

OLIVER WYMAN

Financial Services

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**Perspectives on Trade
Finance in times of the crisis**

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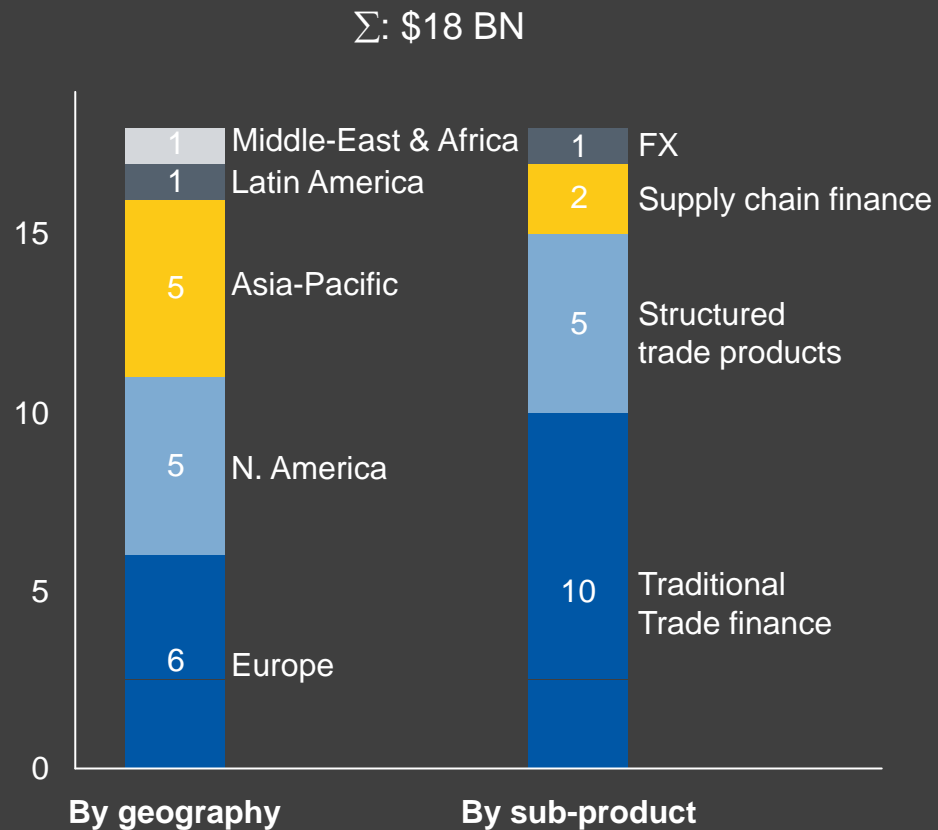
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The historic dominance of traditional Trade Finance products is now seeing a revival

Global Trade Finance revenues (2008)



