Furthermore, in order to meet customer demand for standardised processing, Commerzbank opened its trade processing centres in Poland and Malaysia – providing 18 hour per day processing across Asia and Europe – allowing the bank to deliver LCs to the world within 24 hours and offering better services to both corporate and correspondent banking clients.

Commerzbank, as a leading provider of trade finance, is actively involved in all major industry-wide efforts seeking to drive standardisation forward. Change will not happen quickly, but by addressing some of the barriers to standardisation now, the industry can look forward to a more efficient market in the long-term.

### Meet Commerzbank at...

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<td>Indonesia Trade &amp; Commodity Finance Conference*</td>
<td>Jakarta, Indonesia</td>
<td>24th April</td>
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<td>ICC BI-Annual Meeting</td>
<td>Dubai, UAE</td>
<td>27th - 30th April</td>
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<td>ADB Annual Meeting</td>
<td>Astana, Kazakhstan</td>
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<td>EBRD Annual Meeting</td>
<td>Warsaw, Poland</td>
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<td>Commerzbank Business Update</td>
<td>Frankfurt, Germany</td>
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<td>AfDB Annual Meeting</td>
<td>Rwanda, Africa</td>
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<td>Europe Trade Finance Week (Sponsored by Commerzbank)</td>
<td>Hamburg, Germany</td>
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<td>Asia Trade Finance Week</td>
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* Spotlight: In Indonesia, Bashar A Barakat, our Senior Representative in Jakarta, will moderate a panel on "The evolving nature of trade finance in Indonesia"
Commerzbank scoops two “Deals of the Year” awards for Greek Trade Enhancement Programme

Commerzbank has been awarded two “Deals of The Year” by leading financial publications, Trade Finance and Trade & Forfaiting Review (TFR). Both have recognised Commerzbank as a trade finance expert for its participation in the €500 million Trade Enhancement Programme for Greece, which aims to rejuvenate trade and help the country pursue export-led growth for economic recovery.

TFR commented: “One of the key criteria for a “Deal of the Year” is how it has transformed a local economy and this €500 million LC confirmation package supported by Commerzbank, Citi and HSBC is a shining example.”

Commerzbank agreed to contribute €100 million in trade financing to the programme, which will see the bank confirm letters of credit and other trade finance instruments with terms of up to one year issued by the three participating Greek banks – National Bank of Greece, Piraeus Bank and Eurobank Ergasias.

The European Investment Bank is providing guarantees to Commerzbank and the other commercial banks involved for trade financing. As these guarantees are being used on a revolving basis, they will support EUR 1.5 billion worth of trade transactions per year.

The deal highlights how Commerzbank has adapted to the needs of the real economy in Greece and enlarged its tool-kit, allowing it to employ short-term lending instruments in favour of Greek import banks to support international trade with Greek companies.

CoTrax Finance II-1 named “Best Securitization Deal in EMEA”

Commerzbank’s CoTrax Finance II-1 trade finance securitization has been awarded “Best Securitization Deal in EMEA” by EMEA Finance Magazine. The deal is the first of its kind involving the securitization of pre-export and import financing transactions with financial institutions.

Commerzbank is a leading bank in trade finance with decades of experience in providing trade related financings for corporate customers and financial institutions. It is also a leading name in the securitization market, highlighted by the stable performance of its SME loan securitizations – which are issued twice a year. With CoTrax Finance II-1, Commerzbank brought together these two strengths; successfully placing a US$22 million mezzanine tranche of a US$500 million portfolio of inter-bank trade financing transactions with institutional investors.

In light of Basel III capital adequacy requirements, trade finance securitizations such as CoTrax Finance II-1 provide an innovative way for banks to reduce their risk-weighted assets and consequently achieve core capital relief.

Acknowledging the award, Hans Krohn, Head of Trade Products, said “CoTrax Finance II-1 is a significant step forward for the trade finance industry, highlighting that, when well-structured, trade finance securitizations can hold substantial appeal for institutional investors. We therefore see this type of transaction playing a major role in helping banks manage their trade finance portfolios in the future. The award is an endorsement of both Commerzbank’s reputation in the field of international trade finance and of its position as a leader in the securitization market.”
Commerzbank and IDB issue US$115 million green line to Banco Pine

Commerzbank and the Inter-American Development Bank (IDB) have joined forces to provide a US$115 million credit line to Brazilian bank, Banco Pine S.A, to expand access to financing for environmentally sustainable projects in Brazil. The deal was closed on 24 March 2014.

