

Banks Test CDOs for \$10 Trillion Trade Finance Market

Patrick Jenkins and Brooke Masters in London

Some of the world's biggest banks are trying to extend the principles of securitization to the plain-vanilla world of trade finance – a market worth an estimated \$10 trillion a year – as concern mounts that regulatory changes could constrain a key lubricant of the global economy.



Trade

JPMorgan is among several banks that have begun testing investor appetite for the trade finance equivalent of collateralised debt obligations – the derivative products blamed for compounding the financial crisis – in an attempt to boost lending capacity.

Trade finance supports more than 80 percent of global trade. But it has been disrupted by the financial crisis, as some lenders got into trouble, and by the regulatory response to the crisis, as banks have been ordered to hold more capital against lending.

Banks have lobbied hard against the constraints imposed on trade finance by the Basel III global rule book, due to be phased in from 2013.

The new rules for overall bank borrowing – the leverage ratio – treat a typical three-month trade finance loan as a year-long exposure, effectively forcing banks to hold far more top-quality capital against the loan.

That is deterring some banks from staying in the business and could push up trade finance prices by 300 percent or more, critics predict.

Regulators have made some adjustments but have been reluctant to rewrite the rules, which they see as a critical backstop to keep banks from becoming over-leveraged.

“The industry needs to develop new instruments,” said Jeremy Shaw, JPMorgan’s head of trade services for Europe, Middle East and Africa. “We have tested the water with potential buyers. Institutional investors have the appetite.”

French banks, previously big players in trade finance, have retreated from the market in dramatic fashion in recent months, as they raced to shrink balance sheets in line with new European capital targets and their access to dollar funding – the currency of much global trade – dried up.

JPMorgan, one of the leading trade financiers, believes there is particular scope to “slice-and-dice” exposures to export credit agencies – the quasi-government entities that support export business – and repackage them as simple CDO-like instruments. A similar process is common for credit card debt.

Finding a legal structure that can pass regulatory scrutiny is proving difficult, however. Partners at several London law firms say they have been asked by clients to work on possible deals, but none have come off to date.

By transferring the bulk of such exposures off a bank’s own balance sheet, and on to third-party investors, the capital requirements would be reduced. There is also scope to syndicate, or restructure, trade finance exposures to corporate customers, JPMorgan believes.