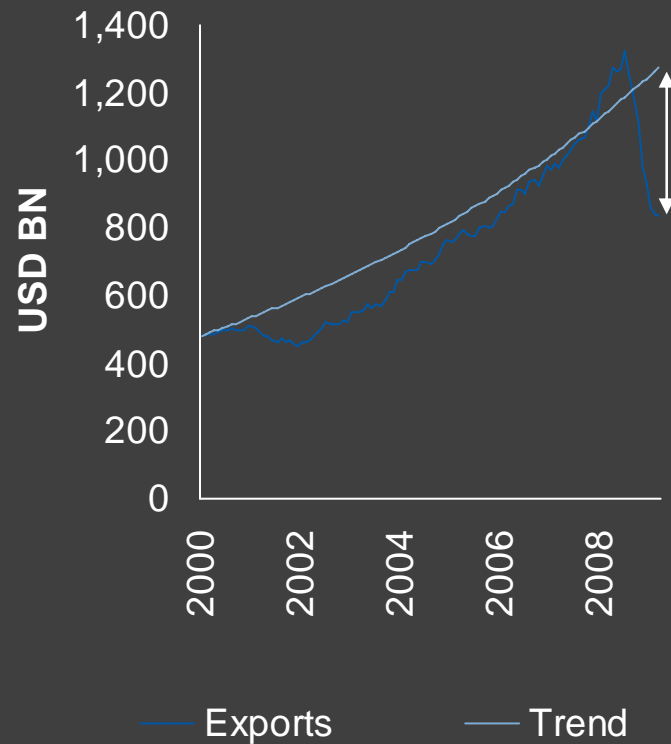
Observations

- Trade Finance is an \$18BN revenue business
 - Market has substantially shifted towards Asia
- Pre-crisis: strong push towards open account and structured transactions but now some return to traditional instruments like the letter of credit
 - Supply outgrowing demand
 - However, many large US buyers are not reversing their historic shift towards open account
- Supply chain perspective has become ever more important as all trade participants seek to eliminate costs along the supply chain

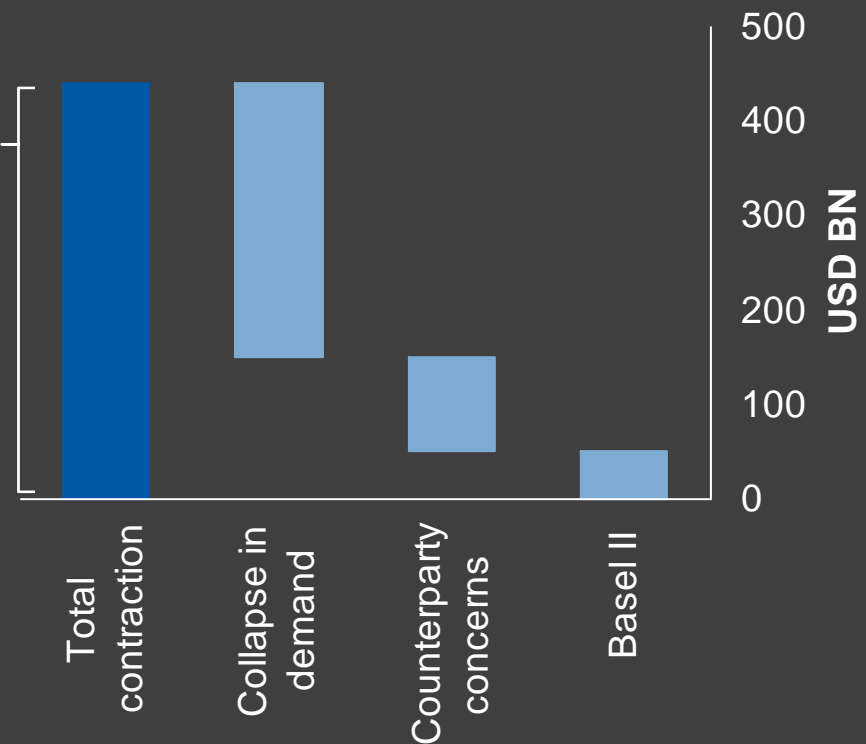
Source: Oliver Wyman proprietary data and analysis

While initial signs of recovery become visible, global trade has collapsed substantially

World exports of goods
Jan-00 to Mar-09 (monthly data)



Factors reducing trade



- Spreads have increased by as much as 200-300 bps
- Basel II with a pro cyclical nature – as particularly PDs have increased, available risk limits are eaten up

Source: OECD, EIU, IMF, World Bank and OW estimates

Going forward we believe that the industry should react in four ways

- Despite slump in global trade flows, cost base is largely fixed
- Critical for banks to identify cost savings opportunities, particularly by addressing fixed cost base, e.g. by outsourcing

- Long term impact of the crisis will have substantial influence over future global trade volumes
- Critical for banks to estimate likelihood of different scenarios and to prioritize investments accordingly



- Corporate treasurers have fundamentally changed their behaviour along a number of dimensions
- Critical for banks to react correspondingly and set right short term priorities