This is the second green loan Commerzbank has completed with the IDB – following a facility to Banco Itaú in May 2013 – showcasing Commerzbank’s commitment to sustainable banking practices in Latin America. The green loan comprises a US$75 million A loan from the IDB and US$40 million B loan from Commerzbank.

“Banks play a pivotal role in society – not only economically but also from an environmental and social perspective, which is why we try to increase the focus of our financing activity on renewable energies,” says Thomas Krieger, Regional Head, Latin America at Commerzbank.

“The IDB looks for like-minded partners in banking that seek to combine financial profitability with environmental returns. Banco Pine and Commerzbank were the right fit in Brazil,” says Marcelo Paz, project team leader for the IDB.

Krieger adds: “Commerzbank hopes to join forces with the IDB on similar deals in the future and is committed to doing banking with added value.”

Commerzbank leads the way in EUR-covered bond issues from Canadian banks

For seven out of eleven euro-denominated covered bonds issued by Canadian banks, Commerzbank has acted as joint lead manager – demonstrating a strong track-record in this specialist area.

Three reasons explain the bank’s strength in Canadian banks’ issuance to the euro-market. First, Commerzbank is currently ranked fifth in the Bloomberg league table for covered bonds globally, highlighting an excellent track-record in this asset class. Second, the bank’s strong distribution capabilities with German investors (which provides the bulk of buyers for Canadian EUR-covered bond issues, with approximately 40% of allocated orders). Finally, there is Commerzbank’s longstanding relationships with the Canadian banks, which dates back to 2006 and the first EUR-covered bond issues.

Furthermore, Commerzbank has managed to sustain the role as a reliable advisor for Canadian EUR covered bonds throughout the transition from a contractual framework to a legislative covered bond framework. Since 2013 – with the establishment of the legislative covered bond framework – Commerzbank has acted as joint lead manager on four out of seven deals. This includes the Canadian Imperial Bank of Commerce’s inaugural five-year EUR1 billion issue; the Royal Bank of Canada’s five-year EUR1.5 billion issue; and two EUR benchmark issues from the National Bank of Canada with a five- and seven-year tenor.

Four out of seven deals. This includes the Canadian Imperial Bank of Commerce’s inaugural five-year EUR1 billion issue; the Royal Bank of Canada’s five-year EUR1.5 billion issue; and two EUR benchmark issues from the National Bank of Canada with a five- and seven-year tenor. Commerzbank has acted as joint lead manager on four out of seven deals. This includes the Canadian Imperial Bank of Commerce’s inaugural five-year EUR1 billion issue; the Royal Bank of Canada’s five-year EUR1.5 billion issue; and two EUR benchmark issues from the National Bank of Canada with a five- and seven-year tenor.

Hydroelectric Power Dam of Itaipu, Brazil

Small solar cell at Ipanema beach, Brazil
Partnership Focus: Helping Russian SMEs seize global growth opportunities

Alexander Zotikov, a leading economist and trade finance specialist at BystroBank – one of Commerzbank’s Russian partner banks – outlines how Russian SMEs are looking to international markets and how the bank’s trade finance capabilities are helping

Small and Medium Enterprises (SMEs) account for roughly 20 per cent of Russia’s jobs and 86 per cent of the country’s private firms. As such, these companies are essential to the Russian economy, yet access to funding has long been an obstacle to their operations. SME financing is therefore a key focus for BystroBank.

The regional bank specialises in retail services and corporate business with a focus on micro and small business lending. Indeed, nearly half of BystroBank’s loans target SMEs. For example, BystroBank has been cooperating with the European Bank for Reconstruction and Development (EBRD) since 2011 when it first signed a loan agreement for RUB 300 million to provide SME financing. With this financial support, BystroBank provided business development loans to more than 2000 entrepreneurs and SMEs, resulting in the creation of approximately 750 jobs and an increase in these businesses’ gross revenue volume of 22% on average.

What is more, Russian SMEs are increasingly spreading their wings, looking to capitalise on increasing opportunities to trade on a global, rather than national, basis. This is a trend we are witnessing, particularly with businesses domiciled in Russia’s provinces and regional centres. In a challenging banking environment with competition from the large state-owned banks, BystroBank has therefore worked to extend its competence in international trade finance to meet the demands of its SME clients. And this is one of the reasons why we decided to partner with Commerzbank.

Providing trade finance is important for corporates to succeed in the international markets. For our clients, LCs still play a minor role in the handling of foreign trade operations. However we see an upward tendency in this regard.

Increasing understanding among Russian corporates of the benefits of trade finance – namely in mitigating counterparty risk – remains a key strategic objective for us. In this respect, BystroBank has been working alongside Commerzbank in educating its corporate clients. In addition, Commerzbank’s ‘on-the-ground’ training has also...
been important on the financial institution side, providing our knowledgeable team with a deeper understanding of the dynamics, risks and product structures available to assist corporate clients with their international trade business requirements.

In order to offer standard trade finance instruments to Russian corporates, Commerzbank’s LC processing/confirming capability has also proven essential. For example, last year Commerzbank confirmed 48 of our LCs and standby LCs under the guarantee of the EBRD, enabling us to help our SME clients reach into new markets.

Thanks to the work of Commerzbank and the EBRD in Russia, the future is looking brighter for Russian SMEs seeking to develop their businesses and enter into international trade operations. We very much hope our partnership with Commerzbank will prosper so that we can continue providing our corporate clients with trade finance services.

“Commerzbank has a long history of supporting SME business and we are delighted to be working alongside BystroBank and the EBRD to help provide access to much needed trade finance. Clearly, the guarantees provided by the EBRD under the TFP are of great benefit to both Russian SMEs, as well as our own “Mittelstand-clients”, involved in the international export/import business, as they shoulder the political and commercial payment risk of trade transactions. Certainly, the TFP is especially useful in supporting SME-business – indeed, most transactions handled under the programme have a volume of under €1 million.”
Ruediger Geis explains how stricter KYC/AML regulation could unintentionally cause a problem of ‘unbanked banks’ and what can be done to mitigate this.

**What are the risks with these relationships and how do you protect your bank from these?**

One of the reasons why certain banks are stepping out of the trade finance arena is because they foresee the cost of compliance becoming too much. Of course we have to fulfil all the regulatory requirements, and the scale of KYC across 5,000 corresponding relationships is huge. Therefore, we are constantly investing in our back office systems and skilled staff in order to do business with these banks.

**But how do you know these systems are robust enough – there is always bound to be some local bank, that hasn’t covered all the bases?**

At the end of the day, this is a people business. Systems can only provide support, final sense checks, and ‘what is the smell of this’ judgements are made by people. You cannot scan all payments and LCs individually, but good systems give warning signals that prompt you to take a closer look at those transactions. In addition, we have a particular advantage with 45 representative offices located all over the world. Based on a permanent exchange and involvement of these offices and their local knowledge we are constantly questioning which risks we can take and where we have to stop.

**Some of the banks we heard at BAFT were complaining about the sheer cost of doing business with fragile local banks. Given the number of counterparties you deal with in this category, what is in it for your bank?**

We think it is worthwhile investing in these relationships. If you have the flows we have, processing more than 100,000 LCs per annum, then the economic benefit associated with the large network is clear. For smaller banks that process a limited number of LCs, maintaining a network of thousands of correspondents may make less sense. So our →
customers can benefit from our large-scale processing capabilities. You also have to bear in mind that German importers and exporters have a wide reach across the world. While they don’t really need Commerzbank to reach into Luxembourg or Belgium, the fact we can offer trade routes into places such as Iraq and Angola is of considerable interest to them. As such, our network is essential to our business.

What made your bank decide to focus on this particular type of correspondent relationship and how long have you done this for?

We were founded 144 years ago as a merchant bank and have representative offices in 45 countries. So we are very close to the banks in these countries and it’s fair to say that trade is in our genes.

You can find the full interview with Ruediger on the TFR website: www.tfreview.com

Country Focus: Nigeria in the spotlight

Following the recent release of Commerzbank’s second Sub-Saharan Africa study, F.I. News focuses on recent developments in Nigeria and what it means for the country’s financial industry.

With a stable political and economic framework, large population and easy access to commodities, Nigeria has been growing sustainably for the last decade. Indeed, with the recent rebasing of the country’s GDP, Nigeria has now overtaken South Africa to become the largest African economy by GDP size. It is Africa’s most populous country (with approximately 169 million people) and the continent’s largest oil producer. With its abundance of natural reserves, Nigeria is a successful exporter of commodities, yet the country remains reliant on the import of finished goods – a clear impediment to its growth. If the country is to succeed economically and become less vulnerable to external shocks, it must therefore take steps to improve its value-added depth, investing in infrastructure to become a producer of finished goods, not merely an exporter of raw materials.