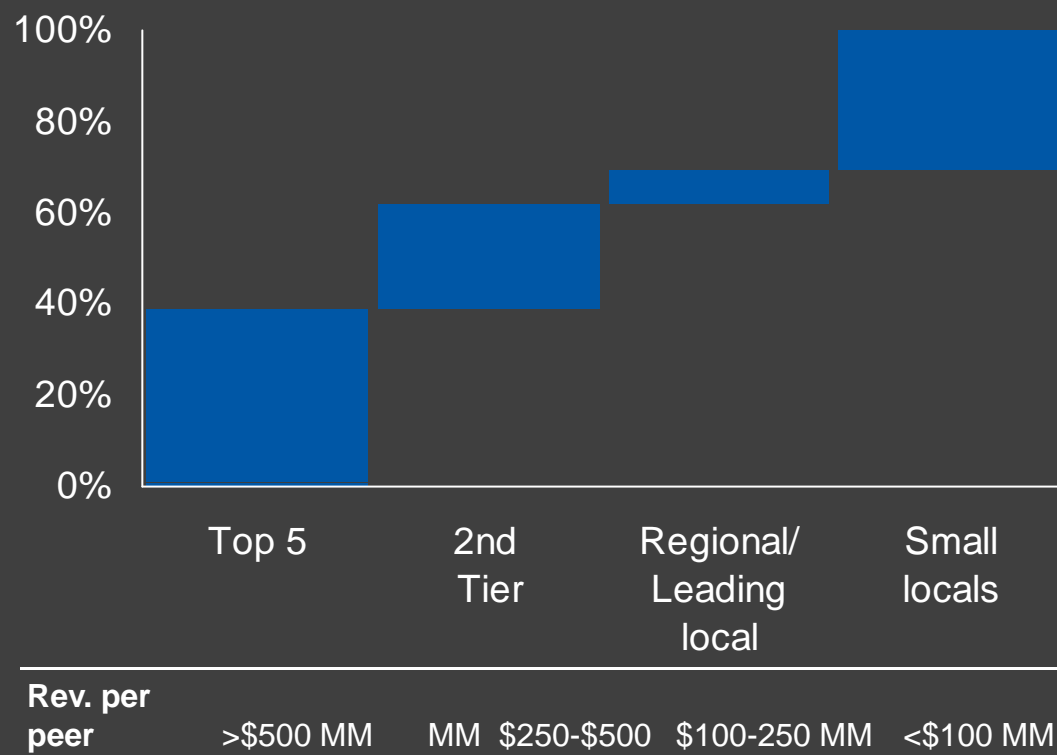
- Overall the crisis has substantially increased the importance of Transaction Banking
- Critical for banks that have historically run TF as 'a silo' to develop a much broader perspective



The current crisis will bring Trade Finance economics for many smaller banks under further pressure

Competitors in Trade Finance

Revenue market share by competitor type (2008)



- Concentrated market
 - Landscape is dominated by the global banks with a strong footprint in Asia
 - Top 5 institutions capture over 1/3 of global revenue pool
- Roughly 30% of industry revenues remain in a long tail of small local players
 - Average revenue in the range of \$15-30M
- CIR very much linked to size
 - Market leaders operating in the range of 50%
 - Many small players with CIR >100%
- Financial crisis with a very negative impact on economics as cost base is largely fixed

Source: Oliver Wyman analysis



Banks should therefore address their cost base, with a particular focus on the processing side

Main functions	Areas of improvement	Upside
FO <ul style="list-style-type: none">▪ Sales▪ Relationship management	<ul style="list-style-type: none">▪ Increased client proximity▪ Backing RMs with specialist trade finance sales people▪ Actively promoting cross-selling efforts and adjusting incentives accordingly▪ Detailed business planning at client level with specific product targets rather than just global client budgets	<ul style="list-style-type: none">▪ ~25% revenues improvement
MO <ul style="list-style-type: none">▪ Customer service operations▪ Credit processing▪ Discrepancy approval▪ Compliance	<ul style="list-style-type: none">▪ Middle office operations at most banks tend to be relatively lean▪ Key focus in terms of improving efficiency should be in reducing operational risk▪ Optimize level of centralization	<ul style="list-style-type: none">▪ ~5% reduction in CIR
BO <ul style="list-style-type: none">▪ Initiation, control and settlement processes	<ul style="list-style-type: none">▪ Reengineering and optimization of processing trade finance transactions▪ Front to back IT integration, with data capture initiated through web based graphical user interface▪ Direct and faster access to trade transaction data across different locations▪ Consolidation of processing centers	<ul style="list-style-type: none">▪ Up to 30% reduction in BO cost / transaction

Source: Oliver Wyman analysis



Banks need to focus on providing better advice / transparency, but can enforce cross sell more actively

Corporate treasurers' future demands from banks

Realizing the increased importance of credit

- Corporates are more willing than ever to reward banks for credit lines
- However, most banks are still relatively poor at enforcing cross-sell
- At the same time treasurers are spreading deposits to reduce risks

Expecting integration with client systems

- Corporates expect easier integration with the bank in order to better manage their cash position and increase visibility
- Still questionable whether SWIFT initiatives are likely to gain further traction among larger corporates as it allows them to reduce dependency on banks

Expecting to work with banks as advisory partners

- Balance sheet management and forecasting capabilities are particularly demanded
- Clients are now ready to accept collateralized funding requirements (ready to install the systems / technology in order to access bank financing)

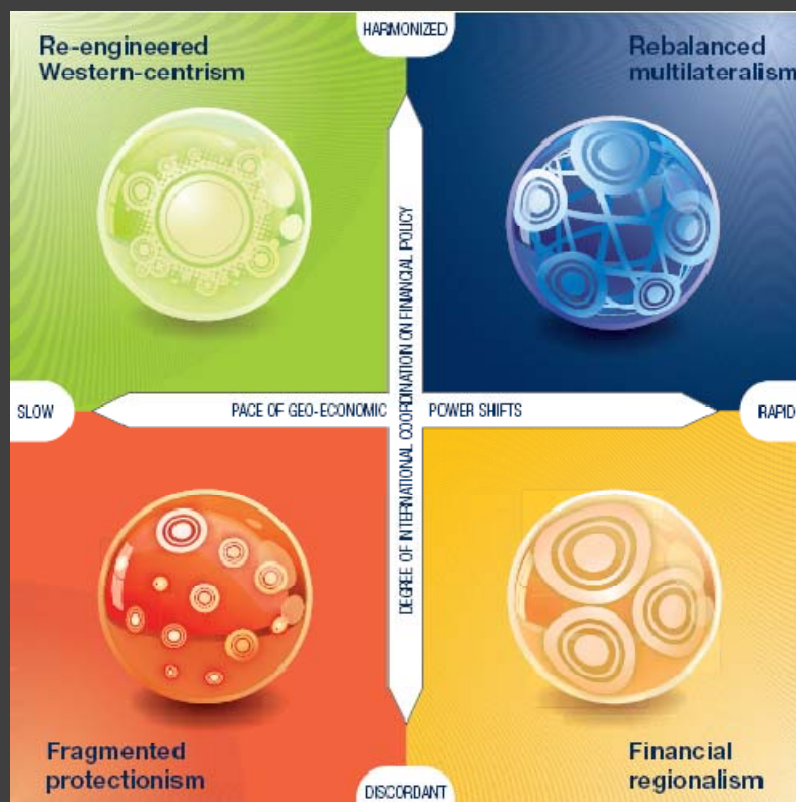
Looking for accurate and timely information

- Given the importance of cash visibility in helping to forecast and manage cash, corporates will increasingly demand rapid availability of accurate data, presented as management information to help them better manage their own business



We see four distinct scenarios for the future of the global financial system

Long-term scenario framework



Critical uncertainties

Degree of international coordination on financial policy (Y-axis)

- Typified by cross-border cohesion in financial regulation
- Has increased greatly since the middle of the 20th Century
- Higher coordination typically yields greater degree of freedom in cross-border capital flows and added growth opportunities for financial firms

Pace of geo-economic power shifts (X-axis)

- Refers to the difference in GDP growth rates between advanced and emerging economies
- Underlying factors include terms of trade, relative exchange rates, economic growth rates, and trends in energy and commodity prices

Source: World Economic Forum, Oliver Wyman



Re-engineered Western-centrism

A highly coordinated and financially homogenous world that has yet to face up to the realities of shifting power and regulating for the last crisis rather than the next

Key questions The world in 2020

Who leads?