The oil sector is a case in point. It continues to be the driving force behind the Nigerian economy, accounting for 96 percent of exports. However, the country still imports the majority of its refined oil products (it has just one oil refinery) and leaves itself vulnerable to the price fluctuations of a single commodity.

As well as oil, agriculture is also an important sector in Nigeria, employing approximately 60 percent of the working population and accounting for around a quarter of the country’s GDP (it accounted for a third prior to the rebasing). In fact, the non-oil sector has been growing faster than the oil sector for some time. Nevertheless, Florian Witt, Head of Africa at Commerzbank says “the agricultural sector has been strongly neglected since the early 1970s with Nigeria’s beginning oil boom and as a result, the country, which was once self-sufficient, turned into a food importer.”

Therefore, in order to maximise its potential, Nigeria needs help from further afield. Olaf Schmueser, Senior Representative at Commerzbank’s...
Lagos Representative Office comments: “Foreign direct investment will be vital to develop value-adding industries in Nigeria. The country also offers tremendous opportunities for foreign exporters, particularly as regards the export of machinery, components and services.”

Yet some challenges still lie ahead for Nigeria before it becomes a real economic powerhouse and moves up the value chain, including job creation, political uncertainty and the risk of external shocks on oil prices.

The financial industry also has a role to play in the country’s development. Nigeria is the biggest financial centre in West Africa and the banking system is now well-capitalised, having strengthened since the 2008 global financial crisis. Schmueser says “as Nigerian banks have seen their capital base increase, so too have they excited the appetites of global banks. As a result, the Nigerian financial sector is now attracting foreign investments, kick starting the diversification of the oil-reliant economy.”

In Nigeria, Commerzbank maintains strong relationships with financial institutions and assists the local banks in handling issues relating to letters of credit in respect of capital goods and other imports. The bank has a local team of professionals who are integrated into the Nigerian community and liaise with local government and business circles. As such, the bank is an expert on the local market. Witt concludes “Nigeria’s growing status as an important new emerging market has prompted us to expand so we may meet the changing needs of our international clients.”
Commerzbank people on the move

April 2014
Thomas Heupel took over as Head of Financial Institutions Services.
Harald Lipkau took up new responsibilities in Brazil.
Joerg Motel became Head of Financial Institutions across Asia and the Indian Subcontinent. (see also page 14)

January 2014
Juan Guillermo Gruben took over as head of the Representative Office in Bucharest. (see page 14)

October 2013
Oliver Schufmann took over as head of the Representative Office in Belgrade.
Robert Christian Schoepf became head of the Representative Office in Riga.
Olaf Schmueser took over as head of the Representative Office in Lagos.

September 2013
Olaf Letzel, who was previously Senior Representative for the FI New York Desk, took over as head of the Representative Office in Ashgabat in Turkmenistan.

August 2013
Hovsep Voskanyan took over as Head of the Representative Office in Minsk, Belarus
Peter Hofmann took over as Head of the FI Desk New York.
Close up: Joerg Motel and Juan Gruben

Joerg Motel

How many years have you worked at Commerzbank?
I joined Commerzbank in 2008, having worked for BW-Bank and LBBW in Hong Kong for several years. As such, I know the region very well and have travelled extensively so I am looking forward to working in my new role and touching base with our customers in these countries again.

What does your new role involve?
I will be responsible for business with banks in Asia or to be more precise in the Greater China region, ASEAN countries and the Indian Sub-Continent. I will also be looking after our staff, both here in Frankfurt and in our Representative Offices in the region. One of the key focuses will be supporting our Financial Institutions customers in the processing of their Asian-European trade but also getting more involved in intra-Asian transactions.

What did you enjoy most about working in Asia?
I like the professionalism of the people and the diversity of the culture. It is also exciting to witness the fast-paced development taking place in these countries.

Juan Guillermo Gruben

How many years have you worked at Commerzbank?
I joined Commerzbank at the time of the merger with Dresdner Bank in 2008. I started working for Dresdner bank in 1985 and, over the course of my career, spent time in Lisbon, Buenos Aires and Riga.

What does your new role involve?
My role as Head of the Representative Office in Bucharest involves looking after Commerzbank’s relationships, primarily with the local banks in Romania.

What do you enjoy most about living in Romania?
Firstly, the people. They are extremely friendly and always ready to help you. Secondly, the landscape. The more you get to know Romania, the more you love it. Lastly, I love the local cuisine. There is lots of variety as it is influenced by the mixture of nationalities present in the country.