- The G4 – comprised of US, China, EU and Japan – has led the formation of new rules for international coordination
- Emerging economies are calling for greater inclusion

What is regulated?

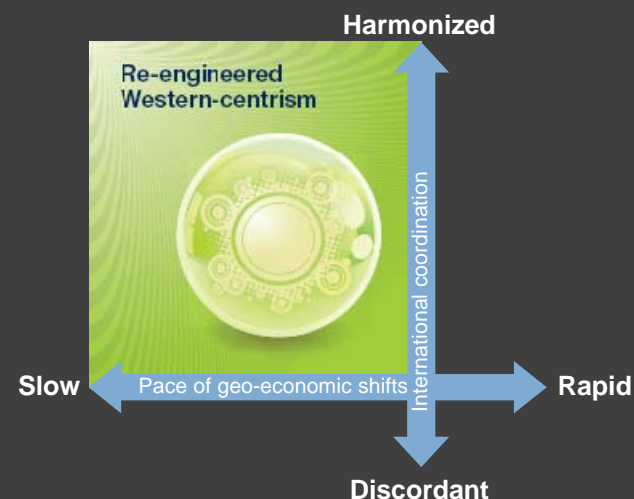
- New rules on liquidity, stricter controls on capital requirements, transparency and risk management
- Concern that over-homogenization of financial markets has increased risk of contagion

What cooperation exists?

- A supranational regulator coordinates global regulation
- Closer macroeconomic coordination on fiscal and monetary policy

What bodies dominate?

- Supranational regulator drives global financial regulation
- Also functions as global crisis management body and a global lender of last resort



Key implications for Trade Finance

- Rationalization of global regulations have put a premium on scale, leading to widespread industry consolidation
- Incumbent trade banks become even larger and gain an even larger share of the market
- Widespread concern over potential for another global financial crisis and market stability

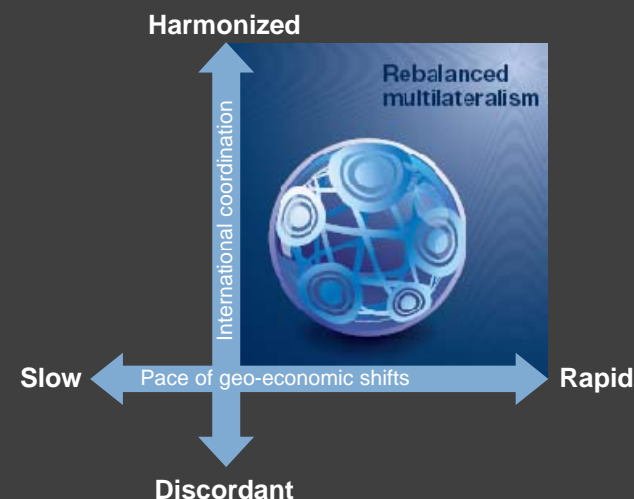
Source: World Economic Forum, Oliver Wyman



Rebalanced multilateralism

A world in which initial barriers to coordination are overcome in the context of rapidly shifting geo-economic power

Key questions	The world in 2020
Who leads?	<ul style="list-style-type: none">▪ “Emergent” markets now set international coordination agenda
What is regulated?	<ul style="list-style-type: none">▪ New regime characterized by heavier regulation with broader mandate for direct government intervention▪ Focus is on risk management, exchange rate movements, derivative regulation and systemic risk containment
What cooperation exists?	<ul style="list-style-type: none">▪ Domestic regulators strive for transparency and ease of interoperability▪ International institutions set mandatory minimum standards▪ Significant cooperation for crisis prevention
What bodies dominate?	<ul style="list-style-type: none">▪ Bretton Woods institutions have been gradually overshadowed and replaced by new international bodies, created and led by emerging countries▪ BIS is now the global lender of last resort



Key implications for Trade Finance

- Diminution of Western financial powers, with broad-based shift in ownership to shareholders in BRIC countries
- BRIC and emerging markets banks become the dominant force in Trade Finance
- Significant growth opportunities in emerging markets, e.g. BRIC countries, Africa, Southeast Asia

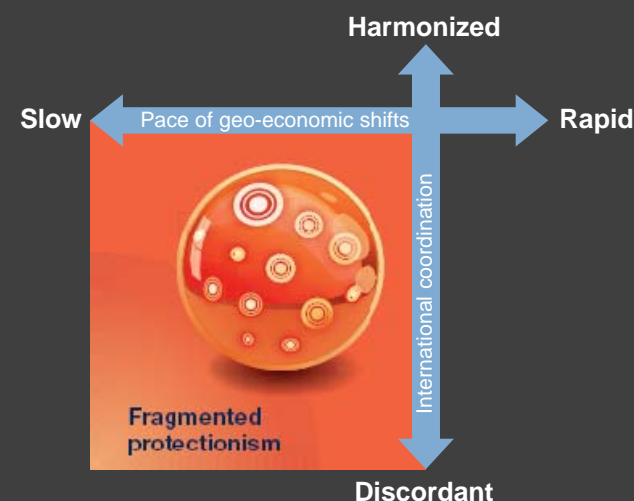
Source: World Economic Forum, Oliver Wyman



Fragmented protectionism

Division, conflict, currency controls and a race-to-the-bottom dynamic only serves to deepen the long-term effects of the financial crisis

Key questions	The world in 2020
Who leads?	<ul style="list-style-type: none">Financial regulations and policy decided at the national levelInternational financial and regulatory bodies now in disuse
What is regulated?	<ul style="list-style-type: none">Currency controls have re-emerged, with tight restrictions on cross-border investmentNations have also imposed rules on risk and capital mgmtNation-level regulation leading to arbitrage
What cooperation exists?	<ul style="list-style-type: none">Minimal financial policy cooperationEra instead marked by restricted capital flows, low-trust geopolitical environment, widespread trade protectionism
What bodies dominate?	<ul style="list-style-type: none">National institutions are the most powerful, due to the demise of international cooperationBretton Woods institutions exist largely as museums



Key implications for Trade Finance

- Overall, substantially lower trade volumes
- Opportunities created for market participants with higher tolerance for risk, including political and military
- Need for subsidiaries (rather than branches) with separate management, capital requirements and treasury operations in each jurisdiction

Source: World Economic Forum, Oliver Wyman



Financial regionalism

Post-crisis blame shifting and the threat of economic contagion create three major blocs on trade and financial policy, forcing global companies to construct tripartite strategies

Key questions

The world in 2020

Who leads?

- World is split into three major trading regions
- Regulation is led at the regional level
- Significant variation across economic jurisdictions

What is regulated?

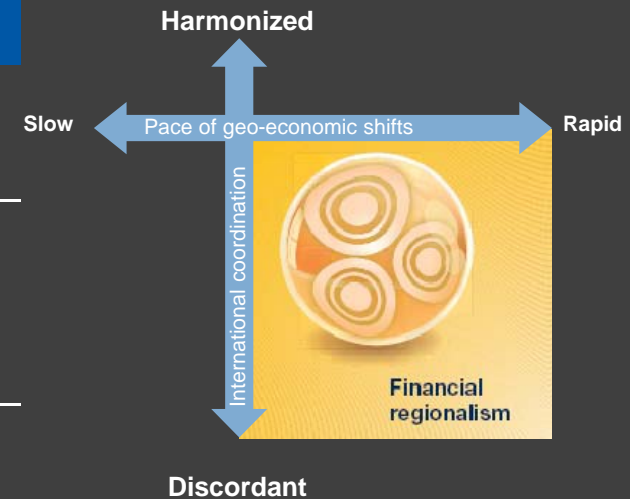
- US/Allies push for “market democracy” with limited regulation
- Eastern bloc characterized by strong state intervention
- EU pushes through heavy financial regulation and institutes protectionist policies

What cooperation exists?

- Little coordination across the three blocs
- However, some regulatory and monetary policy convergence
- Global FS firms generally split into three entities, one per bloc

What bodies dominate?

- Development bodies are specific to their particular regions
- Bretton Woods institutions generally defunct, due to collapse of global multilateral cooperation



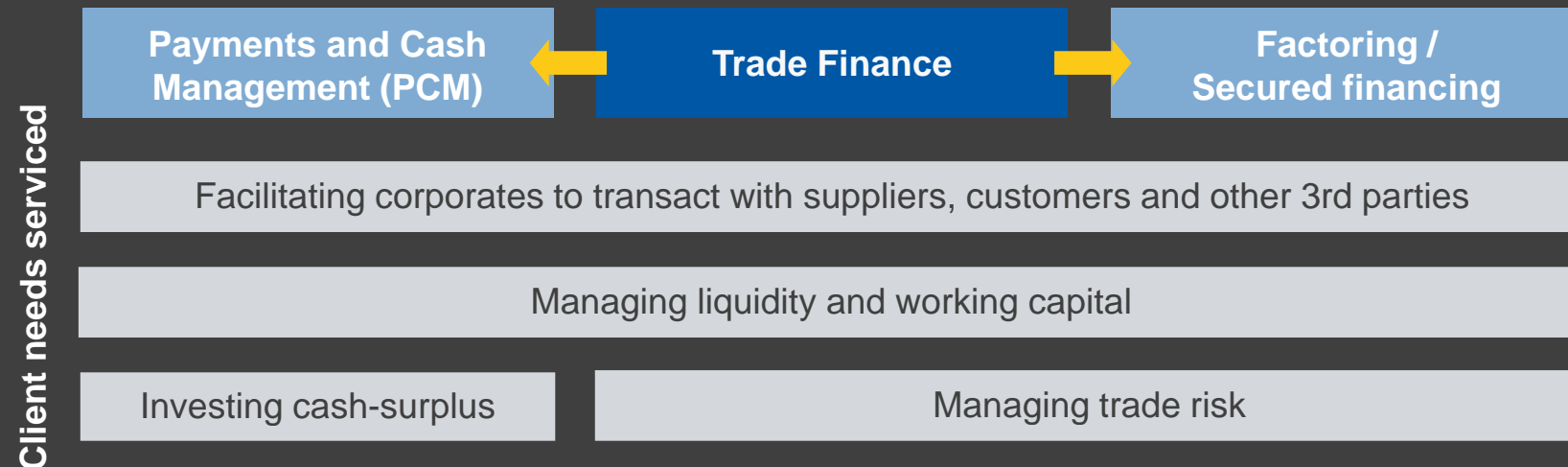
Key implications for Trade Finance

- Capital flows between the regions are severely impeded
- System of separate regional regimes splits global FS firms into corresponding regional entities, reducing global correlation
- Growth prospects across the regions are not all equal, with some regions focused on creating national champions

Source: World Economic Forum, Oliver Wyman



Finally, banks should appreciate that the new model of Corporate Banking will be one of Corporate Transaction Banking



- The old model of corporate banking (lending focused approach) is dead
 - The new model will be a model of corporate transaction banking
- ▼
- This is driven by three critical reasons
 - Corporate deposits are a critical source of bank funding
 - Corporate deposits need to ‘finance’ lending business
 - Sophistication in cash management allows to better understand their clients needs and to achieve both better cross-selling ratios and lower risk lending

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